March 2010
IMF Country Report No. 10/80

Hungary: Fifth Review Under the Stand-By Arrangement, and Request for Modification of Performance Criterion

The following documents have been released and are included in this package:

- The staff report, prepared by a staff team of the IMF, following discussions that ended on February 15, 2010, with the officials of Hungary on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on March 5, 2010. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A Press Release summarizing the views of the Executive Board as expressed during its March 24, 2010 discussion of the staff report that completed the view.

The document(s) listed below will be separately released.

Letter of Intent sent to the IMF by the authorities of Hungary*
Technical Memorandum of Understanding*
*Also included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

HUNGARY

Fifth Review Under the Stand-By Arrangement, and Request for Modification of Performance Criterion

Prepared by the European Department
(In Consultation with Other Departments)

Approved by Anne-Marie Gulde and Lorenzo Giorgianni

March 5, 2010

- **Stand-By Arrangement**. A 17-month SBA in the amount of SDR 10.5 billion (1015 percent of quota) was approved on November 6, 2008. Access was front loaded, with purchases of SDR 4.2 billion (date of approval), SDR 2.1 billion (First Review, March 25, 2009), and SDR 1.3 billion (Second Review, June 23, 2009). The arrangement was extended by six months to October 6, 2010, the undisbursed amounts were re-phased over the remainder of the arrangement, and the fourth purchase of SDR 50 million was made at the Third Review (September 25, 2009). Given the gradual improvement in economic and financial conditions, the authorities chose not to draw the SDR 725 million made available upon the completion of the Fourth Review (December 17, 2009). The European Union (EU) has disbursed €5½ billion of the €6½ billion that were approved. The World Bank has also made funds available to cover the financing need under the program, but the loan documents have not yet been signed.

- **Program status**. All end-December 2009 quantitative performance criteria, the continuous performance criterion on non-accumulation of external arrears, and the indicative target on central government debt were met. The structural benchmarks on government lending to banks, passage by parliament of amendments strengthening the remedial powers of the HFSA, and submission of amendments strengthening the bank resolution framework were also met.

- **Disbursement**. As at the Fourth Review, the authorities do not intend to draw the amount that would be made available upon completion of this review (SDR 725 million).

- **Discussions**. Discussions were held in Budapest during February 3-15, 2010. The mission met with Prime Minister Bajnai, Minister of Finance Oszkó, central bank Governor Simor, HFSA Chairman Farkas, other senior officials, and representatives of financial institutions and the main opposition party Fidesz. The staff team comprised Mr. Morsink (head), Ms. Carare, Mr. Wiegand, Ms. Popescu (all EUR), Mr. Frécaut (MCM), Mr. Goyal (SPR), Ms. Luedersen (LEG), and Mr. Martin (FAD). Ms. Ivaschenko (Resident Representative) assisted the mission. Mr. Rosenberg (EUR, future mission chief) and Mr. Abel (OED) attended most of the meetings. Teams from the EC, ECB, and the World Bank joined.

- **Publication**. The authorities have consented to the publication of the staff report.

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I. Introduction and Summary

1. **Hungary was affected immediately and significantly by global deleveraging because of its high levels of government and external debt**. These vulnerabilities were built up over several years, reflecting both substantial risk appetite on the part of foreign investors during the boom years and over-borrowing by the public and private sectors in Hungary. The government embarked on fiscal consolidation in 2006, but this adjustment was incomplete when the global financial crisis hit in late 2008. In light of the sharp increase in global risk aversion, gross financing needs became more difficult to meet, necessitating both a stronger policy response and significant external official assistance from the IMF (SDR 10½ billion or about €12½ billion at the time), the EU (€6½ billion), and the World Bank (€1 billion) to underpin a reduction in financial strains.

2. **The combination of stronger policies, the availability of official financing, and the easing of global financial conditions has anchored the stabilization of the economy**. The underlying fiscal position improved by 3 percentage points of GDP in 2009, while the fiscal deficit target was increased in the first half of 2009 to avoid exacerbating the economic contraction. In the financial sector, liquidity support was provided in a timely way, and bank supervision and the remedial action framework were substantially enhanced. Together with significant, front-loaded external financial assistance, this strengthening of policies helped to limit the depreciation of the exchange rate and increases in interest rates in early 2009, thus avoiding even worse macroeconomic outcomes, and instead created room for reductions in the policy interest rate. As a result, investor confidence is returning, and the economy is on the road to recovery.

3. **Further strengthening of policies is required to ensure macroeconomic stability and growth over the medium term**. Against the backdrop of fragile global conditions and high gross financing needs, an increase in financial strains could disrupt Hungary's stabilization. Continued improvement in fiscal sustainability will be essential, requiring strict expenditure control and—to insure against risks—a cautious use of budgetary reserves and readiness to take additional action if necessary. In 2011, additional measures will be needed to reduce the general government deficit to below 3 percent of GDP and put government debt firmly on a declining path. Further improvement in banking supervision and the resolution framework for banks would contribute to the preservation of financial stability. To the extent allowed by financial market conditions, further gradual and cautious cuts in the policy interest rate would be appropriate.

4. **Policy discussions took place against the backdrop of forthcoming parliamentary elections**. The parliamentary session before the elections is expected to be very short. The two election rounds are scheduled for April 11 and 25. Staff met with the economic leadership of the main opposition party, Fidesz, which is leading in opinion polls. Fidesz representatives expressed their intention to reduce the fiscal deficit over time, but did not discuss specific objectives or policies.

5. **Fund staff have continued to cooperate closely with the staff of the European Commission (EC)**. Fund and EC staff consult each other regularly regarding economic and policy developments, and field parallel missions to Hungary. Fund staff have also cooperated closely with World Bank staff on macro-critical structural issues (Informational Annex, Appendix II).

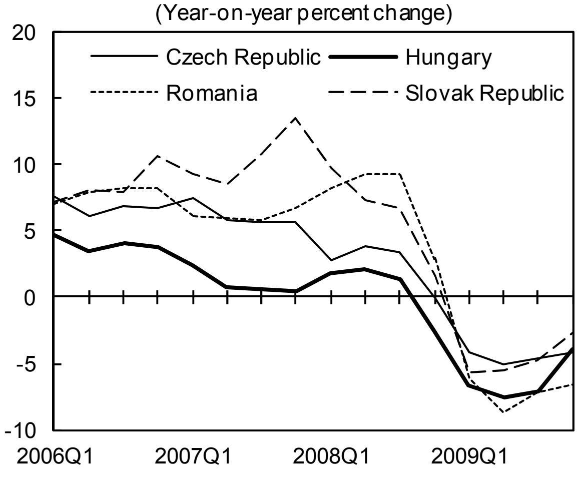
6. **As at the last review, the authorities do not intend to draw the resources that would be made available at the completion of this review** (SDR 725 million, 70 percent of quota). They view the cumulative resources from both reviews (SDR 1,450 million), which would be available subject to satisfactory policy performance, as insurance against the impact of any unforeseen deterioration in external financing conditions. The authorities have indicated that, as at the last review, they will not request the release of EU balance of payments upon completion of this review.

II. Recent Developments

7. **Economic activity is still falling, but the pace of contraction has eased markedly** (Table 1 and Figure 1):

- ***Real GDP declined by 6.3 percent in 2009, less than expected at the last review***. The pace of economic contraction eased in the fourth quarter of 2009, with real GDP falling by 4.0 percent (y-o-y), from 7.1 percent in 2009Q3—broadly in line with the performance of neighboring emerging economies (text chart)—as a positive contribution from net exports partly offset weak domestic demand. Private consumption remained weak as the unemployment rate increased and credit contracted.

Real GDP Growth
(Year-on-year percent change)



Source: Haver.

- ***Loans to households remained stable in 2009, though credit to corporations fell by 5 percent*** (Figure 2 and Box 1). New lending to households shifted from foreign to domestic currency. In the fourth quarter of 2009, credit to the private sector fell by more than anticipated.

- ***CPI inflation has been temporarily boosted since mid-2009 by increases in the VAT rate and excise taxes***. The headline rate accelerated to 6.4 percent in January, due to increases in excise taxes, higher food and energy prices, and the reweighting in the CPI basket. Private sector wage growth excluding bonuses decreased to 3.5 percent y-o-y in December.

- ***The current account is estimated to have been in surplus in 2009 for the first time in over 15 years*** (about ½ percent of GDP). The trade balance increased significantly as the fall in domestic demand led to a more rapid decline in imports than exports. The income balance also improved as profits fell. As a result, the current account is estimated to have adjusted by over 7½ percentage points of GDP.

8. **Financial conditions have continued to stabilize, notwithstanding recent strains in global markets** (Figure 3):

- ***The forint has been trading in a relatively narrow range against the euro (HUF 265-275)***. The foreign currency swap market has operated normally since May 2009. In real effective terms, the forint is 11½ percent below its July 2008 peak (Figure 4).

- ***Government bond markets have been broadly stable***. After declining significantly for several months, long-term yields and CDS spreads have increased slightly since November 2009, reflecting the global re-pricing of risk following events in Dubai and Greece. The government issued a 10-year $2 billion bond at 265 bps over U.S. Treasuries in late January. It continues to issue local-currency bonds to cover its deficit and rollover debt falling due, and no further external bond issuances are planned for 2010. In the corporate and mortgage bond markets, spreads remain significantly above pre-crisis levels and liquidity has not yet fully returned.

- ***In view of the improved external financing conditions, the government did not draw on the IMF or EU resources that became available at the completion of the last review***. Gross international reserves have almost doubled from the pre-program level of €17.4 billion in September 2008 to €32.5 billion in January 2010. Although net international reserves fell slightly in 2009Q4 (by about €0.5 billion), the end-2009 target was met comfortably. Parent banks maintained their exposures to their subsidiaries, in line with their European Bank Coordination Initiative (EBCI) commitments, and rollover rates of bank liabilities falling due in 2009Q4 are expected to have been close to 100 percent.

III. Policy Discussions

A. Macroeconomic Framework

9. **The macroeconomic outlook has improved since the Fourth Review**:

- ***Real GDP is expected to decline by 0.2 percent in 2010, an improvement of ½ percentage point since the last review*** (LOI ¶s 7–10). Reflecting stronger global demand, export and investment growth have been revised up. However, private consumption is expected to be sluggish, due to the continued weakness of the labor market and consistent with slower-than-previously anticipated credit growth. This is in line with previous episodes of prolonged increased household savings (Figure 5). Risks to the GDP forecast are tilted to the downside.

- ***Credit to the economy is expected to contract further in early 2010, before picking up in the second half of the year*** (Table 2). Weak demand and lack of risk appetite among lenders will curtail corporate credit in the first half of 2010, especially to small and medium-sized enterprises. A gradual recovery is projected to set in around mid-year, in line with the strengthening of economic activity. Credit to households is expected to remain subdued throughout the year, mostly reflecting weak demand.

- ***CPI inflation is projected to fall to about 3 percent y-o-y in the second half of 2010***. The increase relative to the Fourth Review is due to the reweighting of the CPI basket, and a reassessment of the expected impact of administrative measures in the first half of 2010, related to the subsidy schemes for gas, district heating and housing. Inflation is expected to remain elevated in the first half of 2010, due to the pass-through of indirect tax increases, and then fall to around the central bank's target of 3 percent in the second half of the year. In 2011, inflation is projected to moderate further to 2½ percent, due to the continued disinflationary impact of the large output gap and weak labor market conditions.

- ***The external current account balance is expected to deteriorate modestly in 2010*** (to a deficit of 0.4 percent of GDP). This deterioration reflects a worsening of the income balance as profits increase and a small reduction in current transfers. EU capital transfers would more than offset the deficit.

10. **External vulnerabilities remain significant, given high integration into global financial markets, large rollover needs, and a still-fragile global environment** (Tables 3-5). The gross external financing requirement is projected by staff to be about €36 billion (36 percent of GDP) in 2010, and rollover needs would remain large over the medium term. In the baseline scenario, non-residents would be expected to maintain their share of local-currency government bonds and finance most of the foreign-currency government bond redemptions, and corporations and banks would be expected to roll over maturing external debt at increasing rates (approaching 100 percent by the second half of 2010). As a consequence, reserves coverage of short-term external debt at remaining maturity (including

intercompany loans) would rise modestly from 85 percent in 2009 to about 90 percent at end-2010. Uncertainties include political and external risks, such as the ECB's speed of exit from its current monetary stance and the potential contagion from Greece.

11. **Economic growth is projected to recover in 2011 and beyond** (Table 6). The global recovery and a lower tax wedge on labor are projected to boost export growth. Domestic currency interest rates should continue to decline owing to fiscal consolidation, thus supporting domestic demand. Risks to medium-term growth remain tilted to the downside, reflecting risks to fiscal policy and the global recovery.

12. **The current account adjustment and projected pick-up in growth over the medium term should place the high external debt on a declining path**. Having increased sharply over the past two years, external debt is projected to have peaked at 137 percent of GDP in 2009 and is expected to decline to 113 percent of GDP by 2015. These projections, however, are particularly sensitive to the exchange rate (Appendix Table 1 and Figure 1).

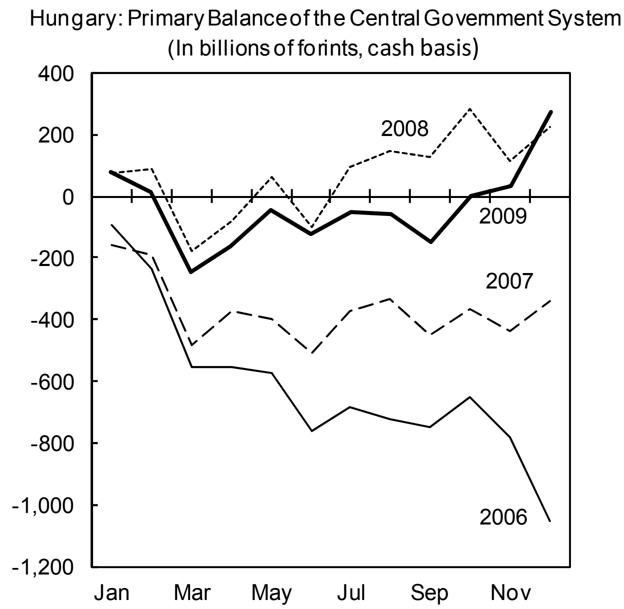
B. Fiscal Policy

13. **Important progress has been made towards strengthening fiscal sustainability, but more needs to be done**. The structural general government balance is estimated to have improved by 3 percentage points of GDP in 2009. Based on the prudent implementation of the 2010 budget, a further ½ percentage point of GDP adjustment is expected this year. Regarding 2011, further measures of about 1¼ percent of GDP will be needed to achieve the authorities' announced objective of bringing the headline deficit below 3 percent of GDP, in line with EU commitments. Beyond that, no further adjustment is assumed over the medium term. Based on these assumptions, the government debt-to-GDP ratio is expected to peak at about 79 percent at end-2010 and then decline to about 64 percent by 2015 (Appendix Table 2 and Figure 2). The roughly unchanged structural balance between 2011 and 2015, which implies a substantial improvement in the headline balance as the output gap narrows, is essential to reduce the government debt-to-GDP ratio under a broad range of adverse shocks.

14. **The end-December 2009 target on the primary cash balance of the central government was met** (text chart and LOI ¶11). Tax revenue was broadly in line with projections, reflecting that lower-than-projected PIT revenues, social security contributions, and fees and duties were offset by higher VAT and other revenues. Tax compliance appears to have remained robust. Nontax revenue was higher than expected, reflecting higher interest revenue, one-off revenues related to the voluntary shift of eligible workers from the second pillar to the first pillar of the pension system,[1] and dividends from state-owned companies.

[1] As part of the pension reform adopted in 2009, the government gave workers who had joined the second (private) pillar voluntarily and were older than 52 at end-2008 the option to switch back to the first (public) pillar during the second half of 2009. The transfer of these second-pillar assets to the government occurred in late 2009 and early 2010.

Spending was slightly lower than projected, reflecting mainly lower transfers to local governments and spending by the social security funds. Spending by line ministries was only slightly higher than expected, but carry-over balances and payment arrears were somewhat higher than expected.



Source: Hungarian Ministry of Finance.

15. **The general government deficit target for 2009 of 3.9 percent of GDP (Maastricht definition) appears to have been met** (Tables 7-8 and LOI ¶12). In ESA terms (i.e. after accrual/cash adjustments for early payments of dividends, late payments of tax refunds, and other factors), the central government deficit is expected to have been 3.6 percent of GDP, in line with projections. The fiscal performance of the local government is expected to have broadly conformed to expectations.

16. **The general government deficit target for 2010 of 3.8 percent of GDP remains appropriate to preserve a credible commitment to debt sustainability, while avoiding an excessively negative impulse to economic activity** (LOI ¶13). Compared to the Fourth Review, tax revenue is expected to be lower, as the fiscal impact of the Constitutional Court's rulings related to the property tax and the taxation of family allowances are only partly offset by additional revenue stemming from the improvement in the macroeconomic outlook. Primary spending is expected to be higher, owing to higher healthcare spending and higher capital transfers, in turn reflecting government support to the Budapest public transport company (BKV) and outlays related to the government take-over and subsequent restructuring of the national airline company (Malev). These lower tax revenue and higher primary spending are expected to be broadly offset by lower projected interest payments, reflecting lower yields, and additional one-off revenue related to the shift from the second pillar to the first pillar of the pension system (text table). Although the structural fiscal balance in 2010 is now weaker than envisaged at the last review, the fiscal effort needed in

2011 to bring the headline deficit below 3 percent of GDP and put the government debt-to-GDP ratio firmly on a downward path is unchanged (see below). This is because the short-term macroeconomic outlook has improved and the projected central bank loss has declined.

Hungary: Changes to the 2010 Fiscal Projections
(General governement, accrual basis; percent of GDP)

	Macro-related	Non Macro-related	Total
Change to the underlying primary balance	-0.01	-0.47	-0.48
Primary revenue	0.04	-0.24	-0.21
Interest revenue	-0.05	0.00	-0.05
Additional spending	0.00	0.22	0.22
Malev	…	0.11	0.11
BKV	…	0.06	0.06
Healthcare spending	…	0.05	0.05
One-off items	0.00	0.24	0.24
Revenue related to the shift in the pension system		0.24	0.24
Change to primary balance		-0.24	-0.24
Decline in interest payments		-0.18	-0.18
Change to overall balance		-0.06	-0.06

Source: IMF staff estimates.

17. **Staff agreed with the authorities on the importance of strict expenditure control to meet the 2010 fiscal targets, and encouraged them to take additional structural measures** (LOI ¶14). The authorities noted that spending discipline would be underpinned by the assignment of treasurers to line ministries (to ensure that commitments are in line with budget appropriations) and clarity on appropriations from the beginning of the year. Regarding structural measures, the authorities and staff agreed that the Constitutional Court decisions would result in a lower-than-previously-envisaged structural adjustment in 2010, and that re-submitting the property tax law to take into consideration the Court's reservations would be the best way to address this issue. However, the authorities emphasized that, given the proximity of elections, such legislation would not be passed by Parliament.

18. **To manage the substantial risks in 2010, the authorities have prepared a contingency plan to supplement budgetary reserves** (LOI ¶15). The likelihood of higher spending by local governments in an election year, as well as higher-than-budgeted subsidies to the public transport system, are so significant that they are reflected in staff's baseline scenario, leaving budgetary reserves at about 0.5 percent of GDP. Remaining risks include residual uncertainties related to local governments, state-owned enterprises, and Malev, as well as macroeconomic uncertainty. An additional risk to the headline fiscal deficit

target is the possibility that Eurostat may decide that revenues related to the shift of workers from the second to the first pillar of the pensions system should only count towards revenue in 2009. The authorities and staff agreed that, while remaining budgetary reserves appear broadly adequate to cover these risks, the preparation of a contingency plan was warranted to cover tail risks. The authorities have therefore identified savings amounting to 0.2 percent of GDP, which they will implement if the fiscal outlook deteriorates significantly. The authorities and staff also agreed that any extra revenues stemming from better-than-anticipated macroeconomic performance should be saved, and that any revenue from the sale of emission credits should be spent exclusively on new environmental projects, either this year or in the future. Moreover, there are uncertainties related to possible policy decisions by the government that takes office following the April elections, including the risk that it may decide to assume some or all of the loans contracted by the state-owned railway company, MAV (1 percent of GDP at end-2009), or other state-owned enterprises.

19. **To bring the general government deficit below 3 percent of GDP in 2011, additional measures will be required** (LOI ¶16). Fiscal effort amounting to about 1¼ percent of GDP is needed to offset the impact of the increase in the threshold for the top PIT bracket that will take effect in 2011 (projected to be 0.5 percent of GDP), the projected weak growth of some of the tax bases, including the wage bill, relative to GDP (projected to be about 0.5 percent of GDP), and the budgetary effect of the central bank's loss in 2010 related to the central bank's sterilization of the government's use of external financing (projected to be about 0.1 percent of GDP), as well as to yield an improvement in the structural balance of 0.1 percent of GDP. Staff observed that government spending relative to GDP in Hungary is high compared to neighboring countries (Box 2). The authorities have requested technical assistance on expenditure rationalization, which is expected to be delivered soon after the elections.

20. **To reduce medium-term risks to fiscal sustainability, staff underlined the need to address the fiscal drain related to the public transport system**. The government is finalizing a public service agreement with MAV consistent with the 2010 budget. The government has discussed the 2010 business plan for MAV that was prepared in December 2009 with the company and final adoption is expected by end-March 2010. Staff noted that the delay in finalizing the public service contract was unfortunate and urged speedy adoption of the business plan. In addition, staff emphasized the need to develop, and start implementing, an ambitious medium-term restructuring plan aimed at tackling the structural inefficiencies affecting the sector's profitability.

21. **The authorities remain committed to modernizing the budgetary framework in consultation with the Fiscal Council** (LOI ¶17). They have better aligned budgetary procedures with the Public Finance and Fiscal Rule Acts. To improve fiscal transparency, they will publish annually a report on the contingent liabilities of the financial and nonfinancial state-owned enterprises. This would be a first step towards publishing statistics on the nonfinancial public sector balance. Lastly, the authorities will continue to modernize

their tax administration, including by reviewing the selection criteria for assigning taxpayers to the large taxpayer unit to give it responsibility for a higher share of the tax base.

C. Financial Sector Policies

Developments and outlook

22. **The banking system has weathered the difficult macro-financial environment of 2009** (LOI ¶18, Table 9). Notwithstanding a tripling of loan-loss provisions, banks remained profitable as they preserved interest margins, reduced operating costs, and benefited from one-off factors such as a favorable revaluation of their government bond portfolio. As a consequence, average return on equity was almost 10 percent in 2009, close to the result in 2008. Profits were mostly added to the capital base, which contributed to an increase in the banking system's capital adequacy ratio to 12.9 percent, almost 2½ percentage points higher than at end-September 2008.[2] Bank funding and liquidity also improved in 2009, following the sharp liquidity strains in the last quarter of 2008. Both deposits and parent bank funding increased significantly in the first half of the year and have since stabilized at high levels. Banks invested much of the additional funds in liquid assets. The flipside, however, has been feeble credit to the private sector, which contracted by almost 5 percent in 2009, reflecting a mix of weak demand and banks' low risk appetite.

23. **The expected further deterioration in credit quality appears manageable** (LOI ¶19). Non-performing loans (NPLs) increased from 3.0 percent at end-2008 to 6.7 percent at end-2009, and are projected to peak just below 10 percent around mid-2010, with problem loans concentrated in unsecured consumer lending and project financing. Most banks appear well prepared, in view of high capital buffers—especially for credit institutions without a foreign parent—and the provisioning already made in 2009. Profits are expected to decline sharply, however, as one-off factors dissipate, interest margins narrow, and banks keep provisioning levels high. With improved liquidity buffers, the banking system is better prepared to withstand external financing stress, though risks remain.

European Bank Coordination Initiative (EBCI)

24. **The EBCI provides assurances about the stability of funding of the six largest foreign subsidiaries**, which account for 60 percent of banking system loans (LOI ¶20):

- All six parent banks confirmed in writing the pledges that they gave at the meeting in Brussels on November 19, 2009. Taking into account Hungary's improved balance of payments position, parent banks' commitment to maintain total net exposure to Hungary was set at 95 percent of the level prevailing at end-September 2008, i.e., just

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[2] In February 2010, FHB (a mortgage bank) repaid the capital injection of €100 million that it had received in April 2009 from the government's capital enhancement fund.

before the initiation of program discussions. Banks' commitment to bring additional capital should the need arise remains unchanged. Parent banks are expected to meet these commitments even in the case of pressures on their own balance sheets.

- Looking forward, the authorities support a wider role for the EBCI as a forum to discuss policies that would strengthen the economic recovery. A Hungary-specific workshop on means to foster bank lending, including through the wider use of existing guarantee schemes, will take place in Budapest on March 5. The authorities and the parent banks of Hungary's largest subsidiaries will participate in the EBCI Full Forum scheduled for March 19 in Athens, Greece. The largest Hungarian domestic bank, which has no parent bank and was thus not involved in the initial phase of the EBCI, will attend both events.

Regulation and supervision

25. **Reforms to the institutional framework for financial regulation and supervision amount to a substantial improvement, but fall short of staff's advice to give the HFSA the authority to issue binding regulations** (LOI ¶21):

- The Hungarian Financial Supervisory Authority (HFSA) has been upgraded to an autonomous organization reporting directly to Parliament. This upgrade has paved the way for a far-reaching internal reorganization strengthening the HFSA's operational effectiveness. However, the HFSA was not given the authority to issue binding regulations, which would have required a constitutional change and therefore a two-thirds majority in parliament. Within existing constitutional boundaries, the HFSA has been given the right to issue binding administrative acts to temporarily suspend financial products in case of risks to financial stability.

- The newly created tri-partite Financial Stability Council (FSC) is operational. The FSC—consisting of the Minister of Finance, the Governor of the Central Bank (MNB), and the Chairman of the HFSA—is meeting monthly to review developments in and policies related to the stability of the financial system. Minutes of FSC meetings are published.

- Both the MNB and the FSC have the right to propose legislation or regulation on financial sector issues on a "comply or explain" basis, i.e., the government needs to indicate agreement with the proposal within 15 days or explain why it disagrees.

- Going forward, staff will review the effectiveness of the new regulatory framework, including the "comply or explain" mechanism. If necessary, staff will discuss with the authorities how to address remaining concerns, in particular with regard to the HFSA's power to issue regulations.

26. **Banking supervision capacity continues to increase** (LOI ¶22):

- On-site inspections of seven of the eight largest banks were finalized in 2009, with the inspection of the remaining bank scheduled to be completed in April 2010. Further, the HFSA has completed targeted inspections of credit quality for two large credit institutions without a foreign parent (structural benchmark for end-March). Similar targeted inspections are planned this year for all other systematically important banks. The completion of two such inspections by end-June is a new structural benchmark.

- Progress has been somewhat slower as regards the reviews of foreign subsidiaries of Hungarian banks. The assessments of subsidiaries within EU countries are progressing as scheduled, but the public tender to commission reviews of subsidiaries outside the EU was inconclusive because of the lack of competition, and a new tender is being launched. At the same time, cooperation between the HFSA and key foreign supervisors has improved significantly.

- A sub-committee of the FSC continues to monitor the credit institutions that received loans from the government in 2009 (LOI ¶23). This specialized sub-committee consults regularly with IMF staff on its work program, as part of the related continuous structural benchmark. Any request for a loan or stand-by facility from the government would be granted only in case of unusually unfavorable funding conditions for the affected credit institution, a well-documented public interest, and after in-depth verification of that institution's financial standing and stress-resilience.

27. **Regulation to safeguard future household credit quality will come into effect in the first half of 2010**. From March 1, loan-to-value (LTV) ratios for all mortgage and long-term consumer loans denominated in forint will be limited to 75 percent, with lower limits applying to loans in foreign currency. From June 1, banks' scoring systems for the approval of household loans will be modified such that the monthly installment for a loan denominated in foreign currency will be lower than the installment for a comparable forint loan. While these changes will tighten access to credit for some households, the overall impact on lending activity is expected to be small.

Remedial action and resolution framework

28. **The remedial action regime for banks has been improved** (LOI ¶24a). Enhancements enacted in March 2009 provide for stronger legal protection of the supervisory commissioner. Amendments to the Law on Credit Institutions and Financial Enterprises in December 2009 establish an additional mandatory threshold for the appointment of a supervisory commissioner, and clearly state that the HFSA has the sole power to initiate bank liquidation proceedings (structural benchmark).

29. **A legislative proposal to broaden bank resolution tools has been developed, but will not be adopted before the elections** (LOI ¶24b). The authorities submitted to parliament on February 12, 2010 a set of amendments to broaden bank resolution techniques (structural benchmark), addressing successfully some difficult legal issues. Once adopted, these changes would allow for purchase-and-assumption transactions and the creation of a bridge bank when the capital adequacy ratio of a systemically-important bank falls below 2 percent or when the bank experiences severe liquidity strains. Parliament will not have time to consider the legislation before the elections, and staff will take up this issue with the new government. This delay will make it possible to conduct some additional technical work on the draft legislation, regarding, for example, sources of funding to facilitate a purchase-and-assumption transaction in case of a shortfall in assets, and the temporary status of bridge banks.

D. Monetary and Exchange Rate Policy

30. **Monetary policy has eased further** (Figure 6 and LOI ¶25). Since July, the MNB has cut the key policy rate by a total of 375 bps to 5.75 percent, while slowing the pace of rate cuts from 50 bps to 25 bps from December 2009. These cuts have reflected the marked easing in external financial strains since mid-2009. Excluding the temporary impact of recent increases in VAT and excise duties on inflation, the *ex ante* real policy rate stands at about 3¼ percent. Modest underlying inflation, the large output gap, and an only moderately upwards sloping yield curve point to further room to cut policy rates should the relaxation in financial strains persist. Markets expect the policy rate to drop to around 5½ percent in the second quarter of 2010. As the interest rate differential with the euro area narrows and forint borrowing becomes relatively more attractive, the traditionally limited impact of policy rate changes on credit may become stronger going forward.

31. **Demand for the central bank's extraordinary liquidity facilities has remained subdued, reflecting banks improved liquidity positions**. Of the various HUF and FX liquidity facilities introduced in late 2008 and early 2009, the only facility with a significant outstanding amount is the 3-month FX swap facility (€1.25 billion in mid-February). However, even this volume is far below the originally envisaged amount (up to €5 billion at end-2009).

32. **The MNB is introducing a new facility to foster liquidity in the mortgage bond market** (LOI ¶26). Notwithstanding the general easing of financial strains, mortgage bond yields have remained about 200 bps higher than government bond yields, compared to a spread of about 30 bps before the crisis, even though mortgage bonds tend to enjoy better credit ratings than sovereign debt. To boost market liquidity, the central bank will purchase modest amounts of mortgage bonds in the primary and secondary markets (with a maximum share of 20 percent of any individual issue and an overall ceiling of HUF 100 billion, about 1 percent of central bank assets). The longer-term objective is to provide additional sources of domestic currency funding for banks, which may, in turn, spur domestic currency lending to households. Staff welcomed the intention to complement the new facility with regulatory

initiatives to standardize mortgage bond characteristics and broaden the set of issuers beyond mortgage banks.

33. **The authorities and staff agreed on the importance of maintaining an adequate level of international reserves, taking into account access to official external financing** (LOI ¶27). At this juncture, reserves are broadly adequate, using the metric of 100 percent coverage of short-term debt at remaining maturity, including inter-company loans, once all the remaining resources under the IMF, EU, and World Bank facilities are considered.

IV. Program Modalities

34. **The attached Letter of Intent (LOI) sets out the authorities' priorities and targets for the period ahead** (Box 3, LOI ¶s 2-5, LOI Tables 1-3, and Tables 10-11).

- ***The performance criterion on net international reserves for end-March 2010 would be modified***. It would be adjusted upward to reflect the higher-than-programmed increase in reserves at end-December 2009 and the expected improvement in external financing conditions in the first quarter of 2010.

- ***An adjustor for the performance criterion on the primary cash balance of the central government system would be added***. To reflect additional revenue that could result from the sale of emission credits accrued under the Kyoto protocol and that would either be spent on new environmental projects or saved for such projects in later years, the floor on the primary cash balance will be adjusted upward for any revenue received from such sales and downward for expenditures on new environmental projects financed from this revenue (Technical Memorandum of Understanding ¶ 11).

- ***The end-March 2010 structural benchmark on targeted bank inspections would be modified and a new benchmark introduced for end-June 2010***. The end-March benchmark—on the completion of reports on thematic inspections focusing on credit risk and loan portfolio quality for at least *three* banks selected with a systemic risk-based approach—would be modified to *two* large credit institutions without a foreign parent bank, since higher than expected demands on supervisory resources limited the scope for an additional priority inspection. Instead, the HFSA is planning to conduct similar inspections in the second quarter for *two* large subsidiaries of foreign parent banks (new benchmark, end-June).

35. **With the continued stability of external financing conditions, the authorities are taking decisions about drawing on a review-by-review basis**. As at the Fourth Review, they do not intend to draw the SDR 725 million (70 percent of quota) that would be made available upon the completion of this review; they also do not intend to request the release of EU balance of payments assistance. They are treating the cumulative resources

of SDR 1,450 million from the Fourth and Fifth Reviews, as well as the remaining EU and World Bank funds, as insurance against unanticipated shocks.

V. Staff Appraisal

36. **The authorities' economic program, supported by the Stand-By Arrangement, has put Hungary on a path to stability and growth**. The weak public and private sector balance sheets in the run-up to the crisis necessitated urgent and decisive policy action to improve fiscal sustainability and preserve financial stability. Under the Fund-supported program, the underlying fiscal position has improved, timely liquidity support was provided to the financial sector, and bank supervision has been significantly enhanced. As a result, macro-financial vulnerabilities are being lowered, investor confidence is returning, and the economy is on the road to recovery.

37. **Policies under the program remain on track**. All end-December 2009 quantitative performance criteria, the continuous performance criterion on the non-accumulation of external arrears, and the indicative target on central government debt were met. The three structural benchmarks for the Fifth Review—related to monitoring the financial soundness of banks receiving government support, the passage by parliament of amendments to strengthen the remedial powers of the Hungarian Financial Supervisory Authority (HFSA), and the submission to parliament of amendments to improve the bank resolution framework—were also met.

38. **The economy is expected to start recovering during the course of 2010, reflecting the strengthening of policy credibility and higher global demand**. A small current account surplus was recorded in 2009, and a small deficit is expected in 2010. Inflation is expected to remain elevated in the first half of 2010, due mostly to the increases in the VAT rate and excise duties, and then fall to the central bank's inflation target in the second half of the year.

39. **The underlying fiscal position has been strengthened, but more needs to be done to put debt firmly on a declining path**. In 2010, strict expenditure control, cautious use of contingency buffers, and saving of revenue windfalls are essential to manage risks and meet fiscal targets. If existing buffers prove to be insufficient, the authorities would need to take further action. Looking beyond 2010, structural measures will be required to meet the objectives of bringing the general government deficit below 3 percent of GDP in 2011 and of reducing significantly government debt over the medium term. In that regard, the restructuring of the public transport system will need to be tackled more forcefully so as to reduce its drain on the budget in a durable way.

40. **Notwithstanding the substantial progress already made, continued implementation of measures to preserve financial stability remains essential**. Following the severe liquidity strains in late 2008, bank funding and liquidity improved in 2009, and capital levels are well above regulatory requirements. However, pressures on capital may

increase as credit quality deteriorates further as a result of the economic downturn. The HFSA has stepped up on-site inspections and is planning to conduct additional follow-up inspections on capital adequacy and credit quality. Sustained vigorous implementation of the reform of the institutional arrangements for bank supervision is also essential. Further, the authorities need to continue to carefully monitor the financial soundness of credit institutions that receive FX loans from the government, so as to safeguard financial stability and minimize risks to public finances. The issue of the HFSA's regulatory power and the enactment of a stronger bank resolution framework will need to be taken up with the new government after the elections.

41. **Monetary policy should continue to ease gradually and cautiously, to the extent allowed by financial market conditions**. While monetary policy was constrained in the first half of 2009 by the need to avoid disorderly exchange rate movements, reduced external financial strains since mid-2009 and increased confidence in fiscal sustainability have created room for substantial interest rate cuts since then. Going forward, continued fiscal consolidation and stable external financing conditions would allow for further cautious interest rate cuts. It is important to maintain an adequate level of international reserves, taking into account access to official external financing.

42. **Continued adherence to prudent policies will be essential if Hungary is to ensure macroeconomic stability and return to sustained growth**. Government and external debt levels remain high, and a deterioration in external conditions or policy slippages could hinder Hungary's stabilization efforts. Much has been accomplished, but more remains to be done. Staff supports the authorities' requests for completion of the Fifth Review and modification of the performance criterion for net international reserves and of the adjustor for the performance criterion on the primary cash balance of the central government system.

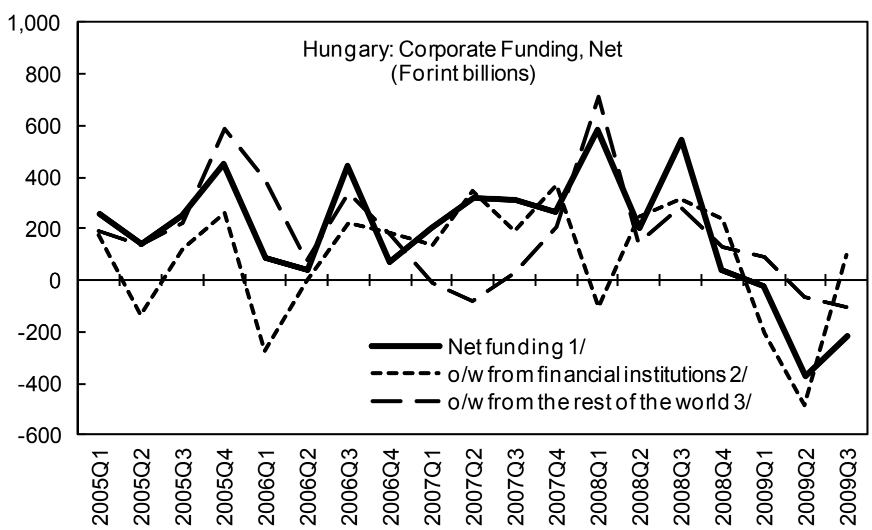
Box 1: Corporate Funding

The funding of non-financial firms is important to understanding the contribution of the sector to economic growth. This box analyzes development in corporate funding using flow-of-funds data and points out the linkages to bank funding during the crisis.

The non-financial corporate sector is largely foreign-owned and relies heavily on loans. Non-residents hold about 60 percent of equity. Debt financing is almost exclusively in the form of loans, of which about 40 percent are from non-residents (including parent companies) and another 40 percent from domestic financial institutions.

Net corporate funding has declined sharply since 2008Q4 and was negative in the first three quarters of 2009. The initial reduction in net funding in 2008Q4 was driven mainly by a collapse in trade credit. The sharp fall in net funding in 2009Q2 was mostly due to a significant drop in net bank lending, which in turn reflected mainly an increase in corporate deposits. Net corporate funding became less negative in 2009Q3 (although the improvement may reflect seasonal factors), mostly due to higher net bank lending, as corporate deposit drawdown more than offset the continued weakness in new bank credit. External funding has been surprisingly resilient, though it turned slightly negative recently.

Overall, foreign parent funding of the non-financial corporate sector was a stabilizing factor during the period of acute financial strains. This mirrors the pattern of parent bank support to Hungarian banking subsidiaries, which increased greatly during 2008Q4 and 2009Q1, before falling back later in 2009.



Sources: Magyar Nemzeti Bank, and IMF staff estimates.
1/ Transactions of financial liabilities minus financial assets.
2/ Loans net of deposits with domestic financial institutions (in both forint and foreign currency).
3/ Net equity plus net loans from non-residents, minus holdings of foreign deposits and securities.

Box 2: Government Spending

General government spending in Hungary has declined since 2006 but remains significantly higher than in neighboring countries (see table below). General government spending fell from 54 percent of potential GDP in 2006 to 50 percent of potential GDP in 2008, but this was still about 9 percentage points of GDP higher than the average in the other Visegrad countries.

Higher general government spending in Hungary reflects higher primary current spending and higher interest payments, which more than offset lower capital spending. In 2008, primary current spending was 7½ percent of GDP higher than the average of the other Visegrad countries, reflecting mainly a higher government wage bill (3½ percent of GDP), higher social benefits (2 percent of GDP), and higher intermediate consumption (1¼ percent of GDP). Interest payments were about 2½ percent of GDP above the average of the other countries. Capital spending was significantly lower than in these countries. In functional terms, the higher level of spending mostly related to social protection and general public services.

The reforms adopted in 2009-10 are expected to further reduce spending, though it would remain above the regional average. Based on current projections, spending would decline by 4½ percentage points of potential GDP between 2008 and 2010. The bulk of this adjustment would come from a broad-based reduction in primary current spending, though the government wage bill and social transfers would remain at relatively high levels.

Further reforms could enhance the credibility of fiscal consolidation, improve the efficiency of public services delivery, and create the fiscal space necessary for higher capital spending and lower taxes. While significant progress has been made in recent years in a number of areas (including health care, education, public administration, pensions, and subsidies), further progress is possible (OECD Economic Survey of Hungary, February 2010). In particular, new measures could be identified to reduce further the government wage bill and eliminate redundancies between government levels.

Spending reforms should be accompanied by measures to further improve budget processes and reduce fiscal risks. Public finance management measures should notably aim at: (i) setting fiscal reforms in a medium-term perspective, including through the implementation of a medium-term fiscal framework and program budgeting; (ii) better managing carry-overs; and (iii) strengthening budgetary controls, to make sure commitments are in line with allocations. With regard to risks, measures aim at improving the operating and financial performance of state-owned enterprises should be accelerated.

Box 2: Government Spending (concluded)

Table. Selected Central Eastern European Countries: General Government Spending, 2008
(in percent of GDP)

	Hungary (1)	Average of comparable neighboring countries 1/ (2)	Difference =(2)-(1)
Total expenditure	49.2	40.3	8.9
Central government	32.8	24.8	8.0
Local governments	11.4	10.3	1.1
Social security funds	5.0	5.2	-0.2
Current Spending	45.0	34.8	10.2
Primary current spending	40.9	33.3	7.6
Compensation of employees	11.5	8.1	3.5
o.w. Central government	5.8	4.0	1.8
Local governments	5.6	3.9	1.7
Intermediate consumption	7.1	5.8	1.3
Social benefits	18.7	16.7	2.0
Subsidies	1.1	1.3	-0.2
Other	2.5	1.5	1.0
Property income	4.1	1.5	2.6
Gross fixed capital formation	2.7	3.8	-1.2
Capital transfers	1.5	1.7	-0.1
Functional classification (2007)			
Social protection	17.4	13.0	4.3
General public services	9.4	4.5	4.8
Education	5.3	4.8	0.5
Others	17.8	17.4	0.4

Source: Eurostat.
1/ Czech Republic, Poland and Slovak Republic.

Box 3. Hungary: Stand-By Arrangement

Access: *Exceptional*. SDR 10.5 billion (1,015 percent of quota).

Length: 23 months from November 6, 2008 (extended from 17 months at the Third Review).

Phasing:
- *Front loaded*. SDR 4.2 billion was disbursed after the Board's approval of the arrangement on November 6, 2008, followed by SDR 2.1 billion after the completion of the First Review on March 25, 2009, and SDR 1.3 billion after the completion of the Second Review on June 23, 2009.
- *Re-phasing*. Access was re-phased, and SDR 50 million was disbursed at the completion of the Third Review on September 25, 2009.
- *Insurance*. The authorities did not draw the tranche (SDR 725 million) made available at the completion of the Fourth Review on December 17, 2009, and have indicated their intention not to draw the tranche (SDR 725 million) that would be made available at the completion of this (Fifth) Review. Subject to satisfactory policy performance, these amounts would remain available through the end of the program period. The remaining amount (SDR 1,450 million) is contingent upon completion of further quarterly reviews.

Conditionality:
- *Quantitative Performance Criteria*
  - Floor on the central government system primary cash balance
  - Floor on the change in net international reserves
  - Band around the 12-month rate of inflation of consumer prices
  - Non-accumulation of external debt arrears

- *Quantitative Indicative Target*
  - Ceiling on the total debt stock of the central government system

- *Structural Benchmarks*
  - Operation of the subcommittee described in the March 2009 LOI ¶18 as long as there is any government capital or funding support outstanding to banks, and consultation of the subcommittee with Fund staff on its work program. *Continuous*
  - Completion of reports on thematic inspections focusing on credit risk and the quality of the loan portfolio for the two large credit institutions without a foreign parent bank. *By end-March 2010*
  - Completion of reports on thematic inspections focusing on credit risk and the quality of the loan portfolio for two large subsidiaries of foreign parent banks. *By end-June 2010*

Table 1. Hungary: Main Economic Indicators, 2006–10

	2006	2007	2008	2009		2010	
				4th Rev.	5th Rev.	4th Rev.	5th Rev.
Real economy (change in percent)							
Real GDP	4.0	1.0	0.6	-6.7	-6.3	-0.6	-0.2
Total domestic demand 1/	0.9	-2.1	0.6	-11.2	-13.0	-1.8	-1.4
Private consumption	1.9	-1.6	-0.6	-6.8	-7.2	-2.3	-3.0
Gross fixed investment	-3.6	1.6	0.4	-8.3	-6.8	1.0	1.5
Foreign balance 1/	3.1	3.1	0.0	4.5	6.7	1.2	1.3
Exports	18.6	16.2	5.6	-12.3	-9.5	3.6	6.0
Imports	14.8	13.3	5.7	-16.5	-15.3	2.7	5.4
CPI (end year)	6.5	7.4	3.5	5.2	5.6	2.5	3.0
CPI (average)	3.9	7.9	6.1	4.2	4.2	3.9	4.3
Unemployment rate (average, in percent)	7.5	7.4	7.8	10.0	10.0	10.9	10.6
Gross domestic investment (percent of GDP) 2/	24.0	23.5	23.4	19.3	19.2	20.0	20.4
Gross national saving (percent of GDP, from BOP)	16.5	16.7	16.2	18.8	19.6	18.5	20.0
General government (percent of GDP), ESA-95 basis 3/							
Overall balance	-9.3	-4.9	-3.7	-3.9	-3.9	-3.8	-3.8
Primary balance	-5.4	-0.9	0.4	0.4	0.5	0.7	0.4
Debt	65.6	65.8	72.9	78.7	77.7	80.2	78.9
Money and credit (end-of-period, percent change)							
Broad money	13.6	11.0	9.2	3.6	3.4	4.3	4.0
Lending to the private sector, flow-based	19.6	18.4	11.4	-3.7	-4.7	1.4	-0.6
Interest rates (percent)							
T-bill (90-day, average)	7.0	7.6	8.9	...	8.2	...	...
Government bond yield (5-year, average)	7.4	7.0	9.3	...	9.3	...	...
Balance of payments							
Goods and services trade balance (percent of GDP)	-0.9	1.2	0.7	5.6	6.6	5.6	6.3
Current account (percent of GDP)	-7.5	-6.8	-7.2	-0.5	0.4	-1.5	-0.4
Reserves (in billions of euros)	16.4	16.4	24.0	29.7	30.7	32.5	33.9
Gross external debt (percent of GDP) 4/	91.1	98.4	115.3	136.6	137.3	131.7	132.3
Exchange rate							
Exchange regime	Floating						
Present rate (March 3, 2010)	Ft 195.65 = US$1; Ft. 266.79 = €1						
Nominal effective rate (2005=100)	94.1	100.2	101.4	...	91.2	…	…
Real effective rate, CPI basis (2005=100)	95.8	108.1	112.8	...	105.3	…	…
Quota at the Fund	SDR 1038.4 million						

Sources: Hungarian authorities; IMF, *International Financial Statistics*; Bloomberg; and IMF staff estimates.
1/ Contribution to growth. Calculated using 2000 prices. It includes change in inventories.
2/ Includes change in inventories.
3/ Consists of the central budget, social security funds, extrabudgetary funds, and local governments.
4/ Excluding Special Purpose Entities. Including inter-company loans, and nonresident holdings of forint-denominated assets.

Table 2. Hungary: Monetary Accounts, 2006–10

	2006	2007	2008	2009		2010				
				4th Rev.	5th Rev. Est.	March	June	Sept.	Dec. 4th Rev.	Dec. 5th Rev.
	(in billions of forint, unless indicated otherwise)									
Monetary Survey										
Net foreign assets	-83	-952	-1,487	564	567	995	1,197	1,311	735	1,387
Net domestic assets	12,809	15,078	16,908	15,414	15,376	15,108	14,877	14,867	15,924	15,196
Domestic credit	16,190	18,907	21,481	20,722	20,846	20,536	20,330	20,287	21,292	20,554
Net claims on government	3,026	3,270	2,952	2,837	3,032	2,830	2,671	2,621	3,153	2,840
Credit to the economy	13,165	15,637	18,529	17,885	17,814	17,706	17,659	17,666	18,139	17,714
Other items, net	-3,381	-3,829	-4,573	-5,308	-5,470	-5,429	-5,452	-5,420	-5,368	-5,358
Broad money	12,727	14,126	15,422	15,978	15,943	16,103	16,075	16,178	16,658	16,583
Currency in circulation	1,838	2,068	2,137	2,046	2,039	2,052	2,047	2,045	2,109	2,127
Total deposits	10,075	10,869	12,114	12,504	12,328	12,509	12,457	12,531	13,006	12,807
Domestic currency deposits	7,827	8,704	9,737	9,781	9,646	9,871	9,791	9,847	10,239	10,083
Foreign currency deposits	2,248	2,165	2,377	2,723	2,682	2,638	2,666	2,684	2,767	2,725
Short-term securities	35	200	313	433	461	461	461	461	433	461
Money market instruments	779	990	858	995	1,115	1,081	1,110	1,141	1,111	1,187
Accounts of the Magyar Nemzeti Bank (MNB)										
Net foreign assets 1/	3,838	3,941	5,988	6,680	7,261	7,445	7,520	7,625	6,845	7,693
Net domestic assets	-1,404	-1,150	-3,383	-4,113	-4,755	-4,877	-4,962	-5,084	-4,202	-5,102
Net domestic credit	-1,369	-1,138	-3,193	-3,722	-4,092	-4,319	-4,407	-4,552	-3,810	-4,585
Net claims on government	-141	-108	-1,286	-644	-709	-815	-1,085	-1,073	-764	-945
Claims on government	233	147	360	310	279	279	279	279	310	279
Liabilities to government 2/	373	255	1,646	954	988	1,094	1,364	1,352	1,073	1,224
Net claims on the economy	-5	0	0	0	0	0	0	0	0	0
Net claims on banks	-1,223	-1,029	-1,907	-3,078	-3,383	-3,504	-3,322	-3,479	-3,047	-3,641
Other items, net	-34	-12	-190	-391	-663	-559	-555	-532	-392	-516
Base money	2,434	2,791	2,605	2,566	2,506	2,568	2,558	2,541	2,643	2,592
Currency in circulation	1,838	2,068	2,137	2,046	2,039	2,052	2,047	2,045	2,109	2,127
Cash in bank vaults	130	134	171	171	149	155	146	129	172	86
Banks' reserves	466	589	296	349	318	361	364	367	362	378
Required reserves	615	682	322	349	338	361	364	367	362	378
Excess reserves	-149	-92	-26	0	-20	0	0	0	0	0
Other Monetary and Financial Institutions										
Net foreign assets	-3,920	-4,892	-7,475	-6,116	-6,694	-6,450	-6,323	-6,315	-5,573	-6,307
Net domestic assets	14,809	16,951	20,759	20,047	20,597	20,501	20,350	20,447	20,123	20,762
Domestic credit	17,554	20,045	24,674	24,444	24,938	24,855	24,737	24,839	24,565	25,139
Net claims on government	3,166	3,378	4,238	3,481	3,741	3,645	3,756	3,694	3,379	3,784
Credit to the economy	13,165	15,637	18,529	17,885	17,814	17,706	17,659	17,666	18,139	17,714
Net claims on the central bank	1,223	1,029	1,907	3,078	3,383	3,504	3,322	3,479	3,047	3,641
Banks' reserves and overnight deposits	838	1,062	296	349	318	361	364	367	362	378
Other items, net	-3,584	-4,156	-4,211	-4,746	-4,658	-4,715	-4,751	-4,759	-4,804	-4,755
Banks' liabilities	10,888	12,058	13,285	13,932	13,904	14,051	14,028	14,132	14,550	14,455
Total deposits	10,075	10,869	12,114	12,504	12,328	12,509	12,457	12,531	13,006	12,807
Demand deposits	3,995	4,280	4,023	4,153	4,094	4,155	4,137	4,162	4,319	4,254
Time deposits	6,080	6,589	8,090	8,351	8,233	8,355	8,320	8,369	8,686	8,554
Short-term securities	35	200	313	433	461	461	461	461	433	461
Money market instruments	779	990	858	995	1,115	1,081	1,110	1,141	1,111	1,187
Memorandum items :										
	(percentage change, y-o-y)									
Base money	10.7	14.7	-6.7	-1.5	-3.8	-1.9	2.2	-0.1	3.0	3.4
Broad money	13.6	11.0	9.2	3.6	3.4	1.2	1.6	3.0	4.3	4.0
Credit to the economy	16.7	18.8	18.5	-3.5	-3.9	-12.5	-3.6	-1.9	1.4	-0.6
Lending to the private sector, flow-based 3/	19.6	18.4	11.4	-3.7	-4.7	-4.3	-3.8	-2.5	1.4	-0.6
	(percentage)									
Foreign currency loans to total loans	47.9	56.4	64.7	63.0	63.3	63.3	63.0	63.0	63.3	63.1
Foreign currency deposits to total deposits	22.3	19.9	19.6	21.8	21.8	21.1	21.4	21.4	21.3	21.3
Net international reserves	4,000	4,051	4,908	5,106	5,284	5,479	5,517	5,623	5,235	5,691
plus IMF disbursement to the government 4/	0	0	1,215	1,864	1,879	1,869	1,869	1,869	1,864	1,869
minus other non-reserve liabilities (net)	162	110	135	290	-98	-97	-134	-134	254	-134
= net foreign assets of the central bank	3,838	3,941	5,988	6,680	7,261	7,445	7,520	7,625	6,845	7,693

Sources: Magyar Nemzeti Bank; and IMF staff estimates.

1/ Includes disbursements of IMF, EU and WB funds to the government.
2/ Includes built-up of government deposits commensurate with the disbursement of IMF, EU and WB funds; as well as the use of deposits to finance the government's net borrowing requirements.
3/ Loans to households, non-financial corporations and non-bank financial intermediaries. This aggregate is slightly smaller than "credit to the economy", which also includes banks' holdings of private sector securities. Adjusted for movements in the exchange rate.
4/ The first two IMF tranches and the fourth tranch were disbursed to the government, who deposited the funds with the MNB and converted them into forint. As a result, IMF disbursements were recorded as a foreign asset but domestic liability of the MNB. The third tranch was disbursed to the central bank. All future tranches are also assumed to be disbursed to the central bank.

Table 3. Hungary: Balance of Payments, 2008-11 1/

(In millions of euros)

	2008	2009						2010						2011
		Mar	Jun	Sep	Dec			Mar	Jun	Sep	Dec			
	Est	Est	Est	Est	Proj.	4th Rev.	5th Rev.	Proj.	Proj.	Proj.	Proj.	4th Rev.	5th Rev.	Proj.
Current Account	-7,591	-587	475	698	-210	-430	376	73	-143	-138	-216	-1,500	-424	-1,056
Goods and service, net	780	843	1,815	1,986	1,489	5,184	6,132	1,529	1,627	1,527	1,587	5,468	6,270	5,934
Exports	86,390	16,575	17,513	18,520	19,440	70,561	72,049	18,122	18,906	19,331	19,805	73,633	76,164	81,835
Imports	-85,610	-15,732	-15,699	-16,534	-17,952	-65,376	-65,917	-16,592	-17,280	-17,804	-18,218	-68,165	-69,894	-75,900
Income, net	-7,697	-1,278	-1,470	-1,418	-1,459	-5,368	-5,625	-1,362	-1,675	-1,570	-1,708	-6,371	-6,315	-7,058
Current transfers, net	-674	-152	130	130	-239	-247	-131	-95	-95	-95	-95	-598	-379	68
Capital Account	1,034	300	415	354	168	1,526	1,238	484	478	490	492	1,853	1,943	1,864
Net capital transfers from the EU	937	295	417	354	578	1,543	1,645	484	478	490	492	1,853	1,943	2,071
Financial Account	9,629	-643	-3,462	1,248	-692	-3,942	-3,549	474	-862	-727	110	-1,386	-1,004	726
Direct investment, net	2,499	109	-1,063	-174	536	-942	-591	49	203	-66	-17	-194	169	584
Direct Investment Abroad	-568	-175	-537	-12	-164	-835	-887	-185	149	-347	-370	-692	-754	-789
In Hungary	3,067	284	-526	-162	700	-107	296	235	54	282	353	498	923	1,373
Portfolio investment, net	-3,174	-2,940	-542	2,907	-2,246	-671	-2,821	1,375	-313	-483	304	912	882	119
Assets	5,351	762	1,713	1,705	48	3,596	4,229	-179	-185	-55	-56	-290	-474	-365
Equity	-2,191	-390	169	-437	-27	-623	-686	-192	-197	-68	-68	-341	-525	-138
Debt securities	7,542	1,153	1,545	2,143	75	4,219	4,915	13	13	13	13	51	51	-227
Liabilities	-8,525	-3,702	-2,256	1,202	-2,294	-4,267	-7,050	1,553	-128	-428	360	1,202	1,357	484
Equity	-260	135	628	59	30	1,049	853	-50	143	440	473	1,196	1,006	534
Debt securities	-8,265	-3,838	-2,883	1,143	-2,324	-5,316	-7,902	1,603	-271	-868	-113	7	351	-50
Other investment	10,304	2,188	-1,858	-1,485	1,018	-2,329	-137	-950	-751	-178	-176	-2,104	-2,056	24
Assets	-1,818	-2	-1,125	584	75	-449	-467	-75	-76	-50	-51	-243	-252	-847
o/w: short-term assets	1,274	-310	-1,308	573	108	-946	-937	-41	-42	-15	-16	-104	-114	-577
Liabilities	12,121	2,189	-733	-2,069	943	-1,880	330	-875	-675	-128	-126	-1,861	-1,804	870
o/w short-term liabilities	2,506	1,495	-664	-1,341	498	-1,397	-12	-455	-443	-44	-43	-918	-985	1,592
Net errors and omissions	-2,593	394	-86	-1,031	187	-434	-536	-134	-134	-134	-134	-434	-536	-268
Overall Balance	479	-536	-2,659	1,269	-546	-3,280	-2,471	896	-661	-509	252	-1,468	-22	1,267
Program financing 2/	2,000	2,000	0	1,500	0	3,500	3,500	0	800	900	0	2,000	1,700	0
European Union	2,000	2,000	0	1,500	0	3,500	3,500	0	300	400	0	1,000	700	0
World Bank	0	0	0	0	0	0	0	0	500	500	0	1,000	1,000	0
Others	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Net International Reserves (increase -)	-2,479	-1,464	2,659	-2,769	546	-620	-1,029	-896	-139	-391	-252	-532	-1,678	-1,267
Gross Reserves	-7,402	-3,831	1,270	-3,907	546	-5,496	-5,923	-896	-932	-1,183	-252	-2,871	-3,263	-1,267
Reserve Liabilities	4,923	2,368	1,389	1,138	0	4,876	4,894	0	793	793	0	2,339	1,585	0
Fund disbursements 2/	4,923	2,368	1,389	54	0	3,811	3,811	0	793	793	0	2,339	1,585	0
SDR allocation	0	0	0	1,083	0	1,065	1,083	0	0	0	0	0	0	0
Current account (in percent of GDP)	-7.2	-2.8	2.1	3.0	-0.8	-0.5	0.4	0.3	-0.6	-0.6	-0.7	-1.5	-0.4	-1.0
Gross external debt (in percent of GDP)	115.3	136.9	138.5	139.2	137.3	136.6	137.3	138.2	138.8	139.7	132.3	131.7	132.3	124.3
Gross official reserves	24,040	27,890	26,950	30,603	30,676	29,650	30,676	31,572	32,504	33,687	33,940	32,521	33,940	35,206
In percent of short-term debt at remaining maturity 3/	72.2	79.2	76.5	86.0	84.9	85.1	84.9	83.8	85.1	89.3	88.8	81.5	88.8	97.6

Sources: Hungarian authorities and IMF staff estimates.

1/ Excluding Special Purpose Entities.

2/ Shows available official financing from June 2010 to program expiration in October 2010. Undrawn balances of € 1,600 million (IMF) and € 300 million (EC) remain available, if needed.

3/ The short-term debt at remaining maturity includes an estimate of intercompany loans falling due in the short term.

Table 4. Hungary: Program Financing, 2008Q4–2010Q3

(In millions of euros)

	2008	2009				2010			Total
	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep	
	Est.		Est.		Proj.		Proj.		Proj.
Total financing requirements	-1,341	-836	-3,074	915	-714	412	-1,139	-999	-6,776
Current account deficit	-2,268	-587	475	698	-210	73	-143	-138	-2,101
Financial account outflows	992	-643	-3,462	1,248	-692	474	-862	-727	-3,671
Direct investment, net	1,310	109	-1,063	-174	536	49	203	-66	905
Portfolio investment, government net 1/	-4,407	-2,483	-255	2,259	-2,016	1,751	-127	-740	-6,017
Portfolio investment, private net 2/	-1,256	-457	-287	648	-230	-376	-186	256	-1,888
of which, financial derivatives 3/	-1,157	-1,356	768	1,186	57	0	0	0	-502
Other investment	5,346	2,188	-1,858	-1,485	1,018	-950	-751	-178	3,329
Bank Guarantee Fund	0	0	0	0	0	0	0	0	0
Net errors and omissions	-66	394	-86	-1,031	187	-134	-134	-134	-1,004
Total financing sources	-3,582	-1,531	1,685	-2,053	714	-412	346	206	-4,627
Capital account inflows	739	300	415	354	168	484	478	490	3,428
Net capital transfers from the EU	660	295	417	354	578	484	478	490	3,756
Program Financing	2,000	2,000	0	1,500	0	0	800	900	7,200
European Union	2,000	2,000	0	1,500	0	0	300	400	6,200
World Bank	0	0	0	0	0	0	500	500	1,000
Change in gross reserves	-6,321	-3,831	1,270	-3,907	546	-896	-932	-1,183	-15,255
Financing need	-4,923	-2,368	-1,389	-1,138	0	0	-793	-793	-11,403
Fund credits	4,923	2,368	1,389	54	0	0	793	793	10,319
SDR allocation	0	0	0	1,083	0	0	0	0	1,083

Sources: Hungarian authorities; and IMF staff estimates.
1/ Includes government FX bond issuance of US$ 2,000 million in 2010Q1.
2/ During the fourth quarter of 2009, banks with foreign parent banks are expected to have rolled 95 percent of short-term debt, and others 70 percent, recovering gradually to 100 percent in the second half of 2010.
3/ Assumes no net gains from financial derivatives.

Table 5. Hungary: Indicators of External Vulnerability, 2005–09

	2005	2006	2007	2008	2009 Est.
Financial Indicators					
M3, end-of-period, percent change	14.7	13.7	11.0	8.7	3.5
Lending to the private sector, flow based, end-of-period, percentage change 1/	15.4	19.6	18.4	11.4	-4.7
T-bill, 90-day, average, in percent	6.7	7.0	7.6	8.8	8.4
Government bond yield, 5-year, average, in percent	6.8	7.4	7.0	9.2	9.3
Share of foreign currency liabilities in total liabilities	34.4	39.3	42.4	45.6	47.0
Share of foreign currency loans by sector					
Corporates	47.7	47.1	52.6	60.3	61.3
Households	32.6	46.8	59.0	70.7	70.2
Other loans	75.2	75.4	81.7	87.1	85.7
Non-performing loans to gross loans 2/	2.3	2.6	2.3	3.0	6.7
External Indicators					
Exports of goods and services, annual percentage change	12.9	15.4	16.6	7.0	-16.6
Imports of goods and services, annual percentage change	10.0	14.7	13.5	7.7	-23.0
Real effective exchange rate, percentage change, + = appreciation	2.4	-4.2	12.8	4.4	-6.7
Current account balance, in percent of GDP	-7.2	-7.5	-6.8	-7.2	0.4
Capital and financial account, in percent of GDP	0.7	0.7	0.7	1.0	1.3
Financial account, in percent of GDP	12.9	10.1	7.9	9.1	-3.8
Net foreign direct investment, in percent of GDP	5.0	3.1	1.6	2.4	-0.6
Gross official reserves, in millions of euros	15,721	16,397	16,385	24,040	30,676
In months of imports	2.7	2.5	2.3	4.4	5.3
In percent of short-term debt at remaining maturity	112.2	123.6	88.9	72.2	84.9
Total external debt, including SPEs, in percent of GDP 3/	..	105.6	114.2	144.6	..
Total external debt, excluding SPEs, in percent of GDP	75.7	91.1	98.4	115.3	137.3
Of which:					
Direct investment intercompany loans	11.9	16.4	18.9	22.0	28.9
General government	29.1	33.2	33.6	36.2	42.5
Of which: non-residents holdings of local currency government bonds	11.5	13.0	12.8	8.1	8.7
Central bank	1.2	1.1	0.6	1.1	5.1
Banks	21.5	27.6	30.6	40.4	42.9
Non-financial institutions	11.9	12.8	14.6	15.5	19.3
Short-term debt at remaining maturity 4/	14,012	13,270	18,428	33,314	36,141
Financial Market Indicators					
Stock market index, local currency, end-of-period	20,785	24,844	26,236	12,242	21,227
EMBI Global bonds spread, end-of-period	74.0	58.0	84.0	504.0	186.0
CDS spread, 5-year, end-of-period	26.2	20.8	54.8	419.1	237.9

Sources: Hungarian authorities; and IMF staff estimates.

1/ Loans to households, non-financial corporations and non-bank financial intermediaries. This aggregate is slightly smaller than "credit to the economy", which also includes banks' holdings of private sector securities. Adjusted for movements in the exchange rate.

2/ Non-performing loans are defined as corporate, household, interbank, foreign and other loans that are past due for more than 90 days.

3/ Special Purpose Entities are defined as resident corporations of non-resident owners, which perform a passive, financial intermediary function between their non-resident partners. SPEs have a marginal impact on the domestic economy, and their transactions have negligible net impact on the balance of payments (an enterprise that has a non-negligible net impact on the balance of payments is removed from the list of SPEs). Foreign assets and liabilities of SPEs are largely matched, and loans are considered as FDI in accordance with international statistical standards. Data for SPEs are not available prior to 2006.

4/ Includes an estimate of intercompany loans falling due in the short-term.

Table 6. Hungary: IMF Staff's Illustrative Medium-Term Scenario, 2007-15

	2007	2008	2009 Est.	2010 Program	2011	2012	2013	2014	2015
	(In percent, unless otherwise indicated)								
Real GDP growth	1.0	0.6	-6.3	-0.2	3.2	4.5	4.0	3.5	3.0
Nominal GDP, forint billions	25,408	26,543	26,030	26,627	28,209	30,071	31,984	33,924	35,800
Inflation (CPI; year average basis)	7.9	6.1	4.2	4.3	2.5	2.6	2.8	3.0	3.0
Inflation (CPI; end-year basis)	7.4	3.5	5.6	3.0	2.5	3.0	3.0	3.0	3.0
	(Annual percentage change, constant prices)								
Domestic demand	-2.1	0.7	-13.5	-1.6	1.9	3.4	4.3	3.8	3.3
Total consumption	-2.0	-0.6	-6.4	-2.7	2.3	3.5	2.9	2.8	2.8
Gross fixed capital formation	1.6	0.4	-6.8	1.5	2.8	5.0	5.0	5.0	5.0
Exports of GNFS	16.2	5.6	-9.5	6.0	6.5	7.0	7.2	7.2	7.2
Imports of GNFS	13.3	5.7	-15.3	5.4	5.8	6.5	7.8	7.8	7.8
	(In percent of GDP, unless otherwise indicated)								
External current account balance	-6.8	-7.2	0.4	-0.4	-1.0	-2.1	-3.0	-3.5	-3.5
Gross national saving	16.7	16.2	19.6	20.0	19.5	18.1	17.8	17.6	17.5
Gross national investment 1/	23.5	23.4	19.2	20.4	20.5	20.2	20.8	21.1	21.0
Capital account, net	0.7	1.0	1.3	2.0	1.8	1.8	1.8	1.6	1.5
Financial account, net	7.9	9.1	-3.8	-1.0	0.7	3.7	5.0	1.0	3.1
Gross external debt 2/	98.4	115.3	137.3	132.3	124.3	120.2	117.0	115.1	113.2
General government (ESA-95)									
Revenue, total	44.9	45.5	45.8	44.7	43.5	43.3	43.3	43.3	43.3
Expenditure, primary	45.8	45.1	45.3	44.3	42.1	41.1	40.4	39.9	39.7
Primary balance	-0.9	0.4	0.5	0.4	1.4	2.2	2.9	3.3	3.6
General government balance (including the costs of pension reform)	-4.9	-3.7	-3.9	-3.8	-2.8	-2.0	-1.1	-0.5	0.1
Interest expenditure	4.0	4.1	4.3	4.2	4.2	4.2	4.0	3.8	3.6
General government debt	65.8	72.9	77.7	78.9	77.3	74.5	71.2	67.6	64.0
Memorandum items									
Output gap	2.4	1.1	-6.0	-6.9	-5.5	-3.3	-1.6	-0.4	0.3
Potential GDP growth	2.0	2.0	0.8	0.8	1.6	2.1	2.2	2.3	2.3
Structural general government balance	-5.1	-4.0	-0.9	-0.4	-0.2	-0.5	-0.4	-0.3	-0.1
Structural primary balance	-1.1	0.2	3.4	3.9	4.0	3.6	3.6	3.5	3.5

Sources: Hungarian authorities; and IMF staff estimates.
1/ Includes change in inventories.
2/ Excluding Special Purpose Entities. Including inter-company loans, and nonresident holdings of forint-denominated assets.

Table 7. Hungary: Consolidated General Government, 2006-11 1/
(In percent of GDP, unless otherwise indicated)

	2006	2007	2008	2009		2010		2011
				4th Rev.	Est.	4th Rev.	Proj.	IMF staff proj.
Total revenues	42.7	44.9	45.5	46.2	45.8	45.5	44.7	43.5
Current revenues and current transfers (incl. grants)	41.8	44.0	44.9	44.9	44.4	44.2	43.4	42.0
Tax revenues	37.0	39.5	40.1	39.8	39.3	39.3	38.5	37.6
Taxes on income, profits and capital gains	9.4	10.2	10.6	10.2	9.9	10.1	9.7	9.2
Personal income tax	6.7	7.1	7.7	7.6	7.3	7.1	6.9	6.4
Corporate income tax	2.3	2.8	2.6	2.2	2.2	2.4	2.3	2.3
Other (incl. wealth, capital, and property taxes)	0.4	0.4	0.3	0.4	0.4	0.6	0.4	0.4
Taxes on payroll and workforce and Social Security contributions	12.6	13.6	13.9	13.4	13.2	12.3	12.1	11.7
Taxes on goods and services	15.0	15.6	15.6	16.3	16.2	16.9	16.7	16.7
VAT	7.5	7.8	7.6	8.2	8.2	8.7	8.7	8.6
Other (incl. excises and duties)	7.5	7.9	8.0	8.1	8.0	8.1	8.1	8.1
Current non-tax revenues	4.0	3.8	4.1	4.2	4.2	4.0	3.9	3.4
Of which : interest	0.3	0.3	0.5	0.4	0.4	0.4	0.3	0.2
Current transfers (incl. grants)	0.8	0.6	0.7	0.9	0.9	0.9	1.0	1.0
Capital revenues and capital transfers (incl. grants)	0.9	0.9	0.6	1.3	1.3	1.3	1.3	1.5
Total expenditures	52.0	49.9	49.2	50.1	49.6	49.3	48.5	46.3
Current expenditures and current transfers	45.7	44.3	45.1	46.1	45.6	45.3	44.3	42.2
Compensation of employees 2/	12.2	11.5	11.5	11.6	11.5	11.1	10.9	10.3
Goods and services	7.0	6.7	7.1	7.3	7.4	7.3	7.2	6.7
Interest payments	4.0	4.0	4.1	4.4	4.3	4.5	4.2	4.2
Subsidies	1.4	1.4	1.1	0.8	0.9	0.9	0.8	0.7
Current transfers to households	18.5	18.1	18.7	19.6	19.2	19.0	18.6	17.9
Social security	13.5	13.5	14.3	15.2	14.9	14.8	14.7	14.4
Of which unemployment benefits	0.4	0.4	0.4	0.6	0.6	0.5	0.5	0.5
Other	5.0	4.6	4.4	4.4	4.3	4.2	3.9	3.5
Other current transfers	2.7	2.6	2.5	2.5	2.5	2.5	2.4	2.3
Capital expenditures	4.3	3.6	2.6	2.7	2.6	2.7	2.7	2.9
Capital transfers	1.9	1.9	1.5	1.4	1.3	1.3	1.6	1.3
General government balance	-9.3	-4.9	-3.7	-3.9	-3.9	-3.8	-3.8	-2.8
Primary balance	-5.4	-0.9	0.4	0.4	0.5	0.7	0.4	1.4
Memorandum items:								
Primary expenditure	48.0	45.8	45.1	45.8	45.3	44.8	44.3	42.1
Output gap (in percent of potential GDP)	3.5	2.4	1.1	-6.2	-6.0	-7.5	-6.9	-5.5
Cyclically-adjusted overall balance (CAB, in percent of potential GDP)	-11.2	-6.1	-4.3	-0.8	-0.9	-0.1	-0.5	-0.3
Change in CAB	-2.3	5.0	1.9	3.6	3.4	0.7	0.4	0.2
One-off items (net)	-0.8	-1.0	-0.3	0.1	0.1	-0.2	-0.1	-0.1
Structural balance (in percent of potential GDP)	-10.3	-5.1	-4.0	-0.9	-0.9	0.1	-0.4	-0.2
Change in the structural balance	-1.2	5.2	1.2	3.2	3.0	1.0	0.6	0.1
Gross public debt	65.6	65.8	72.9	78.7	77.7	80.2	78.9	77.3
Real GDP growth (in percent)	4.0	1.0	0.6	-6.7	-6.3	-0.6	-0.2	3.2
In nominal terms (HUF billions)								
Total revenue	10,133	11,411	12,077	11,876	11,913	11,922	11,908	12,278
Of which tax revenues	8,797	10,043	10,654	10,233	10,229	10,288	10,253	10,618
Total expenditure	12,350	12,666	13,069	12,884	12,918	12,925	12,927	13,071
Of which primary expenditure	11,409	11,638	11,970	11,761	11,793	11,746	11,796	11,873
Primary balance	-1,276	-227	107	115	120	176	113	405
Overall balance	-2,217	-1,256	-992	-1,008	-1,005	-1,003	-1,019	-793

Sources: Hungarian authorities; and IMF staff estimates.
1/ Data are classified following the ESA'95 methodology, as reported to the European Commission.
2/ Including social security contributions.

Table 8. Hungary: Borrowing Requirement of the Central Government, 2009-10
(In billions of forints)

	2009					2010				
	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4	Year
Net borrowing requirement 1/	564.8	218.4	246.1	-140.7	888.6	625.9	294.8	119.1	-162.4	877.5
Redemptions										
In Hungarian forints	1,105.9	1,935.3	1,736.1	1,667.4	6,444.7	1,107.1	1,487.2	1,292.1	1,419.9	5,306.2
In foreign currency (euro)	160.2	113.0	9.7	28.8	311.8	11.2	8.1	326.0	11.0	356.4
Gross borrowing requirement	1,830.9	2,266.7	1,991.9	1,555.5	7,645.0	1,744.2	1,790.1	1,737.2	1,268.6	6,540.1
Actual and planned financing										
Gross issuance (actual and planned)										
In Hungarian forints	1,044.5	1,208.9	1,755.0	1,666.6	5,675.0	1,398.4	1,447.3	1,579.4	1,485.3	5,910.4
In foreign currency	1,307.5	0.0	686.9	3.1	1,997.5	387.3	0.0	0.0	0.0	387.3
Drawing on deposits with banking system	-521.0	1,057.8	-450.0	-114.2	-27.5	-41.5	342.8	157.8	-216.7	242.5

Source: Hungarian Debt Management Agency.
1/ Overall budget balance of the central government system (cash basis).

Table 9. Hungary: Financial Soundness Indicators for the Banking Sector, 2005-09
(In percent unless otherwise indicated, end of period)

	2005	2006	2007	2008	2009
Capital adequacy					
Regulatory capital to risk-weighted assets 1/	11.6	11.0	10.4	11.2	12.9
Capital (net worth) to assets	8.2	8.3	8.2	8.0	8.5
Asset composition and quality					
Annual growth of bank loans 2/	19.8	18.4	22.1	20.9	-8.4
Sectoral distribution of bank loans (in percent of total loans)					
Corporates	45.7	43.2	39.8	35.3	34.8
o/w in foreign currency	21.8	20.3	20.9	21.3	21.4
Households	29.2	31.5	32.7	36.0	37.0
o/w in foreign currency	9.5	14.8	19.3	25.4	26.0
Other loans	25.0	25.3	27.5	28.7	28.1
Financial institutions	12.3	11.3	10.7	9.5	9.2
Central government	0.6	0.5	0.5	0.2	0.2
Nonresidents	5.1	6.2	9.1	12.2	12.5
Other	7.0	7.2	7.2	6.8	6.4
o/w in foreign currency	18.8	19.1	22.5	25.0	24.1
Denomination of FX loans to corporates					
EUR	74.7	70.8	67.6	66.9	75.2
USD	5.7	4.6	4.9	4.1	3.4
CHF	19.2	24.4	26.4	27.8	20.6
Other	0.4	0.2	1.0	1.1	0.8
NPLs to gross loans 3/	2.3	2.6	2.3	3.0	6.7
Provisions to NPLs 3/	65.1	57.1	64.8	58.9	53.2
NPLs net of provisions to capital 3/	6.3	8.9	6.8	11.3	24.1
Earnings and profitability					
ROA (after tax) 4/	1.4	1.5	1.2	0.8	0.7
ROE (after tax) 4/	24.5	23.8	18.4	11.6	9.8
Net interest income to gross income	64.4	64.7	61.3	56.0	55.7
Noninterest expenses to gross income	48.6	48.7	50.2	50.4	43.5
Personnel expenses to noninterest expenses	47.2	48.3	48.9	49.4	48.2
Trading and fee income to total income	33.8	32.3	36.1	30.7	39.2
Spread between loan and deposit rates 4/	3.7	3.5	3.2	2.6	2.3
Liquidity					
Liquid assets to total assets	21.0	20.0	16.4	15.6	22.7
Liquid assets to short term liabilities	35.7	36.8	30.5	31.4	45.2
Loans to deposits	107.7	109.9	121.6	125.1	115.0
FX liabilities to total liabilities 5/	34.4	39.3	42.4	45.6	47.0
Sensitivity to market risk					
Net open position in FX to capital	3.5	7.2	6.0	13.7	16.4

Source: Magyar Nemzeti Bank.
1/ Capital Adequacy Ratio.
2/ Year-on-year percentage change, not adjusted for exchange rate changes. All loans, including to the public sector.
3/ 90 days+ overdue, full portfolio.
4/ Annualized.
5/ Own capital is excluded.

Table 10. Hungary: Schedule of Reviews and Purchases

Date	Schedule: Amount of Purchase 1/ Millions of SDRs	Schedule: Amount of Purchase 1/ Percent of Quota	Conditions
November 6, 2008	4,215.0	405.9	Approval of arrangement
March 25, 2009	2,107.5	203.0	First review and end-December 2008 performance criteria
June 23, 2009	1,264.5	121.8	Second review and end-March 2009 performance criteria
September 25, 2009	50.0	4.8	Third review and end-June 2009 performance criteria
December 18, 2009	725.1	69.8	Fourth review and end-September 2009 performance criteria
March 15, 2010	725.1	69.8	Fifth review and end-December 2009 performance criteria
June 15, 2010	725.1	69.8	Sixth review and end-March 2010 performance criteria
September 15, 2010	725.2	69.8	Seventh review and end-June 2010 performance criteria
Total	**10,537.5**	**1,014.8**	

Source: IMF staff estimates.

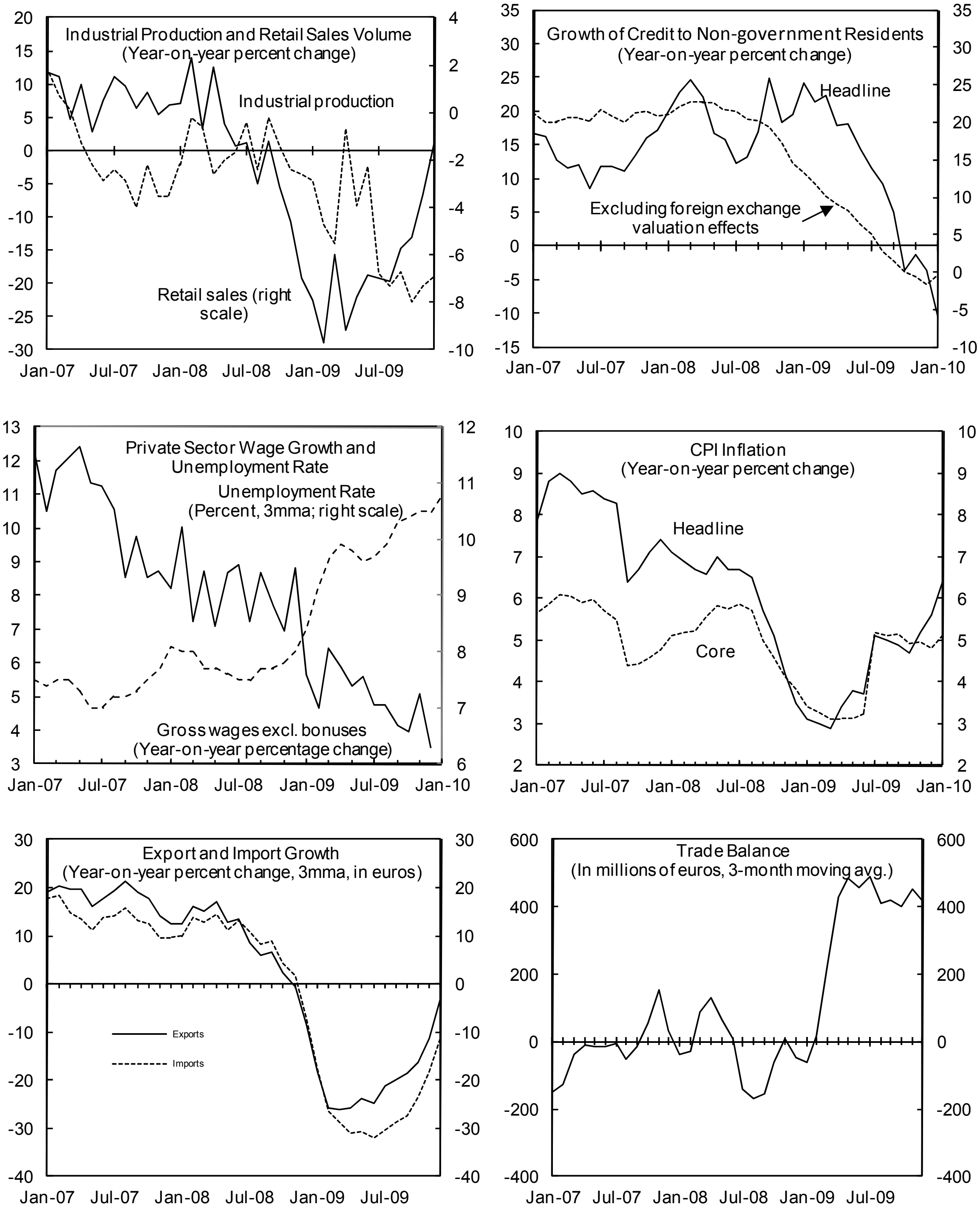
1/ For November 2008-September 2009. After September 2009 it reflects the amounts available for purchase.

Table 11. Hungary: Indicators of Fund Credit, 2008-16
(In millions of SDR)

	2008	2009	2010	2011	2012	2013	2014	2015	2016
Existing and prospective Fund credit									
Disbursement	4,215	3,422	1,450	0	0	0	0	0	0
Stock 1/	4,215	7,637	10,538	10,538	7,317	2,683	635	0	0
Obligations	0	148	241	278	3,484	4,799	2,076	639	0
Repurchase	0	0	0	0	3,220	4,634	2,049	635	0
Charges	0	148	241	278	264	165	28	5	0
Stock of existing and prospective Fund credit									
In percent of quota	405.9	735.5	1014.8	1014.8	704.7	258.4	61.1	0.0	0.0
In percent of GDP	4.3	9.1	11.5	10.9	7.2	2.5	0.6	0.0	0.0
In percent of exports of goods and services	5.2	11.7	15.0	14.0	9.1	3.1	0.7	0.0	0.0
In percent of gross reserves	18.8	27.6	33.6	32.5	22.6	8.3	2.1	0.0	0.0
Obligations to the Fund from existing and prospective Fund arrangements									
In percent of quota	0.0	14.2	23.2	26.8	335.5	462.2	199.9	61.6	0.0
In percent of GDP	0.0	0.2	0.3	0.3	3.4	4.5	1.8	0.5	0.0
In percent of exports of goods and services	0.0	0.2	0.3	0.4	4.3	5.6	2.2	0.6	0.0
In percent of gross reserves	0.0	0.5	0.8	0.9	10.7	14.9	7.0	2.1	0.0

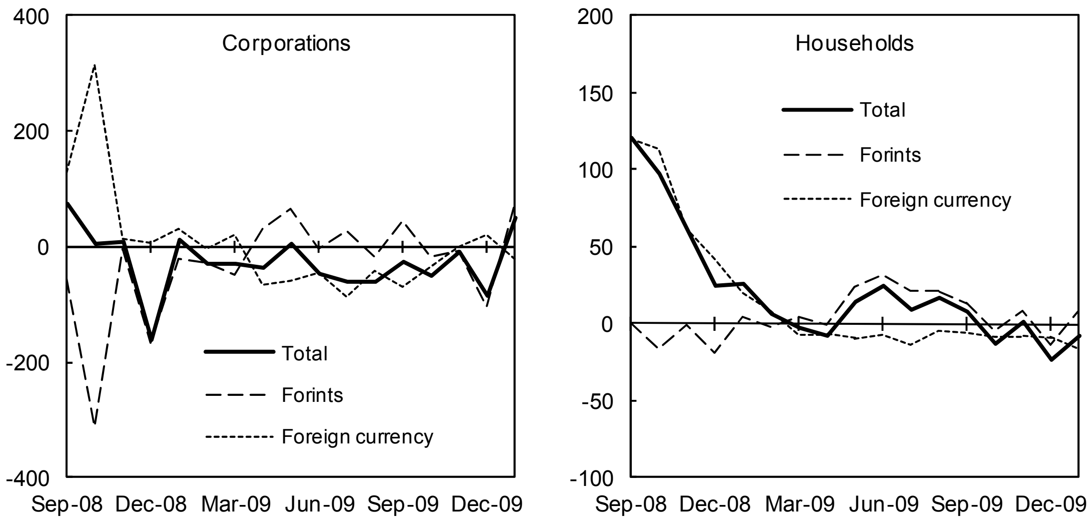
Source: IMF staff estimates.
1/ End of period. Assumes that all prospective Fund resources would be disbursed.

Figure 1. Hungary: Recent Economic Developments, 2007-10



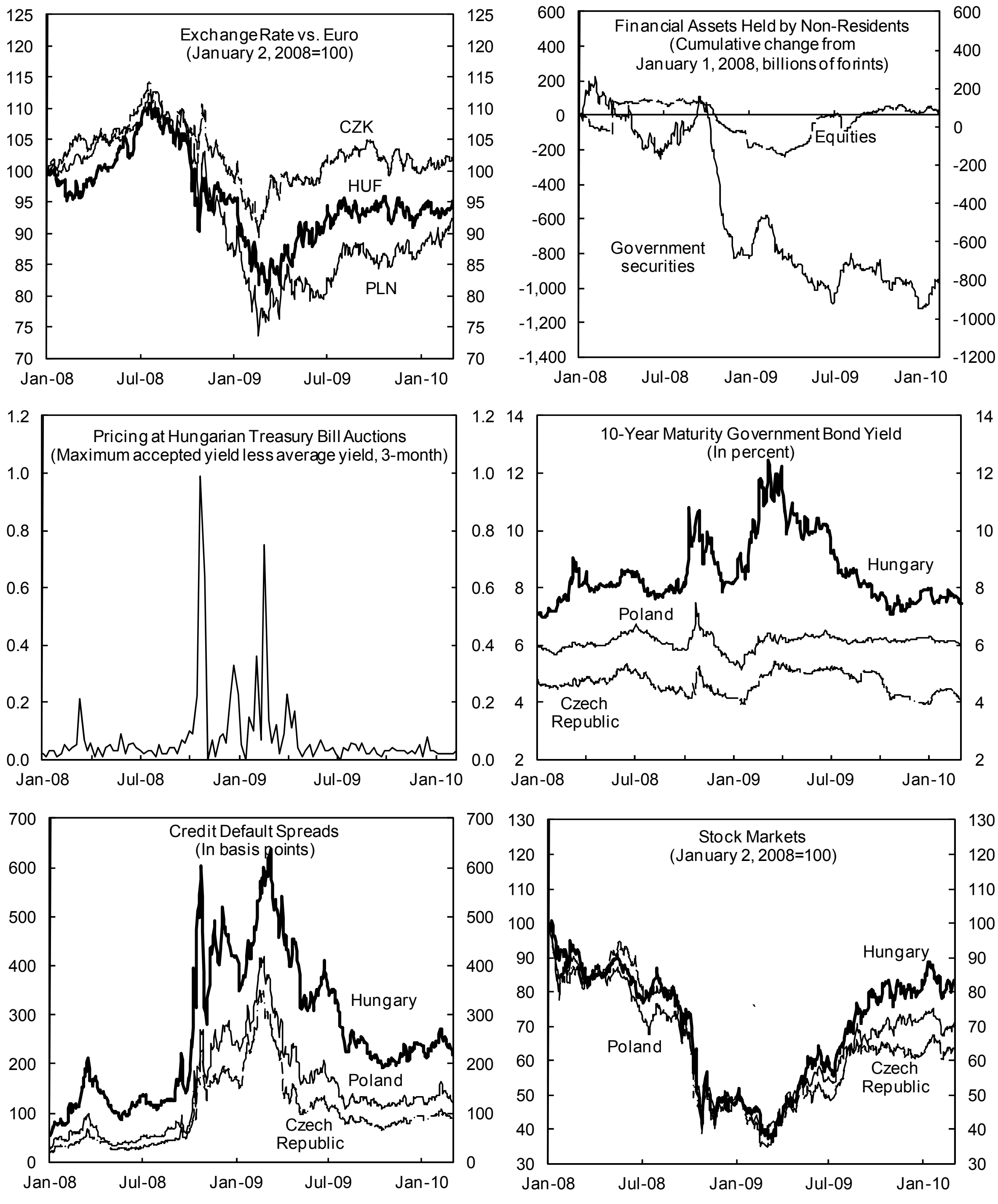
Sources: Hungarian Statistical Office; and IMF staff estimates.

Figure 2. Hungary: Bank Lending to Corporations and Households, 2008-10
(In billions of forints, flows)



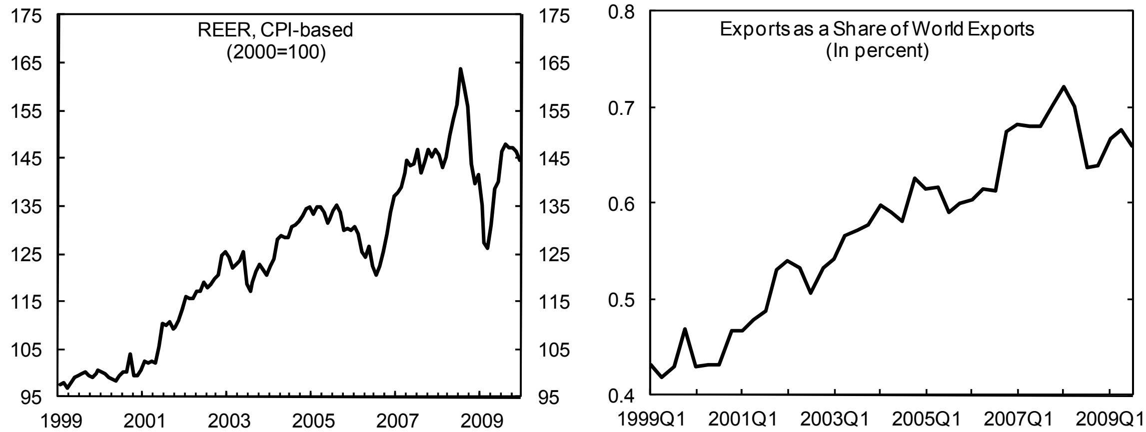
Source: Magyar Nemzeti Bank.

Figure 3. Hungary: Financial Market Developments, 2008-10



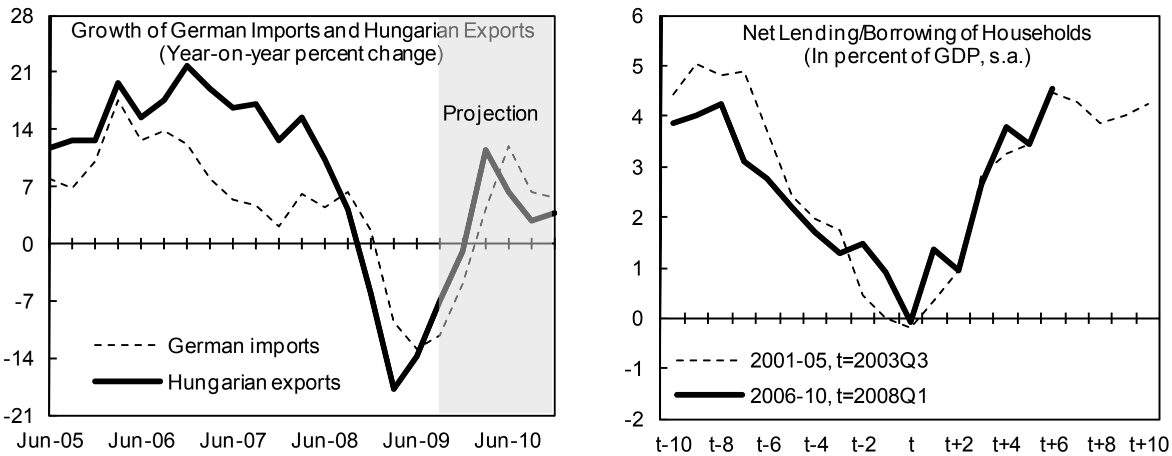
Sources: Hungarian national authorities; Bloomberg; and Hungarian Debt Management Agency.

Figure 4. Hungary: Competitiveness Indicators, 1999-2009



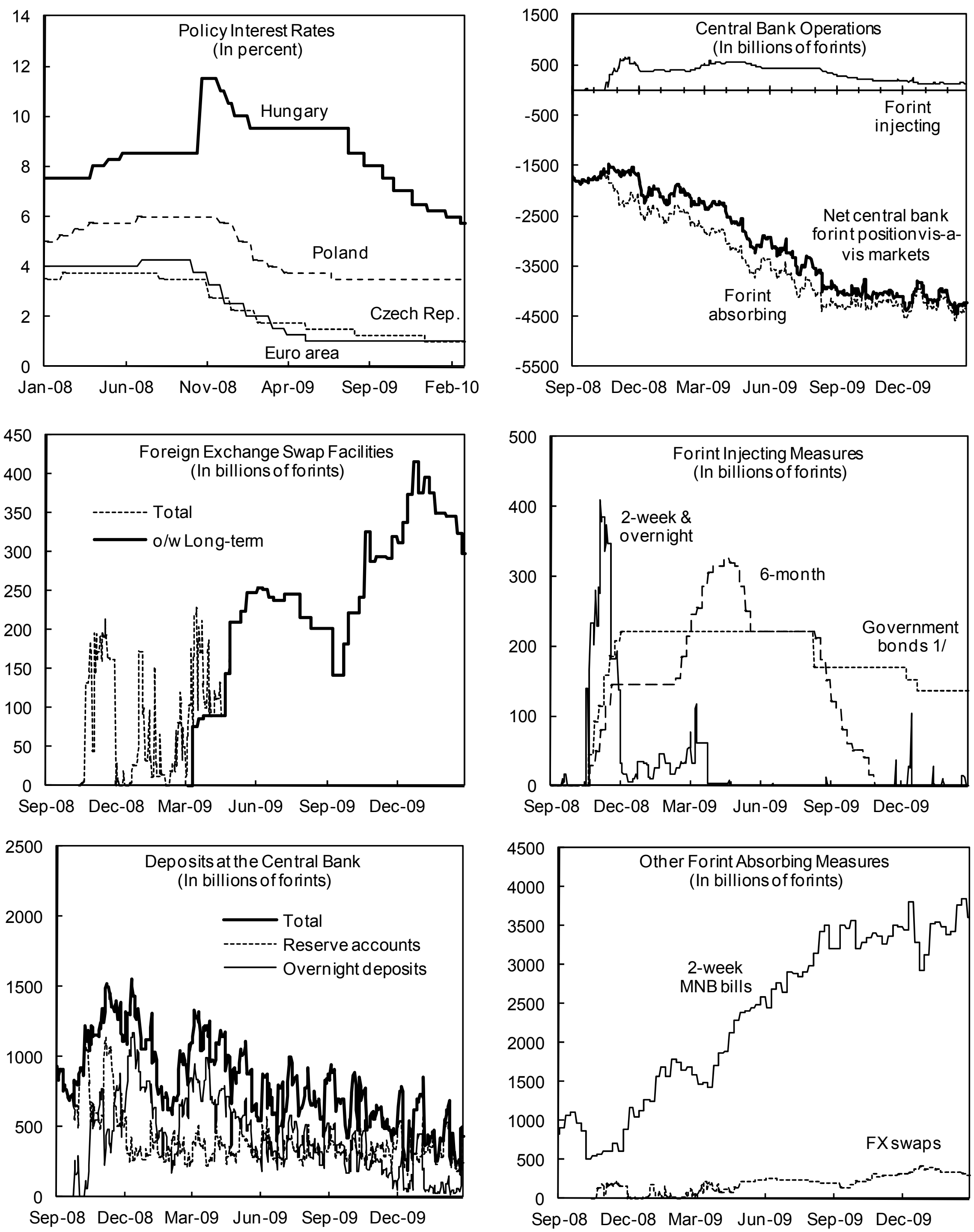
Sources: IMF, *Information Notice System*; and IMF, *Direction of Trade Statistics*.

Figure 5. Hungary: Economic Outlook Indicators



Sources: Hungarian Statistical Office; Magyar Nemzeti Bank; IMF staff estimates.

Figure 6. Hungary: Monetary Policy Indicators, 2008-10



Sources: Hungarian national authorities; Bloomberg; and IMF staff estimates.
1/ Facility to purchase government bonds from primary dealers.

Appendix Table 1. Hungary: External Debt Sustainability Framework, 2005-15
(In percent of GDP, unless otherwise indicated) 1/

	Actual					Projections						
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Debt-stabilizing non-interest current account 7/
Baseline: External debt	75.7	91.1	98.4	115.3	137.3	**132.3**	**124.3**	**120.2**	**117.0**	**115.1**	**113.2**	**-2.6**
Change in external debt	8.7	15.4	7.3	16.9	22.1	-5.1	-8.0	-4.1	-3.1	-1.9	-1.9	
Identified external debt-creating flows (4+8+9)	-2.3	2.2	0.9	1.9	11.6	-2.0	-5.7	-4.9	-3.4	-2.0	-1.1	
Current account deficit, excluding interest payments	4.3	4.2	3.1	1.8	-5.5	-4.3	-4.2	-2.9	-1.9	-1.4	-1.3	
Deficit in balance of goods and services	1.2	0.9	-1.2	-0.7	-6.6	-6.3	-5.7	-4.7	-3.8	-3.3	-3.3	
Exports	67.7	77.0	79.9	81.8	77.7	77.0	78.1	78.8	79.8	81.4	83.5	
Imports	68.9	78.0	78.7	81.0	71.1	70.7	72.5	74.1	76.0	78.1	80.2	
Net non-debt creating capital inflows (negative) 2/	-5.0	-2.9	3.2	-1.0	-0.9	-2.6	-2.7	-1.8	-1.9	-1.6	-1.3	
Automatic debt dynamics 3/	-1.6	0.9	-5.4	1.2	18.0	5.0	1.2	-0.2	0.4	0.9	1.5	
Contribution from nominal interest rate	2.9	3.2	3.7	5.4	5.1	4.8	5.2	5.0	4.9	4.8	4.8	
Contribution from real GDP growth	-1.5	-3.0	-0.8	-0.6	8.3	0.2	-4.0	-5.2	-4.5	-3.9	-3.3	
Contribution from price and exchange rate changes 4/	-3.1	0.6	-8.3	-3.6	4.5	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 5/	11.0	13.2	6.3	14.9	10.5	-3.1	-2.3	0.8	0.3	0.0	-0.7	
External debt-to-exports ratio (in percent)	111.7	118.3	123.2	141.0	176.8	171.7	159.1	152.4	146.6	141.4	135.6	
Gross external financing need (in billions of euros) 6/	20.8	21.8	20.7	32.7	33.7	35.7	38.6	38.4	43.6	48.6	47.6	
in percent of GDP	23.4	24.3	20.5	31.0	36.3	36.1	36.8	34.4	36.7	38.6	35.8	
Scenario with key variables at their historical averages 7/						**132.3**	**129.0**	**127.9**	**126.4**	**124.8**	**122.4**	**-7.1**
Key Macroeconomic Assumptions Underlying Baseline 8/												
Real GDP growth (in percent)	2.4	4.0	1.0	0.6	-6.3	-0.2	3.2	4.5	4.0	3.5	3.0	
GDP deflator in euros (change in percent)	5.2	-2.5	11.4	3.8	-6.2	6.7	2.7	2.1	2.3	2.4	2.4	
Nominal external interest rate (in percent)	4.7	4.3	4.5	5.7	3.9	3.7	4.2	4.3	4.3	4.4	4.4	
Growth of exports (euro terms, in percent)	12.2	15.4	16.6	7.0	-16.6	5.7	7.4	7.6	7.7	8.1	8.3	
Growth of imports (euro terms, in percent)	9.7	14.7	13.5	7.7	-23.0	6.0	8.6	9.1	9.1	8.9	8.4	
Current account balance, excluding interest payments	-4.3	-4.2	-3.1	-1.8	5.5	4.3	4.2	2.9	1.9	1.4	1.3	
Net non-debt creating capital inflows	5.0	2.9	-3.2	1.0	0.9	2.6	2.7	1.8	1.9	1.6	1.3	

1/ Excluding Special Purpose Entities. Including inter-company loans and nonresidents' holdings of forint-denominated assets.

2/ Includes EU capital transfers.

3/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in euro terms, g = real GDP growth rate, ε = nominal appreciation (increase in dollar value of domestic currency), and α = share of domestic-currency denominated debt in total external debt.

4/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\varepsilon > 0$) and rising inflation (based on GDP deflator).

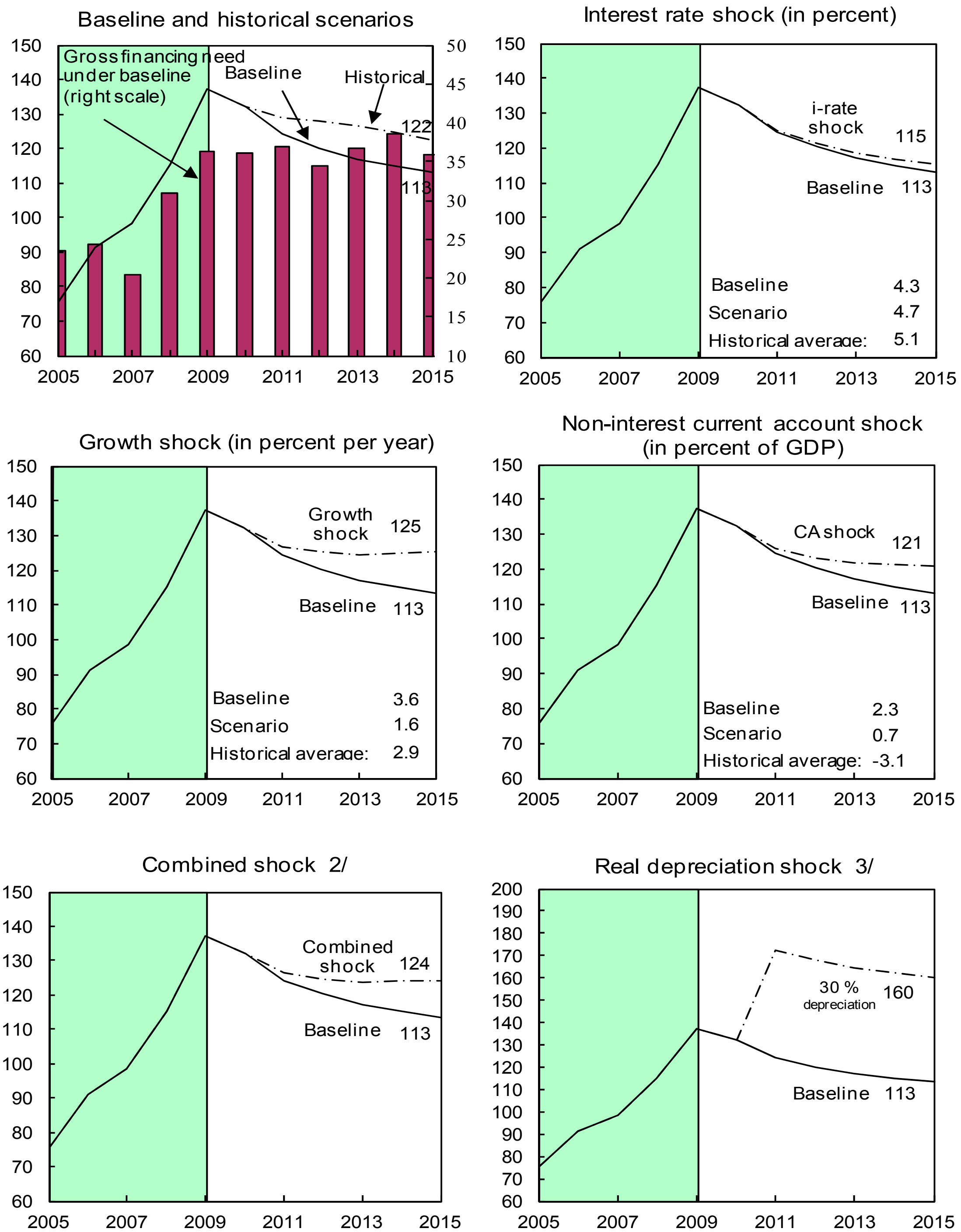
5/ For projection, line includes the impact of price and exchange rate changes.

6/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

7/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

8/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Appendix Figure 1. Hungary: External Debt Sustainability: Bound Tests 1/
(External debt in percent of GDP)



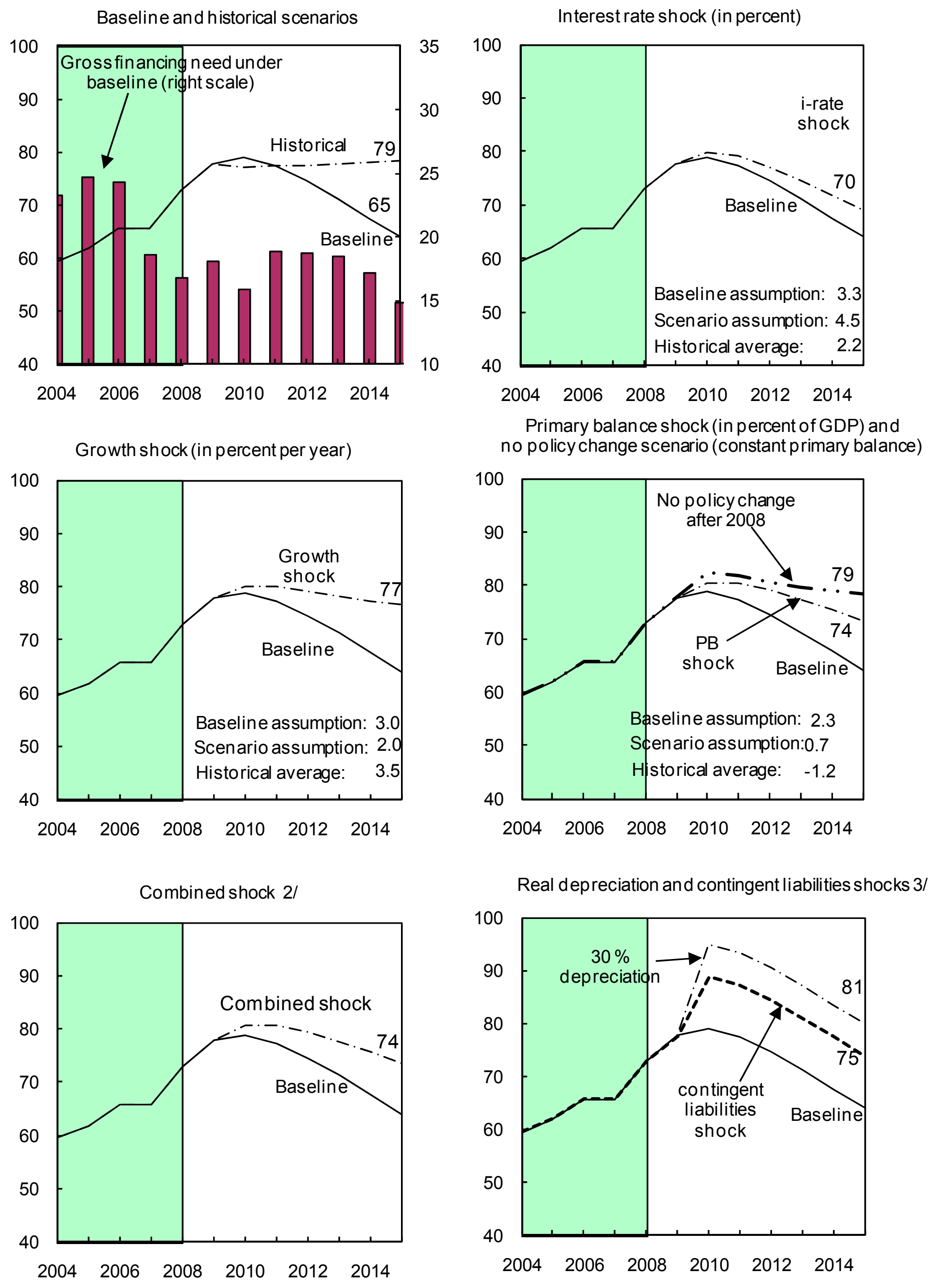
Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
3/ One-time real depreciation of 30 percent occurs in 2011.

Appendix Table 2. Hungary: Public Sector Debt Sustainability Framework, 2005-15
(In percent of GDP, unless otherwise indicated)

	Actual				Projections							
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	**Debt-stabilizing primary balance 9/**
Baseline: Public sector debt 1/	61.8	65.6	65.7	72.9	**77.7**	**78.9**	**77.3**	**74.5**	**71.2**	**67.6**	**64.0**	**0.2**
o/w foreign-currency denominated	17.4	18.5	18.5	26.3	33.2	32.5	30.6	27.9	25.2	22.7	20.9	
Change in public sector debt	2.4	3.8	0.0	7.2	4.8	1.2	-1.6	-2.8	-3.3	-3.6	-3.6	
Identified debt-creating flows (4+7+12)	5.2	1.7	-1.2	3.4	5.3	2.1	-1.6	-2.8	-3.3	-3.6	-3.6	
Primary deficit	3.7	5.4	0.9	-0.4	-0.5	-0.4	-1.4	-2.2	-2.9	-3.3	-3.6	
Revenue and grants	42.3	42.6	44.8	45.5	45.8	44.7	43.5	43.3	43.3	43.3	43.3	
Primary (noninterest) expenditure	46.0	48.0	45.7	45.1	45.3	44.3	42.1	41.1	40.4	39.9	39.7	
Automatic debt dynamics 2/	3.4	-2.4	-2.1	3.8	5.8	2.5	-0.2	-0.6	-0.5	-0.3	0.0	
Contribution from interest rate/growth differential 3/	0.6	-0.7	-0.3	1.5	5.8	2.5	-0.2	-0.6	-0.5	-0.3	0.0	
Of which contribution from real interest rate	2.9	1.6	0.3	0.9	1.1	2.4	2.2	2.6	2.3	2.1	1.9	
Of which contribution from real GDP growth	-2.3	-2.3	-0.7	0.6	4.7	0.1	-2.4	-3.2	-2.8	-2.4	-1.9	
Contribution from exchange rate depreciation 4/	2.8	-1.7	-1.8	2.3	...	...	...	...	...	...	...	
Other identified debt-creating flows	-2.0	-1.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	-2.0	-1.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	-2.8	2.1	1.3	3.8	-0.5	-0.9	0.0	0.0	0.0	0.0	0.0	
Public sector debt-to-revenue ratio 1/	146.3	154.1	146.6	160.2	169.8	176.4	177.5	172.1	164.4	156.1	147.8	
Gross financing need 6/	24.6	24.3	18.6	16.7	18.0	15.8	18.9	18.6	18.5	17.2	14.9	
in billions of U.S. dollars	27.2	27.5	25.9	26.0	23.3	23.0	29.0	30.3	31.8	31.0	28.1	
Scenario with key variables at their historical averages 7/					**77.7**	**77.1**	**77.3**	**77.5**	**77.8**	**78.0**	**78.3**	**-0.8**
Scenario with no policy change (constant primary balance) in 2009-2015					**77.7**	**82.3**	**81.7**	**80.6**	**79.6**	**78.9**	**78.5**	**0.2**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	4.0	4.0	1.1	-1.0	-6.3	-0.2	3.2	4.5	4.0	3.5	3.0	
Average nominal interest rate on public debt (in percent) 8/	7.4	6.9	6.6	6.6	5.8	5.6	5.7	5.8	5.7	5.7	5.6	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	5.2	3.0	0.6	1.3	1.1	3.1	3.0	3.7	3.4	3.2	3.1	
Nominal appreciation (increase in US dollar value of local currency, in percent)	-15.6	11.5	11.0	-11.2	...	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	2.2	3.9	6.0	5.3	4.7	2.5	2.7	2.0	2.3	2.5	2.5	
Growth of real primary spending (deflated by GDP deflator, in percent)	7.2	8.6	-3.8	-2.3	-5.9	-2.4	-1.9	2.1	2.2	2.3	2.3	
Primary deficit	3.7	5.4	0.9	-0.4	-0.5	-0.4	-1.4	-2.2	-2.9	-3.3	-3.6	
Memorandum item												
Growth of real public debt	7.0	7.8	-0.2	11.7	-1.0	0.8	1.3	-0.2	-1.3	-2.2	-3.0	

1/ General government gross debt.
2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi(1+g)$ and the real growth contribution as -g.
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.
5/ For projections, this line includes exchange rate changes.
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
8/ Derived as nominal interest expenditure divided by previous period debt stock.
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Appendix Figure 2. Hungary: Public Debt Sustainability: Bound Tests 1/
(Public debt in percent of GDP)



Sources: International Monetary Fund, country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2009, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

ATTACHMENT I: HUNGARY LETTER OF INTENT

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, DC, 20431
U.S.A.

Budapest, March 4, 2010

Dear Mr. Strauss-Kahn:

1. The significant strengthening of policies over the past 1½ years has placed Hungary firmly on the path towards stability and growth. Macro-financial vulnerabilities have been reduced, through an improvement in the underlying fiscal position, an upgrading of bank supervision, and timely liquidity support to the financial system. As a result, confidence has begun to return and the economy is on the road to recovery. To be sure, there are still significant risks, much remains to be done, and firm adherence to prudent policies will be essential, especially against the backdrop of still fragile external conditions.

2. We have met our commitments for the Fifth Review of the Stand-By Arrangement (Tables 1 and 2):

- *Quantitative performance criteria*. All end-2009 criteria were observed.
- *Structural benchmarks*. Parliament approved amendments to strengthen the remedial powers of the Hungarian Financial Supervisory Authority on December 14, 2009 (¶21). Amendments to improve the bank resolution framework were submitted to parliament on February 12, 2010 (¶24). The financial stability sub-committee that monitors the financial soundness and stress-resilience of banks receiving capital or refinancing support from the government remains operational and is consulting with Fund staff on its work program (continuous benchmark, ¶23).

3. We request modifications to the performance criteria at end-March 2010 on net international reserves to lock in the increase in reserves. Quantitative performance criteria through end-June 2010 are set out in Table 2 and the attached Technical Memorandum of Understanding.

4. We also request modification of the end-March 2010 structural benchmark on the completion of reports on thematic inspections focusing on credit risk and loan portfolio quality for at least three banks selected with a systemic risk-based approach. Owing to higher

than anticipated demands on resources, we are preparing reports on thematic inspections of two banks in the first quarter. Plans are being finalized for two more banks to undergo similar inspections in the second quarter. We therefore propose to modify the end-March benchmark to two banks, and to introduce a new benchmark for two more banks at end-June. Structural conditionality is set out in Table 3.

5. The policies set forth in this letter and our previous letters (of November 4, 2008; March 12, 2009; June 11, 2009; September 16, 2009; and December 4, 2009) are adequate to achieve the objectives of our economic program, and we remain committed to meeting all our targets. Our government stands ready, however, to take additional measures as appropriate to achieve its objectives. As is standard under all IMF arrangements, we will consult with the IMF before modifying measures contained in this letter, or adopting new measures that would deviate from the goals of the program, and provide the IMF with the necessary information for program monitoring. The sixth review of the arrangement will take place after June 14, 2010 and the seventh review after September 14, 2010.

6. On account of our strengthened economic and financial condition, we are taking decisions on drawings on a review-by-review basis. As at the Fourth Review, we do not intend to draw the amount that would be made available upon the completion of this review (SDR 725.1 million, 70 percent of quota). The cumulative IMF resources of SDR 1,450.2 million from the Fourth and Fifth Reviews that would remain available to us subject to satisfactory policy performance provide assurance against unforeseen deteriorations in financing conditions.

Macroeconomic framework

7. The turning point in economic activity is getting closer. The pace of economic decline eased further in the fourth quarter of 2009, with real GDP falling by 4.0 percent (y-o-y), as a positive contribution from net exports partly offset weak domestic demand. Overall, output contracted by 6.3 percent in 2009. Looking forward, real GDP is projected to fall by 0.2 percent in 2010, as the pick-up in exports continues. Private consumption remains weak as the improvement in the labor market is lagging (the unemployment rate is still increasing) and credit is stagnant.

8. Consumer price inflation is projected to average 4.3 percent in 2010 and to slow to about 2½ percent in 2011. CPI inflation accelerated to 6.4 percent in January 2010 from 5.6 percent in December, due to increases in excise taxes, higher food and energy prices, and the reweighting in the CPI basket. However, inflation is projected to gradually moderate in the coming months, owing to the continued disinflationary impact of the large output gap. In the second half of 2010, CPI inflation is projected to fall to a level around the central bank's midpoint target of 3 percent, as last year's VAT and excise tax hikes will no longer affect the consumer price index.

9. A sharp adjustment of the external current account by about 7½ percentage points of GDP resulted in an annual surplus for the first time in over 15 years (estimated at 0.4 percent of GDP in 2009). This adjustment was due largely to an improvement in the balance on goods and services by about 6 percent of GDP, as imports contracted more sharply than exports. The income balance also improved on account of weaker earnings. A modest deterioration—to a deficit of 0.4 percent of GDP—is forecast for 2010, as domestic demand recovers and the terms of trade worsen.

10. Gross international reserves have nearly doubled from €17.4 billion in September 2008 to €32.5 billion in January 2010. External financing conditions have been broadly stable in recent months, notwithstanding some strains in international markets. Rollover rates of bank liabilities falling due in the fourth quarter of 2009 are expected to have been close to 100 percent. The commitments by parent banks to maintain their exposures to their subsidiaries in the context of the European Bank Coordination Initiative were met (¶20). On January 26, 2010, the government successfully placed a 10-year, $2 billion bond at 265 bps over U.S. Treasuries. No further foreign currency bond issues are planned this year.

Fiscal Policy and Structural Fiscal Reforms

11. The cash primary balance of the central government at end-2009 was above the program floor (performance criterion). Tax revenue was in line with program projections and nontax revenue was higher than expected (owing to higher interest revenues, revenues related to the voluntary shift of eligible workers from the second pillar to the first pillar of the pension system, and dividends). Spending was lower than expected, as lower transfers to local government and lower spending by the social security funds were only partly offset by slightly higher spending by line ministries. Interest payments were in line with projections.

12. We expect to have achieved our objective to limit the overall deficit of the general government to 3.9 percent of GDP in 2009 (Maastricht definition). The central government deficit (in ESA terms) is expected to have been 3.6 percent of GDP, in line with projections. Developments at the local government level also appear to have been as expected.

13. We remain fully committed to our general government deficit target (Maastricht definition) of 3.8 percent of GDP in 2010. Compared to the budget, we expect tax revenue to be lower, owing partly to rulings of the Constitutional Court on the property tax and the taxation of family allowances. Moreover, primary spending is expected to be higher, reflecting higher healthcare spending and transfers to Budapest public transport company (BKV). The impact of these developments on the overall balance will be partly offset by lower net interest payments and higher revenues related to the shift from the second pillar to the first pillar of the pension system. To cover the residual impact, we froze half of the stability reserve and allocated part of the general reserves to finance the transfer to BKV.

14. Downside risks to the fiscal target in 2010 include the uncertainty surrounding tax revenue and interest payments projections, the financial performance of MAV, BKV and

Malev, and spending by local governments in an election year. Further, there is a possibility that Eurostat may decide that revenues related to the shift from the second pillar to the first pillar of the pension system would count towards the 2009 fiscal balance. To mitigate these risks:

- treasurers assigned to line ministries should reduce overspending risks, by keeping spending in line with budgetary commitments (in contrast to 2009 when the treasurers were assigned towards the end of the year).

- we have discussed the MAV business plan that we prepared in December 2009 with the company. While progress has been slow, we expect final adoption by the Ministry of Transport on behalf of the state by end-March. We will sign a public service agreement for 2010 with the company, consistent with the government support in the 2010 budget.

Should risks materialize nevertheless, the policy response would include both the use of budgetary reserves, which amount to about ½ percent of GDP, and the implementation of identified additional spending cuts of 0.2 percent of GDP.

15. Any extra revenue that could result from a better-than projected macroeconomic performance will be used to boost reserves, which are being kept available to safeguard against risks and to reduce the adjustment in spending that will be needed in 2011. Also, any additional revenue that could result from the sale of emission credits accrued under the Kyoto protocol will be either spent on new environmental projects or saved for such projects in later years.

16. Looking ahead, we remain committed to reducing the general government deficit to below 3 percent of GDP in 2011. Measures will be needed, including to offset the revenue losses from the planned increase that year in the top personal income tax bracket, and the Constitutional Court’s abolishment of the property tax. As regards property taxation, the first-best solution would be to address the constitutional court’s concerns to correct the implied structural fiscal loosening. Further, we intend to review, with Fund technical assistance, expenditure rationalization aimed at improving the efficiency of the delivery of public services. Measures are also needed to safeguard that the activities of local governments and state-owned enterprises are consistent with fiscal sustainability.

17. To ensure the consistency of budget procedures with the Act on the legal status and financial management of budgetary institutions adopted in December 2008, we adopted and published in December 2009 a government regulation on the implementation of the Act. We have also adopted a government regulation relative to the rules on advance payment of EU subsidies, aligning these rules with best practices. To improve fiscal transparency, we will publish annually by end-August a report on the contingent liabilities of the financial and non-financial state-owned enterprises. This would be a first step towards preparing and publishing

statistics on the non financial public sector balance. We will continue to implement our tax administration (APEH)'s medium-term modernization strategy, which has been instrumental in avoiding a general decline in taxpayer compliance during the crisis. In particular, by end-August, we will review the selection criteria for assigning taxpayers to the large taxpayer unit (LTU) to give it control over at least 50-60 percent of the tax revenue base.

Financial Sector Policies

18. The banking system has continued to be profitable, with capital buffers well above regulatory requirements and stable funding. According to preliminary data, after-tax return on equity was 9.8 percent in 2009, compared to 11.6 percent in 2008. Interest margins remained stable in 2009, profits from investment activities increased—due largely to rising prices of Hungarian government bonds—and costs were compressed, resulting in a sizeable increase in pre-provisioning profits. However, non-performing loans increased to 6.7 percent at end-2009, compared to 5.9 percent at end-September and 3.0 percent at end-2008,[1] and the corresponding sharp increase in provisioning triggered a reduction in net profits. The banking system's capital adequacy ratio stood at 12.9 percent at end-December, compared to 11.2 percent a year earlier, reflecting retained profits that strengthened the capital base, capital injections, and reductions in risk-weighted assets. As regards the banking system's funding situation, corporate deposits fell in the second half of 2009, following a significant increase in the first half, but household deposits and external bank funding remained stable. Banks' credit to the private sector fell by 4.7 percent in 2009,[2] with a stronger contraction in credit to small and medium-sized enterprises, reflecting both weak demand and increased risk aversion among lenders.

19. Going forward, the challenges to the banking system are significant but appear manageable. Profits are expected to shrink substantially in 2010 and may be negative for some banks as interest margins narrow, profits from investment activities fall and banks continue to step up provisioning. Non-performing loans are expected to peak around 9-10 percent during the course of 2010. Under the macroeconomic baseline scenario, most systemically important banks should be able to absorb projected loan losses from gross profits. Moreover, banks can dip into substantial capital buffers should this be needed. Less well capitalized banks are expected to take measures as needed to safeguard adequate capital cushions above the regulatory minimum, under close supervision from the Hungarian Financial Supervisory Agency (HFSA).

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[1] Non-performing loans are defined as corporate, household, interbank, foreign and other loans that are past due for more than 90 days.

[2] Exchange rate adjusted growth rate of bank credit to households, non-financial corporations and other financial corporations.

20. We have received letters confirming the commitments given by the parent banks of Hungary's six largest subsidiaries, as discussed during the meeting in Brussels on November 19, 2009 as part of the European Bank Coordination Initiative. Parents' minimum exposure level to Hungary was fixed at 95 percent of the level at end-September 2008, i.e., just before the initiation of program discussions. At end-December 2009 all parent banks were in compliance, based on the data for their subsidiaries in Hungary available to the HFSA. The banks also agreed to provide additional data on exposure to non-affiliated entities in Hungary, so that their overall exposure to the country can be monitored. Such data are in the process of being collected by the HFSA and are expected to be available by end-March.

21. We have implemented the wide-ranging changes to the legislative framework for financial sector supervision that were approved by parliament on December 14. The HFSA has been upgraded to an autonomous organization accountable directly to Parliament, paving the way for a thorough internal reorganization to strengthen the HFSA's operational effectiveness. The HFSA's management structure has been streamlined, performance incentives for staff have been reinforced, and the HFSA's management is now able to reallocate staff flexibly and rapidly to respond to supervisory challenges. The HFSA has also been given the right to issue binding administrative acts to temporarily suspend financial products in case of threats to financial stability. The new tri-partite Financial Stability Council (FSC) established in law—consisting of the Minister of Finance, the Governor of the Hungarian National Bank (MNB), and the Chairman of the HFSA—is meeting monthly to review developments and policies related to the stability of the financial system. Both the MNB and the FSC have the right to propose legislation or regulation on a "comply and explain" basis, i.e., the government needs to indicate agreement with the proposal within 15 days or explain why it disagrees. Looking forward, the effectiveness of financial supervision would be increased if the HFSA would obtain the right to issue binding regulations.

22. Banking supervision capacity continues to increase. Comprehensive on-site inspections of the seven largest banks were finalized in 2009. The inspection of another large bank will be completed in April 2010. The findings of these inspections have confirmed the need to focus on banks' credit portfolios. As a consequence, the HFSA has assigned priority to targeted follow-up on-site inspections in this area. By end-March 2010 such thematic inspections will be completed for two large credit institutions without a foreign parent (structural benchmark) and by end-June 2010 for two large subsidiaries of foreign parent banks (structural benchmark). The credit portfolios of the other large systemically important banks will be inspected in the second half of 2010. The reviews of foreign subsidiaries of Hungarian banks within EU countries are progressing as scheduled. The public tender to commission reviews of subsidiaries outside the EU was inconclusive because of the lack of competition, but a new tender is being launched.

23. A sub-committee of the FSC[3] has continued to monitor the three credit institutions that received loans from the government in 2009, in line with the continuous structural benchmark under the program. Any request for a loan or stand-by facility from the government will be granted only in case of unusually unfavorable funding conditions for the affected credit institution, a well-documented public interest, and after in-depth verification by the sub-committee of the institution's financial standing and stress-resilience, including by analyzing recent supervisory reports and recommendations from the HFSA. Moreover, we will ensure compliance with EU rules. The sub-committee is expected to report to the FSC on a regular basis, and in addition when supervisory and external audit reports become available.

24. We have made further progress in strengthening the remedial action and resolution regime for banks.

a. A set of amendments to the Law on Credit Institutions and Financial Enterprises was passed on December 14, 2009, thus assuring that the end-December structural benchmark was met. These amendments stipulate an additional mandatory threshold for the appointment of a supervisory commissioner and clearly state that only the HFSA has the power to initiate bank liquidation proceedings.

b. Moreover, draft legislation to further strengthen the bank resolution framework has been submitted to parliament on February 12, in line with the corresponding structural benchmark. The draft legislation broadens the available bank resolution techniques by allowing, among other things, for purchase-and-assumption transactions and the creation of bridge banks. These powers related to systemically important credit institutions would become available where the financial condition has deteriorated significantly but prior to reaching the threshold for the initiation of liquidation proceedings. As parliament will not be able to consider these amendments before the elections scheduled for April, the draft legislation will need to be reintroduced when parliament reconvenes. At the time, there will be the opportunity to further improve the draft legislation. Future progress will benefit from the technical work already made.

c. We will seek the European Commission's approval for the extension of the capital enhancement fund under the financial stability act until end-2010. The act grants extended resolution powers to the authorities, and therefore provides a safety net while the enhanced bank resolution framework is not yet in place.

[3] Previously sub-committee of the financial stability committee.

Monetary and Exchange Rate Policy

25. The MNB remains committed to the inflation target of 3 percent over the medium term, while acting as needed to mitigate risks to financial stability. Since July 28, 2009 the MNB has cut the key policy rate by a cumulative 375 bps to 5.75 percent, in line with the strengthening of investor confidence and the associated easing of financial strains. Given that inflation is projected to be below the target at the policy horizon (¶8), there is room for further gradual and cautious cuts in policy rates should the improvement in market sentiment prove sustainable.

26. The MNB is creating temporary facilities to support the Hungarian mortgage bond market, whose functioning continues to be affected by insufficient liquidity.
From March 2010, the central bank will purchase mortgage bonds in both the primary and secondary markets up to a total notional value of HUF100 billion (0.4 percent of GDP) to improve market liquidity. The central bank will buy parts of mortgage bond issues in the primary market only if the issuer proves that continuous market making in the bonds in the secondary market is granted. The experience with these facilities will be reassessed later in the year. Over the longer term, the objective of the program is to support foster alternative domestic currency funding options for banks, which may help boost domestic currency lending. The facility will be complemented by regulatory initiatives to support the mortgage market.

27. A key objective of the government's economic program is to maintain an adequate level of international reserves, taking into account access to official external financing. The target on net international reserves (NIR) under the program is designed to meet this objective, while allowing room for stabilizing market conditions in a fragile external environment. The government will refrain from issuing short-term debt for the purpose of meeting the NIR target.

/s/	/s/
Péter Oszkó	András Simor
Minister of Finance	Governor of the MNB

Table 1. Hungary: Program Monitoring

	Measure		
Quantitative Performance Criteria		December 2009	February 2010
1	Floor on the cash primary balance of the central government system	Observed	
2	Floor on net international reserves	Observed	
Continuous Performance Criteria			
	Non-accumulation of external debt arrears	Observed	
Inflation Consultation Clause			
	Inner band	Observed	
	Outer band	Observed	
Indicative Target			
	Ceiling on total debt stock of the central government system	Observed	
Structural Benchmarks			
1	Operation of the sub-committee described in the March LOI para 18 as long as there is any government capital or funding support outstanding to banks, and consultation of the sub-committee with Fund staff on its work program (Continuous)	Observed	
2	Passage by parliament of the amendments strengthening the remedial powers of the HFSA as listed in paragraph 20 (i), (ii), and (iv) of the March 2009 Letter of Intent (end-December, 2009)	Observed	
3	Submission to parliament of the amendments strengthening the bank resolution regime as listed in paragraph 20 (iii) of the March 2009 Letter of Intent (February 12, 2010)		Observed

Table 2. Hungary: Quantitative Program Targets

	2008			2009								2010	
	end-Sep	end-Dec		end-Mar		end-Jun		end-Sep		end-Dec		end-Mar	end-Jun
	Actual	Prog.	Outcome	Prog.	Outcome	Prog.	Outcome	Prog.	Outcome	Prog.	Outcome	Prog.	Prog.
I. Quantitative Performance Criteria													
1. Overall floor on the cumulative cash primary balance of the central government system (floor, in billions of forints) 1/	130	215	226	-280	-248	-155	-123	-160	-148	190	273	-280	-280
2. Cumulative change in net international reserves (floor, in millions of euros) 2/	17,096	-6,465	+1,398	-4,451	+1,464	-4,629	-1,195	-3,540	1,574	-2,378	1,028	-1,075	-937
II. Continuous Performance Criterion													
3. Non-accumulation of external debt arrears	…	0	0	0	0	0	0	0	0	0	0	0	0
III. Inflation Consultation													
4. 12-month rate of inflation in consumer prices 3/													
Outer band (upper limit)	...	7.1	...	5.0	...	5.0	...	5.0	...	5.0	...	5.0	5.0
Inner band (upper limit)	...	6.1	...	4.0	...	4.0	...	4.0	...	4.0	...	4.0	4.0
Central point	5.7	5.1	3.5	3.0	2.9	3.0	3.7	3.0	1.2	3.0	3.1	3.0	3.0
Inner band (lower limit)	...	4.1	...	2.0	...	2.0	...	2.0	...	2.0	...	2.0	2.0
Outer band (lower limit)	...	3.1	...	1.0	...	1.0	...	1.0	...	1.0	...	1.0	1.0
III. Indicative Target													
5. Ceiling on the total debt stock of the central government system (in billions of forints) 4/ 5/	15,973	16,230	15,925	16,281	15,936	15,100	15,162	15,267	15,057	15,166	14,992	15,800	15,800

1/ Cumulative flows from the beginning of the calendar year.
2/ The end-September 2008 NIR figure is a stock. The change in NIR for December 2008 is from September 2008, while all cumulative changes for 2009 and 2010 are from December 2008.
End-June program target is before adjustment for the delayed EU BoP support disbursement (see TMU).
3/ The inner band for consultation is +/-1 percent around the central point, and the outer band is +/-2 percent around the central point. Under the inflation consultation mechanism we will monitor the headline CPI inflation adjusted by 3.0 percent in 2010 based on the actual pass through of indirect tax increases (see TMU).
The figure of 1.2 percent in end-September 2009 corresponds to the headline inflation of 4.9 percent adjusted by the technical effect of the indirect tax increases (3.7 percent; see September TMU).
The figure of 3.1 percent in end-December 2009 corresponds to the headline inflation of 5.6 percent adjusted by the technical effect of the indirect tax increases (2.5 percent; see November TMU).
4/ Foreign-currency denominated debt calculated at program exchange rates.
5/ These are the indicative target ceilings adjusted for EU transfers and other items described in the TMU. Before adjustment, these ceilings were 16,320 for end-December 2008, 15,872 for end-March 2009, 15,074 for end-June, 15,070 for end-September, and 15,050 for end-December 2009.

Table 3. Hungary: Structural Conditionality

	Measure	
Structural Benchmarks		
1	Operation of the sub-committee described in the March 2009 LOI para 18 as long as there is any government capital or funding support outstanding to banks, and consultation of the sub-committee with Fund staff on its work program	Continuous
2	Completion of reports on thematic inspections focusing on credit risk and the quality of the loan portfolio for two large credit institutions without a foreign parent bank	By end-March 2010
3	Completion of reports on thematic inspections focusing on credit risk and the quality of the loan portfolio for two large subsidiaries of foreign parent bank	By end-June 2010

ATTACHMENT II. TECHNICAL MEMORANDUM OF UNDERSTANDING (TMU)

March 4, 2010

1. This Technical Memorandum of Understanding (TMU) defines the variables subject to quantitative targets (performance criteria and indicative targets), specified in the Letter of Intent (LOI). It also describes the methods to be used in assessing the program performance and the information requirements to ensure adequate monitoring of the targets. Reference to “days” in this TMU should be understood to mean “business days in Budapest”.

2. The exchange rates for the purposes of the program of the Hungarian forint (HUF) to the Euro is set at HUF 243.17 = €1, to the U.S. dollar at HUF 169.15 = $1, and to the Swiss franc at HUF 154.01 = CHF 1, the rates as shown on the Hungarian central bank’s (Magyar Nemzeti Bank, MNB) website as of September 30, 2008.[1]

Central Government System

3. **Definition**: The central government system (CGS) is defined to include the central government (state budget), extra budgetary funds, and social security funds. In case the government establishes new extra budgetary funds, they will be consolidated within the central government system.

Quantitative Performance Criteria, Indicative Ceiling, and Continuous Performance Criteria: Definitions and Reporting Standards

A. Floor on the Net International Reserves of the MNB[2]

	(Millions of Euros)
Outstanding stock: end-December 2008	18,493.8
Floor on cumulative change in net international reserves from end-December 2008:	
End-March 2009 (actual)	1,464
End-June 2009 (actual)	-1,195
End-September 2009 (actual)	1,574
End-December 2009 (actual)	1,028
End-March 2010 (performance criterion)	-1,075
End-June 2010 (performance criterion)	-937

[1] These exchange rates were derived from the file posted on the MNB website at http://english.mnb.hu/Resource.aspx?ResourceID=mnbarfolyamfile&f=0.

[2] Several items, such as the foreign currency receipts from EU transfers, and foreign exchange market financing of the government, increase the central bank's capacity for intervention under the NIR target, in addition to the decline in NIR.

4. **Net international reserves (NIR)** of the central bank of Hungary (MNB) are defined as the Euro value of gross foreign assets of the MNB minus gross foreign liabilities of the MNB with maturity of less than one year and all of the government and the MNB's credit outstanding from the Fund. Non-Euro denominated foreign assets and liabilities will be converted into Euro at the program exchange rates. Data will be provided by the MNB to the Fund with a lag of not more than five days past the test date.

5. **Gross foreign assets** are defined consistently with SDDS as readily available claims on nonresidents denominated in foreign convertible currencies. They include the MNB's holdings of monetary gold, SDRs, foreign currency cash, foreign currency securities, deposits abroad, and the country's reserve position at the Fund. Excluded from reserve assets are any assets that are pledged, collateralized, or otherwise encumbered, claims on residents, claims in foreign exchange arising from derivatives in foreign currencies vis-à-vis domestic currency (such as futures, forwards, swaps, and options), precious metals other than gold, assets in nonconvertible currencies, and illiquid assets.

6. **Gross foreign liabilities** are defined consistently with SDDS as all foreign exchange liabilities to residents and nonresidents, including commitments to sell foreign exchange arising from derivatives (such as futures, forwards, swaps, and options), and banks foreign currency deposits against reserve requirements. Government foreign exchange deposits and forward liabilities arising from swap arrangements with the MNB are not treated as foreign liability of the MNB.

7. **NIR targets** will be adjusted upward (downward) by the surplus (shortfall) in program disbursements relative to the technical assumption below. Program disbursements are defined as external disbursements from official creditors that are usable for the financing of the overall central government budget. For program purposes, any program disbursement from the EU or the World Bank in 2010 would result in an upward adjustment of the NIR target. Furthermore, the SDR allocations received by Hungary in August and September 2009 are excluded from NIR.

External Program Disbursements (technical assumption)

Cumulative flows from end-December 2008:	(In millions of Euros)
End-March 2009	2,000
End-June 2009	2,000
End-September 2009	3,500
End-December 2009	3,500
End-March 2010 (technical assumption)	3,500
End-June 2010 (technical assumption)	4,300
End-September 2010 (technical assumption)	5,200

B. Consultation Mechanism on the 12-Month Rate of Inflation

8. **The quarterly consultation band for the 12-month rate of inflation in consumer prices** is based on the measure of the headline consumer price index (CPI) published by the Hungarian Central Statistical Office no later than the 15th day of the following month.[3] Consistent with the headline CPI inflation target of the MNB, the central point for end-quarter inflation will be 3 percent, with lower and upper bands around each target of ±1 and ±2, respectively. The targets for end-March and end-June 2010 are performance criteria. For the purpose of monitoring performance under the inflation consultation mechanism, CPI inflation will be adjusted by 3.0 percentage points, which is equal to the estimated impact of the increases in VAT (2.2 percentage points) and excise taxes (0.8 percentage points) on the consumer price index.

9. **The CPI inflation consultation band will be an important part of each review under the arrangement**. In line with our accountability principles, we are committed to report to the public the reasons for any breach of the inner band and our policy response. In this vein, the MNB will conduct discussions with the Fund staff should the observed year-on-year rate of CPI inflation fall outside the inner band. In addition, should the observed year-on-year rate of CPI inflation fall outside the outer band specified above, the authorities will complete a consultation with the Fund on their proposed policy response before requesting further purchases under the program.

C. Floor on the Cash Primary Balance of the Central Government System

	(In billions of forints)
Cumulative primary balance from January 1, 2009:	
End-December 2009 (actual)	273
Cumulative primary balance from January 1, 2010:	
End-March 2010 (performance criterion)	-280
End-June 2010 (performance criterion)	-280

10. The primary balance of a budgetary institution is defined as the difference between total revenues and non-interest expenditures of that institution.

[3] The exact publication rule is as follows. Data is published on the 11th day of the following month. If the 11th day of the month falls during a week-end, the publication takes place the following Tuesday. In January and February there is an exception to this rule, as it takes an additional couple of days to compute the annual average for the previous year and the new basket weights. The exact calendar of releases can be found online at: http://portal.ksh.hu/portal/page?_pageid=38,863287&_dad=portal&_schema=PORTAL

11. The floor on the primary balance of the CGS will be monitored from above the line on a cash basis. It is understood that transfers among entities of the CGS are mutually consistent; hence, the difference between the simple sum of revenues and the simple sum of primary expenditures across all CGS entities yields the consolidated CGS balance. Should discrepancies arise, reconciliation between reported transfers and reported revenues from other CGS entities will be required before compliance with the CGS primary balance ceiling can be assessed. The floor on the primary balance of the CGS will be adjusted upward for the revenue from the sale of emission credits accrued under the Kyoto protocol and will be adjusted downward for the expenditure on new environmental projects financed from this revenue. Data will be provided by the Ministry of Finance to the IMF with a lag of no more than seven days past the test date.

12. For the purpose of the program, the primary expenditure of the CGS excludes any cash payment related to bank recapitalization and to transfers to the Bank Guarantee Fund.

13. Net lending of any component of the CGS will be considered as a non-interest expenditure item, whereas negative net lending of any component of the CGS will be considered as a revenue item.

D. Indicative Ceiling on Overall Stock of Debt of the Central Government System

14. The ceiling on the overall stock of the debt, as outlined below, shall apply to the HUF value of total stock of debt contracted by the central government system. Excluded from this indicative ceiling are credits from the IMF, external program financing, normal trade-related credits, reserve and long-term liabilities of the MNB, and the absolute net value of mark-to-market deposits of the Hungarian Debt Management Agency (ÁKK).[4] Liabilities related to the bank support package are not included. All stated benchmarks of ÁKK in terms of public debt management will be maintained as much as possible, depending on market conditions and the possible use of IMF credit.

Outstanding stock:	(In billions of forints)
End-December 2008 (actual)	15,925
End-March 2009 (actual)	15,936

[4] According to ÁKK's benchmarks, foreign currency debt should be kept wholly in Euro denomination and the interest rate composition is also fixed. To meet this benchmark while issuing debt in non-Euro currency—such as the U.S. dollar, Japanese Yen, and the Pound Sterling—ÁKK uses cross-currency and interest rate swaps. To limit counterparty risks in such transactions, ÁKK places (or accepts) cash deposits as collaterals. Any such deposit thus increases public debt for reasons autonomous to the government's financing plans. For this reason, these mark-to-market operations are excluded from the indicative ceiling.

End-June 2009 (actual)	15,162
End-September 2009 (actual)	15,057
End-December 2009 (actual)	14,992
End-March 2010 (indicative ceiling)	15,800
End-June 2010 (indicative ceiling)	15,800

15. Data on the total stock of debt of the central government system will be provided to the IMF by ÁKK on a quarterly basis within 10 days of the end of each quarter.

16. The program exchange rate will apply to all non-HUF denominated debt.

17. The indicative ceiling will also be adjusted upward (downward) by the shortfall (surplus) in net EU transfers relative to the baseline projection which forms the basis of the government budget and financing plans. The term "net EU transfers" refers to the net effect of pre- and post-financing of certain EU transfers, which are excluded from the public deficit but included in the public debt.

Net EU Transfers (Baseline Projection)

Baseline projections:	(In billions of forints)
End-March 2010 (program projection)	73
End-June 2010 (program projection)	160

18. The indicative ceiling will also be adjusted upward (downward) for an increase (decrease) of the ÁKK's cash reserves (built for liquidity management purposes) in the Single Treasury Account held at the MNB relative to the baseline projection.

Cash reserves at the Single Treasury Account (Baseline Projection)

Baseline projections:	(In billions of forints)
End-March 2010 (program projection)	466
End-June 2010 (program projection)	220

E. Continuous Performance Criteria on Non-accumulation of External Debt Payments Arrears by the Central Government System

19. The central government system will accumulate no new external debt arrears during the program period. For the purposes of this performance criterion, an external debt payment arrear will be defined as a payment by the central government system, which has not been made within seven days after falling due.

20. The stock of external arrears of the central government system will be calculated based on the schedule of external payments obligations reported by the ÁKK. Data on external arrears will be reconciled with the relevant creditors, and any necessary adjustments will be incorporated in these targets as they occur.

21. The performance criterion will apply on a continuous basis. The ÁKK will provide the final data on the stock of the central government system external arrears to the Fund, with a lag of not more than seven days after the test date. This performance criterion does not cover trade credits.

INTERNATIONAL MONETARY FUND

HUNGARY

Fifth Review Under the Stand-By Arrangement, and Request for Modification of Performance Criteria-Informational Annex

Prepared by the European Department

March 5, 2010

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Appendix

APPENDIX I. HUNGARY: FUND RELATIONS
(As of January 31, 2010)

I. **Membership Status**: Joined on May 6, 1982; Article VIII.

II. **General Resources Account**:

	SDR Million	Percent of Quota
Quota	1,038.40	100.00
Fund holdings of currency	8,601.57	828.35
Reserve position in Fund	73.83	7.11

III. **SDR Department**

	SDR Million	Percent of Allocation
Net cumulative allocation	991.05	100.00
Holdings	937.72	94.62

IV. **Outstanding Purchases and Loans:**

	SDR Million	Percent of Quota
Stand-By Arrangements	7,637.00	735.46

V. **Financial Arrangements**:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-by	11/6/08	10/5/10	10,537.50	7,637.00
Stand-by	3/15/96	2/14/98	264.18	0.00
Stand-by	9/15/93	12/14/94	340.00	56.70

VI. **Projected Payments to Fund**: (SDR million; based on existing use of resources and present holdings of SDRs)

	Forthcoming				
	2010	2011	2012	2013	2014
Principal			3,220.19	3,818.50	598.31
Charges/Interest	184.89	184.56	162.62	58.36	4.73
Total	184.89	184.56	3,382.81	3,876.86	603.04

VII. **Exchange Rate Arrangement**:

The de facto exchange rate arrangement for the Hungarian forint is floating, effective November 1st, 2008.

VIII. **Article IV Consultations**:

Hungary is on a 24-month consultation cycle. The last Article IV Board discussion took place on September 17, 2008. The associated Executive Board assessment is available at http://www.imf.org/external/np/sec/pn/2008/pn08124.htm and the staff report and selected issues papers at http://www.imf.org/external/pubs/cat/longres.cfm?sk=22374.0 and http://www.imf.org/external/pubs/cat/longres.cfm?sk=22375.0. Hungary has accepted the obligations of Article VIII and maintains an exchange rate system free of restrictions on the making of payments and transfers on current international transactions except for those maintained solely for the preservation of national or international security and that have been notified to the Fund pursuant to Executive Board Decision No. 144-(52/51).

IX. **Technical Assistance:**

Year	**Department.**	**Purpose**	**Date**
1995	FAD	Tax administration	February
1995	FAD	Treasury	February
1995	FAD	Treasury	May
1995	FAD	Treasury	November
1995	FAD	Debt management	November
1995	MAE	Central bank internal auditing	November
1995	MAE	Monetary analysis and research	December
1996	FAD	Tax policy	May
1996	MAE	Central bank accounts	September
1996	FAD	Subsidies	November
1997	FAD	Subsidies follow-up	May
2000	MAE	FSAP	February
2000	FAD	Tax legislation	June
2000	STA	Money and banking statistics	October
2000	FAD	Tax legislation follow-up	November
2002	FAD	Expenditure rationalization	November
2004	STA	ROSC update of the fiscal sector	January
2005	MFD	FSAP update	February
2005	FAD	Tax policy and administration	October
2006	FAD	Fiscal ROSC	May
2006	FAD	Public-private partnership	September
2007	FAD	Tax policy	April
2007	FAD	Public financial management	June
2007	FAD	Tax administration	October
2008	FAD	Pension reform	May
2008	FAD	Tax administration	October
2009	FAD	Tax administration	March
2009	MCM	Banking Supervision	July
2009	FAD	Tax administration	August
2009	LEG	Bank resolution framework	September
2009	FAD	Tax administration	November

X. **Resident Representative:**

Ms. Iryna Ivaschenko assumed her duties on May 1, 2009.

APPENDIX II. HUNGARY: IMF-WORLD BANK COORDINATION

Joint Management Action Plan Implementation Table
As of February 19, 2010

Title	Products	Provisional Timing of Missions	Expected Delivery Date
1. Bank Work Program	Hungary Financial Sector Loan - Supervision and financial technical assistance	March 2010, May 2010	
	T.A. on local bonds markets (to be defined)	April 2010	
	Social Public Expenditure Review	April 2010	June 2010: Discussion of framework with the new administration
	Private sector business regulatory environment Technical Assistance	May 2010	June 2010: T.A. Notes and Policy Recommendations
2. Fund Work Program	T.A. on Expenditure Rationalization	May/June 2010	September 2010
	Missions for the 6th and 7th reviews of Hungary's SBA-supported program	May 2010, August 2010	June 2010, September 2010

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

Press Release No.10/110
FOR IMMEDIATE RELEASE
March 24, 2010

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Fifth Review Under Hungary's Stand-By Arrangement

The Executive Board of the International Monetary Fund (IMF) today completed the fifth review of Hungary's economic performance under a program supported by a Stand-By Arrangement (SBA). The completion of the review makes available SDR 2.1 billion (about €2.4 billion or US$ 3.2 billion), but the authorities do not intend to draw this amount. The availability of Fund resources will help to provide insurance against the impact of any unforeseen deterioration in external financing conditions. The total amount disbursed under the program remains SDR 7.64 billion (about €8.7 billion or US$11.6 billion).

The SBA was approved on November 6, 2008 (see Press Release No. 08/275) for SDR 10.54billion (about €12 billion or US$ 16 billion). The arrangement entails exceptional access to IMF resources, amounting to 1,015 percent of Hungary's quota.

Following the Executive Board's discussion on Hungary, Mr. John Lipsky, First Deputy Managing Director and Acting Chair, said:

"The steadfast implementation of prudent economic policies over the past year-and-a-half has contributed to strengthening investor confidence and a significant improvement in external financing conditions, thus helping economic recovery. As in the case of the last review, the authorities do not intend to draw the amount that would be made available upon completion of this review. The program continues to focus on improving fiscal sustainability and preserving financial stability, providing the basis for strong, sustainable growth in the medium term.

"Important progress has been made in fiscal sustainability, reflecting structural spending reforms to the pension system, social transfers, and subsidies. At the same time, tax reform has shifted the tax burden from labor to consumption, which should boost labor participation and potential growth over the medium term. Strict expenditure control, cautious use of contingency buffers, and readiness to take further action if necessary are required to meet the fiscal targets. Additional structural measures will be needed to put government debt firmly on a declining path. Restructuring the public transport system must be tackled forcefully to reduce its drain on the budget.

“In the financial sector, liquidity support has been provided in a timely manner, and banking supervision and the remedial action framework have been substantially enhanced. The upgrading of the Hungarian Financial Supervisory Authority to an autonomous agency represents significant progress, and consistent implementation of the related reforms to the institutional framework is essential. Further improvements in banking supervision and the resolution framework for banks remain important.

“Monetary policy should continue to ease gradually and cautiously, to the extent allowed by financial market conditions. Maintaining an adequate level of international reserves is important, taking into account available access to official external financing.”