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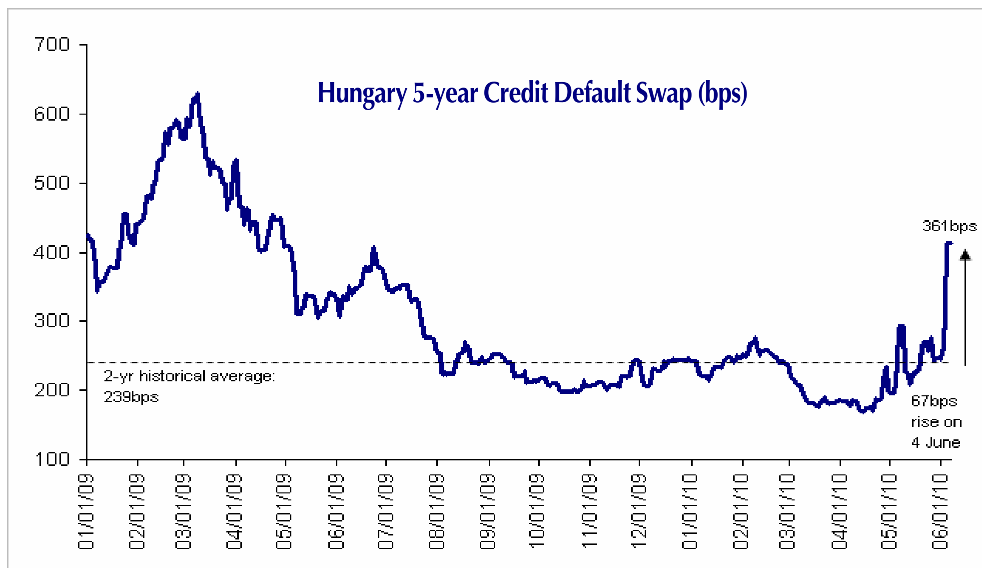
Hungary: At first sight, it's like Greece all over again...

The ghost of Greece re-visited financial markets on Friday, after a senior Hungarian official said the previous government had 'manipulated', and 'lied' about the state of the economy. Party deputy chairman Lajos Kosa said Hungary has a 'slim chance to avoid a Greek situation'. EUR/USD fell below 1.20 as a result (the first time since Apr 2006), with the single currency at 1.1967, intra-day low of 1.1956. EUR was below 1.19 at one point this morning. The Hungarian forint weakened almost 5% (against EUR) over the last two days, with EUR/forint rising 2% on Friday alone, at 286.75. Hungarian CDS surged 63bps to 371, intra-day high of 416bps. Fearing another Greece, Spain CDS rose 22bps to 278, Portugal +26bps to 365, Ireland +32bps to 292 and Greece +59bps at 783. Even Italy was up 30bps at 264. Equities were sold off across Europe, with FTSE 100 -1.6%, DAX -1.9%, France CAC 40 -2.9%, and Austria ATX -4.1%. Across the Atlantic, DJI fell 3.16%, ending the day at 9,931.



Latest developments on 5 June weekend

Hungary's new government rushed to calm markets on 5 June, Saturday with a pledge to keep the country's official budget deficit goal for 2010 at 3.8% of GDP, stressing that the country isn't facing any sovereign credit default. Reports also indicate that an official of the new cabinet, which took office a week ago, also emphasised Hungary's commitment to adopt the euro. The Hungarian cabinet has been called for a three-day extraordinary meeting. The cabinet is to come up with an action plan to keep the budget on course within 72 hours, with plans for tax cuts still in place..

Hungarian policymakers tried to control the damage, saying that the recent comments were 'unfortunate', pledging to keep country's deficit at 3.8% of GDP, and stressing that the country is not facing a sovereign default. It is possible that there could be some moderate upward revision in the 2010 deficit goal, probably to around 4.5% of GDP,. Budget performance in 2010 will be vital for the 2011 budget target under its plans to adopt the euro. Under its current targets Hungary plans to shrink its budget deficit to 2.9% of GDP in 2011, below the 3% threshold set for Eurozone applicants

The market is certainly perplexed by such negative comments from policy makers. Most thought the govt may be pushing for more austerity measures to meet the IMF package -- the new govt last month indicated that fiscal deficit could hit 7.5% of GDP, against the IMF target of 3.8%.

Given the size of Hungary's economy (about half the size of Greece), and that Hungary is not part of the EUR (implying that it does have the option of FX weakness as policy adjustment), the price action on Friday was a little exaggerated. It was clearly a 'confidence' issue. After Greece, another country in EU is caught manipulating their fiscal position. The question now is whether there are more skeletons to be thrown out.

Numerically, Hungary's situation is certainly not as grievous - whether it is debt/GDP or fiscal deficit/GDP (refer to tables). Indeed, IMF MD Strauss-Khan over the weekend affirmed that he was 'surprised' by Orban govt's comments. Also, unlike Greece (or the PIGS countries), Hungary is not part of the single currency, which means there is still FX flexibility, as a policy tool. Additionally, IMF-EU had already provided Hungary with a $25bn bail-out package in 2008. Unless the Hungarian fiscal deficit (currently estimated at 3.8%) spirals to double-digits (Greece estimated at 13.5% of GDP), there is no reason why the IMF-EU will not provide additional aid, if needed.

Following the weekend comments by the Hungarian government that it will meet fiscal targets and produce an economic action plan this week, we should see stability this week, although it would depend on how other assets markets respond over the next few days. On Monday morning, markets are still nervous, as reflected by the Nikkei sliding 3.8%. Longer-term, we maintain that austerity measures in the European space means further FX weakness to cushion the economic fall-out. **We maintain our target of 1.22 by end 2Q10, and then towards 1.18 end-2010.**

Further Risks

One concern over the forint's weakness is that corporates and households are rather exposed in terms of FX liabilities. Lenders had been encouraged by the persistently wide spread between interest rates in Hungary and western European countries, a relatively stable currency, and the expectation of convergence. As a result, households and enterprises have become increasingly indebted in foreign currency, especially in Swiss francs. Hungary's total external debt reached about 120% of GDP at the end of 2008, compared to less than 50% in Poland and 40% in the Czech Republic.

Developments in financial markets may be affected by news out of Hungary on whether the government presents a credible set of fiscal measures. Given that Hungary is already on IMF and EU support and has to meet certain conditions, the risk of a sovereign default by Hungary seems quite low. Recent talk of a possible sovereign default by Hungary, which sent the Hungarian currency and bonds crashing last week, is "wildly exaggerated", a top European Union official said Saturday. EU officials will be visiting Hungary this coming week to look into Hungary's financial situation and assess if it needs additional aid.

Hungary: Is it as grievous as Greece?

There are concerns that Hungary's fiscal deficit could hit 7.5% of GDP (against targeted 3.8%). Average fiscal gap in EU is about 6.3%, and almost 13% in Greece. Also, Hungary's overall public debt is around 79% of GDP, as compared to EU's average of 84%, and Greece at 113%. On GDP growth, after a contraction of 6.3% in 2009, the economy is expected to post expansion of 2.8% by 2011, following little or no growth this year. By all calculations, and the fact that the country is abiding by its austerity plan, there is little reason to believe that Hungary will walk down Greece's path in the near future.

Hungary and the IMF-EU bailout package of 2008

On 27 October 2008, Hungary reached an agreement with the IMF, EU and World Bank for a rescue package of US$25bn, aiming to restore financial stability and investors' confidence. IMF lent SDR 10½ bn or about EUR12½ bn at the time, the EU, EUR6½ bn, and the World Bank EUR1 bn to underpin a reduction in financial strain. Hungary currently targets its 2010 budget deficit at 3.8% of GDP under its standby credit line with the IMF and EU. Due to its high external debt and weak fiscal policies, Hungary was the first EU country that secured IMF support when hit hard by the global economic crisis in 2008.

Going forward, reports indicate that Hungary's budget deficit this year could reach 7.5% of GDP without fiscal measures. The National Bank of Hungary estimated in its latest policy paper May 31 that current revenue and expenditure trends will lead to a 4.5%-of-GDP budget deficit this year. Given the lifeline provided by the IMF-EU, and the fact that not the entire package has been utilised, there is little reason to think that Hungary has a sovereign risk in the immediate future.

Hungary's Economy: Looking back....

Hungary joined the European Union on 5 Jan 2004 after a successful referendum among the EU-10. The EU's free trade system helps Hungary, as it is a relatively small country and thus needs export and import. After the accession to the EU, Hungarian workers could immediately work to Ireland, Sweden and the United Kingdom. Hungary has natural resources such as bauxite, coal, natural gas, fertile soils, arable land. Agriculture/forestry constitutes 3.4% of GDP, and main products are meat, corn, wheat, sunflower seeds, potatoes, sugar beets, dairy products. Industry and construction, 45.4% of GDP include machinery, vehicles, chemicals, precision and measuring equipment, computer products, medical instruments, pharmaceuticals, textiles.

Hungary: Economic Fundamentals

	Greece	Portugal	Spain	Ireland	Italy	Hungary	US	China	Germany
Nominal GDP (US$ bn)	331	228	1,464	228	2,118	129	14,256	4,909	3,352
% of World Nominal GDP	0.6	0.4	2.5	0.4	3.7	0.2	24.6	8.47	5.79
% of EU Nominal GDP	2.0	1.4	8.9	1.4	12.9	0.8	86.7	29.9	20.4
Real GDP (% YoY growth)*	-2.0 (-2.5)	0.3 (-3.3)	-0.4 (-3.6)	-1.5 (-7.5)	0.8 (-5.0)	-0.2 (3.2)	3.1 (-2.4)	10.0 (12.2)	1.2 (-5.0)
Unemployment Rate	11.3	9.2	19.1	13.8	8.3	10.6	9.7	9.6	7.8
Population Size (in mn)	11.3	10.7	45.9	6.2	60.2	10.0	309.2	1,337.4	81.8

Hungary: Fiscal Snapshot

	Greece	Portugal	Spain	Italy	Ireland	Hungary
Current account deficit (2009) (avg. of 4 qtrs through 09:04)	-11.9	-10.1	-6.1	-3.5	-2.9	-0.4
Budget deficit (2009) (% of GDP)	**-12.7**	**-9.3**	**-11.4**	**-5.4**	**-14.3**	**-3.9**
Public debt (% of GDP)	**113.4**	**76.6**	**55.2**	**113.9**	**60**	**79**
Public debt in (US$ bn)	**375**	**175**	**805**	**2412**	**137**	**101**
Nominal GDP (in US$ bn)	331	228	1464	2118	228	129
Public debt service in 2010* (% of GDP)	11.6	2.5	4.7	14.1	12.0	14.0
External Debt (% of GDP)	167 (553bn)	223 (507bn)	165 (2410bn)	101 (2328bn)	1004 (2287bn)	137 (176bn)

Source: IMF, National Agencies
* Includes long-term debt redemptions and interest payments

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