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PRESS RELEASE NO. 08/275

# Press Release: IMF Executive Board Approves 12.3 Billion Euro Stand-By Arrangement for Hungary

November 6, 2008

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The Executive Board of the International Monetary Fund (IMF) today approved a 17-month SDR 10.5 billion (about €12.3 billion or US$15.7 billion) Stand-By Arrangement for Hungary to avert a deepening of financial market pressures. The approval makes SDR 4.2 billion (about €4.9 billion or US$6.3 billion) immediately available and the remainder will be available in five installments subject to quarterly reviews. The Stand-By Arrangement entails exceptional access to IMF resources, amounting to 1,015 percent of Hungary's quota, and was approved under the Fund's fast-track Emergency Financing Mechanism procedures.

The IMF arrangement is designed to facilitate the rapid reduction of financial market stress in Hungary, while supporting the country's longer-run economic goals by creating conditions necessary to facilitate appropriate reforms in government finances and in the banking sector. Specifically, the IMF-supported economic program is based on two key objectives: to implement a substantial fiscal adjustment to ensure that the government's debt-financing needs will decline; and to maintain adequate liquidity and strong levels of capital in the banking system.

The recent international financial turmoil has increased the rollover risk of Hungary's external debt. The IMF's financial support, combined with the commitments by the European Union (€6.5 billion or about US$8.4 billion) and the World Bank (€1 billion or about US$1.3 billion), which total €20 billion (about US$25.8 billion) in financial support, will provide Hungary with the amount of reserves that is sufficient to meet its external obligations, even in extreme market circumstances.

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

"Hungary's successful macroeconomic adjustment in recent years has been disrupted by the global financial crisis. Over the past two years, fiscal consolidation has sharply reduced the fiscal deficit. The introduction of a floating exchange rate regime in early 2008 removed potential conflicts between monetary and exchange rate policies in an inflation targeting environment.

"However, with the decline in global liquidity and increase in risk aversion, financial markets in Hungary came under intense pressure, given Hungary's high debt levels and significant balance sheet mismatches. Several government bond auctions failed, liquidity in the secondary bond market dried up, and bond yields rose sharply. At the same time, the stock market fell and the currency depreciated.

"Reducing financial market stress will require both a high degree of policy discipline and large external financing. The authorities' comprehensive set of policy measures, supported by the 17-month Stand-By Arrangement under the Fund's exceptional access policy, is designed to strengthen Hungary's economy and thereby foster a reduction in financial market stress. The path of fiscal adjustment has been accelerated, liquidity provision to financial markets is being enhanced, a system is being put in place to ensure that high levels of capital in the banking system are maintained, and financial sector surveillance is being strengthened. These measures address Hungary's most important vulnerabilities and should therefore underpin an improvement in investor confidence. Most important, the combination of accelerated fiscal adjustment and the introduction of a rules-based fiscal framework will help persuade investors that the government's short- and medium-term financing needs are being addressed.

"In the context of global financial market turmoil, the restoration of investor confidence requires not only a strong economic program, but also large external financing support. Support from the international community will provide reassurance that Hungary's external obligations can be met. Against this background, the joint financial assistance being provided by the IMF, the European Union, and the World Bank sends a strong signal of the international community's confidence that, with the consistent implementation of the program, Hungary will weather the current difficulties."

**Recent Economic Developments** **ANNEX**

Hungary was among the first emerging market countries to suffer from the fallout of the current global financial crisis. As financial difficulties in advanced economies led to a decline in global liquidity and an increase in risk aversion, investors increasingly started differentiating among emerging markets. Hungary's high external debt levels, which amounted to 97 percent of GDP at end-2007, and significant balance sheet mismatches, negatively affected investor appetite for Hungarian assets. Even though macroeconomic and financial policies had been strengthened since 2006, with substantial fiscal consolidation and tax administration improvements, Hungary was hit hard by the global deleveraging.

Financial markets in Hungary have come under significant stress in recent weeks, reflecting the rise in perceptions of counterparty risk.

**Program Summary**

Growth is expected to contract in 2009 to -1 percent from around 1¾ percent in 2008. Already weak private consumption and investment will be negatively affected by a sharp reduction in new bank lending. Inflation, which peaked at 9 percent in early 2007, is projected to continue a downward trend and reach 4 percent at end-2009. In a difficult global environment and with low domestic demand, the economy is projected to recover only gradually due to the fact that the slowdown is simultaneously occurring in Hungary's main trading partners and the global deleveraging process that will leave less foreign capital available to quickly return to Hungary. Growth is not expected to reach its estimated potential of 3 percent until after 2011.

The authorities' economic program is designed to foster a rapid return of less stressed financial market conditions, while supporting longer-run structural goals. The main pressure points in Hungary are in public finances and the banking sector. In response, the program is based on the following key elements:

• **Given Hungary's large public debt, substantial fiscal adjustment is required** to provide confidence that the government's financing need can be met in the short and medium run. The program envisages a large structural fiscal adjustment of 2½ percent of GDP with emphasis on expenditure measures, consistent with the need to reduce the country's large public sector. To put fiscal sustainability on a permanent footing, a rules-based fiscal framework will also be introduced. To mitigate social impacts, low-income pensioners will be exempt from the elimination of pension bonuses.

• **Upfront bank capital enhancement is needed** to ensure that banks are sufficiently strong to weather the imminent economic downturn, both in Hungary and in the region. The banking sector support package in the program contains provisions for added capital and resources to finance a guarantee fund for interbank lending to establish a level-laying field for the Hungarian banks in an international environment where their competitors already have access to similar guarantees.

• **Large external financing assistance is needed to support Hungary's return to normal international funding**. In addition to the IMF, contributions are being received from both the EU and the World Bank.

Hungary joined the IMF on May 6, 1982; its quota is SDR 1,038.4 million (about €1,212.9 million or US$1,548.8 million), and it has no outstanding use of IMF credits.

| | 2005 | 2006 | 2007 | 2008 | 2009 |
|---|---|---|---|---|---|
| | | | | Proj. | |
| **Real economy** (change in percent) | | | | | |
| Real GDP | 4.1 | 3.9 | 1.1 | 1.8 | -1.0 |
| CPI (end year) | 3.3 | 6.5 | 7.4 | 5.1 | 4.2 |
| CPI (average) | 3.6 | 3.9 | 7.9 | 6.3 | 4.5 |
| Unemployment rate (average, in percent) | 7.2 | 7.5 | 7.4 | 7.8 | 8.5 |
| Gross domestic investment (percent of GDP) 1/ | 23.6 | 23.1 | 23.0 | 22.8 | 20.0 |
| Gross national saving (percent of GDP, from BOP) | 16.1 | 15.6 | 16.6 | 16.5 | 18.0 |
| **General government** (percent of GDP), ESA-95 basis 2/ | | | | | |
| Overall balance | -7.8 | -9.3 | -4.9 | -3.4 | -2.5 |

| | | | | | |
|---|---|---|---|---|---|
| Primary balance | -3.7 | -5.4 | -0.9 | 0.6 | 1.9 |
| Debt | 61.6 | 65.5 | 65.8 | 67.4 | 70.1 |
| **Money and credit** (end-of-period, percent change) | | | | | |
| M3 | 14.6 | 13.8 | 11.0 | 4.1 | 1.3 |
| Credit to nongovernment | 18.9 | 17.1 | 17.3 | 7.2 | -6.2 |
| **Interest rates** (percent) | | | | | |
| T-bill (90-day, average) | 6.8 | 7.0 | 7.6 | ... | ... |
| Government bond yield (5-year, average) | 8.0 | 6.9 | 7.0 | ... | ... |
| **Balance of payments** | | | | | |
| Goods and services trade balance (percent of GDP) | -1.2 | -0.9 | 1.4 | 1.8 | 7.5 |
| Current account (percent of GDP) | -7.5 | -7.5 | -6.4 | -6.2 | -2.0 |
| Reserves (in billions of euros) | 15.7 | 16.4 | 16.4 | 19.5 | 19.8 |
| Gross external debt (percent of GDP) [3/] | 75.0 | 90.4 | 97.2 | 106.4 | 115.8 |
| **Exchange rate** | | | | | |
| Exchange regime | Floating | | | | |
| Present rate (November 6, 2008) | Ft 202.3 = US$1; Ft. 261.4 = €1 | | | | |
| Nominal effective rate (2000=100) | 111.6 | 105.1 | 111.8 | ... | ... |
| Real effective rate, CPI basis (2000=100) | 132.6 | 127.0 | 142.5 | ... | ... |
| **Quota at the Fund** | SDR 1038.4 million | | | | |

Sources: Hungarian authorities; IMF, International Financial Statistics; Bloomberg; and IMF staff estimates.

[1/] Includes change in inventories.
[2/] Consists of the central budget, social security funds, extrabudgetary funds, and local governments, as well as motorway investments previously expected to be recorded off-budget in 2006-07.
[3/] Including inter-company loans, and nonresident holdings of forint-denominated assets.

**Hungary: Main Economic Indicators, 2005-09**

| | 2005 | 2006 | 2007 | 2008 | 2009 |
|---|---|---|---|---|---|
| | | | | Proj. | |
| **Real economy** (change in percent) | | | | | |
| Real GDP | 4.1 | 3.9 | 1.1 | 1.8 | -1.0 |

| | | | | | |
|---|---|---|---|---|---|
| CPI (end year) | 3.3 | 6.5 | 7.4 | 5.1 | 4.2 |
| CPI (average) | 3.6 | 3.9 | 7.9 | 6.3 | 4.5 |
| Unemployment rate (average, in percent) | 7.2 | 7.5 | 7.4 | 7.8 | 8.5 |
| Gross domestic investment (percent of GDP) 1/ | 23.6 | 23.1 | 23.0 | 22.8 | 20.0 |
| Gross national saving (percent of GDP, from BOP) | 16.1 | 15.6 | 16.6 | 16.5 | 18.0 |
| **General government** (percent of GDP), ESA-95 basis 2/ | | | | | |
| Overall balance | -7.8 | -9.3 | -4.9 | -3.4 | -2.5 |
| Primary balance | -3.7 | -5.4 | -0.9 | 0.6 | 1.9 |
| Debt | 61.6 | 65.5 | 65.8 | 67.4 | 70.1 |
| **Money and credit** (end-of-period, percent change) | | | | | |
| M3 | 14.6 | 13.8 | 11.0 | 4.1 | 1.3 |
| Credit to nongovernment | 18.9 | 17.1 | 17.3 | 7.2 | -6.2 |
| **Interest rates** (percent) | | | | | |
| T-bill (90-day, average) | 6.8 | 7.0 | 7.6 | ... | ... |
| Government bond yield (5-year, average) | 8.0 | 6.9 | 7.0 | ... | ... |
| **Balance of payments** | | | | | |
| Goods and services trade balance (percent of GDP) | -1.2 | -0.9 | 1.4 | 1.8 | 7.5 |
| Current account (percent of GDP) | -7.5 | -7.5 | -6.4 | -6.2 | -2.0 |
| Reserves (in billions of euros) | 15.7 | 16.4 | 16.4 | 19.5 | 19.8 |
| Gross external debt (percent of GDP) 3/ | 75.0 | 90.4 | 97.2 | 106.4 | 115.8 |
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| **Quota at the Fund** | SDR 1038.4 million | | | | |

Sources: Hungarian authorities; IMF, International Financial Statistics; Bloomberg; and IMF staff estimates.

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2006-07.

[3/] Including inter-company loans, and nonresident holdings of forint-denominated assets.


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