



MINISTRY
FOR NATIONAL ECONOMY

REPORT
ON ECONOMIC AND FINANCIAL
DEVELOPMENTS

BUDAPEST, 26 JULY 2010

Contents

Summary	1
1. Global growth outlook and financial market developments	4
1.1. Global and European growth prospects	4
1.2. International and domestic financial market developments	5
2. Growth, labour market and inflation prospects	7
2.1. Economic growth	7
2.2. Employment and wage development	13
2.3. Inflationary processes	17
3. External and internal balances	19
3.1. External position	19
3.2. Financial positions of economic sectors	20
3.3. Budgetary developments	24
3.4. Public debt	27
Annex 1: Additional consolidation measures announced in certain EU Member States in the first half of 2010	31
Annex 2: Development of price and cost based indicators of competitiveness	34
Annex 3: Forecasts of institutions for 2010	36

The Report is based on statistical data published until 26 July.

Summary

In the first quarter of 2010 the global recovery was faster than anticipated. The recent developments in the industrial as well as in the confidence indices highlight that in the second quarter the real economy's activity was also very vigorous. Looking ahead, global growth may be around 4.5% in 2010 as well as in 2011; however downside risks have become stronger, especially for 2011.

In 2010, at the third phase of the global crisis (following the financial and the real economy crisis), both global and European financial market developments are determined by sovereign debt problems. In the last six months some of the Euro Zone members were concerned about their budget deficit and about the sustainability of their public debt. Some countries have also experienced a downgrade in their credit ratings. On the other hand, the fiscal stabilisation measures, as well as the emerging EU rescue package, and the plans for enhanced policy coordination in the European Union have helped strengthen investor sentiment, but in general they have only temporarily mitigated market volatility. The trends in the domestic financial markets were mostly affected by the international developments; however some domestic news had temporary effects too. The exchange rate became more volatile, and albeit there were some lifts, overall, bond yields are at a relatively low level compared to the past decade.

The fact that the first quarter domestic GDP data have surpassed the preliminary expectations and that the expansion of the foreign markets was more dynamic than expected before leads to an upward revision of the growth forecast of March 2010. Export growth may return to a near double-digit expansion, while household consumption expenditure may be lower than expected due to the higher than expected inflation rate, in addition to the negative impact of the extraordinary weather damages on farmers' incomes. Besides, the negative risks of dwelling construction indicate a more moderate investment growth. However, some elements of the government's measures may have a positive influence on economic processes already in the short term. Overall, the previously expected 0.2 percent decline of the GDP has been revised to a growth by 0.6 percent in 2010.

This year a gradual slowdown is anticipated in the scale of headcount adaption rate, as well as in the scale of the wage adaption rate in the private sector. In May, the first time since one and a half years, there was an increase in the level of headcount. Nevertheless, the slow pace of employment expansion and a high percentage of those losing their jobs but have permanently stayed on the labour market resulted in a high unemployment rate in the first months of the year. Looking forward, in the second half of the year a further moderate growth in the number of staff is anticipated. The growth in employment may be felt stronger in the manufacturing sector, due to the more favourable exports compared to the last year. Yet, in the services sector expansion may be encumbered due to the labour hoarding experienced previously. As an outcome, the slow growth in the headcount and an increase in the long-term unemployment rate may end up in a high unemployment level.

The expected inflation rate for 2010 is dominated by the disinflationary impact of the low demand (what is expected to be strengthened by the household energy price freeze), while a weaker-than-expected exchange rate, in addition to a higher food price level - coupled with the inflationary pressure of the imported prices - increases the forecast up to 4.7%. Conversely, in the third quarter the inflation rate is

expected to decline significantly due to the transitional impact of the indirect tax increases. It may accelerate in the fourth quarter, largely attributable to items outside the core inflation.

Following the spectacular adjustment in external balances experienced last year, this tendency is expected to continue in 2010 too. The current account balance may be around last year's level (close to balance), while the positive balance of the capital account is projected to increase, due to an expected larger proportion of capital transfers from the EU- compared to the previous year. Overall, Hungary's net external financing capacity could be slightly higher than 1.5% of GDP in 2010.

In a contrast to the real economy - where in some areas clear signs of the recovery can be identified - the economic sectors' financial positions reflect only a deceleration of the crisis provoked adaptation. While credit flows are likely to have reached their trough, substantial recovery can not be expected in the short term.

Concerning budgetary developments, the cash balances have showed no improvement in the first quarter of the year, but the accrual deficit improved in comparison to the first quarter of 2009. However, the general government's position may have deteriorated in the second quarter of the year, because the decline in the expenditures did not offset the decline in the tax revenues. The central government deficit by the end of June amounted to 119% of the annual figure in the approved budget. The effects of the steps addressing the increase of the budget revenues and the cut of expenditures from the package of 29 measures, announced in June, will have an impact throughout the second half of the year, thus ensuring the 3.8% deficit target to be achieved.

The Maastricht debt continued to increase throughout the first quarter of the year and have exceeded 80% of the cumulative four-quarter GDP by the end of the quarter. The increase in the central government debt level reflects - in addition to the impact of the deficit - also the exchange rate revaluation effects resulting from the depreciation of the Hungarian currency. In the second quarter of the year, the change in global investor sentiment has led to increased market volatility. Despite of sometimes turbulent market conditions, there was a sufficient demand for government securities throughout this period.

MAIN INDICATORS OF THE HUNGARIAN ECONOMY 2008-2010

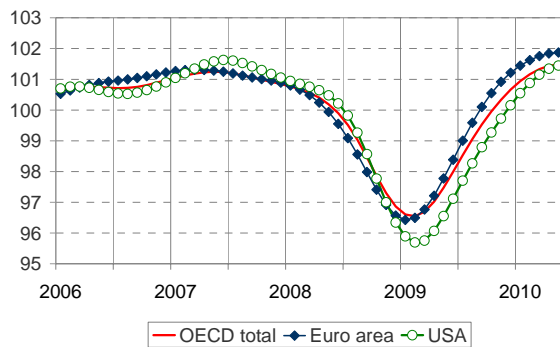
	2008 actual data	2009 preliminary data	2010 forecast	
			(March 2010)	(July 2010)
<i>Annual percentage change at constant prices</i>				
Gross domestic product (GDP)	0.6	-6.3	-0.2	0.6
Domestic use of GDP	0.7	-11.5	-1.5	-1.0
Consumption of households	-0.6	-6.7	-2.6	-2.5
of which: household consumption expenditures	-0.5	-7.6	-2.7	-3.0
Gross fixed capital formation	0.4	-6.5	1.3	0.8
Exports (goods and services)	5.6	-9.1	5.5	9.9
Imports (goods and services)	5.7	-15.4	4.4	8.8
<i>Annual percentage change</i>				
Real wages, per employee	0.7	-2.4	3.0	2.2
Number of employees	-1.2	-2.5	-1.1	-0.5
Unemployment rate (ILO), %	7.8	10.0	10.6	11.7
Consumer price index, annual average	6.1	4.2	4.3	4.7
<i>In per cent of GDP</i>				
Current account balance	-7.1	0.2	-0.4	0.0
ESA95 general government balance	-3.8	-4.0	-3.8	-3.8

1. Global growth outlook and financial market developments

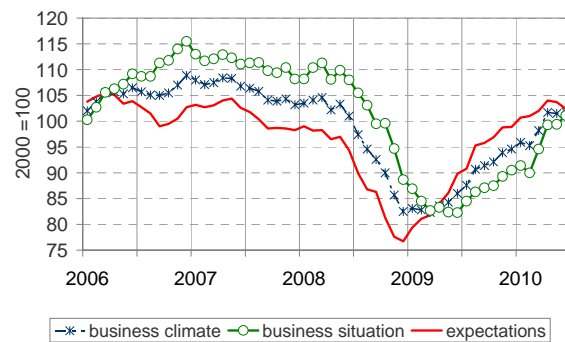
1.1. Global and European growth prospects

In the first quarter of 2010 the global economic development manifested in a more dynamic expansion than originally expected, while real economic activity was likewise affected, as demonstrated by the industrial and confidence indicators, in the second quarter of the year. The world economic growth rate may be around 4.5 percent both in 2010 and 2011, but at the same time the downward risks will probably gain significance, mainly in 2011.

OECD composite leading indicator

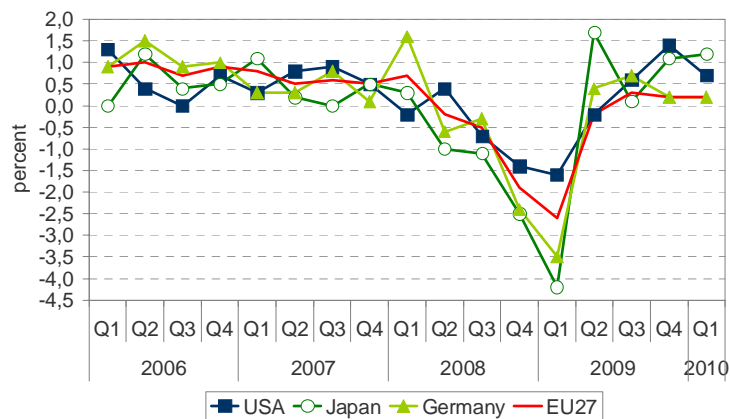


German IFO business climate index



In the main European markets - Germany, France, United Kingdom - fiscal austerity measures were resolved for the period 2011-2014 in order to reduce the government debts rising due to the crisis. In 2011 these consolidation measures may extend up to 1.5% of the national GDPs. A positive impact of the national and international inventory cycles was reflected in the powerful growth achieved by Asian countries in the first half of 2010, while the austerity measures of developed countries exerting their effects in the course of 2011 may curb the extent of economic activity also in this (Asian) region. All in all, the export outlook for Hungary is positively influenced in 2010, and may be negatively influenced in 2011 by the external economic trends outlined herein.

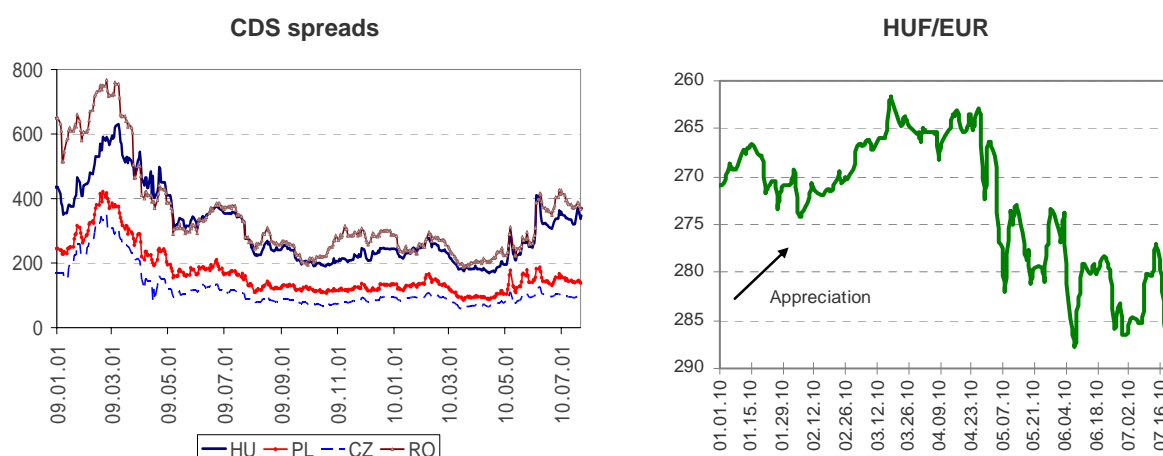
Real GDP growth
(seasonally adjusted data, quarter-on-quarter)



1.2. International and domestic financial market developments

Domestic financial markets have been fundamentally determined by international developments in the past period, although domestic news also had an impact. The HUF exchange rate became more volatile, and a slight increase in yields could also be observed, but in general, the government bond yields remained at a low level that has been uncommon in the past decades.

This year is fundamentally determined by the third phase of the global crisis (following the financial and the real economy crisis), i.e. the debt crisis. Concerns arose from time to time regarding the budgets and the debt sustainability of the so-called PIIGS states (Portugal, Italy, Ireland, Greece, Spain), and numerous downgrading decisions have also been made in the past six months. Among all these negative news, the measures announced in these countries to stabilise the public finances, as well as the EU rescue package - which is still being shaped - and the more efficient EU co-ordination efforts had a positive impact on the markets; although all these were basically sufficient only for calming down the markets on a temporary basis. The domestic financial markets have also been predominantly determined by the international developments, and country-specific factors have been only complementary to these.



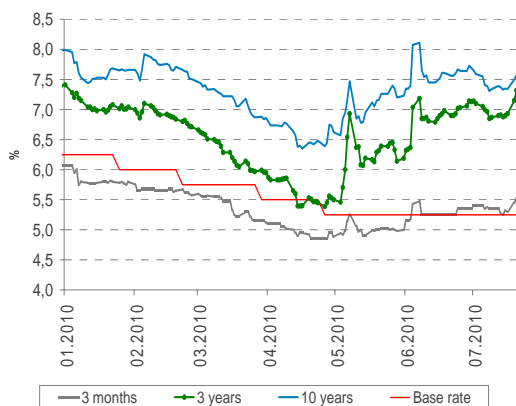
In the first 5 months of 2010 the Forint demonstrated a relative stability in comparison with the Euro: it fluctuated in the 260-275 Forint/Euro range, and then stabilised at a weaker level (around 275-285 Forint/Euro). This is explained by the very uncertain external environment and some statements issued by the government which were misunderstood by the markets. Market reactions related to negotiations with international organisations led to a sudden weakening, which got partly corrected within a few days. In addition to this, due to the significant change in cross rates, the foreign exchange rates have had an even greater impact on the private sector: the strengthening of the Swiss Franc compared to the Euro increases - even assuming a stable Forint/Euro rate - increase the instalments of those indebted in Swiss currency, subject to a delay corresponding to the re-pricing periods.

The government bond market developed similarly to the Forint/Euro rate. The government bond auctions held in the past six months were essentially successful: the coverage ratio was more than two and a half. Government bond market declined up until the end of April, and since then, a perceptible

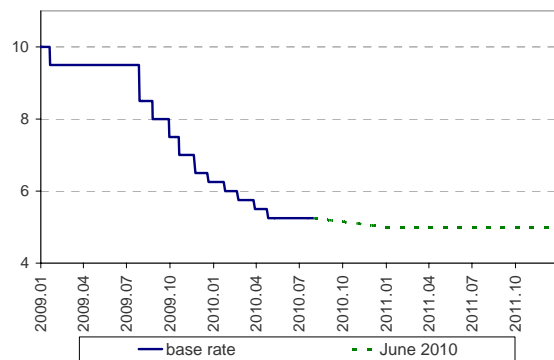
increase has occurred, but taking all this into account, and looking back at the preceding decade, the yields are still at one of their lowest levels. At the same time no such minimal levels can be identified for the spreads vis-à-vis the Euro.

The base rate of the central bank has been stagnating at a record low level since the end of April. At the same time, since then, the Monetary Council has discontinued the series of interest rate cuts, taking into account the intensified risks, and the increased market uncertainty. Analysts anticipate one additional minimal interest rate reduction in the course of this year.

Government bond yields



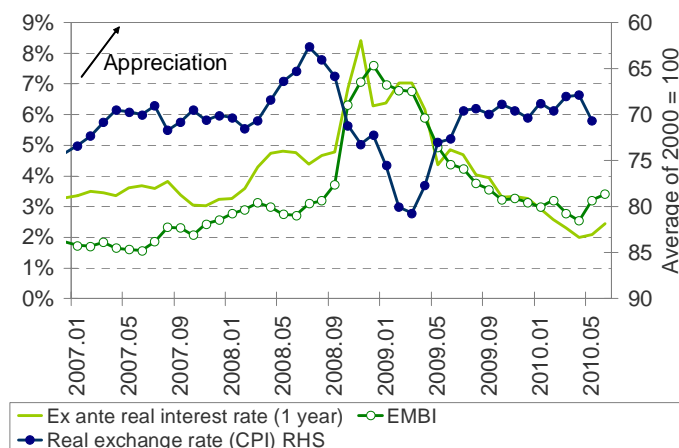
MNB base rate and analysts' forecasts until 2012 (%)



Forrás: MNB, Reuters

The hectic tendencies of the past period make the usual evaluation of monetary conditions for a one-year time horizon difficult. The real exchange rate of Q2 2010 has essentially developed around a long term average level, although when looking back to a one-year time-span, an appreciation can still be observed, due to the significant short-term depreciation in early 2009. The real interest is below the 3-4% range, which has been typical earlier through many years, but extraordinary events of early last year can explain the especially extensive and accelerated reduction from the level of the previous year. The reduction of ex-ante real interest rates was caused by the decline in nominal yields (the inflationary expectations even declined during the previous year).

Monetary conditions

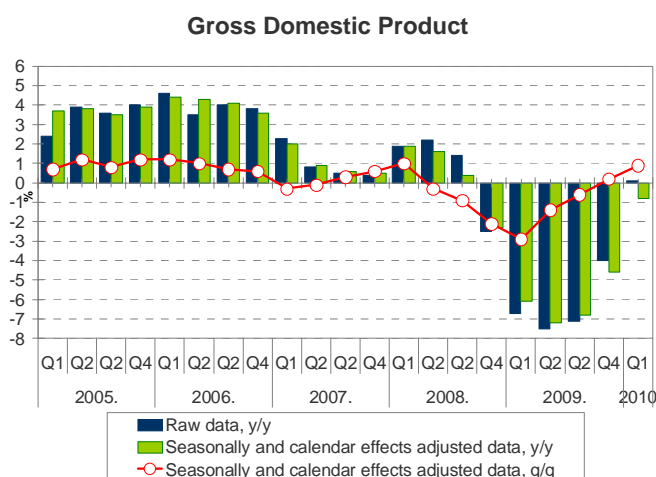


2. Growth, labour market and inflation prospects

2.1. Economic growth

The Q1 GDP data exceeding the preliminary expectations and the much more dynamic expansion of the external market's economic activities justify the upward revision of the growth projection made in March. Exports may return to an expansion by a nearly two-digit rate, however the consumption of households may be restricted by the higher inflation rate and the adverse effects of the damage caused by extraordinary weather conditions, affecting income from agriculture by an extent greater than expected. The strong, negative risks of housing constructions make it likely that investments will expand at a somewhat more modest pace, although certain elements of the government measures may influence the economic progress positively, even in the short term.

Upon the impacts of the crisis, the output of the Hungarian economy dropped by 6.3% in 2009. Recession got gradually deeper in the first half of the year, and then positive trends could be perceived in the last quarter of the year, in real economy. In the first quarter of 2010 - by an extent exceeding the expectations - the gross domestic product increased by an annual rate of 0.1%, while compared with the last quarter of 2009, the economy grew by 0.9%¹. Viewed on a quarterly basis, the economic output remained in the positive domain in two successive quarters, and so an end of the recession may now be presumed. This favourable tendency will probably continue in the remaining part of the year, and the upward trend may even gain strength. Compared with the March projection (-0.2%) - mainly due to the external economic development - a better outlook seems to gain form, and GDP may improve by 0.6% in 2010. In the medium term, however, several risk factors can be identified in world economy, upon the effects of which this upward trend of the economy may become slower and more elongated.



Source: CSO, calculations by the Ministry

The *foreign trade* data of the first four months of 2010 confirm the improved international environment, as the volume of goods export increased by 16.3% and goods import by 13.5%.

¹ The GDP figure adjusted for calendar effect changed by +0.2%, and the GDP adjusted both for seasonal and calendar effects declined by 0.8 percent from last year's Q1.

The gap between the export and the import volumes continues to be significant, and all this occurred accompanied by a record foreign trade surplus of EUR 1.8 billion. The better external conditions appearing in projections of the international institutions, and the facts characterising the foreign trade trends justify a modification of the projection for the export volume growth: the export of goods and services may grow by almost twice the rate forecast in March (5.5%), that is by close to 10 percent in 2010. As domestic demand continues to decline throughout this year, the export growth will continue to exceed the expected growth in imports (8.8%), and so net exports might be significant also in 2010. But due to the continuing increase in international energy prices, the terms of trade may deteriorate by 1 percentage point this year. In the medium term, upon the impact of fiscal restrictions planned in EU member states, the external demand may increase more moderately, and so a worsening in the Hungarian export dynamism may be expected next year.



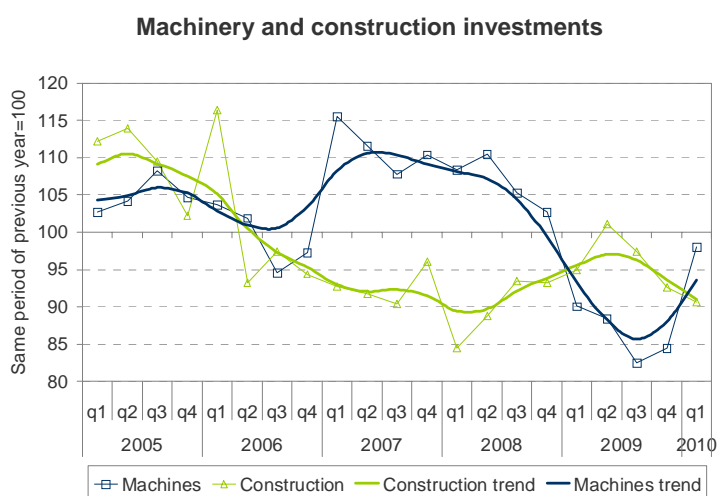
Household *consumption expenditure* declined also in Q1 2010, but the rate of reduction (4.7%) was significantly lower than in 2009. In the first five months of the year, real wages increased perceptibly, and the fall-back in consumption was primarily caused by the cut-back on other non-wage incomes (employer's fridges, cash benefits), the sustenance of the stringent lending system and the inflation rate running up high due to the VAT-increase effective of July last year. Such reduced consumption was reflected in the continued narrowing down of retail sales, car sales and the turnover of catering businesses. In the first five months of the year, retail sales fell back by 5 percent, while the sale of vehicles and vehicle parts fell back by more than 28 percent. The number of cars sold declined by 28 percent, in June still. As for the remaining part of the year, the gradually decreasing inflation rate, the improvement of the employment statistics (as this trend has apparently begun) and the improving consumer sentiment may result in the revival of consumption. At the same time, because of certain measures affecting the public sector, the anticipated downturn in incomes from agriculture (as a result of extraordinary weather conditions early this year) and the increased foreign currency loan repayment instalments due to the foreign exchange rate fluctuations will exert their effects in the direction of restraining consumption. The result of these impacts may be that the consumption expenditure of the households may suffer a more significant fall-back (by minimum 3 percent) in 2010, than was estimated in March (i.e. 2.7 percent).

Government consumption will probably follow a stagnating trend this year, as was typical in Q1 2010, too. Within this category, actual final consumption of government is at the mercy of controversial factors: the restraining effects of cost-cutting measures are counterbalanced by the positive effects of

the 'Pathway to work' Programme. The size of the latter impact is significantly higher than the forecast we calculated in March, as the number of participants in public work may exceed 95 thousand. All in all, actual final consumption of government may increase this year by around 1 %.

The *investments* declined by 6.4% in Q1 2010, compared with the same period of the previous year, but the accelerated recession observed in 2009 has been moderated. In the first three months of this year, compared with the previous quarter, a 0.5% increase can be observed.

Considering the structure of investments in 2009 mainly the machine investments decreased significantly (by 14% per annum), while the volume of construction investments was reduced by a lower rate (4.2%). However, this trend turned around in Q1 2010, as investments in machinery decreased by only 2%, while construction investments reduced by 9.3% on yearly basis.

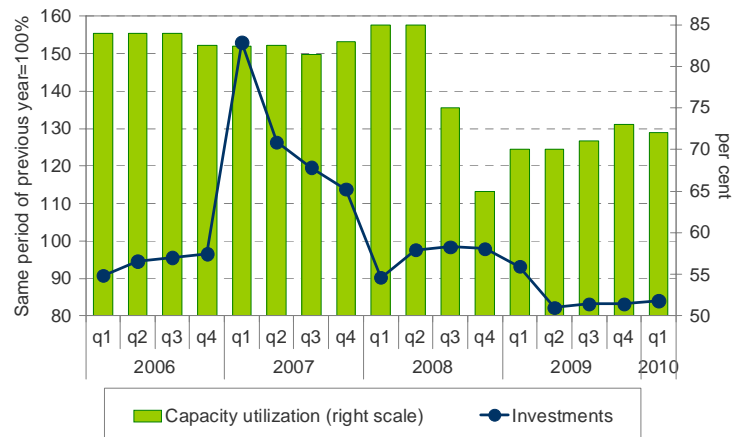


Source: CSO, calculations by the Ministry

This tendency could be explained mainly by the significant decrease in household investments. Investments in real estate sector has reduced by 19% in the first quarter, compared with same period of the previous year. In addition to unfavourable financial outlook and the low lending activity of the banks, new constructions and purchases were negatively influenced also by the restrictions of the home-building subsidy system. Number of dwellings put to use during the first three months of 2010 reduced by almost 26% compared to Q1 2009. The decline in the number of new dwelling construction permits issued has been lowered in the first quarter of this year, but still a 30% reduction could be observed on an annual basis, therefore a continuing decline in the number of new dwellings is expected in the second half of this year. The ban of foreign currency-based mortgage lending entails additional slight negative risk.

In manufacturing, accounting for significant part of corporate investments and hit by the crisis very deeply, the investment activity reduced by 16% in the first quarter of this year. Considering subsections with significant weight, investments in rubber and metal industry decreased at highest rates. For the entire year, considering the revival of external demand and the increasing trend of capacity utilization (currently 72%) for the next 12 months, a revival in corporate investments is anticipated. In the business sector there are some ongoing large scale projects (Mercedes, Hankook), which will generate further growth in investments of this sector.

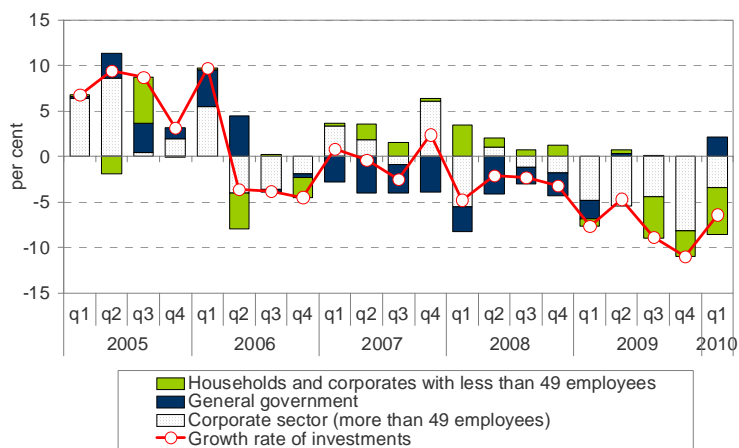
Investment and capacity utilization in the manufacturing



Source: CSO, calculations by the Ministry

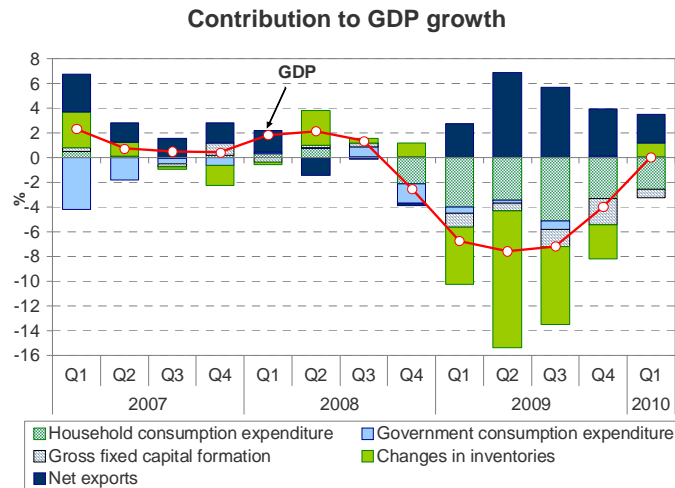
Several of the 29 points of the first action plan of the new government, will affect positively the development of investments. The reduction of corporate tax and the re-structuring of the use of EU funds will increase primarily the investment activity of the small and medium enterprises sector. In connection with the Széchenyi Investment Loan to be launched from 1st September, a positive development is expected also in the SME sector. The limit of the loan will rise from HUF 25 million to HUF 50 million, and the facility that has so far served only as a means to resolve liquidity problems, will be available from now also for investment purposes.

Contribution to the growth of investment

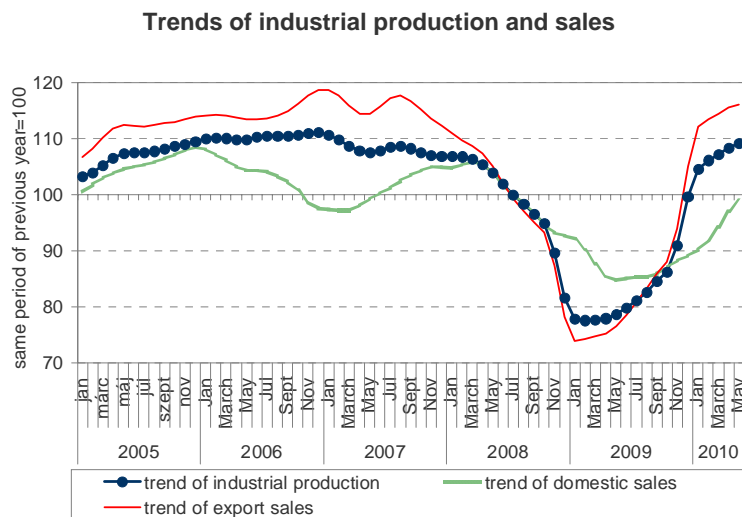


Source: CSO, calculations by the Ministry

All in all, the development of gross fixed capital formation in 2010 will be influenced - in addition to the base effect - by the investments of the budgetary sector financed from EU funds, as well as by the business company-induced developments in line with the reviving external economic activities. At the same time, since the number of new dwelling construction permits developed very unfavourably last year, a large-scale downturn (in excess of 15%) is expected in household investments for 2010. Thus, gross fixed capital formation may increase only slightly, by 0.8%.



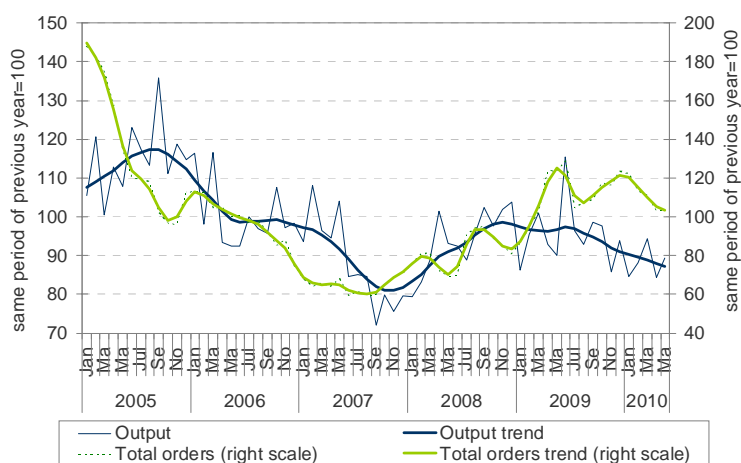
Looking at the production side, industrial production, following a major decline last year (-17.7%), demonstrated an upward trend, by a growth of 7.3%, in the first five months of 2010, on a yearly basis, which is mainly attributable to the recovering external environment, and the improving positions of our export markets. Additionally, the effects of last year's low base have also played a role in this. From the start of the year, industrial export sales increased significantly, by 15.1%, in which the growths of two major manufacturing subsections; the computer, electronic and optical products and the manufacture of transport equipment played a major role. Industrial domestic sales increased by 4.1% on an annual basis, in May, for the first time for quite a long time, but still, in the first five months of the year, a decline by 5.6% could be observed. This increasing trend is mainly linked to the growth in the number of orders related to the domestic supplier networks of export-oriented enterprises.



Taking into account the increasing external demand and the economic upturn, the industrial production may perform better than the 3-5% increase projected earlier for the year 2010. At the same time the fact that the acceleration of *exit* strategies announced by several Member States of the EU may affect negatively the external demand and thus Hungarian export sales opportunities by the end of the year, gives a rise to certain downward risks.

Decline of *construction* continued this year as well, as production volume dropped by 11.6% in the first five months of 2010, compared with the same period in 2009. The monthly figures manifest a powerful fluctuation, while a downward tendency is apparent in the trend curve, thus no real improvement can be expected in the output of this sector. Looking at the two main divisions of the construction industry, both of them suffered significant reductions; thus in the construction of buildings (approx. -10%), and in civil engineering division (approx. -14%) volume of work performed was behind the value of last year.

Construction output and orders



Source: CSO, calculations by the Ministry

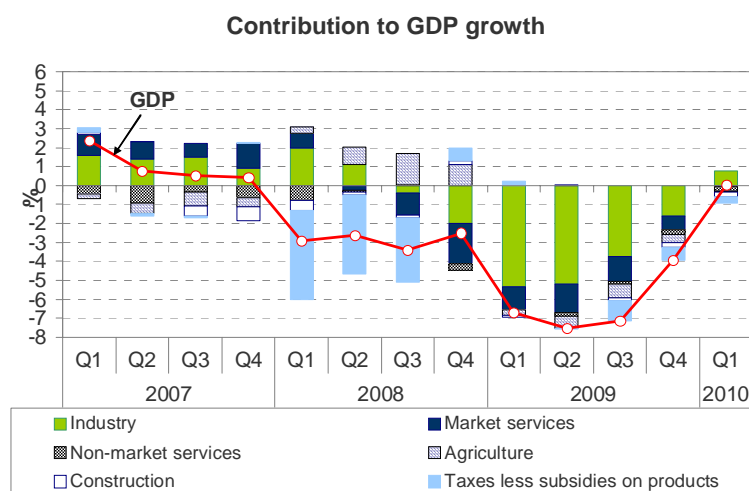
As for the stock of orders, the favourable tendency of the beginning of the year seems to have come to a halt, and the volume of new orders got reduced drastically in April and May, following a large-scale increase in earlier months. For the whole year 2010, a powerful slackening is anticipated in the construction of building sector, due to the downturn in housing constructions, at the same time, in the field of non-residential (commercial, industrial, university) buildings, a slight increase seems probable based on the progress of stock of orders over the past months. As for the other main division, that of civil engineering, again a slight improvement is anticipated. Taking all this into account, a decrease of 5-6%, like last year, seems probable for the year 2010 in the construction activity.

The output of *agriculture* has been essentially influenced by the extremely unfavourable weather conditions in spring and early summer 2010. Due to heavy rainfall, the floods and the ground water exerted a negative impact on the expected quantities and quality of both fruits and grains, and the scarcity of animal feed will be detrimental to the output of animal breeding also in this and the next years. The effect of the lower base of 2009 (originating from the bad average yield, still attributable to adverse weather conditions) could but slightly lessen the rate of decline.

Within the scope of *market services*, the rate of fall-back will be smaller in the fields of commerce, hotels and restaurants, although a reduction by 3.8% occurred still in the first quarter of 2010. Due to the continuance of inadequate residential demand, a slight reduction tendency seems likely for the entire year. The reduction in the aggregate added value of transport, storage and communication services also slowed down a bit, by the end of 2009, to start growing early this year (2.0%), and the performance of this sector actually reflects the favourable development of export sales. These positive effects will manifest themselves in the months to come as well, and so the performance of this sector may demonstrate a growing trend for the whole year. An increase continues to be observable in the

fields of financial, real estate and business services (by 0.8%), and this is mainly attributable to underlying factors such as the increase in financial services, since the banking sector has been characterised by a favourable income situation in the first quarter, despite the smaller volume of loan disbursements and due to the rise in interest margins. The whole-year performance of the sector and the profitability of this field will be significantly influenced by the special tax levied on the banks.

Performance of *non-market services* like public administration, education, health and social work has suffered a slight decline (by 1.6%) early in the year 2010, which was mainly caused by the downswing of healthcare, in which the restraining effects of the government's cost-saving measures also played a role. The opposing effect of the public work programme was able to mitigate this tendency only to a small extent. These effects will be perceivable through the entire year 2010, and so the performance of this sector may stagnate, in aggregate, this year.



Source: CSO, calculations by the Ministry

2.2. Employment and wage development

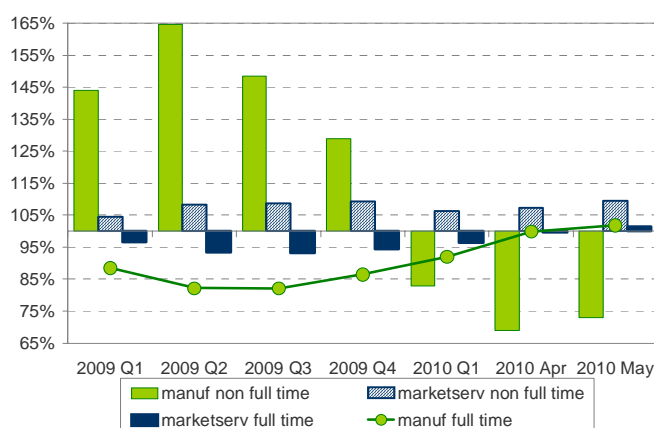
The magnitude of headcount and wage adjustments in the private sector has been slowing down this year. In May, for the first time over the past one and a half years, headcount increased in this sector. At the same time the slow increase in employment and the fact that the layoff stayed on the labour market in greater proportions, resulted in a high unemployment ratio in the first months of the year.

Looking forward, in the second half of the year a further moderate growth in the number of staff is anticipated. The growth in employment may be felt stronger in the manufacturing sector, due to the more favourable exports compared to the last year. Yet, in the services sector expansion may be encumbered due to the labour hoarding experienced previously. As an outcome, the slow growth in the headcount and an increase in the long-term unemployment rate may end up in a high unemployment level.

The data published since the latest report confirm the earlier expectations about an improving trend in the labour market this year. In the private sector, the gradual decline in headcount in the first quarter was followed by a slight increase in headcount in May (+0.5%). In the manufacturing industry -

somewhat earlier than analysts anticipated - the number of full time employees began to increase (May: +1.8%). As the intensive utilisation of these employees suggested, hours worked by the full time employees increased in both the first quarter (+3.2%) and in April (+4.2%). The headcount of non-full time employees continued to drop intensively (May: -27%), therefore labour hoarding is actually diminishing in the sector. Nevertheless, in certain branches of services sector, labour hoarding continues to be a typical phenomenon, since the number of non-full time employees has been still growing (May: +9.6%). The number of full time employees - somewhat contrary to the performance of the sector - increased also in May (by 1.5% on average)².

Number of full time and non full time employees in manufacturing and market services sectors

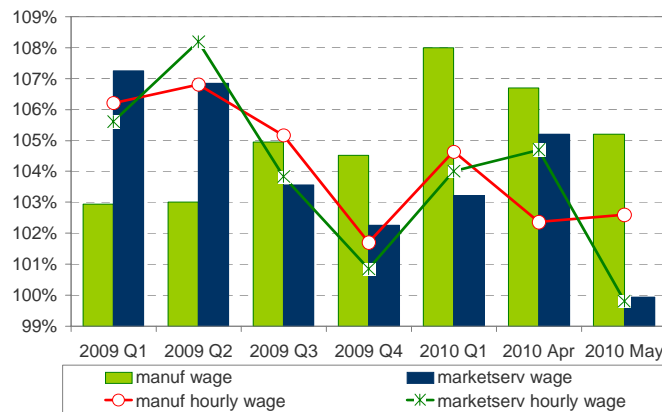


Source: CSO, calculations by the Ministry

A major dichotomy can be observed in the development of wages, between the manufacturing industry and the services sectors. While in the services sector - in line with the fall of domestic demand - wage growth has been mild (and an average reduction was 0.1% in May), in the manufacturing industry wage growth was very powerful, according to the data published so far. One reason for this is the favourable export trends, and the other reason could be the relatively low base, since rather low wage growth occurred in this sector last year in the first two quarters (contrary to market services, where - also mainly in the first two quarters - quite high rates could be observed last year). At the same time, hourly wages (the average wage of full time employees divided by the number of hours worked by full time employees) increased by a much lower rate than the gross wages of the manufacturing industry. The reason for this - apart from the base effect also observable in this case - is the high levels of the number of hours worked, in other words the more intensive 'capacity utilisation' of the full time employees. The rate of hourly wages could increase with the increase of headcount and the reduction of hours worked by employee.

² The increase in the headcount of full time employees occurred mainly in sections M (professional, scientific activities) and N (administration and support service activities). Netting out these two divisions, the index was 98.7% in May.

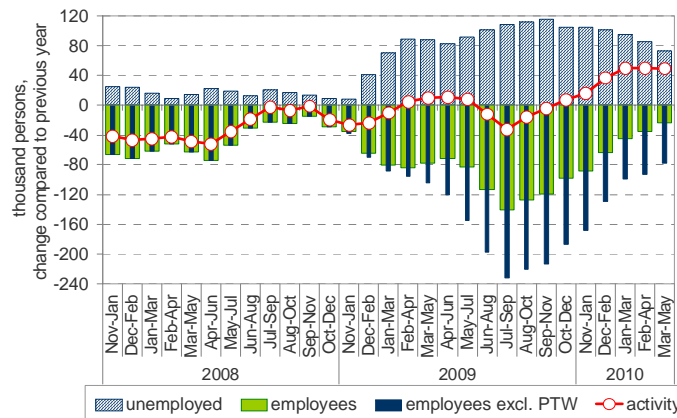
Gross wages and hourly wages of full time employees in manufacturing and market services sectors



Source: CSO, calculations by the ministry

Unemployment increased strongly in the first four months of this year, the unemployment rate reached 11.8% in March and April, and fell back a little bit only in May, to 11.4%. The underlying reason is the still observable reduction in the number of employed persons (and so far very modest increase in the headcount)³. Nevertheless, the decline in the number of employed persons has moderated somewhat since last September, mainly as a result of workers employed in public works within the framework of the 'Pathway to Work' (PTW) programme.

Employees, unemployed and activity



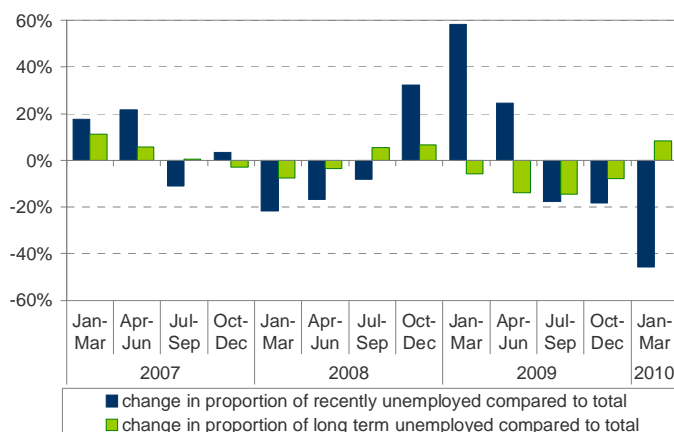
Source: CSO, calculations by the ministry

The high level of unemployment may derive from the fact that people who have become unemployed exit from the labour market in smaller proportions, contrary to the experience of previous years (in other words a smaller number of them will opt for inactive status), that is they tend not to narrow further the scope of aggregated labour supply. In addition to this, more and more among inactive people may

³ An important distinction is to be made between the 'employee' and the 'employed person'. The employee statistics published by the Hungarian Statistical Office (CSO) rely only data reported by enterprises employing more than 5 employees, while the term 'employed persons' means a much broader category, because everyone who - as stated by him/herself - performed an income-generating activity for minimum one hour during the week preceding the data collection, is considered to be an employed person. Apart from having an employed person count higher by almost one million persons this way, this category is also less sensitive to and reacts less quickly to economic shocks due to interflows among the sub-categories (for instance if someone loses his/her job as an employee, he/she may start a private enterprise or may also undertake odd jobs).

enter the labour market as job seekers. The underlying reason for this could be that in many cases secondary earners feel compelled to enter the labour market as job seekers, in addition to the primary earners who have lost their jobs. On the other hand, active labour market measures will also facilitate labour market entry (rather than exit). The fact that a relatively large portion of unemployed (for instance, those losing their jobs during the recession) may stay in labour market as job seekers for a longer period, which will gradually diminish the chances of getting back to work through the erosion of human capital, is also a factor contributing to the high unemployment rate.

Proportions of short term and long term unemployed compared to total
compared to the corresponding period of previous year



Source: CSO, calculations by the ministry

The continuation of these developments is assumed for the rest of the year. Wage differences are expected to be partially prevailing between manufacturing industry and market services sectors. The wages in the market services sector may increase only moderately this year due the scarce domestic demand. Nevertheless, the higher wage growth in the manufacturing industry may be partly mitigated by the raising of the headcount of full time employees and the running-out of the base effect. The measures of the government - i.e. the freezing of the wage bill at state-owned companies, the introduction of a compensation cap in the public sector and the bank levy - may restrain the increase of gross wages and salaries in the private sector by reducing the premiums. Taking all this into account, an approximately 4% increase in average gross wages is anticipated in the private sector for this year.

As regards the headcount, the favourable trends that have started earlier may continue. A significant increase in the number of full time employees is anticipated mainly in the manufacturing industry, while in the market services sector, growth will be somewhat hampered by labour hoarding. Despite this positive trend, in aggregate, a drop in headcount by 1.5-2 percent is still expected.

The moderate increase in headcount will probably not suffice to fully absorb workers, who become active due to the measures aiming at increasing the participation rate, which may again contribute to the increase of the unemployment rate. The same way, the increasing ratio of long-term unemployed to the total number of unemployed also indicates⁴ that unemployment will probably remain permanently high this year. An unemployment rate of 11.7% is anticipated for 2010.

⁴ The growing proportion of long-term unemployed people in the total number of unemployed is partly attributable to the fact that the longer one is jobless, the more his/her human capital gets eroded, and the weaker his/her job seeking intensity will be, which may render such a person unemployed on a permanent basis.

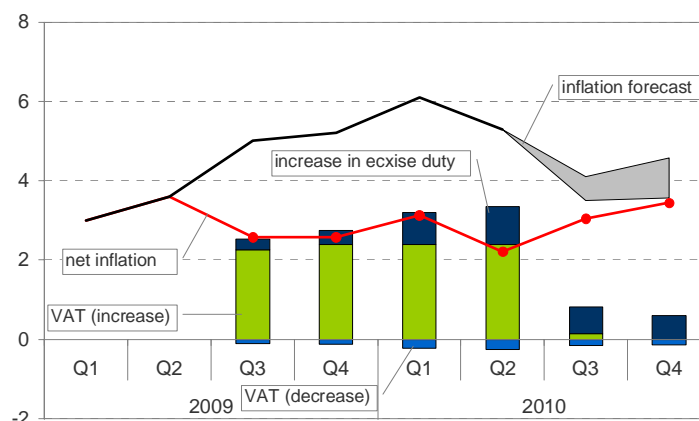
Gross wages are expected to decline slightly (-0.6%) in the public sector this year, partly due to measures affecting the public sector (cancellation of bonuses, compensation cap and the introduction of aggregate wage bill regulation), which could not be offset by the income supplements received early this year in two instalments. Employment in this sector may increase by over 3%, owing to a more significant than previously expected increase in the number of participants in the public work programme which may exceed 95 thousand workers.

2.3. Inflationary processes

The expected inflation rate for 2010 is dominated by the disinflationary impact of the low demand (what is expected to be strengthened by the household energy price freeze), while a weaker-than-expected exchange rate, in addition to a higher food price level - coupled with the inflationary pressure of the imported prices - increases the forecast up to 4.7%.

As a result of the 'carry-over' effects of indirect tax hikes, the repeatedly raised excise taxes early this year and the significantly higher costs of certain items (e.g., fuels, some unprocessed food), the price index increased more than expected in Q1 2010. Despite the recent depreciation of the exchange rate, the price index decreased slightly in Q2 2010, due to the drop-out of the unfavourable base effects of the corresponding period of last year. Disinflation is significant and persistent in the areas exposed most to the effects of poor demand (clothing and market services), while the impact of a poorer exchange rate as well can be perceived in the case of manufactured goods. Furthermore, import prices generate significant inflationary pressure, which was enhanced further by the increase in excise duty in the case of fuels.

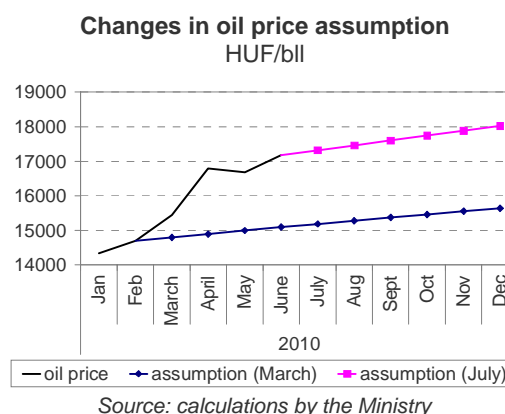
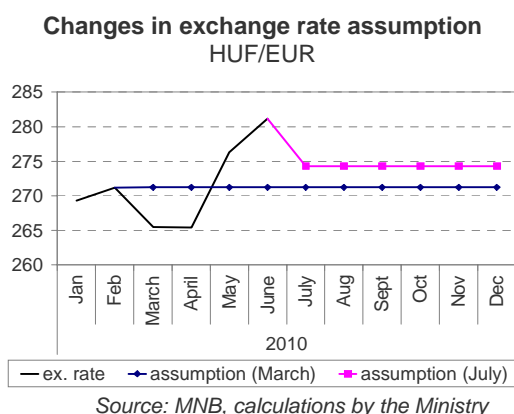
Expected inflation and impact of changes in indirect taxes
changes compared to the corresponding month of the previous year,
per cent/percentage point



Source: calculations by the Ministry

The expected inflation rate for the second half of the year continues to be dominated by the disinflationary consequences of poor demand (an output gap widened by recession); uncertainty of the exact figure is enhanced by hard-to predict exchange rate developments. Following the temporary effects of the indirect tax hikes, the inflation rate may decline more significantly in Q3; this decrease

which is also strengthened by the household energy price freeze. As for Q4, inflation may accelerate mainly due to effects of items outside core inflation.



Against this backdrop, annual average inflation for 2010 is expected to be around 4.7%. This is higher than the previous projection⁵, primarily due to the somewhat weaker exchange rate assumption, the higher expected oil price (in HUF terms), higher expected food prices and the inflationary effects of the somewhat improved economic situation. The development of global energy prices (in HUF terms) indicates additional upside risks.

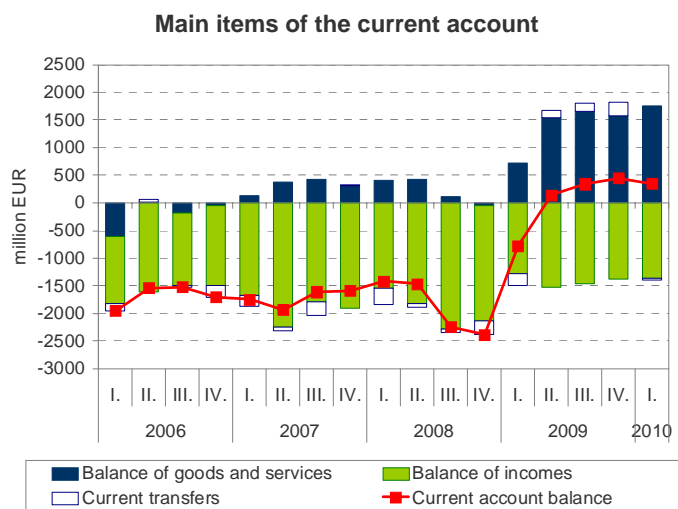
⁵ The March Report contained a projection of 4.3%.

3. External and internal balances

3.1. External position

The drastic improvement of the external position experienced last year will continue in 2010.

In 2009, the current account balance was closed with a surplus of 0.2% of GDP. This surplus is mainly due to the record improvement of the real economic balance (by 5.9%). This tendency continued in Q1 2010 also, and so the current account balance of Q1 reached a surplus of EUR 344 million, translating to 1.5% of the quarterly GDP. Compared with the base period, the balance improved by EUR 1.1 billion. The proportion of EU transfers continues to be substantial, while the net external debt decreased again due to a positive financing capacity. The external financing capacity, which takes into consideration the capital account, had a positive balance of 3.5% of the GDP.



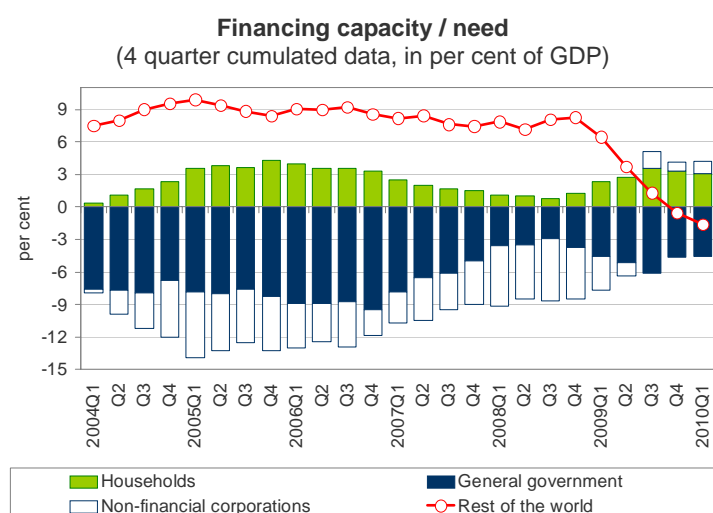
The improvement of financing capacity is attributable to the record surplus achieved by real economy (7.8% of the GDP). This improvement is also explained by the continued intensive adaptation to the external economy in Q1 2010, which is thought to have reached its peak by now. As for the coming quarter, the positive real economy balance may stabilise around the level of Q1, while - because of the revival of internal demand, combined with its deterioration probable by the end of the year - the balance may be somewhat lower, but still significant.

The Q1 figures confirm the expectation that the size of debt-generating and non-debt-generating incomes will develop like in the previous year, in the course of 2010, too. The EU transfers will probably contain capital transfers in a higher ratio compared with previous years; therefore while the proportion of current transfers could be lower, the changed structure will certainly raise the balance of the capital account. Altogether the current account balance may reach an equilibrium in 2010, while the financing capacity may be around 1.7% of the GDP.

3.2. Financial positions of economic sectors

Contrary to the real economy - where the first signs of recovery have already appeared in certain areas - the financial positions of economic sectors have so far been indicative of the bridling of the intensive adaptation efforts induced by the recession. The contraction in lending activity has probably reached its deepest point, but real upturn seems unlikely in the short term.

Based on the financial accounts⁶, the Hungarian economy was in a net lending position in Q1 2010, like in 2009, since the net savings of the private sector overcompensated for the financing requirements of the government sector already on the way of stabilisation. The financing requirement of the government sector may temporarily rise during the year, but a mild improvement of the balance - set as a target - is expected to be realised for the whole of 2010. This way, in addition to the stabilisation of the net savings of households, the external financing position of the national economy is going to be influenced mainly by the development of the corporate sector's net financial position.

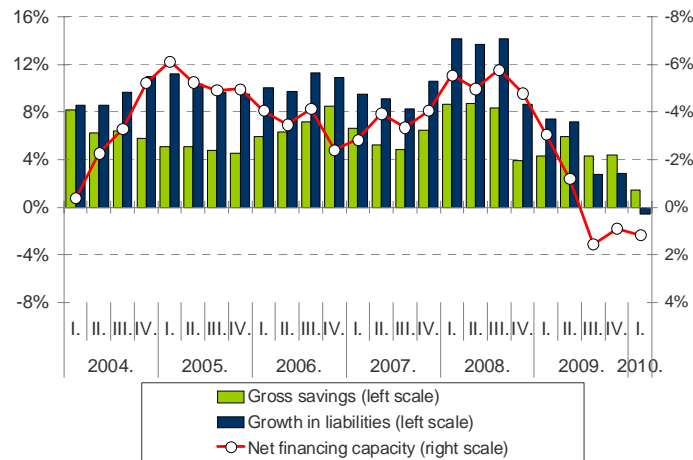


Source: MNB, financial accounts

The savings position of the non-financial *corporate sector* showed a positive value corresponding to 1.2% of the GDP in the twelve months ending in Q1 2010. Nevertheless, focusing on the quarter, the companies demonstrated a net financing requirement, just like in the last quarter of 2009.

⁶ Despite statistical deviations, the tendencies reflected in different statistics (current account, financial accounts) point in the same direction.

Gross savings, liabilities growth, and net financial position of non-financial corporations
(4 quarter cumulated, percentage of GDP)

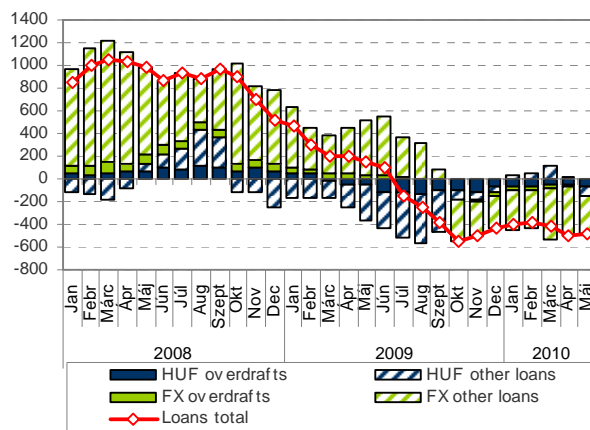


Source: MNB

The gross savings by non-financial companies turned positive again in early 2010. The companies stopped liquidating their cash and deposit portfolios (the cash and deposit portfolio shrank by one-tenth in the second half of 2009), and an expansion by minimal extent occurred in Q1. Regarding non-share securities, the business sector has continually been in a seller's position since Autumn 2008, with the portfolio dropping to half in the past one and half years; Q1 2010 contributed to this substantially, when the EoY 2009 portfolio got reduced by a quarter, due to the transaction. As a new development and perhaps a single impact, the corporate sector performed a significant loan placement in the first quarter, representing 0.6% of the GDP.

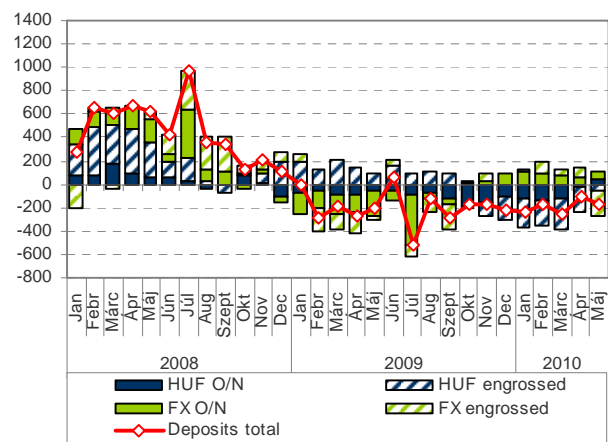
On the Liabilities side, the transaction increased the companies' pool of liabilities by nearly 0.5% of the GDP, which is derived as a balance of growing outstanding liabilities existing in the form of shares and participations and reduced credit portfolios. Nevertheless, one may see this as a good sign that short term (typically working capital) loans stopped declining in the first quarter, after dropping by one-fourth in the three preceding quarters, not counting the revaluations.

Credit stock growth of non-financial corporations
(3 months cumulated change in stock, on 31 Dec 2007 exchange rate, HUF billion)



Source: MNB

Deposit stock growth of non-financial corporations
(3 months cumulated change in stock, on 21 Dec 2007, exchange rate, HUF billion)



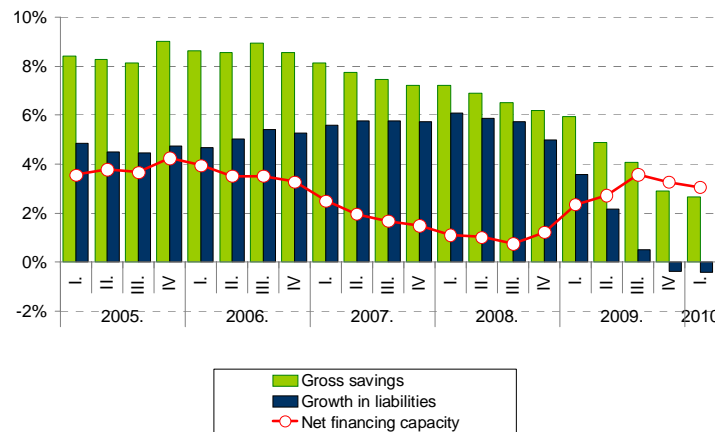
Source: MNB

The shortage of credit will probably continue to be a determinant factor in the development of the business sector's financial position, but no accelerated regression in the credit dynamism is expected. Gross savings may rise with the increase of capacity utilisation and profitability, but it is unlikely that the corporate sector will be in a net saver position in 2010, like in 2009.

The improvement of the financial position of the *households* came to a halt in the second half of 2009, as expected. In the twelve months ending in Q1 2010, the net financial savings of the households represented 3.1% of the GDP, which lags behind the peak achieved in Q3 2009 by only half a percentage point.

Gross savings, liabilities growth, and net financial position of households

(4 quarter cumulated, percentage of GDP)

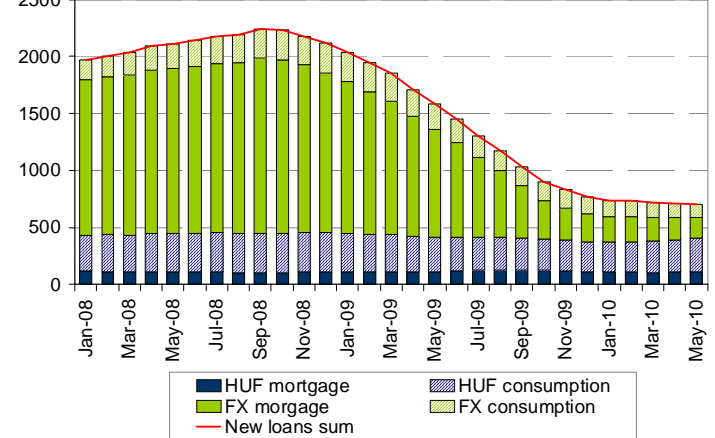


Source: MNB

Recovery from the crisis has not started yet in the area of lending, as household lending remained very modest in Q1 2010, due to the pressure to cleanse the portfolio. At the same time the dynamism of lending has probably reached a minimum, although upon the impact of government measures affecting the financial sector, the anticipated revival will probably not take place in the coming quarters yet.

The contractual value of new loans of households

(12 month cumulated, on 31 Dec 2007 exchange rate, HUF billion)



Source: MNB

The gross household savings continue to stay close to a very low level. At the same time the en masse return to the state pension system played a crucial role in the decline of savings: in Q1 2010 only HUF 71.7 billion flowed into the private pension funds, while the steady quarterly average of the past two years was HUF 100 to 130 billion. This drop is due to the fact that until the end of Q1 2010, altogether 63.3 thousand eligible people were allowed to return to the state pension system, thus the HUF 90 billion savings accumulated in private pension funds was transferred to the national social insurance administration. This single impact has influenced mainly the first quarter of 2010, while it significantly deteriorated the gross household savings figure even in the preceding and the following months.

Effects of returning to state pension fund on the financial savings of households

Under the relevant regulation, the pension system changers' private pension funds will transfer the changers' claims from them to the state, and so since the claims from the state pension fund will not appear in the financial account statistics, the households' financial holdings will be actually reduced by HUF 90 billion in the short term. At the same time, due to the administrative burdens of the mass transfer to the state pension system, the process was not a continuous one, and so the return to the state pension system affected altogether four quarters (so far), mainly the last quarter of 2009 and the first one of 2010.

Returns of private pension funds to the state
(HUF billion)

Quarter	Returns of private pension funds
2009 Q3	0,1
2009 Q4	26,2
2010 Q1	63,1
2010 Q2	0,9
Total	90,3

Source: Information on central government position

Gross and net saving of households corrected with private pension fund returns
(left scale: HUF billion, right scale: percent of GDP)



Sources: MNB

In addition to the short-term, one-time effect, such returns to the state pension system have a longer term, continual impact as well, notably that the amounts that have increased so far their claims from the private pension funds, will from now on flow into the treasury. It is estimated that this will initially reduce the newly created savings of the residents as registered on the financial accounts, by HUF 10 to 20 billion. Naturally, when these people retire, this continual impact will die away gradually, however, at this point, when the age and wage conditions of the returning pension savers is not known, it is impossible to estimate accurately the probable span of this process.

The residents will probably maintain their firm net saver position despite the improving real economy circumstances, and this may remain so in the quarters to follow. The signs of revival in the case of

lending are still unperceivable, while the process of creating gross savings has been declining very slowly so far. Later on, the dynamism gained by the economy and/or the rise in incomes will probably have a stabilising effect on the financial position of households.

3.3. Budgetary developments

Although no improvements can be seen in cash-flow balances in the first quarter, the accrual-based deficit decreased in comparison with Q1 2009. However, general government position could have deteriorated significantly in the second quarter, because the decline in tax revenues was not counterbalanced by the reduction in expenditures. The central government cash-based deficit reached 119% of the budgetary appropriation by the end of June. The revenue increasing and expenditure reducing measures of the 29-item economic action plan will improve the government balance in the second half of the year, and will ensure the achievement of the 3.8% deficit target.

According to the budgetary targets set for 2010, both the ESA95 general government deficit and the central government cash-flow deficit will slightly decrease compared to 2009. The ESA deficit should be 3.8% of the GDP, following 4% in the previous year⁷, while the appropriated cash-flow balance of the central government includes an improvement by nearly HUF 50 billion.

In the first quarter - partly as a consequence of transitional impacts - the primary cash-flow balance of the central government has not changed in the year-to-year comparison, and the total deficit increased by about HUF 40 billion as a result of higher interest payments. The one-off revenues at the beginning of the year, related to the return of private pension fund members to the pay-as-you-go pillar could only partially offset the deficit-increasing impacts of the extra financing of hospitals in January, the payment of the public sector wage compensation early this year, the postponement of corporate income tax revenues in greater proportions to the month of December, and the more evenly distributed (compared with last year) transfers of subsidies to the Hungarian Railway (MÁV).

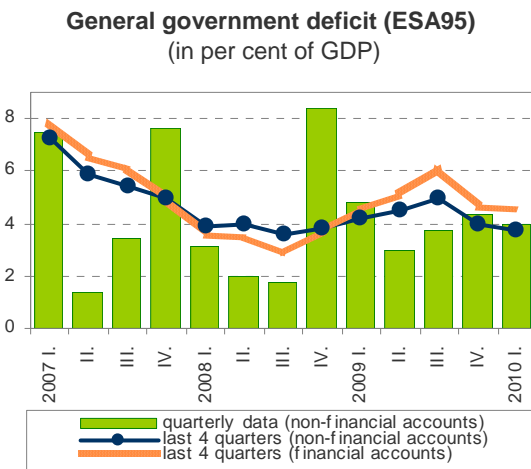
Nevertheless, the ESA 95 general government deficit decreased by HUF 54 billion compared to Q1 2009 (amounting to 4% of the seasonally adjusted quarterly GDP⁸), and the primary balance improved by HUF 37 billion (from -0.1% to +0.5%). The four quarter cumulative data also indicate a slight improvement, the deficit decreased to 3.8% of GDP in the year ending at Q1 2010. The financial accounts have shown similar values: even though the net financing requirement of general government reached 4.6% of GDP in the year ending at Q1 2010, it was only approximately 4% of GDP, excluding the Central Bank statistical operational loss (which - contrary to the financial accounts - is recorded in the non-financial accounts compiled by the Central Statistical Office (CSO) only in the period of government compensation).

However, in the second quarter, the cash-flow data indicate a deterioration in the general government position. The central government deficit in the annual comparison increased by close to HUF 180 billion (by more than HUF 240 billion at the primary level), and so by the end of the first half of the year, it exceeded last year's level by HUF 220 billion. Contrary to the trend in 2009, when deficit rose to

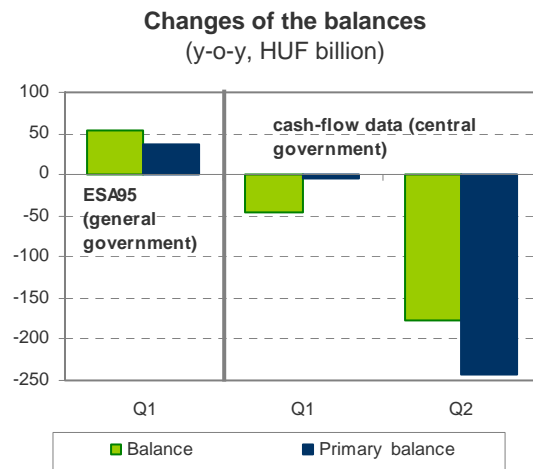
⁷ Based on Notification April 2010.

⁸ The size of deficit was 4.3 as of unadjusted GDP.

above the annual level by September (to 114%, which was reduced later on by year-end tax payments and expenditure cuts), this year's deficit has reached 119% of the appropriation as early as by the end of June.

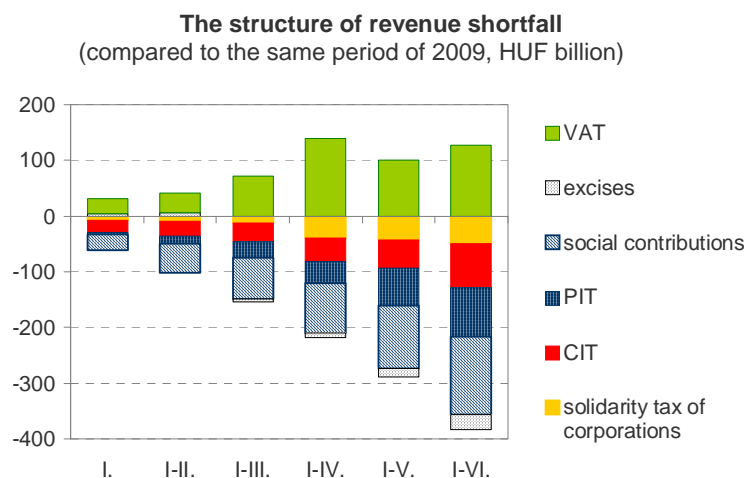


Source: CSO, MNB



Source: CSO, NGM

The decline of the balance was caused mostly (and in an increasing proportion) by the shortfall of tax and contribution revenues. The revenue shortfall aggravated in May and June, although this was partly attributable to transitory factors influencing only the distribution over time (in May, the ratio of VAT refunds was much higher than last year, and the PIT refunds started also earlier). All in all, total cash-based tax and contribution revenue⁹ in the first half of the year was by 6% (by over HUF 260 billion) lower than in 2009. The consequence of the impacts of tax-system restructuring and macroeconomic processes was not a revenue-neutral one, and the higher VAT revenues, due to the increased standard VAT rate, could not compensate for the lost revenues in the case of other tax types (income taxes and social contributions). The impact of abolition of the corporate solidarity tax has been growing for months as well as the shortfall of CIT revenues. Despite the raising of the tax items, revenues from excise taxes were lower than in last year.

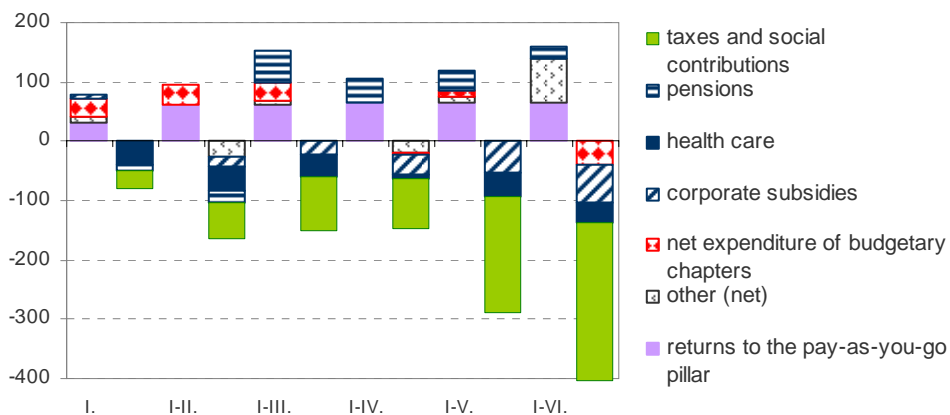


⁹ Tax type payments of corporations and households, consumption related taxes, social contributions and contributions paid to the Labour Market Fund together.

Due to the base effects, the decline of personal income tax and social contribution revenues will be probably more limited in the second half of the year, but in consequence of the lowering of the corporate tax rate, the payment of corporations in December will not be able to mitigate interim revenue losses by as much as has been planned for originally. On the whole, despite better macroeconomic projections, no significant increase in tax and contribution revenues is to be expected, since upward revision of the macroeconomic forecast relates mostly to the better external economic outlook and the resulting better export performance. Thus, the revenue shortfall may be compensated for mainly by the emergence of a new tax type (the special tax levied on financial organisations), in the second half of the year.

Another important component of the deficit rise is that the fall-back of tax revenues was not compensated for by the decrease of expenditures. In addition to the extra spending of the beginning of the year (healthcare, wage compensation, etc.), the realisation of savings planned in the net expenditures of budget chapters, has not even commenced in the first half of the year. The deficit 'caused' by the central budgetary institutions and chapter-managed appropriations¹⁰ exceeded last year's level by HUF 36 billion by the end of June, and its size is larger by almost 6 percentage points than the time-proportionate value (taking into account budgetary appropriations and the general and specific reserves). The increase of deficit as linked to chapters was shared 50-50 percent by the budgetary institutions and the chapter-managed appropriations. In addition, although the budget included a lower appropriation (by more than HUF 140 billion) for the local government subsidies, expenditures essentially remained at the previous year's level until end-June because of the payment of wage compensation early this year, the expenses of flood-prevention and the costs of the 'Pathway to Work' programme. Corporate subsidies increased also, but this is related to the fact that payment of the MÁV subsidy started only in the second half of the year in 2009, and so the deterioration of the balance on this line will continue to decline due to the base effect. The balance was somewhat improved by the cancellation of the 13th month pension in the first half of the year, however this effect has gradually decreased, and will cease completely later on (the appropriation contains an increment of over 2%).

The structure of the increase of primary deficit
(compared to the same period of 2009, HUF billion)



¹⁰ Balance of expenditures, revenues, and payments to the central budget.

Budget-affecting measures of the 29-item economic action plan of the government may restrain the increase of expenditures in the second half of the year. The freezing of certain expenditures, the withdrawal of bonuses, the restriction of asset purchases, the increasing of the payment of budgetary institutions into central budget, etc. will mitigate the net expenditure of budgetary institutions and chapter-managed appropriations. In addition, the improvement of the balance of extra budgetary funds and the state asset chapter, which was set as an objective, may contribute further to the reducing of the deficit. Taking into account the revenue-increasing and expenditure-reducing measures, the ESA95 deficit projection remains unchanged, i.e. 3.8% of the GDP.

3.4. Public debt

The Maastricht public debt has increased further in the first quarter of the year, while the quarterly debt ratio exceeded 80%. The indebtedness of the central government was increased in the second quarter - in addition to the deficit - by the revaluation effect arising from the devaluation of the exchange rate. Financial market volatility increased in the second quarter, which was driven mainly by the change in the international investors' mood. In this period - despite the periodically turbulent market circumstances - an adequate demand was observed at government securities auctions.

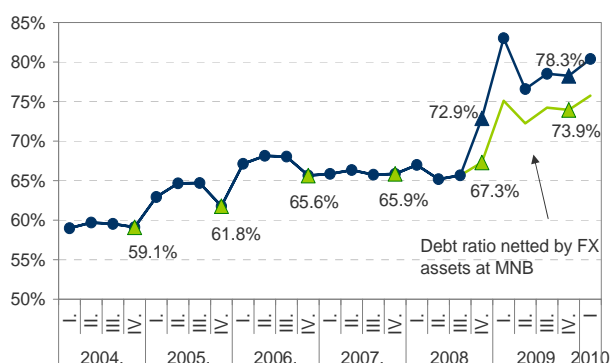
Based on the preliminary financial accounts, the Maastricht public debt amounted to HUF 21,033 billion at the end of March 2010. From the beginning of the year, public debt has increased by HUF 612 billion, and the net financing need was HUF 269 billion. The debt increment on top of the net financing need was mainly due to the significant increase of the portfolio of liquid assets. The revaluation effect originating from exchange rate change increased the foreign currency elements of public debt slightly¹¹. The funds drawn down from international institutions, but not used for financing public debt (financial assets onlent to the banks or kept in foreign currency deposits) amounted to HUF 1,212 billion at the end of Q1 2010.

The debt ratio calculated with the 12 months' cumulated nominal GDP was 80.4% at the end of March, and the same ratio net of the FX denominated assets was 75.8%.

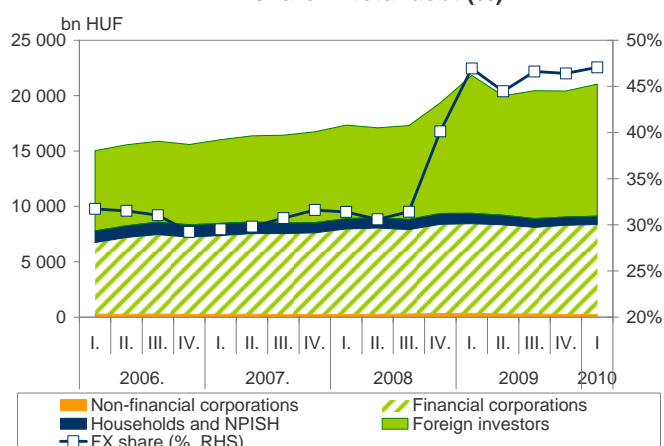
¹¹

	Dec. 2009	Mar. 2010
<i>EUR</i>	270.8	266.4
<i>SDR</i>	294.8	300.6

Development of Maastricht methodology debt ratio
(in terms of 12-month cumulated GDP%)



Investors decomposition of the Maastricht debt (bn HUF),
FX share in total debt (%)



Source: MNB, ÁKK, NGM calculation

The central government debt at the end of June was HUF 20,471 billion (source: ÁKK, GFS statistics). Public debt has increased by HUF 1,060 billion since the end of March.

Main elements of the increment:

- Central government deficit in the second quarter (HUF 424 billion),
- Debt-increasing revaluation effect due to the depreciation of the HUF exchange rate,
- Increase in the portfolio of M2M deposits¹².

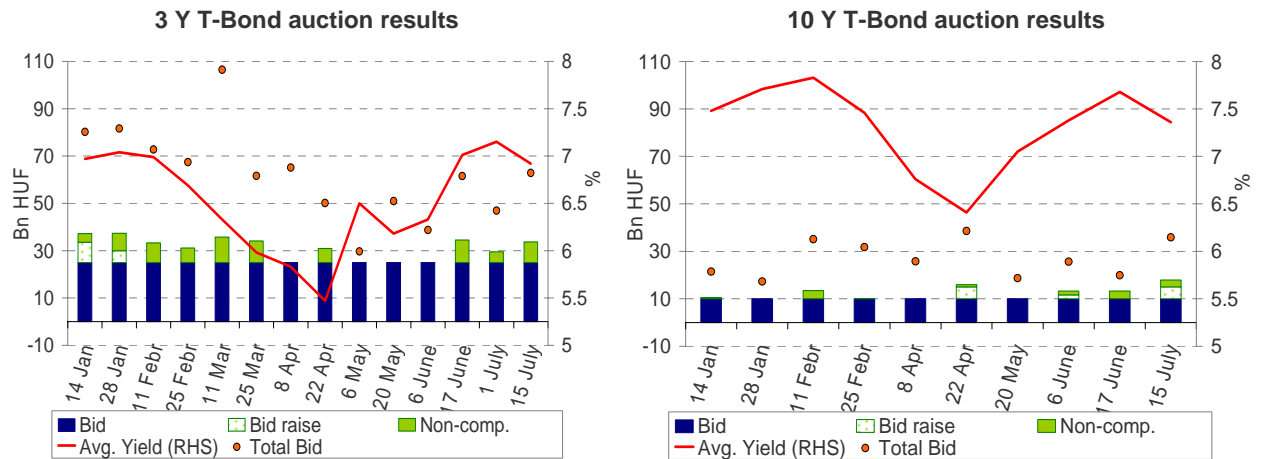
Central government gross debt

	(billion forint)*		
	March 2010.	June 2010.	Change
Foreign currency	8 747	9 478	731
Government securities	4 661	5 012	351
Loans	4 085	4 466	381
HUF denominated	10 554	10 677	123
Government securities	10 116	10 192	76
Loans	439	485	46
Total	19 301	20 156	855
Other debt	110	315	205
Total central government debt	19 411	20 471	1 060
FX deposit with MNB	1 212	1 215	3

* differences due to rounding effect

Despite the volatile investors' mood the demand for government securities was satisfactory during the second quarter of 2010. Adequate demand was seen at the auctions. With the increase of issued amounts and by selling bonds in a non-competitive sale phase, government securities were issued in a higher amount than originally announced. After the peak of April in line with the changes in international investors' mood yields increased significantly.

¹² The Government Debt Management Agency (ÁKK) swaps the non-Euro denominated external market funding to Euro, according to the debt management strategic benchmark policy. In order to reduce credit risk, the swap positions are evaluated at certain time intervals, and the partners create deposits according to the current market value. Since the Euro was depreciated compared to the Dollar and the Swiss Franc, ÁKK's swap positions are profit making at the market value, thus the banks' deposits placed with the state increased by HUF 218 billion. The placement of deposits increase liability levels as well., thus the level of public debt have risen also.

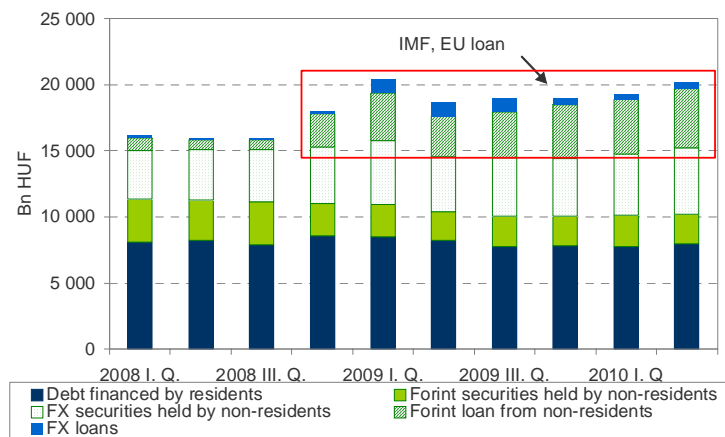


Source: ÁKK

For the first time in nine years ÁKK has sold government bonds with variable interest rate again. The bond No. 2015/B has been auctioned on two occasions so far. On 25th March, bonds worth HUF 12 billion were sold at high demand, while the investors' interest seen at the auction on 1st July was lower, bids worth HUF 5 billion were accepted. The interest on the 5-year variable rate bonds is linked to the yield of the 3-month discount treasury note.

From 1st July 2010, ÁKK's primary dealer system was expanded with three large international investment banks (NOMURA International Plc, The Royal Bank of Scotland Plc., BNP Paribas), which will help to deepen the Hungarian government bond market.

Financing structure of central government debt (foreign-domestic)



Source: ÁKK, NGM calculation

The HUF financing of domestic and foreigner players has followed a steady progress for the past four quarters. The increase of debt was caused by the foreign exchange items, partly due to the transactions, and partly because of the revaluation effect. As a result of all these factors, the share of foreign currency elements in the gross debt has increased to 47%.

Looking at the financing of the debt from domestic and foreign markets, it should be pointed out that the HUF securities held by foreign investors decreased significantly in the second quarter, which was however compensated by the increase of the government securities portfolio held by domestic investors.

Annex 1: Additional consolidation measures announced in certain EU Member States in the first half of 2010

The previous Report published in March 2010 presented the budgetary objectives of the individual EU member states for 2010, based on their Stability and Convergence Programmes submitted by the end of January 2010. Since then, decisions were made in several member states for the acceleration of the budgetary consolidation. According to the latest assessment by the European Commission on effective measures taken by Member States, (i) the additional measures announced in the first half of 2010 in general, focused on both the revenue and the expenditure sides, (ii) are expected to reduce the budget deficit by approximately 0.25% to 2% of the GDP per annum, in the period 2010 to 2011.

Taking into account the economic significance of the announced measures, and regarding the economies relevant for Hungary's external demand, the additional adjustment programmes of five member states (Germany, France, the United Kingdom, Portugal and Spain) are presented below.

Impact of consolidation measures on general government deficit
(as a percentage of GDP)

	Stability and Convergence Programmes		Targets revised in the first half of 2010	
	2010	2011	2010	2011
Germany*	-5.5	-4.5	-4.5	-4.0
Spain	-9.8	-7.5	-9.3	-6.0
France	-8.2	-6.0	-7.7	-6.0
Portugal	-8.3	-6.6	-7.3	-4.6
United Kingdom**	-12.0	-9.1	-10.25	-7.75

* based on the programme for 2011-2014

** data for financial years

In some member states additional measures include steps that increase the budget deficit, but foster economic growth (e.g. reducing corporate income tax, supporting R&D activities etc.).

Germany:

- The introduction of medium term budget planning (up to 2014); structural deficit is to be reduced by 0.5% per annum.
- The size of maximum government borrowing has been fixed in the Constitution (to ensure prudent, sustainable fiscal policy).
- Special support to training and education (additional support in the amount of EUR 12 billion until 2013). In addition to these - according to the plans - 10% of the expenditure of federal states will be spent for this purpose.
- Tax system simplification, reduction of government subsidies. In this context (i) an extra tax on nuclear industry has been imposed (extra revenues amounting to EUR 2.3 billion per annum), (ii) an environmental fee payable by passengers at German airports has been introduced.
- Incentives to work, reforming the social system. In this context: (i) termination of pension support and child allowances of unemployed people in the long run, (ii) modification of child allowances taking into account parents' monthly income, (iii) continuation of the construction of

nursery school infrastructure, (iv) termination of energy price subsidies, (v) incentives for young people to take up work (e.g. vocational trainings).

- Bundeswehr reform, cost saving measures and layoffs in the army.
- Increasing the efficiency of central administration, cost-saving. In this context: (i) reducing the budget of ministries, (ii) freezing the Christmas allowances of public servants, (iii) elimination of around 10 thousand jobs up to 2014, (iv) modification of the bankruptcy law (prioritising liabilities for the central budget).
- Reform of the Federal Labour Agency and strengthening its autonomy. In this context: (i) introducing independent financial management practices (e.g. possibility of borrowing), (ii) adjusting expenses to revenues (without subsequent financial aid from the central budget).
- Reforming local governments' financial management (to be defined later according the Commission Report).
- Introduction of bank tax. Key parameters of the new tax: (i) the financial sector must contribute to the costs of financial crises. Revenues from the bank tax will be transferred to a stabilisation fund. (ii) A common, agreed European solution is on the table, with a deadline of 1st January 2012.

Spain:

- Reducing wages in the public sector by 5% in 2010 (furthermore nominal wages do not increase in 2011).
- Reducing government investment.
- Freezing pensions at the current level (except for the lowest pension category).
- Phasing out personal income tax benefits granted on the birth of children.
- Termination of all tax credits.
- Reducing support grants to local and provincial governments.
- Raising the VAT and excise taxes.
- Introducing saving measures in the area of healthcare expenditure.
- Further structural reforms are also planned to be implemented in the coming years, the details of which are yet to be elaborated (e.g. labour market, pension reform, financial supervision).

France:

- Withdrawal of stimulus measures introduced in previous years.
- General pension reform (e.g. retirement age, indexing, etc.).
- Nominal freezing of subsidies granted to local governments.
- Curbing the healthcare expenditure, and other saving measures.
- Nominal freezing of central government expenditures (except for interest expenditure).

Portugal:

- Measures on the expenditure side: (i) withdrawal of all measures combating the crisis, (ii) reducing supports granted to state-owned companies, (iii) reducing intermediate consumption expenditures of central budget, (iv) setting limits for expenditures of independent funds, (v)

reducing personnel related expenditures in the public sector (e.g. suspending the payment of non-salary benefits, and stopping temporarily the admission of new employees), (vi) reducing salaries of managers in the public sector by 5%, (vii) reducing capital expenditure, (viii) reducing subsidies for local governments.

- Measures affecting the revenue side: (i) increasing the VAT by 1%, (ii) increasing the personal income tax progressively (by 1 and 1.5%), (iii) taxation of annual corporate profits exceeding EUR 2 million by a 2.5% higher rate, (iv) taxation of consumer loans, (v) introduction of motorway toll charges.
- For 2011, introduction of measures presented in the framework of the Stability and Growth Pact is envisaged: (i) stronger control of eligibility for social aid, (ii) changing the eligibility criteria for unemployment allowances, (iii) introducing capital gains tax, (iv) introducing a new, topmost personal income tax bracket (at a rate of 45%).
- Implementation of further structural reforms aiming at enhancing competitiveness are envisaged in the coming years, the details of which are yet to be defined.

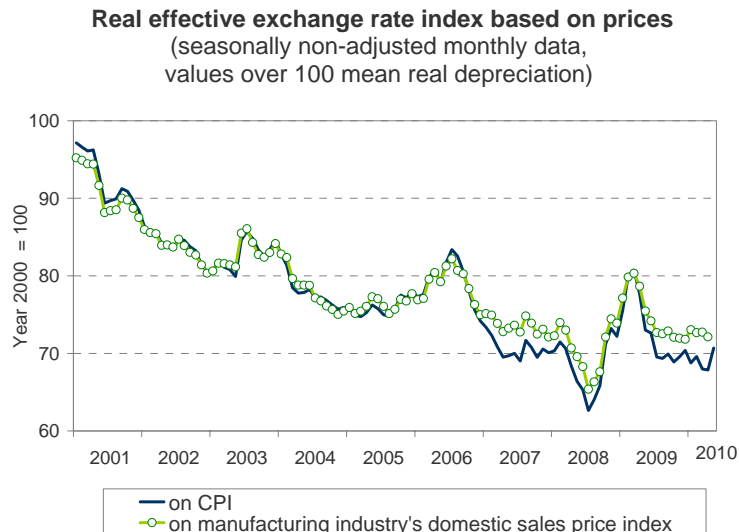
United Kingdom:

- Increasing the general VAT rate (by 2.5%).
- Reducing government investment, revision of earlier projects.
- Continuing with measure aiming at efficiency-improving and cost-saving in the area of healthcare expenditures.
- Lower budget line for ministries and certain government agencies. Setting up budgetary limits for the entire four-year parliamentary cycle, for every organisation.
- Introducing a cap on headcount, and freezing the wages of the public sector for a period of 2 years.
- Reducing social expenditures.
- Introduction of a new bank tax (as of 1st January 2011).
- Reducing the general corporate profit rate, and introducing a preferential tax rate to the SME sector.
- Reducing the social security contributions paid by employers.

Annex 2: Development of price and cost based indicators of competitiveness

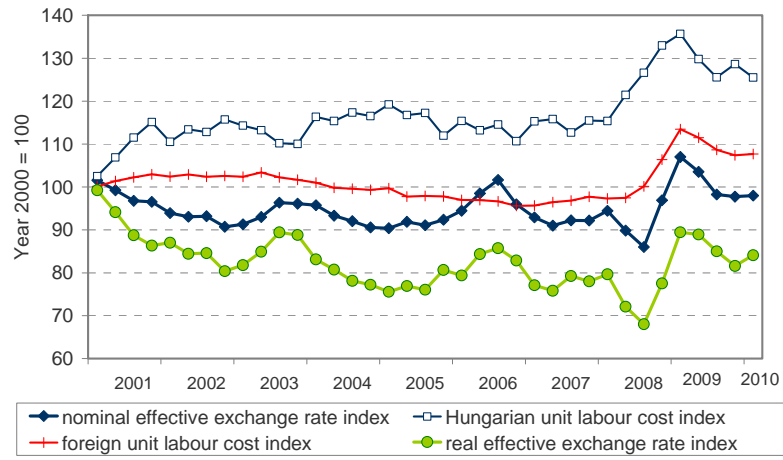
The indicators of competitiveness based on different real effective exchange rate indices signalled real appreciation, deterioration of competitiveness during the past period.

The competitiveness measured on CPI basis deteriorated during January-May 2010 by 10.8% on average compared to the same period of the previous year. Real appreciation emerged in a greater part from the 6.9% appreciation of the nominal effective exchange rate index in that period, in a smaller part as a consequence of the fact that the increase of the Hungarian inflation rate exceeded the increase of the inflation rate realised by our major trading partners by 4.4 percentage points. On the basis of the manufacturing producer price index there was an 8% real appreciation during January-April 2010 on average compared to the same period of the previous year. Appreciation of the nominal effective exchange rate index was slightly mitigated by the smaller increase of Hungarian manufacturing producer prices compared to the increase of manufacturing producer prices realised by our major trading partners.



In a small and open economy, cost competitiveness is a better measure of competitiveness than the price based one. Although competitiveness calculated on cost basis deteriorated by 6% in Q1 2010 compared to the same period of the previous year, this deterioration was exclusively the consequence of the 8.4% appreciation of the nominal effective exchange rate index in that period. It is important to emphasize that this effect was significantly mitigated by the improving harmony between the growth of Hungarian labour cost and productivity gains. The 7.5 % decrease of Hungarian unit labour cost in the manufacturing industry exceeded by 2.4 percentage points the decrease of the unit labour cost in the manufacturing industry realised by our major trading partners.

**Real effective exchange rate index based on unit labour cost
in the manufacturing industry**
(seasonally adjusted quarterly data, values over 100 mean depreciation)



Annex 3: Forecasts of institutions for 2010

	NGM	EU	OECD	MNB	Kopint-Tárki	GKI	ECO-STAT	Reuters poll
	(July 2010)	(May 2010)	(May 2010)	(June 2010)	(June 2010)	(July 2010)	(July 2010)	(July 2010)
Real GDP. %	0.6	0.0	1.2	0.9	1.5	1.0	0.9	0.8
Volume of industrial production. %	cca. 5	-	-	-	6.0	6.0	6.5	7.2
Domestic use of GDP. %	-1.0	-1.5	0.9	-0.2	0.1	-	0.2	-
of which: Household consumption. %	-2.5	-3.2	-3.1	-	-1.0	-	-2.9	-
Government consumption. %	1.1	-0.4	-0.4	-	0.0	-	1.5	-
Investment. %	0.8	1.0	-2.3	1.4	1.0	1.0	1.0	-
Volume of exports (goods and services). %	9.9	6.6	8.4	8.8	10.0	12.0**	9.4	-
Volume of imports (goods and services). %	8.8	5.4	9.3	8.1	9.0	12.5**	9.4	-
Current account deficit. billion EUR	0.0	-	-	-	1.0***	2.4***	-1.0	0.4
Current account deficit. in % of GDP	0.0	-0.2	0.8	-0.6	1.0***	-	-1.0	-
CPI (annual change). %	4.7	4.6	4.5	4.9	5.0	4.8	4.8	4.8
Real wage per capita. %	2.2	-	-	-2.9*	3.0	-	2.3	-
Unemployment rate (ILO. %)	11.7	10.8	11.0	-	11.6	11.0	11.2	-
General government deficit. in % of GDP (ESA95)	3.8	4.1	4.5	4.5 (4.3) ⁺	4.2	930 ⁺⁺	4.0	4.0

* / Real per capita income

** / Foreign trade turnover of goods at constant prices, in EUR

*** / Current + capital account

⁺ / In brackets: in case of fully freezing the budget reserves

⁺⁺ / GFS deficit, excl. local governments, billion of HUF