

Short note – Fixed Income Research – May 18, 2009

Hungary: New budget deficit target for 2009

2009 budget deficit target can be raised to 3.9% of GDP

It has just been announced by the Finance Minister Péter Oszkó at a press conference that the IMF and the EU agree that the 2009 budget deficit target of no higher than 3% of GDP can be raised to 3.9% of GDP. The announcement did not come as a big surprise, because rumors that that the strong recession will prompt both the IMF and the EU to let Hungary raise the budget deficit above 3% of GDP have emerged many times. In 2010, the deficit could also remain above 3% of GDP and it could fall below the Maastricht level of 3% of GDP just in 2011. The reason for the modification of the deficit target is that the economic outlook turned out to be worse than previously expected and contrary to earlier rumors appeared also in the press, according to the latest announcements, there won't be room for further tax reductions in Hungary this year.

The government now expects a 6.7% y/y GDP decline for 2009 (their earlier expectation for the 2009 GDP was -5.5-6%), followed by a 0.9% y/y contraction in 2009. The government's current view on the economy is among the most pessimistic ones, as even the EC predicted "just" a 6.3% y/y fall in GDP in 2009 in their spring forecasts.

As for the inflation rate, it is expected to reach 4.5% y/y in 2009, due to regulatory changes. The Governor of the CB András Simor said that the CB and the officials from the EU and IMF think that it is worth focusing on the CPI index, which excludes the price increasing effects of one-off tax changes.

Assessment: The new budget deficit target for 2009 has had to find the balance between the facts that (1) there is hardly any room for the government to increase the financing needs of the state in the current difficult market environment and (2) if economic outlook is continuously deteriorating, more adjustment measures will be needed, but these would further hinder growth thus the economic policy would become extremely pro-cyclical. Thus, it can be seen as favorable that the IMF and EU officials let the country raise somewhat the deficit in order to avoid this trap. And last but not least, the announced increase of 0.9 percentage points in the deficit target means less than HUF 250bn, which is expected to be acceptable for the markets, as well.

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