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Dear Reader,

The most important events this month was the approval of the 2013 budget key figures and the first round of long-awaited negotiations with IMF/EU. The financial markets seem to be in optimistic mood, HUF remained strong and the decline of average yields has continued despite the paltry demand, in keeping with a major decline in secondary market yields over the past few weeks.

In contrast to the earier practice and legal provision of submitting the annual budget by September to Parliament, this year the next year budget framework was submitted by June 30 and was speedily adopted by Parliament. According to the official explanation, the government want to send a strong signal to financial markets about its commitment to the Convergence Programme as the submitted budget draft envisaged a deficit figure of 2.2% of GDP.
The Budget Council, however, expressed serious concerns about the soundness of the underlying figures. Moreover, just couple of days after the draft budget had been submitted, the government announced a new 10 point plan "to protect jobs and growth", the financial coverage of which was deemed dubious by financial analysts.
According to the Economic Ministry the plan would be covered from a new "transaction tax" which was to be extended to transactions by the National Bank. In the meantime, it turned out that such a tax can violate independent monetary policy formulation of the MNB, moreover technically speaking the losses in the books of the central bank should be covered one year later also by the central budget. Therefore it can be concluded that the potential hole in the 2013 Budget amounts to HUF 500bn (EUR 1.7bn), in other words not only the promised 2.2% deficit target will be missed, but it can easily exceed the 3% threshold.

The issue of the 2013 was on the agenda of the IMF-EU talks, as well the transaction tax on the central bank. However, PM insists on imposing the FTT on the central bank, as well, although the ECB published its opinion that the tax impairs the central bank's functional and institutional independence. Orbán's remarks reaffirm the impression shared by analysts that the government is not in a hurry to seal the deal on the credit line.

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EU relations

The IMF/EU mission started negotiations

European Commission officials, International Monetary Fund staff and observers from the ECB, conducted a joint mission to Hungary from 17 to 25 July. According to the press release issued they held a useful first exchange of views on recent developments and policy initiatives and on policies that the EU and the IMF could support under a possible precautionary programme, also with a view to Country Specific Recommendations issued under the European Semester in July.

The main points of discussions with government representatives were the macroeconomic framework for next year and the budget deficit, where the two parties have very different forecasts. As expected, the third issue was a government plan to terminate the central bank's exemption from paying a financial transaction tax.

The IMF/EU mission also had wide-ranging discussions with the Hungarian authorities on progress with implementing the Széll Kálmán Plan and on how to stimulate further structural changes notably in the area of tax policy, labour and product markets as also recommended by the Council in the context of the European Semester.

The focus should be on a tax system that is more employment and investment friendly IMF/EU emphasised. Economic policy should avoid *ad hoc* charges on various sectors of the economy including the Central Bank, and progress with reforms to restore the soundness of the banking system so that it can play its role in supporting the economic recovery.

Moreover, it will be important to promote competition, reform loss making state-owned enterprises, especially in the area of transport, and put in place a regulatory level-playing field for all companies. The Hungarian chief negotiator Mihaly Varga expects an agreement by Autumn, although a date for continuation of the talks in September has not been fixed yet.

Court case on the judges' retirement age to continue

The Hungarian Constitutional Court, on Monday 16 July, rescinded the law, challenged by the European Union, which required judges to retire at age 62. The court took the view that this law infringed the independence of the Hungarian judiciary. That part of the law which lowered the age limit, previously set at 70, was found by the court to be in breach of the Constitution, and application was annulled retrospectively from 1 January 2012. It was in April that the European Commission decided to refer this law to the EU Court of Justice, deeming it in breach of European law and of provisions on discrimination at work.

Viviane Reding, Commissioner responsible for this issue, welcomed the ruling, however the case before the Court of Justice of the EU will not be closed because of this decision. The latter agreed to a hearing on the matter on 18 September and, between now and then, the EC will closely monitor the situation in Hungary and the way in which the authorities respond to this Constitutional Court ruling.

Economic policy

HEBC presented its annual report on economic policy to the government

The Hungarian European Business Council which consists of the leaders of 15 subsidiaries of foreign companies representing a combined net annual revenue of some HUF 3,500bn (EUR 12.3bn) and employing about 62,000 people published its annual report on the economic policy. HEBC forum emphasised that predictability and competitiveness were the main interests of investors in Hungary.

Laszlo Kerekes, regional CEO of AkzoNobel emphasised that companies interested in a quick agreement with IMF as it would improve the investment climate. Balazs Erenyi of Shell Hungaria noted that the tax system should be more neutral.

On behalf of the government, Foreign Minister Martonyi said that starting the talks this week and providing a successful outcome were important for both Europe and Hungary. The minister welcomed the fact that the annual report of the HEBC was not restricted to the economy and had a wider scope embracing social policy, a sign, he said, that it was looking to the future.

A recent report by Bloomberg also confirmed that investors' main concern in Hungary was the uncertain and fast-changing regulatory environment.

Budgetary policy

Central Bank sees a HUF 500bn gap in draft 2013 budget

Overall, MNB has identified a potential gap of HUF 500bn (EUR 1.7bn) in the budget, the Central Bank reported. Reaching the 2.2% budget deficit target for 2013 is not viable, the bank said, citing revenue estimates as overstated and expenditures as understated. At best the deficit can be cut to 2.4% by freezing some budget reserves, without which it would run to 2.8%. The higher budget deficit estimates stem from completely different growth projections by the MNB. Next year's budget draft was drawn up on the assumption that the economy will grow by 1.6%, but the MNB is less bullish on growth, signalling a rebound of only 0.8% for 2013.

The 2012 budget deficit may overshoot

In view of the January-June fiscal data, Hungary's government may considerably overshoot its 2012 budget deficit target, but by cancelling (not using) its central free reserves it can keep the shortfall below 3% of GDP expected by the European Union, the Central Bank said in a report prepared for the Fiscal Council. MNB staff believes the budget gap will be larger than expected because the macroeconomic path will be worse then expected and that will lead to lower tax revenues, and also because control on the spending side was loosened up as certain targets proved overly stringent. But the 2012 budget may be helped by a better-than-expected balance at local governments and that smaller EU funds will be drawn than previously envisaged so the budget's contribution will be smaller too.

In fact the H1 gap stands at HUF 517bn (EUR 1,8bn), which means that 90% of the full-year target was reached by the end of June. A number of local institutions (e.g. the Central Bank, the State Audit Office and the Fiscal Council) have warned over the past few days that the full-year goal is likely to be missed and that several risks are attached to it.

Monetary policy

The policy rate says unchanged

The Central Bank kept the base rate at 7% for the seventh consecutive month, in line analysts expectations. Governor András Simor told at the press conference that there was a "significant majority" in favour of holding rates, rather than the "overwhelming majority" one month earlier. A substantial and lasting drop in inflation and in premiums on Hungarian asset prices is required before the MNB can start monetary easing, Simor added. Stating that he expects inflation to significantly overshoot the MNB's 3% target both this year and next, Simor said only a 2014 date for hitting the target is realistic. The deflationary effects of weak household consumption and investment activity are offset by new taxes, which directly and indirectly boost inflation.

Employment

The job-protection plan financing under fire

The government's job protection plan will considerably deteriorate the position of the budget without substantially expanding employment, economic research company GKI said in an analysis. GKI said the job protection plan will not have a major impact as companies' savings will be offset by their increased expenditures of a telephone tax and a financial transactions tax. The compensation they receive for the elimination of the income tax refund and the minimum wage hike will also be lowered next year, increasing costs by a combined HUF 150-200bn (EUR 500-700 mn) for companies, GKI said. As it had been reported in our previous newsletter, the government's job-protection scheme is a mix of tax and contribution cuts for vulnerable groups announced on July 2, largely to be paid for by the financial transaction tax.

Government Decree for the training subsidy

Investment-encouraging training subsidy is available on Governmental decision for investments that create at least 50 new jobs. The source of the subsidy is the national budget. The maximum amount is EUR 1mn up to 500 new jobs created, and subsidy amount can reach EUR 2mn for more than 500 new jobs.

The maximum aid intensity is 60% for general training and 25% for specific training. The aid intensity may be increased up to a maximum of 80% of eligible costs if the aid is granted to an SME or if the training is given to disabled or disadvantaged workers. Training subsidy can be granted for employees engaged under the terms of the Hungarian Labour Code, up to the number of newly created jobs. At least 60% of the training participants need to be employed for 12 months after the completion of their training.

The subsidy opportunity had already been available previously, but the new Government Decree – which came into effect on 7 July 2012 - has modified the possibility in many ways, the most important of which being that the subsidy application procedure has been shortened, training planning has been made simpler, and significant limits of the eligible costs have been abolished.

Competitiveness

HUF 44bn repatriated from tax havens

Some HUF 7.7bn (EUR 27 mn) was transferred from offshore tax havens to Hungary in May, a record since the government declared a tax amnesty for those repatriating money from offshore accounts last year. As such transfers are subject to a 10% tax, the budget received HUF 770mn (EUR 2.7 mn). An estimated HUF 44bn (EUR 154 mn) of hidden assets has been returned since the amnesty was announced.

A recent report by the UK's Tax Justice Network campaign revealed that an estimated USD 21 trillion of global wealth has been lost to tax havens. The study found that the amount of offshore wealth originating from Hungary between 1998 and 2010 could be USD 242bn (HUF 55,000 trillion), more than three times the country's annual budget. Hungary is ranked 13 out of 20 in terms of money hidden in tax havens.

Business environment

Number of bankruptcies record high

The number of Hungarian companies going bust due to a shortage of cash has never been as high as at present, according to a report by international business evaluation company Dun and Bradstreet Hungaria. The proportion of bankrupt companies reached 4.1% in 2012, compared to 3.3% last year, D&B said in a statement. The number of liquidations in the first six months of this year rose by 30% compared to the same period in 2011. Final accounting procedures have nearly doubled since last year, which also suggests that more and more companies are winding up, the report said. Construction was the sector that suffering the most bankruptcies (7.2 percent) followed by catering and hotels (6.5 percent).

Confidence index rebounds slightly

The latest confidence index compiled by economic research institute GKI and Erste Bank shows modest increases from lows reached in June. The index of both business and consumer confidence improved to -23.2 from -24.5 last month. The measure of business confidence rose to -13.3 from -14.6 in June. The outlook in the industrial sector improved slightly, with greater optimism regarding production, but the expectations of service companies remained unchanged. The consumer confidence index went up slightly, but still remains around levels measured in the fall 2009. Households see their financial position improving, but expect their capacity to save to deteriorate. On the other hand households became less worried about losing their jobs. In international comparison however, Hungarian consumers' confidence is one of the lowest in Europe, as consumer confidence was higher in every European country polled by Nielsen for the fourth quarter in a row.

Legislation

Disaster recovery contribution abolished

The companies using hazardous substances for their operations would have become obliged to pay disaster recovery contribution from the year 2012. However, the modifying act promulgated on 19 June 2012 and entering into force on the following day abolished the disaster recovery contribution. Accordingly, unlike planned, the companies will neither have to pay the advance of the disaster recovery contribution, nor the contribution itself this year and the obligation of submitting declarations was eliminated also.

Legislation becomes more transparent

The Administration and Justice Ministry has launched a freely accessible online data base for laws that have been promulgated but are not yet in force. Laws that have been annulled may also be traced back up to five years, on the website www.njt.hu. As a matter of fact Hungary is joining the Open Government Partnership which functions in more than 50 countries as part of the government's anti-corruption programme. The cabinet's pledges include expanding accessibility to government information, more active involvement of citizens in decision making, upgrading public administration and raising awareness of public service ethics.

Dutch presence in Hungary

Aegon targets cyclists with new policy

The online unit of insurer Aegon has launched a special package for cyclists, the first such product in Hungary. The insurance policy, with a monthly fee of HUF 4,200-12,600, provides 50% cover for theft or damage, which can be supplemented to cover injuries. A recent survey by market researcher TNS-Hoffmann found that more people now use bicycles in Hungary than ever.

It is worth recalling that cycling as a form of sustainable transport is also supported by the Netherlands Embassy' public diplomacy actions such as its support of the Critical Mass events.

Industry

Mercedes supplier expands production

Car window supplier AGC Glass has begun a HUF 3.5bn (EUR 12 mn) investment to expand production capacity at its factory in Tatabánya. The Japanese-owned company will complete the investment, which received HUF 932mn (EUR 3,3 mn) in grants, by 2013. The project will add 50 jobs to the current 610. AGC Glass has a contract to supply the Mercedes factory in Kecskemét until 2021.

TVK builds butadiene plant

TVK will build a butadiene (C_4H_6) plant on its existing property, chairman of Borsod-Abaúj-Zemplén county Roland Mengi announced. The MOL group also considered Bratislava as a possible location, *Napi Gazdaság* reported. TVK will invest HUF 30bn (EUR 105 mn) in the construction of the annual 130,000 ton capacity plant, to open in 2014. In its new factory TVK will further process its raw products. The plant will probably add an annual HUF 8-15bn (EUR 28-52 mn) to its profits.

Henkel supplier HUF 815mn investment

The Hungarian subsidiary of Austrian Electroplast Gmbh is investing HUF 815mn (EUR 2,9 mn) at its factory in Békéscsaba, boosting its moulding capacities by 37%. The project received HUF 187mn in funding from the New Széchenyi plan. It will be completed by the end of the year. The company, which supplies plastic products for Henkel's plant in nearby Körösladány, will put in place three new injection moulding machines and upgrade its electrical network and IT system. Before last year’s opening in Békéscsaba, Electroplast supplied Henkel from Austria, which was both uneconomical and polluting. Emission can be reduced by 278 tonnes of carbon-dioxide annually, the company said. Electroplast expects revenues to climb to EUR 6mn in 2013 from EUR 4mn this year. It has 23 employees and plans to add 12 more in the near future.

Construction/Infrastructure

GPS traffic control for Budapest in 2013

The Budapest transport centre (BKK) is to complete its Futár project, a GPS-based traffic control and passenger information system, by 2013 from HUF 6.7bn (EUR (23,5 mn) in investment. The project, which receives HUF 4bn (EUR 14 mn) from the EU, will replace existing passenger information and traffic control systems, *Napi Gazdaság* wrote. New GPS-based vehicle tracking will be implemented on 2,295 vehicles of the Budapest transport company BKV. Tracking displays will be set up at 257 bus, tram and trolleybus stops, giving real-time information on vehicle locations.

Services

Office space in Budapest remains cheap

Of the top 50 'most expensive’ markets, 19 are in Asia-Pacific, 19 are in EMEA and 12 in the Americas, showed a survey conducted by CBRE that tracks occupancy costs for prime office space in 133 markets around the globe. Hong Kong’s CBD led the "most expensive" list with overall annual occupancy costs of USD 2,678 per square metre. This topped London’s West End, which, reported average occupancy costs of USD 2,370. Tokyo was the third most expensive market, followed by Beijing’s Jianguomen (CBD) and Moscow. Budapest is among the most inexpensive locations.

In Central Europe, Warsaw is the most expensive market with USD 564 per sqm. Prague (USD 527 per sqm) is the second, Vienna (USD 475 per sqm) is the third, followed by Budapest (USD 430 per sqm), and Bratislava (USD 425 per sqm).

Demand up for Budapest office space

The demand for Budapest office space went up 80% from the first to the second quarter reaching 96,000m2, with the increase nearly 10% year-on-year, the Budapest property consultancy forum BIEF announced. In the first half, 149,000m2 was leased, down 9% from one year earlier. The vacancy rate is now 21.3%. Total office space in Budapest, including self-owned and specula-tors' buildings, was 3,176,000m2 in the second quarter.

Financial services

PM Orbán wants higher Hungarian share in banking sector

The new economic model of the Hungarian government also aims to have 50 percent of the banking system in local hands, said Prime Minister Viktor Orbán at a meeting with the presidency of the Hungarian Chamber of Commerce and Industry. "If we can achieve that it will be unique in the whole of Central Europe," Orbán said.
The end-March data by financial markets watchdog PSZÁF show that Hungarians controls 8.9% of the registered capital of credit institutions operating as joint stock companies (excluding Hungarian Development Bank (MFB), clearing house Keler and Eximbank), which consists of a minority stake in OTP and banks majority-owned by the state.

There are additional minority interests in several other smaller banks. Portfolio.hu estimates Hungarian control (excluding state-owned banks) at 13.2% based on total assets.

	Total assets (bn HUF)	Share of Hungarian ownership	Total assets / Hungarian ownership (bn HUF)
Credit institutions operating as joint stock companies	27,282	8.9%	2428
Branches	2335	0.0%	-
Savings co-operative credit institutions	1,717	99.9%	1715
Total	**31,334**	**13.2%**	**4,143**

Source: PSZÁF, Portfolio.hu

Insurance, transaction taxes passed

The bill on the insurance tax was passed in Parliament, without any last minute modifications, and consistent with an agreement reached with insurance companies, *Napi Gazdaság* reported. The new tax will be levied from January 1, 2013 and will cause problems according to the insurer association Mabisz because it cannot be collected from clients having contracts signed earlier, in which case insurers must pay the tax. Agricultural insurers are exempt from the new tax.

Research/Innovation

Pharmaceutical park opens in Debrecen

President János Áder and Debrecen Mayor Lajos Kósa were on hand for the official opening of Pharmapolis, a research centre for pharmaceutical companies. The pharmaceutical cluster was created by the local town, holding a 25% stake, along with the city's Chamber of Industry and Commerce, and drugmaker Richter Gedeon, the biggest stakeholder, as well as other companies. Half of the HUF 6bn (EUR 70,5 mn) funding came from the new Széchenyi Plan.

The research centre will create world-class infrastructure for SMEs engaged in pharmaceutical research, said Richter CEO Erik Bogsch. The 10,500m^2 facility was tailored to meet the demands of researchers, *Napi Gazdaság* writes, adding that Pharmapolis will provide employment for 120 researchers.

Energy

Wildhorse signs an agreement with the government

Wildhorse Energy, the AIM and ASX listed company focussed on developing underground coal gasification (UCG) and uranium projects in Central and Eastern Europe has announced that it has signed a Cooperation Agreement with the Hungarian government to formalise the legislative and regulatory framework required to develop UCG projects in Hungary.

WHE owns the Mecsek Hills UCG Project in the Pécs region of southern Hungary where it recently completed a confirmatory drilling programme of two boreholes and a 3D seismic acquisition campaign over its target area. Consequently, the Company has identified a JORC Inferred resource of 184.5Mt within this target area.
The potential technologies applied in developing the project (such as directional drilling, coal gasification and syngas separation and purification) have mostly been used in the hydrocarbon industry in Hungary. However, the combination of technologies used in order to develop the CDP within the frame of this Cooperation Agreement would be applied for the first time.

MOL is the biggest Hungarian company

MOL, Hungary's largest company, has become a multinational, with diversified operations. Half of the energy company's annual revenues of HUF 5 trn (EUR 17,5 bn) are generated by foreign subsidiaries but MOL has not adjusted its management structure to the new conditions. Actually MOL is involved in exploration projects in Iraq, Pakistan, Kazakhstan and Russia, and has refining or retail units in Austria, Italy, Romania, Slovenia and the Czech Republic.

The aim of the organisational overhaul that has been taking place now is to create a Budapest centre with a staff of around 500 in charge of international operations, overlaying the current divisions, such as exploration, refining and retail. MOL has announced expanded activities in Kazakhstan after signing an agreement with state-owned KazMunaiGas to acquire 49% of its stake in the North Karpovsky block. The 1,670km^2 license area is close to MOL's Fedorovsky block, in which the company has a 27.5% stake. MOL already discovered oil and gas in the region in 2008.

EIB lends EUR 75mn for gas pipeline link

The European Investment Bank has signed an agreement to lend EUR 75mn to state development bank MFB to finance construction of a gas pipeline between Hungary and Slovakia. The MFB will transfer the funds to its venture capital arm MFB Invest, which has a 49% stake in Magyar Gáz Tranzit, the company responsible for building the 94km Hungarian section of the 115km pipeline. State electricity company MVM owns the remaining 51% stake in Magyar Gáz Tranzit. The pipeline will be capable of shipping 5 bcm of gas annually from 2015. The EU will provide a EUR 30mn grant to the EUR 160mn project.

Environment/Water

FuturAqua mineral water exchange

Mineral water company FuturAqua is planning to set up an international website for mineral water quota trading as an exchange. The regulated trading will allow investors to invest in water as they do in commodities, the company said.

Share of renewable energy drops

Last year, 2,689 Gigawatt-hours of energy was produced by renewable sources in Hungary, contributing 6.3% of the total, the Energy Office announced. The share of renewable energy dropped from 7.1% in 2010. In line with EU plans, Hungary is aiming to reach 14.7% by 2020.

Half of the present renewable energy is provided by wind farms, and biomass power stations contribute 40%. Last year capacity of biomass power stations went down 30%, as for instance power station AES Borsodi Erőmű closed down. **Carbon quota sales**

The Ministry of National Development sold carbon emission quotas equal to 2.5 million EUA (European Unit of Account) between May 23 and June 25 based on an agreement with CF Partners, the Ministry announced. The average sale price was EUR 6.73, yielding EUR 16.8mn in budget revenues.

Agriculture

GMO pollution on the agenda again

In June 1,500 hectares of GMO corn crop were destroyed by orders of authorities, *Népszabadság* reported. The Montoni type corn imported from Romania by German company Saaten Union was GMO infected. The Rural development Ministry informed all farmers concerned to destroy the crops within three days, by July 1. The government has earmarked HUF 600mn to compensate farmers who used banned GMO corn seeds without knowing it and had to destroy their crops, according to *Magyar Nemzet.*.

Food industry

Illegal grain trading drops

"Illegal grain trading dropped over 50% since the so-called reverse VAT payment (when the seller pays the VAT) was launched on July 1," president József Vancsura of grain farmer association Gosz said. According to estimates the reverse VAT system could add about HUF 10bn annually to budget revenues. As to this year grain harvest, Hungary will harvest 3.7-3.8 million tonnes of autumn wheat in 2012 on about one million hectares, down from four million tonnes in 2011, the Hungarian Chamber of Commerce said, adding that the quality will be excellent. The extremely dry weather and lack of precipitation has been unfavourable for corn and sunflower seed, the Cereal Farmers Association added.

Tourism

Budapest 11th on conference list

Budapest was the 11th most popular host city for conferences in 2011, according to the International Congress and Convention Association, rising from 18th in 2010. Prague came 14th and Brussels 17th, while the top three were Vienna, Paris and Barcelona, in that order.Budapest hosted the most conferences with 300-400 guests.

Hotels thrive on foreign guests

The number of guest nights that foreigners spent in commercial accommodation rose 11% year-on-year in May to 1.06 million, the Central Statistics Office announced. The number of foreign guests was up 8.8% to 386,000. The number of guest nights spent by German, Austrian, Italian and Russian tourists rose. In May, 333,000 domestic guests spent a total of 710,000 guest nights at hotels, a drop of 4.4% and 1.8% respectively. The average hotel room occupancy rate was 48%. In the five-star category it was 71%, and 56% for four-star hotels.