Sources of crisis-clear

Financial crisis-started in August 2007
Growth spillover-full swing in fall 2008

Emerging Europe (including Hungary) hit particularly hard:

Large imbalances-demand-led growth in most countries, with significant CA deficits
Financed by capital inflows, that stopped

Hungary vulnerabilities in particular:

- Public debt is high (over 80 % of GDP, compared to around 25% in Romania)
- Resulting extenal debt is high (over 140% of GDP in 2008)
- FX loan stock of over 60% of GDP

IMF stepped in to:

Crisis-fighting programs:

1. Put a floor on investor confidence and avoid banking crises, by
    a. boosting central bank reserves
    b. providing financing for bank recapitalizations and liquidity support
2. Bank coordination initiative
3. Provide room for policies through budgetary support
4. Very targeted programs, flexible to accommodate the unprecedented downturn

In a medium-term, providing loans that are coupled with specific policy goals that are intended to *restore* growth.

Policies are not easy, but better than the alternative: fending for oneself in a world of unforgiving capital markets. Let's look at the numbers:

Total IMF financial commitments since the crisis broke out has exceeded $125 billion, including in Europe:

$2.1 billion for **Iceland**; $15.7 billion for **Hungary**; $16.4 billion for the **Ukraine**; $2.46 billion for **Belarus**; $2.35 billion for **Latvia**; $4 billion for **Serbia**; $118 million for **Moldova**; $17.1 billion for **Romania**; $540 million for **Armenia**; and $1.57 billion for **Bosnia Herzegovina** earlier this month. In addition, a line of credit totaling $20.58 billion was granted to **Poland** under the new Flexible Credit Line, which is designed to provide a backup credit line to countries without a program.

Global outlook:

Satbilizing but at a critical stage. Demand is not dropping as quickly; but private demand still weak. Exports have fallen steeply worldwide.

IMF forecast: the short-term outlook is a little worse than it was earlier this year; but the outlook for 2010 is better.

- Output in the advanced economies: decline by 3.8% in 2009, growth of 0.6% in 2010. Emerging market countries: grow 1.5% in 2009, and 4.7% in 2010. Western Europe recovers slower than the US.

- Continued risks in the financial system. Governments' response reduced the risk of systemic collapse; market confidence is returning; financial condition of banks has stabilized in many countries; appetite for risk has returned.But financial markets remain dependent on public support. Bank balance sheets remain an issue on both sides of the Atlantic. Overall bank credit growth continues to contract.

implications for emerging Europe:

- sluggish demand for exports
- less access to capital
- effects of recession will increase NPLs and unemployment further—stress on banking sector and demand

Stats, CEE:

%, y/y	2009	2010
Export growth	-10	2.5
Capital inflows	-50	-10
GDP growth	-4	1

Hungary

Prorgram on track.
Macro outlook stabilized:-6.7% in 2009, -0.9% in 2010, growth starts in H2 2010
credit contructed but less than expected
Fiscal on track for -3.9% in 2009 and -3.8% in 2010
Inflation 4.5% in 2009, 4.15 IN 2010
Financial stability preserved:

- Banks liquidity and funding position improved.
- Profitability is good in H!
- Capital ratios increased well above regulatory minimum

Stats in H1: ROA slightly down, to 15.1%.. Funding situation has also improved, as deposits from residens have increased. Capital adequacy ratio also rose to 12.3% (from 10.3).
Credit contracted at a moderate pace- 2.7%. NPLs up to 4.8 (from 3.6 at end 2008). Expect to peak at 10% in H1 2010.

<u>Forward:</u>

Hard fiscal steps already done:

Fiscal structural adjustment of over 4% of GDP in 2009-2010.
Just keeping what is approved already plus the 2010 budget will:

- Start reducing Debt/GDP ratio in 2011, from over 80% in 2010 to 70% by 2014
- And external debt ratio: from peak of 176% in 2010 to 146% in 2014

Important—not to unwind good policies already done. Passage of the 2010 budget is key.

Financial: challenges ahead due to weak economy, but appear manageable.

Considering challenges ahead, we support the authorities intention to extend the availability of the capital enhancement scheme into 2010.

The authorities have also made progress in strengthening financial supervision, specifically in the area of on-site examinations, and further enhancements are under way.

Efforts appreciated by investors-1 bn eurobond issuance.
Plus above 900 mn SDR allocation

We reached agreement to extend the program by 6 months, to october, and re-phase.