



POLITICAL FORECAST

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Key Points to Watch

Political Trends	Significance
Half-success: Budget deficit aims 3%	Hungary's draft budget for 2011 aims to keep the deficit at less than 3% of GDP, meeting the Maastricht criteria for euro adoption for the first time since 1995. Nonetheless, Hungary may still run into conflicts with the European Union's power brokers. The government seems to think that its budget-deficit achievement will keep the EU quiet for the time being, leaving Hungary free to blaze its own trail in global politics. Specifically, the administration wants to establish tighter bonds with eastern countries, especially Russia and China, while putting pressure on multinational companies at home. This may run afoul of Western European economic and political interests.
Restricting the jurisdiction of the Constitutional Court	The government will not curtail the jurisdiction of the CC (Constitutional Court) to the extent originally announced: the government's partial retreat is explained by internal conflicts and the need to protect the accelerating process of drafting of a new constitution. At the same time, the government will make every effort to prevent the CC from reviewing the suspension of private pension fund payments and the implementation of emergency taxes.
Ferenc Gyurcsány's two-front battle against Fidesz and the MSZP leadership	In the coming weeks the former prime minister will position himself as the most relentless opponent of the government and look for open and direct conflict with the current head of government. Simultaneously, the government will try to redouble its effort to bring criminal charges against the former prime minister, and the MSZP leadership will take a more public stance against Ferenc Gyurcsány.

Political Forecast

- The draft budget for 2011 aims to keep the deficit at less than 3% of GDP, but **the government is not going to implement wide-ranging structural reforms next year** – at most, it will begin preparing them.
- The most uncertain part of the government's spending plan for 2011 is the revenue it will receive from workers who transfer into the state pension system. The administration predicts 90% of people in the private pension system will join the government scheme. **Direct nationalization of private-retirement funds is unlikely, but the administration will probably change regulations and incentives to encourage as many people as possible to abandon their privately managed plans.**
- State debt is expected to decline, so **it is possible that the government will improve its performance in all the Maastricht criteria in 2011.** This, in turn, will bolster Hungary's negotiating position vis-à-vis the EU.
- **By increasing its room for fiscal maneuver in the short term, Hungary's government has raised risks for the medium term:** The so-called crisis taxes will expire after two years and the effort to eliminate private-pension funds will mean greater burdens for the state in the long term.

- Efforts to curtail the jurisdiction of the Constitutional Court will remain at the top of the political agenda. Compared to its original proposal, Fidesz will make minor and symbolic concessions.
- In theory, the Constitutional Court has the power to annul legislation limiting its rights, although as this would lead to open conflict between the CC (for the most part made up of judges delegated by Fidesz) and the government, such an outcome is highly unlikely.
- With its recent decision the government is putting at risk the conclusion of its constitutional reform by next spring; its move has significantly reduced the chance of achieving even a modicum of cooperation with opposition parties when the bill is submitted to Parliament, undermining the legitimacy of the new Constitution.

- To this day, opposition parties and their support bases are more preoccupied with fighting each other than the government. However, none of them can gain the upper hand and offer an alternative to the government. Accordingly, even if support for Fidesz declines in the coming months, it would primarily increase the number of undecided voters.
- Under the current constellation conflicts within MSZP appear to be intractable; in the most likely scenario, Ferenc Gyurcsány will use the Democratic Coalition (he created within MSZP as a quasi new party) to promote his agenda.
- Fidesz will try to discredit opposition criticism primarily through attacks aimed at Ferenc Gyurcsány, which in turn could tighten the quarantine around the former prime minister.

Analysts consensus

Political Capital analyst consensus: one-month, short term forecast (with change over to the previous month in parenthesis):

Category	Average evaluation		Interpretation
PM Viktor Orbán's position	Very Stable	10 (-)	Viktor Orbán is the strongest PM since democracy was restored in 1990. He is backed by a parliamentary majority of more than two-thirds that is composed of essentially one party (Fidesz and its subgroup, the Christian Democratic People's Party (KDNP)). On October 3, Fidesz consolidated its power with a sweeping victory in the municipal elections. There is no group within Fidesz that is powerful enough to challenge Orbán; almost all important strategic and personnel decisions are in the PM's hands.
Government Commitment to Reform	Medium	6 (-)	The government is expected to initiate some changes in the education and healthcare systems (centralization and integration). The administration also appears determined to cut state subsidies and reduce the size of the bureaucracy. The government has also introduced serious tax reforms.
Intensity of Demonstrations and Strikes	Medium	5 (+2)	Public-sector trade unions will protest some of the government's more unpopular measures (e.g. the extra tax on severance pay for public-sector workers, nationalizing private pension funds, and layoffs – or at least the hiring freeze in the public sector). Protests will be much more muted than they were during the Gyurcsány government.
Activity of Radical Groups	Weak	3 (-1)	Internal conflicts between the "moderates" and "radicals" inside Jobbik, along with growing disillusionment with party president Gábor Vona and his coterie, may lead to a party split and will further weaken Jobbik politically.
Fiscal Discipline	Strong	8(+1)	The government is expected to fulfill the 2010 budget-deficit target of 3.8% of GDP and keep the shortfall below 3% of GDP in 2011. All of the Fidesz government's proposals serve this overarching goal (e.g. requisitioning private pension-fund contributions, narrowing the Constitutional Court's scope of authority).
State Intervention in the Economy	Strong	9 (+1)	The decision to divert private pension-fund contributions to the state, the expected "municipalization" of public utility companies, and sector-specific corporate taxes all point toward stronger state influence in the economy.
The reputation of Hungary on the international markets	Medium	4 (-1)	While fiscal discipline is a good news for investors, other government decisions will harm investors directly. It is almost certain that these policies will deteriorate Hungary's reputation and decrease the chances of significant foreign investment in the coming years.

Methodology: Each month analysts of Political Capital provide estimations on the political events of the upcoming month in a 10-grade scale.

1-2	Very low/very weak/very unstable
3-4	Low/weak/unstable
5-6	Medium
7-8	Strong/high/stable
9-10	Very strong/very high/very stable

Leading Trends

Government Policy

- **The attempt to restrict the jurisdiction of the Constitutional Court carries the highest risk so far for the government, reflected not only in the criticism of opposition parties and civil organizations, but also in cracks in the unity of the government parties.** A number of Fidesz representatives, according to press reports including deputy prime minister Tibor Navracsics, disagree with the proposal. However, the initial reaction of coalition partner, KDNP, hesitating to guarantee its vote for the proposal, has been the most telling sign of internal conflict. (Since then the party has signalled its readiness to vote with Fidesz.)
- **Changing the jurisdiction of the CC requires a two-thirds majority, which means that as few as six governing-coalition representatives could prevent passage of the bill.** In other words, in addition to fending off outside criticism, Fidesz will have to devote at least as much attention to preserve internal unity.
- The objections of Fidesz' supporters among the intelligentsia have been even more vocal than that of the party's internal opponents: papers close the party published a number of critical editorials and several opinion-makers affiliated to Fidesz voiced their concerns. **Due to the weakness of opposition parties, opposition emerging from within party's ranks is the largest threat facing the governing party, potentially much more effective in eroding support for the government.**
- **Aside from the issue of the CC, the government has also been forced to modify its strongly-disputed position in respect to severance pay:** tax legislation limiting severance payments over HUF 2 million also affects public employees with many years of service (e.g., teachers, railroad workers, etc.), a move fiercely resisted by unions. Since the special tax has a minor impact on the budget as a whole, the government is not expected to take on the conflict and the groups mentioned above may be exempted in the bill's amended version returned Parliament.
- **However, the proposal limiting the jurisdiction of the Constitutional Court has in fact little to do with extremely high severance payments awarded at state-owned companies. Rather, the government has been worried that the CC would annul the emergency tax and its attempts to confiscate private pension-fund contributions.** The potential loss of these revenues would turn the 2011 budget on its head.
- The government's arguments in defence of its policy lack any coherence: while initially the motion was justified as a crusade against excessive severance payments, the submitted proposal already criticizes the Constitutional Court's extremely broad jurisdiction on principle. So far, government arguments have made but sporadic references to budgetary concerns.

Opposition

- **While both MSZP and LMP have sharply criticized the government for its intended restriction of the Constitutional Court's jurisdiction, the affair has only demonstrated divisions within the opposition.** None of the opposition parties managed to put real pressure on the government and, instead, the issue has gained public attention thanks to protests by the media and opinion-makers.

- The ineffectiveness of the opposition's objections to the proposed moves against the CC is well illustrated by the three independent demonstrations: Ferenc Gyurcsány organized an anti-government demonstration on November 2 and LMP held its own rally on November 3. MSZP's own manifestation will take place at the end of November. **To date, the mobilization race has been won by Ferenc Gyurcsány; the rally organized by the Democratic Coalition was attended by several thousand, while that of LMP attracted a few hundred demonstrators.**
- In the past few months **LMP** has made a visible effort to keep its distance from MSZP: it continues to criticize the Socialists, while welcoming a number of government initiatives. **However, following the announcement of the government's proposals related to the CC, in a letter sent to the President LMP joined MSZP to express its concerns and recalled their representatives from the parliamentary committee set up to draft a new constitution.** However, cooperation with MSZP is likely to be an isolated event and the party will try to avoid being drawn closer to MSZP along a government vs. opposition logic.
- **In the case of MSZP, proposals related to the Constitutional Court again have only managed to aggravate internal conflicts; the Democratic Coalition led by Ferenc Gyurcsány and the party leadership demonstrate against the government's decision at two separate events.** Overall, the former prime minister can generate more public attention, although his public visibility makes it increasingly apparent that his person continues to be unacceptable to the majority, offering the government the opportunity for mounting a counter attack.
- Against all the odds, **Ferenc Gyurcsány clearly aims to become the leader of the opposition**, which may explain why his criminal liability has been raised again in connection to the "Sukoró-affair". **There are strong indications that the prosecutor's office will soon charge him with criminal offences.**
- There is a clear correlation between reports that Mr. Gyurcsány's criminal prosecution has entered a new phase and his increasingly active presence in the political arena: on the one hand, Mr. Gyurcsány's strong attacks of the government are motivated by the charges levelled against him; the more he can present himself as the leader of the opposition, the more credible his claim that the charges levelled against him are simply meant to discredit him politically. On the other hand, Fidesz also has a vested interest in keeping up the pressure, offering the party a convenient opportunity to make regular references to the "crimes" of the previous administration and simultaneously eliminate an opposition politician, the most relentless critic of the government.
- **Internal Splits in Jobbik can lead to break-up.** Conflicts within the far-right party have strengthened following its worse-than-expected performance in the October 3 municipal elections. Jobbik is now facing its deepest internal crisis since entering Parliament last April. Both the „radicals” (László Toroczkai, Tamás Gaudi-Nagy, Krisztina Morvai) and „moderates” (e.g. Lajos Pösze, former deputy caucus leader) might challenge the leadership of Gábor Vona and the party leadership. Successful local organizations (e.g. in Borsod-Abaúj-Zemplén County) also have grounds for criticizing the party's Budapest-based elite – Jobbik performed very poorly in the capital in both the parliamentary and municipal elections. The conflicts will weaken and paralyze the party; Jobbik's challenge to Fidesz will grow weaker by degrees. (Political Capital will soon release a detailed analysis on this topic).

Economic Policy

- Hungary's **draft budget for 2011 aims to keep the deficit at less than 3% of GDP**, meeting the Maastricht criteria for euro adoption for the first time since 1995.
- **The draft budget foresees 3.5% inflation and 3% GDP growth for 2011. The inflation number matches most analysts' forecasts, but the economic-growth projection appears somewhat rosier than most expectations:** Most analysts see GDP rising 1.7-2.5% next year. The budget's authors made their 3% forecast for political reasons: If the governing Fidesz party were to lower its growth forecast, it would be admitting that the administration's fiscal measures (especially the business-sector surtaxes) will slow the economy down. **Even if GDP grows less than 3%, the government will have no trouble reaching the budget-deficit target.**
- **The government managed to increase its room for fiscal maneuver in the 2011 budget by seriously raising the risks for budgets in 2013 and thereafter. This is why the 2011 spending plan is not going to assuage investors for long.**
- You can see our detailed analysis on Budget 2011 at riskandforecast.com.

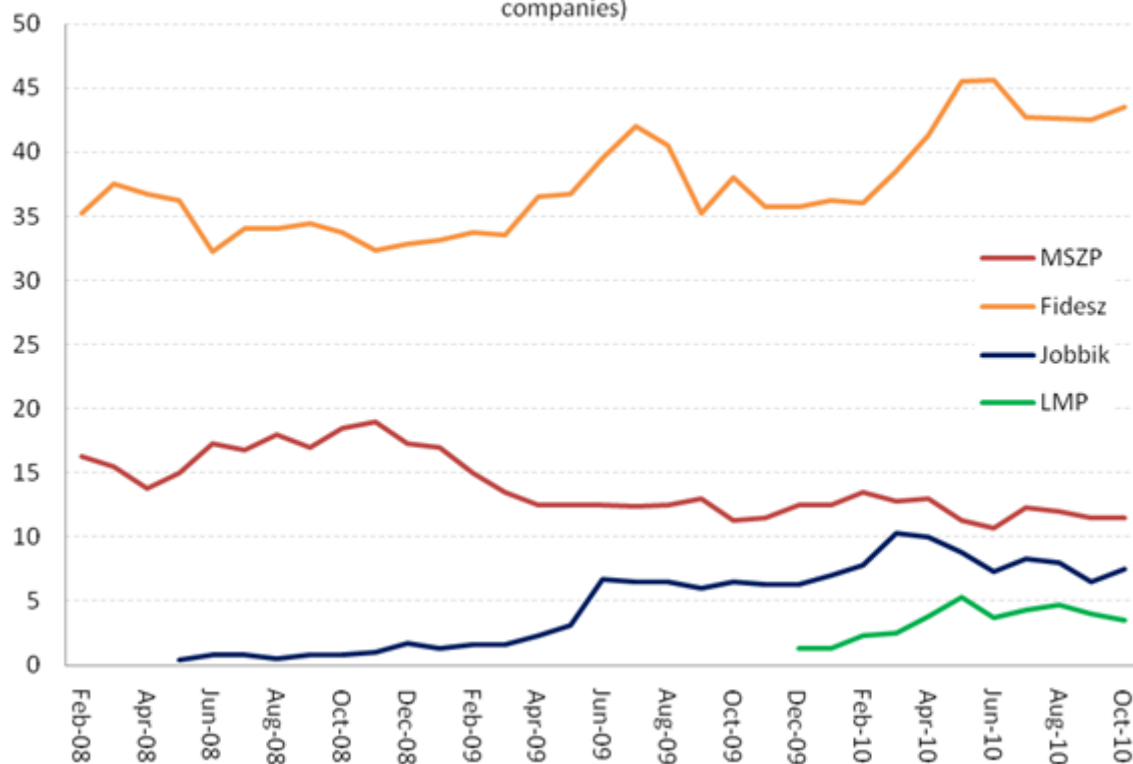
Parliament Watch

- Viktor Orbán's summer promises and the autumn's more relaxed legislative program notwithstanding, following the municipal election the government continued where it had left off in the summer: **the legislative process continues at a furious pace and bills are still submitted by individual representatives, reducing the time available for mandatory debate.**
- **Two bills aimed at limiting the jurisdiction of the Constitutional Court** (amending the Constitution and the Constitutional Court Act) **will also be submitted to Parliament as individual motions. The final vote will be held on November 8.** The House is also expected to vote on constitutional amendments ending representatives' right to question the chief prosecutor and tying his appointment to a two-thirds majority. **In general Fidesz intends to dilute all checks and balances and in the medium term sacrifice everything on the altar of effective governance.**
- On November 8 the government submits to Parliament details of the 2011 budget, while the so-called 'omnibus legislation' underlying the budget will be submitted on November 12. The House will vote on the total amounts budgeted for next year on December 7, 2010.
- Earlier plans called for the election of the president and members of the National Bank of Hungary (MNB) Board of Supervisors at the next session, although at the request of Fidesz this has been postponed by one week, to November 15.

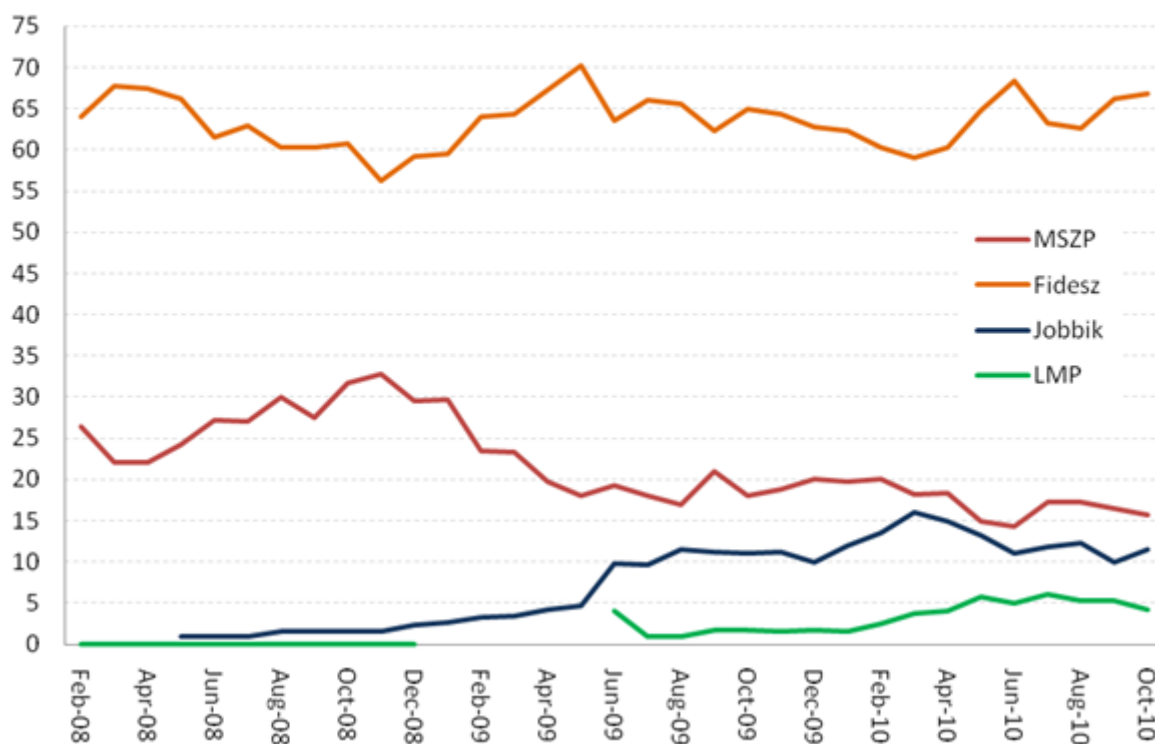
Opinion Polls

- **October party-preference surveys did not show significant shifts in support for the parties.** Fidesz enjoys the support of around 43% of the adult population (3.4 million people). The ranking of opposition parties is led by MSZP with 11-13%, and the former governing party is followed by Jobbik with 6-9% and LMP with 4%. However, only one of the surveys was conducted following the announcement of the proposal aimed at limiting the jurisdiction of the Constitutional Court.

Support for Parliamentary parties in the past two years
 (% basis: adult population, based on the measurements of four public-opinion survey companies)



Support for Parliamentary parties in the past two years
 (% basis: active voters with party preferences, based on the measurements of four public-opinion survey companies)



Regional Risk Map

- **After the Czech coalition-government lost its majority at the October Senate election, using accelerated procedures it attempts to pass cost-cutting measures rejected by the opposition.** The cabinet plans to cut the current 5.3% deficit to 4.6%, reducing public spending by CZK 40 billion (EUR 16.4 billion). The 10% reduction of the public-employee wage bill and child care support, and the retroactive taxation of state subsidies for home savings are the most important measures already passed by the Lower House (on the night of November 3 in an accelerated procedure, i.e., without debate). The package may run into strong union opposition and a potential nationwide strike could undermine the stability of the coalition. The position of the government could be weakened further as the president of the opposition Czech Social Democratic Party (ČSSD) announced the party's plans to challenge the austerity measure in the Constitutional Court.
- **Poland signed an agreement with Russia effective through 2037 on gas exports and gas deliveries to Germany. The success of the talks conducted with the participation of European Union representatives improves gas-delivery guarantees to Poland and the EU as well.** In the meantime, the Polish finance minister, Jacek Rostowski, announced that this year's deficit will exceed the 6.5% target but remain under 8%, with the final figure coming to around 7.8-8%. To reduce the 2011 deficit, the Tusk cabinet plans to increase the VAT from 22 to 23% and introduce a bank tax along the Hungarian model. While the majority of the population is ready to accept the VAT hike, the Bank Association is fiercely opposed to the bank tax. If the government waits for an EU decision concerning a single bank tax, its introduction will generate considerably less tension, although its rate is expected to fall short of the currently budgeted PLN 1.7 billion.
- **The World Bank and the International Finance Corporation published their *Doing Business 2011* report on November 4. Of the six countries in the region, Slovakia continues to provide the best conditions for conducting business. The last two regional spots are occupied by Poland and the Czech Republic, although in respect to the full list the latter improved its ranking by 19 spots.** Of the 183 economies under review the report made special mention of 10 countries implementing reforms in the largest number of areas. This year Hungary has made the list; in the course of 2009/2010, out of the total of nine areas it introduced reforms in four (dealing with construction permits, registering property, paying taxes, closing a business). The table below illustrates the position of the region's economies in the ranking of countries under review, based on aggregate and specific criteria.

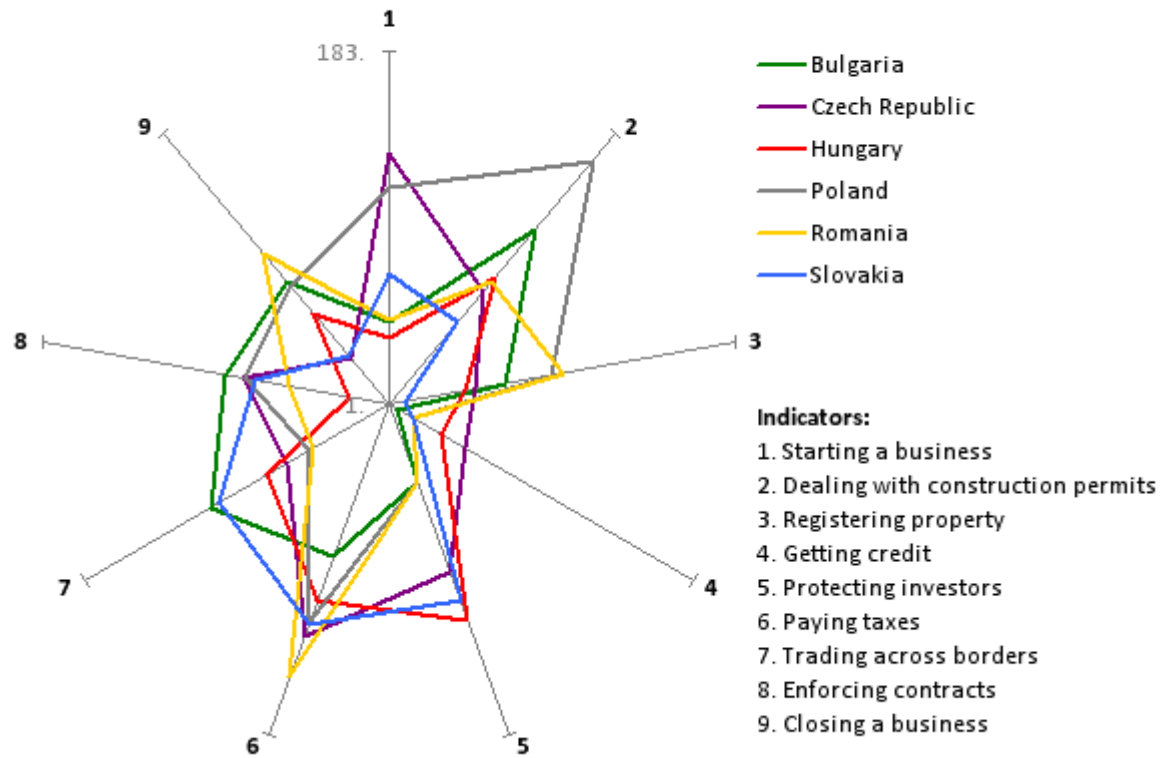
Rankings on the ease of doing business

(Source: *Doing Business 2011 Report*)



Rankings on the indicators of Doing Business 2011

(Source: Doing Business 2011 Report)



Key Political Figures - Hungary

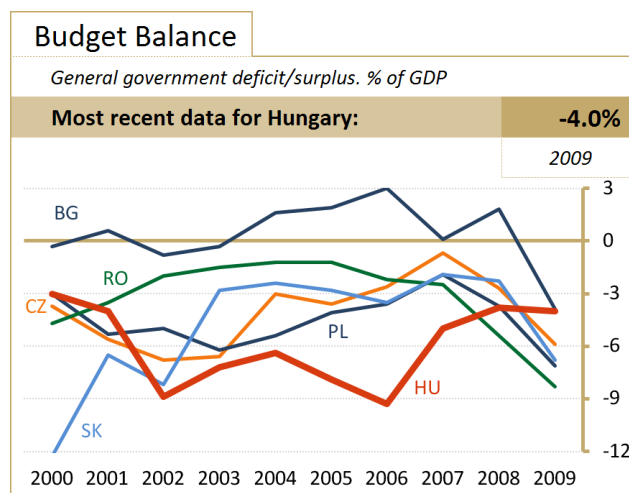
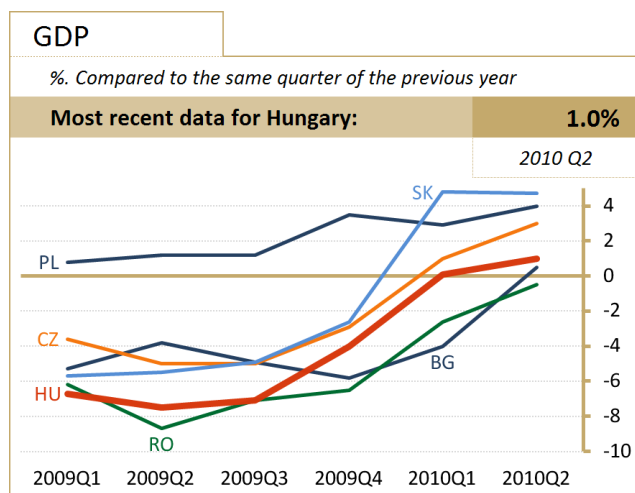
Population	10.0 million	Major Ethnic Groups	Hungarian 92.3%, Roma est. 6-8%
Religions:	Roman Catholic 51.9%, Calvinist 15.9%, Lutheran 3%, Greek Catholic 2.6%, other Christian 1%, other or unspecified 11.1%, unaffiliated 14.5% (2001 census)		
Head of State	President Pál SCHMITT (since August 6, 2010, end of term: 2015)	Head of Government	Prime Minister Viktor ORBÁN (since May 29, 2010, next parliamentary elections: 2014)

Government Officials	
Deputy Prime Minister, Minister of Public Administration and Justice - Tibor NAVRACSICS	
Deputy Prime Minister - Zsolt SEMJÉN	
Head of PM's Office, State Secretary - Mihály VARGA	
Minister of Economy - György MATOLCSY	
Minister of Human Services - Miklós RÉTHELYI	
Minister of National Development - Tamás FELLEGI	
Ministry of Rural Development - Sándor FAZEKAS	
Interior Minister - Sándor PINTÉR	
Minister of Defence - Csaba HENDE	
Foreign Minister - János MARTONYI	

Legislative branch	
386 seats; members elected by popular vote under a system of proportional and direct representation to serve four-year terms	
Government majority (263/386)	
<i>Fidesz - Hungarian Civic Union</i> (conservative, center-right, 226 seats, caucus leader: János LÁZÁR)	
<i>Christian-Democratic People's Party - KDNP</i> (Christian democrat, 37 seats, caucus leader: Péter HARRACH)	
Opposition	
<i>Hungarian Socialist Party - MSZP</i> (socialist, 58 seats, caucus leader: Attila MESTERHÁZY)	
<i>Jobbik - The Movement for a Better Hungary</i> (far-right, 47 seats, caucus leader: Gábor VONA)	
<i>Politics Can be Different - LMP</i> (green, 15 seats, caucus leader: András SCHIFFER)	
<i>Independent</i> (3 seats)	

Party Leaders	
Fidesz – Viktor ORBÁN (since 2003)	MSZP – Attila MESTERHÁZY (since 2010)
KDNP – Zsolt SEMJÉN (since 2002)	Jobbik – Gábor VONA (since 2006)
	LMP – collective leadership

Key Economic Indicators



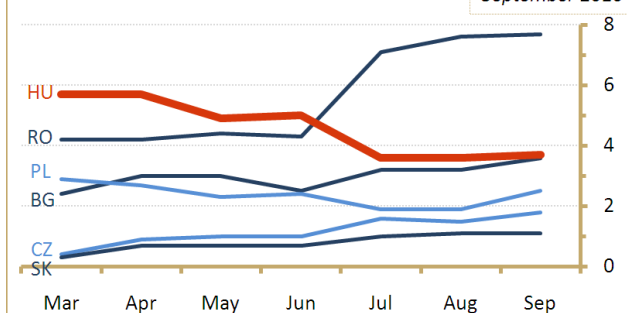
GDP AND BUDGET BALANCE ESTIMATIONS FOR HUNGARY												
	2010						2011					
	Fiscal Council	NBH	EU	IMF	OECD	EBRD	Fiscal Council	NBH	EU	IMF	OECD	EBRD
GDP Growth	1.0	0.9	0.0	0.6	1.2	1.2	2.9	2.8	2.8	2.0	3.1	2.1
Budget Balance	-4.0	-4.3	-4.1	-	-4.5	-	-4.2	-4.1	-	-4.3	-	-

Inflation

% , compared to the same month of the previous year

Most recent data for Hungary: **3.7%**

September 2010

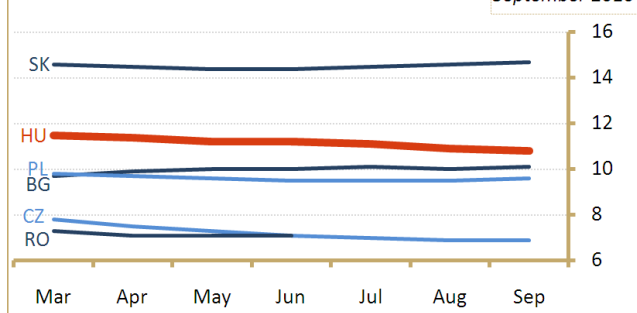


Unemployment

Seasonally adjusted unemployment rate

Most recent data for Hungary: **10.8%**

September 2010

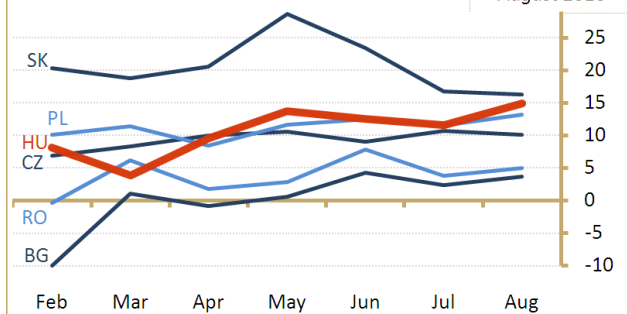


Industrial Production

% , compared to the same month of the previous year

Most recent data for Hungary: **14.9%**

August 2010

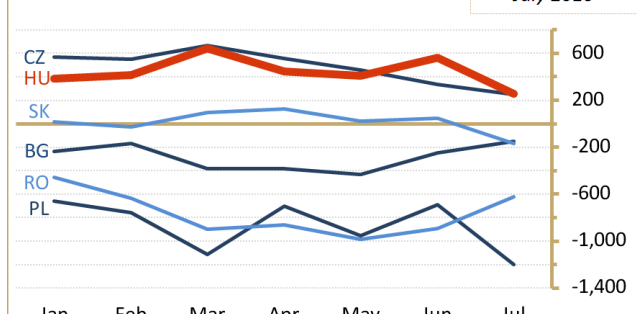


External Trade Balance

in € million

Most recent data for Hungary: **252.6**

July 2010

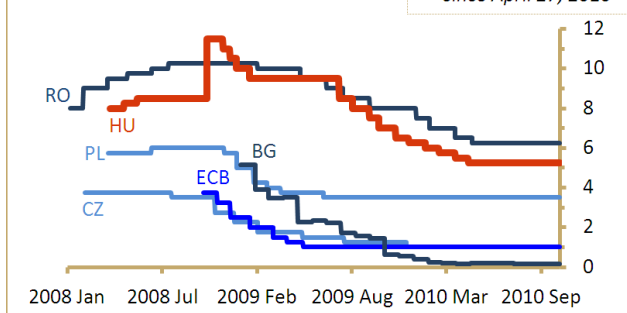


Base Interest Rates

%. Source: National banks and the European Central Bank

Most recent data for Hungary: **5.25%**

since April 27, 2010

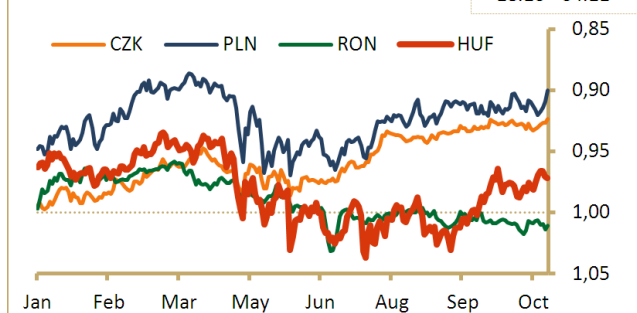


Euro Exchange Rates

2009 XCR Average = 1. Source: European Central Bank

Last 14 days' average of EUR/HUF: **273.8**

18.10 - 04.11



(Where not stated, the source of data is Eurostat.)

Calendar for the next weeks

Political events

08.11.2010.	Government submits chapters of its budget
12.11.2010.	The government submits its 'omnibus legislation' underlying the budget
20.11.2010.	Final vote on tax legislation
27.11.2010.	MSZP demonstration against limiting CC's jurisdiction
04.12.2010.	The Council for Higher Education debates the new educational policy
07.12.2010.	Parliament votes on total amounts budgeted for 2011

Economic events

09.11.2010.	External trade (KSH, January-September 2010, preliminary)
11.11.2010.	Consumer prices (KSH, October 2010)
12.11.2010.	Gross Domestic Product (KSH, Q3 2010, preliminary)
12.11.2010.	Industry (KSH, September 2010)
12.11.2010.	Statistical balance sheet of the NBH (NBH, October 2010)
15.11.2010.	Average daily turnover reported by resident credit institutions on the Hungarian FX market (NBH, October 2010)
15.11.2010.	Construction (KSH, September 2010)
15.11.2010.	Agricultural prices (KSH, January- September 2010)
16.11.2010.	Preliminary financial accounts (households, general government, NBH, Q3 2010)
18.11.2010.	International reserves – foreign currency liquidity (NBH, October 2010.)
19.11.2010.	Number of employees and earnings in the national economy (KSH, January-September 2010.)
22.11.2010.	Distribution of securities holdings by sector (NBH, Q3 2010.)
25.11.2010.	Retail sales (KSH, September 2010.)
26.11.2010.	Statistical report (KSH, September 2010.)
26.11.2010.	Employment and unemployment (KSH, August-October 2010.)
29.11.2010.	Monetary Council's Meeting (base rate setting)
30.11.2010.	Aggregated balance sheet of credit institutions (NBH, October 2010.)
30.11.2010.	Household and non-financial corporations sector interest rates (NBH, October 2010.)
30.11.2010.	Balance sheet of investment funds (NBH, October 2010.)
30.11.2010.	Investment (KSH, Q3 2010.)
30.11.2010.	Industrial producer prices (KSH, October 2010.)
01.12.2010.	Securities issues statistics (NBH, October 2010.)
20.12.2010.	External trade (KSH, January-September 2010.)
03.12.2010.	Benchmark yields on government debt securities (NBH, November 2010.)
03.12.2010.	Average yields of government securities at auctions (NBH, November 2010.)
03.12.2010.	The Budapest Stock Index (NBH, November 2010.)
07.12.2010.	International reserves (NBH, November 2010.)
07.12.2010.	Preliminary data about the change in the industrial output (KSH, October 2010.)

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