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Dear Minister Matolcsy, Dear György,

Thank you for your letter of 20 September and further information provided afterwards, in particular a "*Report on the consolidation measures to attain the 2012 deficit target*" provided in October and your letter of 4 November, on the fiscal consolidation strategy of the Hungarian government.

As regards the proposal to change the European VAT regulation in order to allow for the introduction of a 35% rate for luxury goods and your plan to increase the standard VAT rate from 25% to 27%, President Barroso and Commissioner Šemeta already communicated to you in separate letters the Commission's position on these matters. Therefore, let me focus in my response on our views on the Hungarian economic and budgetary outlook.

On the occasion of yesterday's publication of the Commission services' autumn forecast, I would like to recall the Council recommendations addressed to Hungary under the Stability and Growth Pact.

The Council Recommendation of 6 July 2009 under Article 126(7) of the Treaty set 2011 as the time limit for Hungary to correct the excessive deficit. Specifically, to this end, the Hungarian authorities were asked to, starting from 2010, rigorously implement the necessary consolidation measures, with increased reliance on structural measures, and ensure, at least, a cumulative 0.5% of GDP fiscal effort over 2010 and 2011.

However, the deficit figures projected by the Commission, 2.8% of GDP in 2012 and 3.7% of GDP in 2013, are higher than the official targets for 2012 and 2013. This forecast has incorporated many of the measures contained the October report. Yet, the Commission has a more pessimistic assessment on both the macroeconomic prospects and - partly linked to the latter - the budgetary outlook. Even considering the measures announce in you letter of 4 November, the risk of breaching the 3% of GDP deficit threshold in 2012 cannot be completely excluded. For 2013, at 3.7% of GDP, a breach of this threshold is expected since measures in the structural reform programme for that year have not yet been sufficiently substantiated.

Mr György Matolcsy
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Therefore, at this stage the excessive deficit cannot be considered to be corrected in a durable manner. Moreover, there was a cumulative deterioration of the structural budget balance of around 2¾% of GDP over 2010 and 2011 as opposed to the recommended cumulative improvement 0.5% of GDP.

Moreover, the first European Semester underlined that sound public finances must be complemented with structural reforms in order to bring Europe back on a path of sustained growth, as reflected in the Council's recommendations of 12 July 2011 addressed to Hungary. I therefore expect the necessary budgetary correction to be carried out with due regard to these recommendations.

I am committed to rigorously apply the new rules of economic governance from day one of their entering into force. As it stands, this would be in mid-December.

Given that the budgetary year 2012 will start soon, a Commission recommendation for a Council decision under Art. 126(8) followed by new recommendations under Art. 126(7) of the Treaty would become unavoidable in the absence of corrective measures that are spelled out in detail and legally adopted by mid-December. The Commission may also consider recommending to the Council to suspend the outstanding commitments from the Cohesion Fund.

I therefore call on you to take the necessary steps to ensure that 2012 target of 2.5% of GDP is met and that the structural reform measures supposed to back the 2.2% of GDP target for 2013 are fully substantiated as a matter of urgency to ensure a timely and lasting correction of the excessive deficit and the implementation of structural reforms according to the Council recommendations.

In this respect, and with a view to ensure Hungary's repayment capacity, I consider the forthcoming Post-Programme Surveillance mission, organised jointly with the IMF, very important. In particular, I expect that our services will be provided by sufficient information about the satisfactory progress regarding the structural reform programme including those areas, such as the local government and the public transport sector, the review of the disability pensions as well as the introduction of the electronic road toll, where significant additional savings and revenues are planned in 2013.

Yours sincerely,