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Hungary receives rescue package, with strings attached

International Monetary Fund, European Union and World Bank join together for £15.38bn bail-out

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The International Monetary Fund, the European Union and the World Bank announced a massive rescue package for Hungary today, in an attempt to save central Europe's former economic powerhouse from bankruptcy.

The $25.1bn (£15.38bn) bail-out, which was much larger than expected, aims to help restore investors' confidence in the country's financial markets and its currency, the forint, and marks the first time in the history of the EU that a member state has been rescued by the IMF.

The deal comes with strings attached, with the IMF insisting on an introduction of austerity measures to curb high public spending.

Right-wing politicians said the agreement endangered Hungary's independence and was an attack on its sovereignty, while some experts warned budget cuts could lead to job losses, exacerbating the already bleak economic situation and increasing the chances of recession.

Markets rallied on the news, boosting the forint after weeks in which it has been in freefall, losing about 20% of its value. The Polish zloty and Czech krona also made gains after what was seen as a message to all of Europe's emerging markets that a support network was in place to help them.

Dominique Strauss-Kahn, the IMF's managing director, said the loan programme - which includes £9.6bn from the IMF, £4.96bn from the EU and £790m from the World Bank - would "bolster the economy's near-term stability and improve its long-term growth potential".

The bail out came as the European Commission called for EU emergency funding available for struggling countries to be more than doubled from €12bn to €25bn.

After deciding to put up a third of the IMF-engineered package aimed at rescuing Hungary and stabilising the rest of post-communist central Europe, the commission said the crisis fund, last used 15 years ago, should be more than doubled by raising money on the markets through bond issues.

"Some member states and neighbours are under stress. We're ready to act," said Joaquin Almunia, the monetary affairs commissioner.

The call to more than double the "balance of payments facility", used as medium-term loans, is to be put to an emergency EU summit on the financial and economic crisis next week, a meeting that is to prepare the ground for the global economic summit in Washington a week later.

Jose Manuel Barroso, the commission's president, said he would unveil a more detailed "EU recovery plan" by the end of next month. Barroso spoke of reallocating spending and investments from the EU's six-year €350bn cohesion funds and of raising the capital base of the European Investment Bank earlier than planned.

The commission warned the financial meltdown was ballooning into an economic crisis that would cost jobs, hit business and households, and cut European growth "significantly" over the next two years.

The financial crisis came as a shock to Hungary, long seen as a solid investor base in former communist Europe. Until recently, the forint had enjoyed a strong standing because of the country's prospects of adopting the euro.

As a result of a strong forint and high interest rates, many Hungarians took out mortgages in foreign currency loans. Hungary's heavy dependence on borrowing from abroad at a time of worldwide economic instability had caused investors to question whether the country's economy could continue to survive.

The Hungarian central bank's move to increase interest rates by 3% to 11.5% last week did little to stop the flow of money abroad or to boost the forint, making the bail-out package - the equivalent of about a fifth of Hungary's annual economic output - a necessity.

It will now allow the Socialist government of Ferenc Gyurcsany to find sufficient funds to finance the 2009 budget. But austerity measures are expected to include a 300 bn forint (£920m) cut in spending, leading to the loss of highly-treasured social benefits which will hit pensioners and civil servants the hardest as their pensions and wages are curbed.

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