May 11. 2009.

Contracting demand

According to the forecast of GKI Economic Research Co. prepared in co-operation with Erste Bank, recessionary trends, which started in Autumn 2008, will continue, moreover, deepen, although the great global pessimism and market panic of the past weeks have eased. The Hungarian economy is influenced by both falling external demand-currently the contraction of Germany's GDP is expected to reach 6 per cent-and by the significant decline of domestic demand. Cuts in general government expenditures and the restructuring of taxes decided by the new government in order to achieve the new deficit objectives, too, have a recessionary impact. Hungary's GDP is expected to drop by about 5.5 per cent but at the same time the current account deficit is set to decrease markedly and internal disequilibria are likely to be in line with international requirements.

In the first months of 2009 production as well as trade decreased substantially. In the first quarter industrial output fell by 22 per cent (although in March it went up by 4 per cent compared to February). Until the end of February, the performance of construction dropped by 11 per cent, retail trade turnover by 4 per cent. In construction mainly the building of houses decreased, nevertheless, the number of homes and houses completed and handed over to owners still increased. In retail trade, sales of non-food products shrank mostly, particularly those of furniture and construction materials (by 14 per cent). Sales of motor vehicles and parts diminished sharply, by 30 per cent. At the same time with deteriorating income position of households as well as changes in consumer behaviour and relative prices, sales of second-hand products, fuel and mail orders were up, though moderately.

The surplus of the foreign trade balance reached EUR0.6 billion, a substantial value already in the first quarter. The shortage of financial market sources forces the external deficit to improve. In 2009 the external financing requirement is expected to drop to EUR2 billion equalling to 2.2 per cent of GDP from EUR7.8 billion in 2008. Foreign trade surplus increases substantially as a result of waning imports, and profit repatriation, too, declines as profits fall, although interest payments rise. Net EU transfers climb to about EUR2.5 billion in 2009 from EUR1.1 billion in 2008. The EUR2 billion deficit of the current and capital account is expected to be financed mostly from the IMF-EU stand-by loan facility.

Until the middle of the year, contracting demand as well as falling global energy and commodity prices will push Hungarian inflation further down to about 2.5 per cent by the middle of the year. The weak forint neutralises to some extent the impact of price decreases, which carries over to more and more product and service prices. From mid-2009, the expected rise in VAT and excise tax rates will accelerate inflation. As a result of the tax rate increases in the middle of the year, inflation may temporarily be close to 7 per cent by the end of the year, the annual average inflation rate is forecast to total about 4.5 per cent.

In the business sector the growth rate of gross earnings decelerated to 3 per cent by February already, and the annual average figure will be even smaller. In the public sector a 3 per cent nominal decrease is expected. Thus, gross earnings in general will increase only slightly, and an approximately 4 per cent drop is expected in real earnings. Taking into account the already implemented 3.1 per cent rise and calculating with the rejection of the payment of the second half of the 13th month pension, the real value of pensions will decrease somewhat more than that of subsidies provided for families. Purchased consumption will fall more than real earnings, by about 6 per cent. This is explained partly by increasing unemployment, but the main reason is the considerable jump in households' propensity to save. The latter trend is a consequence of rising instalments of credit re-payment, hard access to more expensive credits, and of rising interest rates on deposits and higher required own resources, the saving of which takes time. The savings ratio relative to GDP will increase to at least 5 per cent. Investments will drop by about 10 per cent, particularly because of the postponements of investments in machinery. As a consequence of the correction measures, the general government deficit is forecast to reach some 3 per cent of GDP.

Forecast of GKI Economic Research Co. on Developments in the Hungarian Economy in 2009

	2006	2007	2008	Jan-Feb 2009	2009 (forecast)
1. Volume of GDP (previous year=100)	104,1	101,1	100,6	-	94,5
2. Industrial production (constant prices, previous year=100)	110,1	108,1	98,9	77,7*	86,0
3. Investment in the national economy (constant prices, previous year=100)	93,8	101,5	97,0	-	90
4. Construction (constant prices previous year=100)	98,4	85,9	94,9	89,1	95,0
5. Retail trade (volume index, previous year=100)	104,4	97,0	98,2	95,9	95,0
6. Exports (current prices in euro, previous year=100)	116,6	115,7	105,6	73,7*	88
7. Imports (current prices in euro, previous year=100)	113,9	111,9	105,6	71,5*	85
8. Trade balance (EUR billion)	-2,4	-0,1	-0,2	0,6*	2,0
9. Balance of the current and capital account (EUR billion)	-6,2	-5,4	-7,8	-	-2,0
10. Average exchange rate of euro (forints)	264,3	251,3	251,2	297,0**	290
11. Deficit of the general government (cash flow basis, without local governments; billion forints)	2034	1291	907,1	604,1**	750
12. Index of average gross earnings	108,1	108,2	107,5	98,5	101,0
13. Consumer price index (previous year=100)	103,9	108,0	106,1	103,0*	104,5
14. Consumer price index at the end of the period (corresponding month of the previous year=100)	106,5	107,4	103,5	102,9*	106,8
15. Rate of unemployment (at the end of the period, per cent)	7,5	7,7	8,0	9,7*	10

* First quarter 2009
** January-April 2009
Sources of actual data: HCSO, NBH, MoF