

November 9, 2009.

## **Rising foreign trade surplus and unemployment**

**According to the forecast of GKI Economic Research Co. prepared in co-operation with Erste Bank, a 6-7 per cent drop of GDP is expected this year and stagnation is to come in 2010. External disequilibria are improving markedly, and internal disequilibria are likely to be in line with international requirements.**

The Hungarian economy has probably reached the bottom of recession: compared with the preceding quarter, some growth is expected in the fourth quarter of 2009. However, compared with the corresponding period of the previous year, modest growth is likely only in the second half of 2010.

In 2009 only mining and other manufacturing have expanded out of the branches of industry. Domestic sales of the pharmaceutical industry and export sales of the food industry also went up. The construction of buildings declined (by 13 per cent), however, other construction - such as roads - expanded by 11 per cent. Agricultural production will also substantially decrease, mostly because of the 25 per cent lower yields of grain crop (due to bad weather conditions). In retail trade sales of food products and FMCG dropped by 4.5 per cent, those of other goods by 7 per cent and those of motor vehicles by 36 per cent because of shrinking purchasing power and access to credit. Imports are declining much more than exports because domestic demand is contracting. In 2009 Hungary will not be relied on net external financing, because the loans taken will be used either to lift foreign exchange reserves or to repay loans borrowed earlier.

The rate of unemployment has reached two-digit levels already in the third quarter (10.3 per cent). Approximately a 11 per cent rate is expected at the end of the year, because of seasonal factors, the decline of employment (which follows the recession with a time lag) and the end of communal work offers. Decline is expected from the second quarter of 2010. Gross earnings increased by 1.3 per cent in the first eight months of 2009. The annual personal income tax rate bands were shifted higher as of 1 July and as a consequence of this, net earnings went up by about 3.5 per cent in July-August following a 1 per cent increase in the first half of the year. However, the approximately 2 per cent drop of real earnings has remained stable since May (as inflation started to accelerate also from July on). In 2009 a 4-5 per cent drop of real earnings is expected because of rising unemployment, the abolition of the 13th month pensions and the freeze of family support schemes in nominal terms. In 2010 real earnings will stay flat.

Consumer prices were 4.9 per cent higher in September than one year before; the price index was higher in September than in the first half of the year, but lower than in July-August. If the consumer price index is adjusted for the tax changes, the figure is a mere 1.1 per cent, which means that inflation decelerated substantially compared with the first half year were there no changes in taxation.

Despite the considerable contraction of the economy, the general government deficit will be around 3.9 per cent of GDP in 2009. In 2010 a 3.8 per cent deficit is expected, similar to the official target. International money markets would hardly tolerate a substantially higher deficit. However, it may happen that the public debt of state-owned companies will be consolidated by the next government - a practice not unprecedented in election years -, which may raise the deficit by a substantial one-off figure. If the operation of the companies concerned is reformed, international markets may accept a higher deficit.

**Forecast of GKI Economic Research Co. on Developments in the Hungarian Economy in 2009-2010**

|   | <b>2008.</b> | <b>2009. Jan-<br/>Aug</b> | <b>2009</b>       | <b>2010</b> |
|---|--------------|---------------------------|-------------------|-------------|
|   |              |                           | <b>(forecast)</b> |             |
| 1. Volume of GDP (previous year=100)  | 100.6        | 92.8*                     | 93.5              | 100         |
| 2. Industrial production (constant prices, previous year=100)                                       | 98.9         | 79.0**                    | 84                | 103.5       |
| 3. Investment in the national economy (constant prices, previous year=100)                          | 97.0         | 94.0*                     | 95                | 106         |
| 4. Construction (constant prices, previous year=100)  | 94.9         | 96.9                      | 95                | 106         |
| 5. Retail trade (volume index, previous year=100)   | 98.2         | 95.8                      | 95                | 100         |
| 6. Exports (current prices in euro, previous year=100)  | 105.6        | 76.8**                    | 86.5              | 104         |
| 7. Imports (current prices in euro, previous year=100)  | 105.6        | 70.7**                    | 80                | 106.5       |
| 8. Trade balance (EUR billion)  | -0.2         | 3.3**                     | 4.5               | 3.0         |
| 9. Balance of the current and capital account (EUR billion)   | -6.5         | 0.6*                      | 0                 | -0.5        |
| 10. Average exchange rate of euro (forints)   | 251.2        | 282.7***                  | 280               | 265         |
| 11. Deficit of the general government (cash flow basis, without local governments; billion forints) | 909          | 1047.7***                 | 1000              | 870         |
| 12. Index of average gross earnings   | 107.5        | 101.3                     | 102               | 101         |
| 13. Consumer price index (previous year=100)  | 106.1        | 103.9**                   | 104.2             | 103.5       |
| 14. Consumer price index at the end of the period (corresponding month of the previous year=100)    | 103.5        | 104.9**                   | 105.3             | 103         |
| 15. Rate of unemployment (at the end of the period, per cent)                                       | 8.0          | 10.3****                  | 11                | 10.5        |

\* first half of 2009

\*\* January-September 2009

\*\*\* January-October 2009

\*\*\*\* third quarter of 2009

Sources of actual data: HCSO, NBH, MoF