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Options for a budget

In the forecast of GKI Economic Research Co. prepared jointly with Erste Bank, the Hungarian economy will be close to stagnation in 2010, recovery or modest growth is expected only in the second half of the year.

Although technically the recession has come to an end in the world economy, neither the financial, nor the real economic crisis is over. Both the current Hungarian government and the coming one will have to pursue tight fiscal and income policies in 2010, which leaves some room for looser monetary policy. The budgetary law of 2010 reckons with a 3.8 per cent general government deficit. The reserve is planned mostly for handling the risks related to tax revenues; was there also extra spending, countermeasures will have to be taken. If the government wants to keep the deficit target, the 2010 budget can be assessed as correct, tight, and - although there are risks - realistic to attain. However, the new government can alter the fiscal policy and the deficit target may change as well. Politicians of the opposition party mentioned the risk of a 7.5 per cent deficit in 2010, mostly as a result of the so-called consolidation expenses, which are related to the Hungarian State Railways (MÁV), the Budapest Transport Company (BKV), the local governments, hospitals, government institutions, the taking over of some assets from the Hungarian Development Bank (MFB) and the possibility of drawing more of the state guarantees than planned.

Changing the current deficit target, which seems to be preferred by the opposition, is possible along three lines of thought. The starting point of the first approach is that actual government expenditures will be higher than planned earlier not only for 2010, but for a longer period of time as well. This would imply loose fiscal policy for many years and sharp confrontation with international institutions. The second option is that the 3.8 per cent 2010 target is kept - if problems emerge during the year, measures to increase revenues or cut spending will be taken - and exceeding the target is possible only to the extent of actual fiscal consolidation needs (together with corporate restructuring). Hence, allowing for this extra spending would not imply much additional purchasing power for 2010. Then, sustaining an approximately 4 per cent deficit would be announced for the coming years in order to lower taxes, for instance. The third option is that the new government starts in-depth reforms of the general government on the expenditure side together with further substantial cuts on taxes and charges imposed on employment. In this scenario, the consolidation (see the second option) is implemented so that the 3 per cent Maastricht criterion of the general government deficit is met by 2011. The stock of public debt as a share of GDP is expected to decrease from 2011 on and Hungary may join the eurozone in 2014 (or in 2013, if the public debt criterion is interpreted more flexibly). In accordance with this macroeconomic development path, Hungary joins the ERM-2 exchange rate mechanism in 2010 and announces the target date of accession to the European Monetary Union.

The first option is not quite feasible. Even if international institutions accept altering the budget, it can only be a one-off change implemented jointly with restructuring or reforms. If there is a fiscal policy change without the approval of international institutions, the financial markets may punish the Hungarian economy rather rigorously. However, the second option is probably and the third is definitely feasible. In these cases the 2010 deficit target may correspond to around 5 per cent of GDP, whereas it would stay at approximately 4 per cent without one-off consolidation expenditures. From the point of view of economists, the third option is the most favourable: investment climate could further improve helping to reduce the amount of interest payable on the public debt. In the longer term, taking this road could also leave more space for further tax reductions.

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

	2008	Jan.-Oct. 2009	2009 (forecast)	2010 (forecast)
1. Volume of GDP (previous year=100)	100.6	92.9*	93.5	100
2. Industrial production (constant prices, previous year=100)	98.9	79.8	84	103.5
3. Investment in the national economy (constant prices, previous year=100)	97.0	92.9	94	105
4. Construction (constant prices, previous year=100)	94.9	97.3	96.5	106
5. Retail trade (volume index, previous year=100)	98.2	95.3	95	100
6. Exports (current prices in euro, previous year=100)	105.6	77.9	87.0	104
7. Imports (current prices in euro, previous year=100)	105.6	71.6	80	106.5
8. Trade balance (EUR billion)	-0.2	3.8	4.8	3.3
9. Balance of the current and capital account (EUR billion)	-6.5	0.6**	0.5	0
10. Average exchange rate of euro (forints)	251.2	281.3***	280	265
11. Deficit of the general government (cash flow basis, without local governments; billion forints)	909	1123.7***	1000	870
12. Index of average gross earnings	107.5	100.9	101.0	101
13. Consumer price index (previous year=100)	106.1	104.1***	104.2	103.5
14. Consumer price index at the end of the period (corresponding month of the previous year=100)	103.5	105.2***	105.5	103
15. Rate of unemployment (at the end of the period, per cent)	8.0	10.4****	11	10.5

* Q1-Q3 2009
** First half of 2009
*** January-November 2009
**** August-October 2009
Sources of actual data: HCSO, NBH, MoF