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Economic policy dilemmas

According to the forecast of GKI Economic Research Co. prepared in co-operation with Erste Bank in 2010 the Hungarian economy will be close to stagnation, recovery with modest GDP growth is expected only in the second half of the year.

Recovery has started in the world economy, however, its speed is rather uncertain; the recovery process is unstable. The low utilisation of capacities holds investments back, the further deterioration of unemployment - which, at the same time, puts constraints on wage increases - hampers the rise of household consumption. Restructuring has not been finished yet in the European banking sector, confidence did not fully return, therefore credit supply is still limited. Fiscal stimuli cannot continue either, and stopping fiscal expansion and improving the balance is already on the agenda.

The decline has lasted for seven consecutive quarters in Hungary. The annual average drop of GDP was 6.2 per cent in 2009, consumption contracted by 6.7, investments by 6.5 per cent, and inventories were depleted. Industrial production and exports will rise already in the first quarter, however, in that period unemployment will peak and consumption will hit bottom. In the second half of the year, there will be some growth and inflation will be more moderate. Current external and internal equilibrium indicators may be excellent in a European comparison; they can be kept under the EU average even if structural reforms that require additional expenditures are implemented. Global and EU trends mostly determine the room of manoeuvring for the Hungarian economy, so the impact of the government to be inaugurated after the elections will probably be less substantial on economic trends in 2010 than what is generally expected (the effects on the subsequent period can be more considerable). The economic policy of the next government cannot manoeuvre against the expectations of the international money markets and institutions: tight fiscal and income policies will have to be pursued and the economy has to stay on the path of decreasing external debt and sooner or later lowering rates of indebtedness. In the short run only symbolic changes can be expected: e.g. submission of a supplementary budget, with dozens of small changes but not touching the basic trends.

Nonetheless, the government has to make the strategic decision in 2010 (e.g. when the convergence programme is updated) if it intends to adopt the euro by the end of its mandate (in 2014). The introduction of the euro requires further substantial changes and reforms including that of local governments, the education and the healthcare systems.

A "floating" economic policy, which tries to minimise conflicts might also be feasible. In this case the sustained 4 per cent level of general government deficit relative to GDP - still favourable within the EU for years - would be justified by cuts on taxes and by obtaining the necessary financial resources with as little conflict as possible. In this economic policy, which is a patriotic and state-centred approach, which means public financial resources to support Hungarian SMEs, farmers and state-owned corporations, is to play a more important role (which is likely to appear also in the communication of the next government). It is somewhat strange that this policy would hardly improve the competitiveness of the corporate sector, but there is a danger that GDP growth and the quality of public services will be poorer than could beoth4rwise (because of the increased role of the government and less stringent efficiency requirements).

In theory an economic policy with high redistribution that lifts the general government deficit and public debt and openly confronts international organisations is also possible. However, because of the developments that would emerge even in the short-term - depreciation, high interest rates, high rate of inflation, sustained stagnation, capital repatriation - this is not a realistic option.

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

	2008	2009	January 2010	2010. (forecast)
1. Volume of GDP (previous year=100)	100.6	93.7	-	100
2. Industrial production (constant prices, previous year=100)	98.9	82.3	103.4	103.5
3. Investment in the national economy (constant prices, previous year=100)	97.0	91.4	-	103
4. Construction(constant prices, previous year=100)	94.9	95.7	86.5	103
5. Retail trade(volume index, previous year=100)	98.2	94.8	94.0	98
6. Exports (current prices in euro, previous year=100)	105.6	81.1	114.6	105
7. Imports (current prices in euro, previous year=100)	105.6	75.3	102.7	107
8. Trade balance (EUR billion)	-0.2	4.0	0.3	3
9. Balance of the current and capital account (EUR billion)	-6.5	1.4	-	1.5
10. Average exchange rate of euro (forints)	251.2	280.6	270.5*	265
11. Deficit of the general government (cash flow basis, without local governments; billion forints)	909	918.6	351*	880
12. Index of average gross earnings	107.5	100.5	106.5	102
13. Consumer price index (previous year=100)	106.1	104.2	106.1*	104.3
14. Consumer price index at the end of the period (corresponding month of the previous year=100)	103.5	105.6	105.7*	103.3
15. Rate of unemployment (at the end of the period, per cent)	8.0	10.5	11.4**	10.5

* January-February 2010
** December 2009-February 2010
Sources of actual data: HCSO, NBH, MoF