July 5. 2010.

The emergency game is over

According to the forecast of GKI Economic Research Co. prepared in co-operation with Erste Bank, the output of exporting and service industries will expand most in 2010, which consists of first of all manufacturing, a segment of road transportation and inbound tourism. However, the turnover of firms selling their goods and services in the domestic market - e.g. those in construction and trade - continues to contract. In 2010, the rate of GDP growth is projected to total approximately 1 per cent.

As a consequence of the official communication envisioning economic emergency, moreover, state bankruptcy, the credibility of the Hungarian government and economy suffered serious damage. Credibility can only be restored by applying clear and sustained discipline in economic policy. As there is no more room for increasing the deficit, in 2010 an approximately 4 per cent general government deficit relative to GDP is forecast that is close to the figure accepted by Parliament. The 29-point Action Plan of the government elaborated in 3 days and announced by the Prime Minister at the beginning of June, is a necessary reaction to the situation: many of its elements indicate the appropriate direction, but the details are not necessarily sufficient. For the markets (for foreign actors and the EU) the most important message of the announcement was that the government would not take irresponsible steps enhancing the deficit to stimulate the economy. For the Hungarian society the main message of the Action Plan is that the government is on board.

Imposing a temporary levy on financial institutions in order to generate general government revenues in the amount of HUF200 billion in four months this year (corresponding to about half of the annual profits of financial institutions) seems to be unrealistic and it may have serious consequences on the already strict conditions to access to credit. The expected savings of HUF120 billion (by squeezing government expenditures) and nearly HUF 50 billion (by cutting on public sector wages) raise more questions, since - for instance - decreasing aggregate wages in state-owned companies do not have any positive impact on the budget. As in recent months the 2010 general government deficit was overestimated by the new government, it is not necessarily a problem if some of the yet unannounced but planned austerity measures are not implemented.

Assuming an economic policy agreed with the international institutions and counting also on the gradual stabilisation of international investor climate, the demand for Hungarian financial assets may increase again in the second half of 2010. In this case the central bank will be in the position to reduce its reference rate to about 5 per cent by the end of 2010. The exchange rate of the forint to the euro will be around HUF270 in the second half of 2010 that will be similar to the level of the first half but stronger than that of this June. Furthermore, when the convergence programme is updated in autumn, the declaration of meeting the general government criteria including both the deficit and the government debt by 2012 and 2013 the latest will be unavoidable. This would make the introduction of the euro by Hungary 2014 possible. In the circumstances outlined, announcing the introduction of the euro in 2014 and initiating the access to the ERM-2 mechanism by the end of 2010 would be reasonable. It could act as an economic policy anchor, enlarge the room for cutting the reference rate of the National Bank of Hungary, strengthen the capital absorption capabilities of the country and contribute to the acceleration of the potential growth in the years to come.

The external balance, too, will be rather favourable this year, there was an EUR0.8 billion surplus on the current and capital accounts already in the first quarter. In terms of the net position, Hungary will not need foreign financing sources - only a part of the loans due needs to be renewed - the current account will be balanced, and the overall external financing need will be in surplus valued at EUR2.4 billion (2.4 per cent of GDP), higher than last year. In 2010 Hungary's net foreign debt decreases to EUR48 billion from EUR 52 billion last year.

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

	2008	2009	April 2010	2010 (forecast)
1. Volume of GDP (previous year=100)	100.6	93.7	100.1*	101
2. Industrial production (constant prices. previous year=100)	98.9	82.3	105.7	106
3. Investment in the national economy (constant prices. previous year=100)	97.0	91.4	93.6	101
4. Construction (constant prices. previous year=100)	94.9	95.7	88.0	97
5. Retail trade (volume index. previous year=100)	98.2	94.8	95.3	98
6. Exports (current prices in euro. previous year=100)	105.6	81.1	118.0	112
7. Imports (current prices in euro. previous year=100)	105.6	75.3	114.1	112.5
8. Trade balance (EUR billion)	-0.2	4.0	1.8	4.2
9. Balance of the current and capital account (EUR billion)	-6.5	1.4	0.8*	2.4
10. Average exchange rate of euro (forints)	251.2	280.6	269.5**	273
11. Deficit of the general government (cash flow basis. without local governments; billion forints)	909	918.6	736.2**	930
12. Index of average gross earnings	107.5	100.5	104.5	103
13. Consumer price index (previous year=100)	106.1	104.2	105.8**	104.8
14. Consumer price index at the end of the period (corresponding month of the previous year=100)	103.5	105.6	105.1**	104
15. Rate of unemployment (at the end of the period. per cent)	8.0	10.5	11.4***	11.0

* First quarter 2010
** January-May 2010
*** March-May 2010
Sources of actual data: HCSO, NBH, MoF