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Exports play the main role

According to the forecast of GKI Economic Research Co. prepared in co-operation with Erste Bank, the rate of GDP growth driven mostly by exports will be approximately 1 per cent. The cycle of reduction in the official rate of the National Bank of Hungary is probably over, and the exchange rate of the forint to the euro will be weaker than previously thought: the annual average is expected to total about HUF 277.

The output of industry, which is the main engine of growth this year, expanded by 7.3 per cent in the first 5 months of the year. This is clearly the consequence of the favourable demand in external markets. Domestic sales of industry dropped further (by 5.6 per cent), exports surged (by 15.1 per cent). The performance of transportation and commercial lodgings increased as well. In May imports grew more rapidly than exports, however, the structure of imports was favourable: first of all imports of intermediary goods, parts and materials used for export production went up. The foreign trade surplus totalled EUR844 million higher than in the same period of 2009. The terms of trade improved by 0.3 per cent. The favourable trends are expected to continue in the rest of the year.

Industries selling their goods and services in the domestic market will have to face much poorer demand and less bright expectations. The shortage of demand is persistent in construction, the performance of housing construction declined by 34 per cent in the first half year. Retail trade cannot recover either; the decline is considerable especially in the case of durables and fuels (more than 10 per cent in the first 5 months of 2010). The expected growth of domestic sales in the rest of 2010 is constrained by the efforts of companies to reduce costs and the enforced savings of households. Therefore, the export-driven nature of growth prospects is not likely to change. In 2010 the rate of GDP growth is projected to reach 1 per cent.

The room of manoeuvring for the Hungarian government's economic policy is determined foremost by the size of general government deficit that is acceptable for international institutions and financial markets. In the given the international environment, the government's vision on state default proved to be a serious tactical mistake at the beginning of June, the unfavourable impacts of which could be dampened by reinforcing the government's commitment to the 3.8 per cent deficit target relative to GDP for this year and launching a 29-point action plan. However, the suspension of the negotiations with the EU and the IMF caused new negative waves in July. As a result of this, confidence in the Hungarian economy worsened considerably. Nevertheless, the final outcome (and the negotiations with the EU) will be determined mostly by the 2011 budget, the revised convergence programme and by government intentions concerning changes in economic policy.

Because of the specific features of the crisis management strategy, Hungarian inflationary trends have not been in line with international ones since the beginning of 2009. The carryover effects of the tax rate increases will fade away in the second half of the year; this and the stagnating purchasing power will moderate the rate of inflation. By the end of the year the rate of inflation will decrease to about 4 per cent month-on-month, the annual average one is expected to equal to 4.8 per cent. A higher price index is also likely if oil prices (expressed in forints) set to increase faster and if vegetable and fruit prices set to climb.

Due to the recent increase of the country risk of Hungary, the official interest rate cuts by the National Bank of Hungary stopped at the 5.25 per cent level. Raising the rate still this year cannot be excluded. The average exchange rate of the forint to the euro was HUF270 in the first half of the year; it is likely to range above HUF280 in the second one resulting in an annual average of HUF277.

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

	2008	2009	May 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	107.3	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	88.4	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	119.1	112
7. Imports (current prices in euro. previous year=100)	105.6	75.3	116.4	112.5
8. Trade balance (EUR billion)	-0.2	4.0	2.2	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	273.3***	277
11. Deficit of the general government (cash flow basis. without local governments; billion forints)	909	918.6	1033.6***	930
12. Index of average gross earnings	107.5	100.5	103.4	103
13. Consumer price index (previous year=100)	106.1	104.2	105.7**	104.8
14. Consumer price index at the end of the period (corresponding month of the previous year=100)	103.5	105.6	105.3**	104
15. Rate of unemployment (at the end of the period. per cent)	8.0	10.5	11.1****	11.0

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