August 30. 2010.

Improving economy - deteriorating international trust

According to the forecast of GKI Economic Research Co. prepared in co-operation with Erste Bank, the rate of growth of Hungary's GDP will be around 1 per cent due to the rapid expansion of exports and the improvement of domestic demand - the latter is expected to take place only at the end of the year. The assessment of the Hungarian economy by financial markets has deteriorated since the elections: the forint saw sustained weakening, the market rate and the country risk increased, thus the official rate of the central bank could not be cut further.

Following the 0.1 per cent growth in the first quarter, Hungary's GDP was up by 1 per cent compared to the same period of 2009. This lags substantially behind the EU average, which is the consequence of the following factors: whereas Hungarian exporting firms could fairly well profit from the improving European - especially German - business cycle, sectors focusing on the domestic market have thus far continued to decline in Hungary.

This ambiguous trend is prevalent in industry as well, which is the engine of Hungarian economic growth. Exports went up by 17 per cent in the first quarter, domestic demand dropped by 5 per cent. However, Hungarian industry could grow by 4 percentage points more dynamically than the EU average. In construction and retail trade the situation is the other way round. The sharp decline of construction has continued in Hungary in the second quarter, while growth has started in the EU. Retail trade is also contracting in Hungary, whereas this sector stays flat in the EU - yet there are great differences by countries.

Although real income grew by 3.7 per cent in the first half of the year, so far consumption did not expand, moreover, its recovery can only be expected in the Christmas season at best. One of the reasons is that unemployment, which peaked in spring, is decreasing only very slowly, and this fall will probably be only temporary as there are more job opportunities in summer. In addition, the real value of pensions and family allowances is smaller than last year, whereas the monthly instalments of credits are increasing because of the weak forint, access to new loans is difficult, and households are not yet brave and cannot consume and invest.

Nonetheless, the competitiveness of domestic producers and manufacturers is usually improved by the weaker forint, although this impact is reduced by the volatility of the exchange rate. At the same time, the interest rate that is stuck at a high level, and the levy to be imposed on the financial sector that causes credits to be more expensive and less accessible will dampen especially the prospects of SMEs.

Inflation cooled to 4 per cent in July as the impact of the tax increases introduced in the middle of 2009 started to phase out. Stagnating purchasing power is also a limiting factor to higher prices. However, due to the forint, which stays weak as compared to the first half year, and the bad crops harvested in the world and in Hungary there is an increasing price pressure in the case of imported goods and food products. Therefore, the rate of inflation can be above 4 per cent at the end of the year. The reduction of the official rate of the central bank stopped at the 5.25 per cent level, and an increase in the rate this year cannot be excluded either. The average exchange rate of the forint to the euro was HUF270 in the first half of the year, it is expected to go to above HUF280 in the second half, so an annual average rate of HUF277 is expected in 2010.

The assessment of the Hungarian government deteriorated significantly because of the "state bankruptcy vision" of the government at the beginning of June, and then because of suspending the negotiations with the EU and the IMF in July. These steps could have had worse impacts, if there was no general expectation that the government will pay the necessary attention to disequilibria after the local government elections. Meeting this expectation will be measured by the 2011 budget and the contents of the revised convergence programme. If they are welcome by international institutions and financial markets, then confidence in Hungary can increase again, which will have a positive impact on the exchange rate and on interest rates. Until then, relatively considerable volatility of the exchange rate is expected.

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

	2008	2009	June 2010	2010. (forecast)
1. Volume of GDP (previous year=100)	100.6	93.7	100.5	101
2. Industrial production (constant prices. previous year=100)	98.9	82.3	109.0	108
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	86.2	93
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	119.8	116
7. Imports (current prices in euro. previous year=100)	105.6	75.3	117.0	115
8. Trade balance (EUR billion)	-0.2	4.0	2.8	5.0
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	103.0	103
13. Consumer price index (previous year=100)	106.1	104.2	105.4**	105.0
14. Consumer price index at the end of the period (corresponding month of the previous year=100)	103.5	105.6	104.0**	104.3
15. Rate of unemployment (at the end of the period. per cent)	8.0	10.5	11.0***	11.0

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