

Economic recession, approaching euro

The forecast prepared by GKI Economic Research Co. in co-operation with Erste Bank shows that in the radically changed global economic environment the Hungarian economy takes a completely new path as well.

The main characteristic of this new path is that both the internal and external balances improve much faster than previously planned but at the same time the economy practically stagnates, the unemployment grows, the inflation and the number of people employed decreases. The improvement of the financial balance of the economy is due to several factors: the increase in the net savings of households; the fact that the increment in the investments of the private sector will be less than the increment of the EU transfers; but in 2009 the most important factor will be the reduction of the general government deficit to approximately 2.5% of GDP.

In the coming months and in 2009 the external and internal demand will grow very slowly or will not grow at all. While the global panic in the money and capital markets may abate even before the end of the year, the access to credits becomes more difficult, the growth prospects are gloomy. After the last year's 1.1% the growth of the economy accelerates to about 2% in 2008, but will decrease again to approximately 0.5% in 2009. The stagnation or recession in the EU reduces the export opportunity for the Hungarian economy. The foreign trade turnover slows down drastically, but the volume of exports continues to expand faster than that of the imports. Among the export driven branches of the industry major problems are expected in the production of motor vehicles – since this branch is very sensitive to deterioration of credit conditions. In this branch there are big differences in the position of various producers. Less problems are expected in the electronics industry, which is strongly influenced by the fast change of fashion.

The uncertain perspectives and the expensive credit hinder the investment activities. The EU transfers will be enough only to replace government contribution. Housing construction will decline. Consumer demand will be limited, because real wages will grow modestly this year and will decrease next year approximately to same extent. Borrowing possibilities are limited, while the amounts needed for the amortization of loans borrowed earlier is growing. The high interest rates and the increasing uncertainty strengthens the propensity to save: especially savings in highly liquid assets: e.g. short term bank deposits and government papers.

Inflation will decline fast in the last months of 2008 and at the beginning of 2009 – mainly due to drop in global energy and agricultural prices but also because of the high basis. In 2008 an annual average 6.2% inflation is expected (5% at the end of the year); in 2009 the annual average will be around 3.9% (3.5% at the end of the year). Because of the uncertainty in the international money market the exchange rate of the forint will be volatile but with a tendency of strengthening. At the end of the year the euro exchange rate will be below 260 forints and in 2009 the annual average expected around 250 forints.

If the international money market stabilizes and the Hungarian general government deficit will continue to decrease from this year's 3.4%, then the excessive deficit procedure against Hungary will come to an end in the spring 2009. As the inflation decreases below 4% Hungary will come close to the criteria of the entry into the euro-zone. Thus, Hungary may enter the ERM-2 system in the near future. After the approval of the new fiscal rules and of the 2009 budget, the government may announce the date of introduction of the euro – most probably 2012. This would strengthen the confidence in the Hungarian economy and the forint.

Forecast of GKI Economic Research Co. on Developments in the Hungarian Economy in 2008

	2006	2007	Jan-Aug 2008	2008 (forecast)	2009
1. Volume of GDP (%)	104.1	101.1	101.9*	102.0	100.5
2. Industrial production (constant prices %)	110.1	108.1	103.1**	102.0	101.5
3. Investment in the national economy (constant prices %)	93.8	101.5	96.7*	100.0	103.0
4. Construction (constant prices %)	98.4	85.9	89.8	93.0	104.0
5. Retail trade (volume index %)	104.4	97.0	98.0	98.5	99.5
6. Exports (current prices in euro %)	116.6	115.7	110.7**	108.0	104.0
7. Imports (current prices in euro %)	113.9	111.9	109.9**	107.5	103.0
8. Trade balance (bn. euros)	-2.4	-0.1	0.2**	0.0	0.6
9. Combined balance of the current & capital accounts (bn. euros)	-6.2	-5.4	-2.6*	-5.1	-3.0
10. Average exchange rate of euro (forints)	264.3	251.3	249.1***	250	250
11. Deficit of the general government (cash flow basis, without local governments; bn. forints)	2034	1291	731.0**	860	780
12. Index of average gross earnings	108.1	108.2	108.0	107.8	104.0
13. Consumer price index	103.9	108.0	106.7**	106.2	103.9
14. Consumer price index at the end of the period (corresponding month of the previous year=100)	106.5	107.4	105.7**	105.0	103.5
15. Rate of unemployment (at the end of the period, %)	7.5	7.7	7.7****	7.9	8.2

* H1 2008

** Jan-Sept. 2008

*** Jan-Oct. 2008

**** Q3 2008

Sources of actual data: CSO. NBH. MoF