

Inevitably fast improvement of internal and external balance

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 must take a completely new path as well. The recession is unavoidable, while its duration is uncertain. At the same time the internal and external balance of the economy is improving fast by necessity.

The policy of economic adjustment introduced in Hungary in the fall of 2006 eased in the first half of 2008, but in the wake of the global financial crisis and the speculation against the forint made the accelerated reduction of the general government and balance of payment deficit inevitable. The deficit of the general government in 2008 is expected to be around 3.3% of GDP, which is still high, but taking into account the balance of the pension funds – which is permitted by the EU – the deficit is below 3%, i.e. fulfills the Maastricht criterion. As a result, the excessive deficit procedure against Hungary will be lifted in the spring of 2009. Moreover, if Hungary fulfills the act on the 2009 budget, the deficit could easily be below 3%, even without the pension fund correction, which is very important for the introduction of the euro and the restoration of the confidence of the international financial community.

The reduction of the balance of payments deficit became inevitable as well because in the present money market situation the access to foreign sources is both difficult and costly. In fact the scarcity of sources compels the reduction of the external deficit. Both the investment and consumer demand will shrink – due partly to the economic crisis, partly to the scarcity and cost increase of the credit sources.

The output of the economy is expected to fall in 2009 by 1-1.5%, because the external demand barely grows and the internal demand shrinks. The EU transfers can only slow down the decrease of the investment demand and the proliferation of the liquidity problems.

Next year gross earnings will increase by approximately 2-3% in the national economy and virtually stagnate in the budgetary sector. Inflation will slow down considerably; nevertheless, real earnings will decrease by approximately 1.5% (but only minimally in the competitive sector). Employment will shrink palpably compared with the situation in autumn 2008. The propensity to save of the households will be strengthened. This will be the result partly of difficult access to and high cost of credit, partly of high yield on deposits and other financial instruments. The share of own contribution demanded from the borrowers is growing and its accumulation is time-consuming.

Inflation will slow down fast at the end of 2008 and beginning of 2009 – because of the high basis and the fall of global energy and agricultural prices. In 2008 the average annual price increase will be 6.2% (at the end of the year around 4.5%); in 2009 the average price increase is expected at 3.5% (at the end of the year around 3.2%). In the uncertain global financial environment the exchange rate of the forint will be volatile, but with a tendency of strengthening. The fact that the cut in the central bank base rate at the end of November was followed by strengthening of the forint, shows that in the coming months there may be a series of smaller or larger rate cuts. At the same time if Hungary enters the ERM-2 system and declares the planned date of the introduction of the euro (2012 or 2013), this would strengthen the confidence in the Hungarian economy and the forint. The result would be faster rate cuts and stronger forint.

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

	2006	2007	Jan-Sept 2008	2008	2009
				(forecast)	
1. Volume of GDP (%)	104.1	101.1	101.5	101.2	98.7
2. Industrial production (constant prices %)	110.1	108.1	101.9*	100.0	100.0
3. Investment in the national economy (constant prices %)	93.8	101.5	97.1	98.0	97.0
4. Construction (constant prices %)	98.4	85.9	92.0	93.0	97.0
5. Retail trade (volume index %)	104.4	97.0	98.0	98.5	97.0
6. Exports (current prices in euro %)	116.6	115.7	110.7	108.0	103.0
7. Imports (current prices in euro %)	113.9	111.9	109.9	107.5	101.0
8. Trade balance (bn. euros)	-2.4	-0.1	-0.2	0.0	1.3
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	250.3***	251	255
11. Deficit of the general government (cash flow basis, without local governments; bn. forints)	2034	1291	731.0*	860	620
12. Index of average gross earnings	108.1	108.2	108.0	107.8	102.5
13. Consumer price index	103.9	108.0	106.5*	106.2	103.5
14. Consumer price index at the end of the period (corresponding month of the previous year=100)	106.5	107.4	105.1*	104.6	103.2
15. Rate of unemployment (at the end of the period, %)	7.5	7.7	7.7****	7.9	8.5

* Jan-Oct. 2008

** H1 2008

*** Jan-Nov. 2008

**** Aug-Oct. 2008

Sources of actual data: CSO. NBH. MoF