

## Three economic policy challenges

According to the forecast of GKI Economic Research Co., in 2011 the government was finally forced to do what it wanted to avoid, and to implement a program envisaging some structural changes. The announcement of the Szell Kalman Plan shows that it took 10 months for Hungarian economic policy to formulate those questions for which the answers should have been given in summer 2010.

At the beginning of 2011 the government faced three major economic problems. First, it became clear that the measures taken in 2010 were **not going to yield a spectacular acceleration** of economic development. The burden on businesses has increased since the lowering of corporate tax rates affected only a small number of companies, and the flat personal income tax rate made some wage increases necessary to keep the level of net earnings unchanged for more than half of the employees. Credit supply has tightened (due to the special levy imposed on banks, nonperforming mortgage loans, and the increase in forint interest rates). The main beneficiaries of tax changes, in most part those with higher incomes, would rather opt for raising their savings. The crisis levies restrict the activity of the firms concerned. The slow start of the new Széchenyi Plan, as well as the decision to freeze the payment and the distribution of EU funds, which limits investment demand, have also adverse effects on the economy. The lack of predictability, the further deterioration of transparency, and anti-foreign bias inhibit new foreign capital investments.

The **second** problem is that the **structural deficit of the general government will increase** in 2011 (instead of its assumed reduction), **threatening with the suspension of EU funds aiming at investments**. This is the reason behind the HUF250bn freezing in the budget. However, it might become necessary to spend HUF50bn to cover the extra expenditures of local governments and HUF100bn to offset the lost general government revenues, thus only HUF100bn would remain for meaningful improvement in the balance. It is questionable whether the EU would be satisfied with the structural deficit that can be achieved this way (essentially of the same magnitude as last year). If not, **further corrective actions** may also be considered **in this year's budget**.

The **third** problem is the **most serious one**: the dominance of the transitional arrangements will cause **huge holes in the budget already in 2012, but particularly in 2013** (HUF450bn and HUF700bn, respectively). Since the **EU directs its attention on sustainability** in the framework of the European Economic Semester introduced this year, this problem will come into focus in April and May 2011. Additional risks are posed by the Constitutional Court proceedings on the nationalization of the private pension fund assets and the EU infringement proceedings because of the extra tax levied on the telecommunications sector. Aimed at creating a sustainable balance, the **Szell Kalman Plan** seeks solutions to these three problems. The English version of its text contains important steps into the right direction; however, its implementation is uncertain owing to the **lack of detailed programs, its dubious social acceptance, and the continued double talk**.

**Although the base of economic growth will be somewhat broader, its driving force remains industrial exports**. Recession in domestic demand will come to an end; however, only a slight recovery can be expected in 2011. Reaching the sixth consecutive years of decline, construction may slightly recover in the second half of 2011. Services are developing only very modestly. Low deposit interest rates indicate that there is no need for new resources (and in a way they compensate for the effects of crisis levies). The number of homes built will decline further to 16-18 thousand units from 20.8 thousand ones in 2010. A slight expansion of retail trade is likely, mainly in the sale of vehicles and consumer durables. GDP will grow at a rate of about 2.5 per cent in 2011. **The acceleration over the last year, however, will be generated almost entirely by agriculture (weather factors)**.

In 2011 the annual average rate of inflation is expected to total 4.2 per cent (energy, fuel and food price indexes will go up by 6-7 per cent); 4 per cent MoM at the end of the year. The **real income of households** (after the disbursement of the real yields of private pension funds) **will increase by about 2 per cent**. Income differentiation will be more intense.

## The forecast of GKI Economic Research Co.: the Hungarian economy in 2011

	2008	2009	2010	01/2011	2011 (projection)
1. Volume of GDP (previous year=100)	100.8	93.3	101.2	-	102.5
2. Industrial production (constant prices, previous year=100)	98.9	82.3	110.5	113.6	109
3. Investments in the national economy (constant prices, previous year=100)	100.4	93.5	94.4	-	101
4. Construction (constant prices, previous year=100)	94.9	95.7	89.9	95.8	97
5. Retail trade (volume index, previous year=100)	98.2	94.8	97.7	100.1	101.3
6. Exports (current prices in euro, previous year=100)	106.3	80.6	121.4	126.1	117
7. Imports (current prices in euro, previous year=100)	106.6	75.2	119.4	130.2	118
8. Trade balance (EUR billion)	-0.3	3.7	5.5	0.4	6
9. Balance of the current and capital account (EUR billion)	-6.8	0.8	3.8	-	4.5
10. Average exchange rate of euro (in HUF)	251.2	280.6	278.7	272.4 *	275
11. Deficit of the general government (cash flow basis, without local governments; HUF billion)	909	918.6	870	559.7 **	690
12. Index of average gross earnings	107.5	100.5	101.4	101.6	103.5
13. Consumer price index	106.1	104.2	104.9	104.0	104.2
14. Consumer price index at the end of the period (corresponding month of the previous year=100)	103.5	105.6	104.7	104.1	104
15. Rate of unemployment (at the end of the period, per cent)	8.0	10.5	10.8	11.2 ***	10.7

\* January-March 2011

\*\* January-February 2011

\*\*\* November 2010 – February 2011

Sources of actual data: HCSO, NBH, MoF