



Consumption drops by 3 per cent next year

According to the forecast of GKI Economic Research Co. prospects for the next year are gloomy, and recession is looming, though less deep than two years ago. This is only in part a consequence of the worsening global economic environment. The austerity measures of Hungarian economic policy prevented an increase in domestic demand and the development of the economy more than previously envisaged.

The state of the Hungarian economy in 2011 is in many respects worse than last year, and where it seems to be better, it is only imaginary (except the improvement of the external balance). Economic growth is only accelerating due to the favourable agricultural harvest caused by good weather. There is no substantial improvement in the labour market. The real general government deficit is much larger now than last year. (The deficit, excluding one-off revenues, will rise to 5 per cent of GDP this year from 2 per cent in 2009.) The general government debt will only decrease due to the nationalization of private pension funds and the reduction of foreign exchange reserves. Companies ready for economic development and investments are overtaxed and their willingness and opportunities to invest are worsening. The government used up a part of the previously accumulated reserves, and income reserves of small businesses and individuals are also being depleted. The money market assessment of Hungary began to deteriorate again in the summer of 2011, and the idea of the preferential lump sum repayment of FX-loans weakened the exchange rate of the forint to the euro to around HUF300. The Hungarian risk premium rose to a very high level. This year the annual average exchange rate of the forint to the euro is above HUF275, in the next few months it will be around HUF290 and in 2012 it is expected to be around HUF285. The National Bank of Hungary may be forced to raise the base rate to 6.5 per cent by the end of the year, and to 7 per cent by the middle of next year.

Economic policy has reached a dead end. Instead of the expected stabilizing effect, the two-thirds majority of the governing parties in Parliament resulted in unpredictable economic decision-making without proper social and professional control. GKI believes that the government should reconsider its so-called tax-cutting fiscal policy, which is, in fact, a tax restructuring one. The tax reduction part of this policy (lowering the corporate tax rate and the personal income tax burden of high-income people) has entailed neither consumption nor investment increases, whereas the gradual phasing out of tax compensation for low-income employees, as well as the various crises and other taxes in the business sector have led to a decline in demand, employment and investments. The main purpose of Szell Kalman Plan was to combat the government debt. Until now this has been no more than mere rhetorical practice. The measures excessively focus on curbing social transfers and on increasing the burdens on companies instead of institutional and operational reforms, whose implementation is also delayed. This is why it became necessary to announce further tax increases.

The government plans to continue the personal income tax reform in 2012. In order to maintain the net worth of the current minimum wage level (HUF78 thousand), it is planned to be raised to HUF92 thousand (by almost 20 per cent). In order to maintain the net earning of people, irrespective of the tax changes, an average gross wage increase of nearly 7 per cent would be needed, while keeping the level of real wages unchanged, about 11 per cent. It is obvious that the majority of companies cannot and will not implement this increase (or if seemingly implement, they will reduce employment and/or make their activities "grey"). Taking into account the great number of uncertainty factors, GKI forecasts an average 1.5 per cent decrease in real earnings in 2012, while gross earnings will rise by 5 per cent. People having gross earnings around HUF140-HUF150 thousand will suffer a decline in net or real wages because a 7–19 per cent increase in earnings, depending on their current wage levels, is impossible. Only the wealthy and high-income people can benefit by the preferential repayment option of FX-loans. It will cause serious losses to banks, increase risk premiums, deteriorate the forint exchange rate, and raise the forint interest rates. Its price will be paid by the whole society. The real income is expected to decrease by 2.5 per cent, and consumption by 3 per cent. Investments are unlikely to increase in 2012, even after three years of fall (due to the huge losses passed on the banks and the lack of predictability). GDP will grow at a rate of around 1.5 per cent this year, and it is expected to decrease by 1 per cent next year.

The forecast of GKI Economic Research Co.: the Hungarian economy in 201-2012

	2009	2010	Jan-July 2011	2011	2012
				forecast	
1. Volume of GDP (previous year=100)	93.2	101.3	102.0*	101.5	99
2. Industrial production (constant prices, previous year=100)	82.3	110.5	106.7	105	105
3. Investments in the national economy (constant prices, previous year=100)	93.5	94.4	96.0*	98	100
4. Construction (constant prices, previous year=100)	95.7	89.9	89.4	90	97
5. Retail trade (volume index, previous year=100)	94.8	97.7	99.7	99.7	97
6. Exports (current prices in euro, previous year=100)	80.6	121.4	116.4	110	111
7. Imports (current prices in euro, previous year=100)	75.2	119.4	114.4	108.5	109
8. Trade balance (EUR billion)	3.4	5.5	4.2	7	9
9. Balance of the current and capital account (EUR billion)	1.4	3.8	1.9*	4.2	4.5
10. Average exchange rate of euro (in HUF)	280.6	275.4	271.2**	275	285
11. Deficit of the general government (cash flow basis, without local governments; HUF billion)	918.6	870	1544.6***	1190	750
12. Index of average gross earnings	100.5	101.4	104.0	104	105
13. Consumer price index	104.2	104.9	103.9***	103.8	104.8
14. Consumer price index at the end of the period (corresponding month of the previous year=100)	105.6	104.7	103.6***	103.6	104.6
15. Rate of unemployment (at the end of the period, previous year=100)	10.5	10.8	10.8****	11.0	10.8

* First half of 2011

** First three quarters of 2011

*** January-August 2011

**** June-August 2011

Sources of actual data: CSO, NBH, NGM