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Signs of recession

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. Inflation is accelerating, the general government deficit is larger than planned, however, it probably will be less than 3 per cent. The external balance continues to improve, mirroring the decline of domestic demand. The government debt to GDP ratio will probably not decrease.

Recent economic data show a slowdown in growth and a continued downturn in many sectors. Industrial production is declining steadily over the year, its level was 1.3 per cent lower in August than in July. Nearly half of the industrial exports comes from two manufacturing subsectors. Vehicle manufacturing exports continued to expand significantly in August (by 20 per cent), whereas exports of computers, electronic and optical products have been decreasing for five months. Domestic industrial sales have not grown in any month since October 2010. Industrial exports will continue to go up in 2012 due to automotive investments starting their production gradually, but domestic sales will continue to fall. Around 5 per cent of industrial growth can be expected in 2011 and in 2012 each.

There has been a recession in construction for five years and it is expected to continue. This is caused by the lack of major investment projects and a significant decline in housing construction. In late August the volume of valid contracts was one-third lower than a year ago. In the first eight months retail sales only approached their levels reached one year ago and this will hardly change in the rest of this year due to the burdens associated with the amortization of bank loans and the preferential repayment of FX-loans. Next year real earnings are expected to decrease by 1.5-2 per cent owing to the change in the personal tax system, including the gradual phasing out of tax compensation, resulting in an additional, approx. 3 per cent drop in retail sales. It is typical that this year, in addition to internet commerce, only the turnover of relatively cheap luxury perfumery and second-hand goods has been noteworthy. Owing to good weather, agricultural production increased by 20 per cent this year. As a result of this, the growth of GDP will not slow down compared with the previous year.

Although employment will slightly mount in 2011, according to GKI surveys the companies' intentions to employ have been declining for several months. Layoffs can be anticipated in 2012 due to an expected restructuring in the public sector, the loss of markets of the business sector and increasing wage costs. The expansion of part-time public employment as a substitute for unemployment benefit may improve the situation only statistically.

Inflation is likely to fluctuate in the range of 4-5 per cent between 2009 and 2012. This year the average rate of inflation is expected to be 3.8 per cent, whereas next year it will be higher, around 4.8 per cent, as a result of tax increases and the weakening of the forint, in spite of declining purchasing power. The planned general government deficit of 2.5 per cent of GDP in 2012 is unlikely to be achieved. On the one hand, the tax-bearing capacity of the economy is deteriorating in recession, in spite of the increasing number of tax types. On the other hand, the systematic reduction of expenditures envisaged in the Szell Kalman Plan seems to go into oblivion. The government is under great international political and financial market pressure to keep the deficit below 3 per cent of GDP. Therefore, the general government deficit will probably be around 2.9 per cent in 2012. However, a lot of steps will still be needed this year and next year to achieve it. International markets welcomed the decisions taken at last week's EU summit. However, its effects might only be temporary. As a matter of fact, they have not been felt in Hungary, and the depreciation of the forint, experienced in recent months, has continued. As a result of the rising risk premiums, the alarmingly reduced demand for Hungarian government securities and the likely downgrade of the Hungarian economy, market interest rates will rise, and the National Bank of Hungary may be forced to raise its base rate.

The forecast of GKI Economic Research Co.: the Hungarian economy in 2011-2012

	2009	2010	Jan-Aug 2011	2011 forecast	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	89.1	90	97
5. Retail trade (volume index, previous year=100)	94.8	97.7	99.8	99.7	97
6. Exports (current prices in euro, previous year=100)	80.6	121.4	116.0	110	111
7. Imports (current prices in euro, previous year=100)	75.2	119.4	114.2	108.5	109
8. Trade balance (EUR billion)	3.4	5.5	4.7	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**	277	285
11. Deficit of the general government (cash flow basis, without local governments; HUF billion)	918.6	870	1571**	1190	750
12. Index of average gross earnings	100.5	101.4	104.3	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	10.7***	11.0	10.8

* First half of 2011

** First three quarters of 2011

*** Third quarter of 2011

Sources of actual data: CSO, NBH, NGM