GKI Economic Research Co.
We analyse and you take the decision.

There is a need for genuine change

GKI Economic Research Co. forecasts that even to start the negotiations with the IMF successfully, genuine economic policy change and the return to market economy principles are required. Next year, however, this would only be enough to mitigate the decline. Regaining the confidence of financial capital and FDI markets can be expected only by 2013, at best.

The immediate positive impact of the announcement of the negotiations with the IMF on the financial markets was almost instantly swept away by the government's insistence on continuing its economic policy, which indicated a complete lack of understanding of the situation or double talk. The subsequent downgrading of the Hungarian economy weakened the forint further and worsened the already negative international assessment of Hungary.

In the third quarter the Hungarian economy increased by 1.5 per cent over the previous year, slightly higher than the 1.4 per cent EU average. However, this was caused by the exceptionally good agricultural harvest due to good weather. In addition, the GDP of many countries in the region grew much more rapidly: Slovakia by 3.2 per cent, Romania by 4.5 per cent, and the Baltic states by 5-8 per cent. The Hungarian economy is affected not only by a deterioration in external demand, but by the negative effects of Hungarian economic policy as well. The lending capacity of the banking system is weakening due to the special taxes and the losses caused by the final repayment option of FX-loans. Renewing loans is becoming increasingly difficult, except for the best customers, and getting fresh loans is almost hopeless. The flat tax system reduced domestic demand widely among low-income households. In a narrow circle of high-income people it might have increased demand, however, it hardly led to domestic investments due to the weakening of legal certainty.

Next year an approximately 1 per cent decline can be expected even if negotiations with the IMF are successfully concluded. This is not primarily the result of deterioration in external demand as industrial exports are likely to maintain this year’s 10 per cent rate due to the starting operation of new automotive suppliers. Declining social benefits, tax increases, growing loan repayment burdens (including final repayment of FX-loans) and inflation, however, will reduce consumption by about 3 per cent. Investments will be stagnant at best due to the measures affecting banks and investor confidence negatively. In summer, as a result of declining demand, employment growth stopped in the business sector as well. In 2012, the recession will further worsen the situation, which may only be improved statistically by the expansion of part-time public employment as a substitute for unemployment benefit.

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 3.9 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. The tax generating potential of the economy is deteriorating in recession, in spite of the increasing number of tax types. The IMF negotiations cannot be successful without introducing at least part of the systemic spending cuts envisaged in the Szell Kalman Plan, but in the meantime partly forgotten. However, these and other additional steps will only be adequate to keep the deficit below 3 per cent of GDP. In addition, even in this case the public debt to GDP ratio will also increase due to the contraction of GDP. However, the external balance will improve (as a result of relatively dynamic exports and the modest growth of imports due to weak domestic demand).

Market interest rates have risen significantly in recent weeks, and several treasury bill issues have been unsuccessful. The central bank should at least follow the market trends. No substantive effect can be expected if the base rate is raised by less 100 points.

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

		2009	2010	Jan-Sep 2011	2011	2012
					forecast	
1.	Volume of GDP (previous year=100)	93.2	101.3	101.8	101.5	99
2.	Industrial production (constant prices, previous year=100)	82.3	110.5	106.2	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	99.9	99.7	97
6.	Exports (current prices in euro, previous year=100)	80.6	121.4	115.0	112	111
7.	Imports (current prices in euro, previous year=100)	75.2	119.4	113.0	110	109
8.	Trade balance (EUR billion)	3.4	5.5	5.4	7.5	10
9.	Balance of the current and capital account (EUR billion)	1.4	3.8	1.9*	4.7	5
10.	Average exchange rate of euro (in HUF)	280.6	275.4	273.7**	280	290
11.	Deficit of the general government (cash flow basis, without local governments; HUF billion)	918.6	870	1327.8**	1190	750
12.	Index of average gross earnings	100.5	101.4	104.4	104.5	105
13.	Consumer price index	104.2	104.9	103.9**	103.9	104.8
14.	Consumer price index at the end of the period (corresponding month of the previous year=100)	105.6	104.7	103.9**	104	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
** January-October 2011
***August-October 2011
Sources of actual data: CSO, NBH, NGM