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

Something happened. Or not?

The forint strengthened considerably last week after the news that the obstacles to the IMF negotiations might be eliminated soon. GKI Economic Research Co. forecasts that the implementation of the Szell Kalman Plan 2.0 may be sufficient to terminate the excessive deficit procedure next year, and the threat of suspending Hungary's access to cohesion funds might also disappear in June this year. However, no genuine changes necessary for a quick IMF agreement can be seen in the government's policy and economic policy, and even the fulfilment of the conditions for the negotiations cannot be taken for granted. Meanwhile, data of the first months of 2012 suggest an economic downturn.

Hungarian industrial production in the first two months only stagnated (in fact, it decreased by 3 per cent after adjusting it for working days). The decline in construction was nearly 10 per cent. Exports, which had grown rapidly in the past, remained almost unchanged. Retail trade declined by 0.4 per cent. The unemployment rate was slightly higher than a year earlier. The number of employees decreased by more than 1 per cent at businesses with at least five employees and in the government sector. As a result, recession seems to be inevitable this year, in spite of the facts that the European economy is expected to improve in the second half of 2012 and some new automotive suppliers will begin to operate in Hungary. No improvement can be expected either in domestic demand or lending, and above-average crop is not likely either.

Inflation jumped to 5.9 per cent in February 2012 from 4.1 per cent in December 2011, and decreased to 5.5 per cent in March. During the year, a further slight slowdown in the rate of consumer price inflation can be expected. Real earnings fell by 3 per cent in the first two months of 2012. A decline of around 2.5 per cent is projected for the whole year. Real incomes and consumption are expected to contract similarly. There is no information about the launch of major new investments and a drop of around 4 per cent can be expected in this sphere.

In the first quarter, the general government deficit reached almost 90 per cent of the target amount for the whole year. The main reason is that GDP is going to decline by 1.5 per cent this year according to the forecast of GKI rather than growing by 1.5 per cent as calculated by the government, which will be seen in consumption and tax revenues related to wages as well. In addition, interest payment requirements will be rising due to, among others, the delay in concluding an agreement with the IMF.

The Szell Kalman Plan 2.0 may be sufficient to terminate the excessive deficit procedure against Hungary next year, and to keep Hungary's access to cohesion funds unchanged. However, the plan concentrates on increasing revenues, thus hindering economic growth. As a result, markets will only be partly reassured, and the investment climate will hardly improve. Measures to guarantee the independence of typical market economy institutions are still missing. The government continues its autonomous economic policy, sometimes manifested in regulation almost at the corporate level, and the government still insists on maintaining the widely controversial flat income tax. It is a question to what extent these issues will be discussed on the IMF negotiations. The distrust of investors would further pick up if the conclusion of an agreement with the IMF is delayed or if it fails. This would result in huge interest expenditures for the budget, capital and credit shortages in the economy, expensive resource costs, extremely fluctuating exchange rates, over-taxation, and a downward demand spiral. Despite the huge losses, an economic policy without an agreement with the IMF may be continued as long as the market does not force the government to implement genuine changes, when, for example, the demand for Hungarian government securities is reduced to zero.

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

		2010	2011	January-February 2012	2012
1.	Volume of GDP (previous year=100)	101.3	101.7	-	98.5
2.	Industrial production (constant prices, previous year=100)	110.5	105.4	100.3	104.5
3.	Investments in the national economy (constant prices, previous year=100)	94.4	95.5	-	96
4.	Construction (constant prices, previous year=100)	89.9	92.2	90.6	95
5.	Retail trade (volume index, previous year=100)	97.7	100.2	99.6	97.5
6.	Exports (current prices in euro, previous year=100)	121.4	111.7	100.4	108
7.	Imports (current prices in euro, previous year=100)	119.4	110.5	102.1	106.5
8.	Trade balance (EUR billion)	5.5	7.0	1.1	8.5
9.	Balance of the current and capital account (EUR billion)	2.8	3.6	-	4
10.	Average exchange rate of euro (in HUF)	275.4	279.2	296.7*	290
11.	Deficit of the general government (cash flow basis, without local governments; HUF billion)	870	1734.4	517.5*	700
12.	Index of average gross earnings	101.4	105.2	105.5	105.5
13.	Consumer price index	104.9	103.9	105.6*	105.3
14.	Consumer price index at the end of the period (corresponding month of the previous year=100)	104.7	104.1	105.5*	104.8
15.	Rate of unemployment (at the end of the period, per cent)	10.8	10.7	11.7*	10.8

* January-March 2012
Sources of actual data: CSO, NBH, NGM