



Stop-go policies

GKI Economic Research Co. forecasts that a recession can be expected in Hungary in 2012, a decline of about 1.5 per cent just like in the first quarter of the year. Though exports will increase in the second half of the year due to automotive investments, domestic demand is not expected to improve. The around 1.5 per cent annual deterioration of the terms of trade is also reducing the income that can be distributed domestically. Starting the negotiations with the IMF and the EU has strengthened the Hungarian forint and reduced the risk premium. However, this may prove to be temporary since in the politics and economic policy of the government no turn has been visible yet that would be necessary for the conclusion of an agreement with the IMF and for the improvement of investor confidence in the economy. Government decisions announced in July loosening this year's and next year's budget may pose a threat even to next year's termination of the excessive deficit procedure against Hungary.

Data available for the second quarter indicate a continuation of decline in the first quarter. After Greece and Portugal, this is the worst performance in the EU, being far behind the majority of countries in the CEE region. The decline can hardly be explained by external factors; Hungarian domestic demand and its underlying economic policy have played a crucial role in it. In the first five months of 2012, Hungarian industrial production declined by 0.7 per cent, exports stagnated, and domestic sales dropped by 2 per cent. Total Hungarian exports, which had grown rapidly, decreased by 1 per cent (calculated in euro). The weak forint, although boosting exports in some sectors such as food industry, could not stop this trend. In addition, by increasing the burdens on those having loans in foreign currencies, it reduced domestic demand. The terms of trade deterioration in the first four months was 2.5 per cent; that is, import prices in foreign currency rose much faster than export prices. The decline in construction was more than 10 per cent. The rate of unemployment is 0.2 percentage points higher than one year earlier. Although employment increased slightly statistically, this was only the result of expanding workfare programs. During the first five months the number of employees decreased by 2.4 per cent in other segments of the public sector, and by 1.6 per cent in the private sphere (employing more than five persons). Inflation jumped above 5 per cent this year, and it is expected to increase by 5.7 per cent in 2012, similarly to the first half of the year. About 40 per cent of inflation is due to tax increases. In the first five months real earnings fell by 3.6 per cent. A decline of around 3 per cent is projected in the whole year. Real income is expected to contract similarly, whereas consumption will decline by around 2.5 per cent. In 2012 investments will decline by 4 per cent. There is no information about the launch of major new investment projects. Some growth can only be expected in exports due to automotive investments starting their production.

The general government deficit in 2012 is expected to exceed the statutory target of 2.5 per cent of GDP; however, it will probably remain under 3 per cent. Deficits caused by a budget based on an overly optimistic economic growth rate have been compensated by budget freezes and interim measures. However, measures adopted by Parliament in July increasing expenditures by HUF100bn have no funding sources yet. The balancing sources of the HUF300bn planned tax revenue loss of the job-protection action plan for 2013 can only be found on paper, too. Thus, there is a risk that Hungary may remain under the excessive deficit procedure in 2013, or, in order to avoid this, further corrective steps should be taken. Seemingly, the government seeks to conclude an agreement with the IMF quickly, but in reality this intention can be called into question seeing the government's procrastination, declared inflexibility in a number of areas, and the creation of new artificial barriers, for example, extending transaction tax to the National Bank of Hungary. At present no long-term strengthening of the forint can be expected. Swinging

the opposite direction, however, may be triggered any time by the deterioration in external conditions. Unfortunately, it might be possible that the agreement with the IMF will only be concluded after such oscillations, following huge losses.

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

	2010	2011	Jan-May 2012	2012
1. Volume of GDP (previous year=100)	101.3	101.7	99.3*	98.5
2. Industrial production (constant prices, previous year=100)	110.5	105.4	99.3	102.5
3. Investments in the national economy (constant prices, previous year=100)	94.4	95.5	91.4**	96
4. Construction (constant prices, previous year=100)	89.9	92.2	89.2	93
5. Retail trade (volume index, previous year=100)	97.7	100.2	99.0	97.5
6. Exports (current prices in euro, previous year=100)	121.4	111.7	99.1	104
7. Imports (current prices in euro, previous year=100)	119.4	110.5	100.4	103.5
8. Trade balance (EUR billion)	5.5	7.0	2.8	7.5
9. Balance of the current and capital account (EUR billion)	2.8	3.6	0.7**	3.5
10. Average exchange rate of euro (in HUF)	275.4	279.2	295.5***	295
11. Deficit of the general government (cash flow basis, without local governments; HUF billion)	870	1734.4	517.7***	700
12. Index of average gross earnings	101.4	105.2	104.4	105.5
13. Consumer price index	104.9	103.9	105.6***	105.7
14. Consumer price index at the end of the period (corresponding month of the previous year=100)	104.7	104.1	105.6***	105.5
15. Rate of unemployment (at the end of the period, per cent)	10.8	10.7	11.2****	10.8

* First quarter of 2012 Seasonally and calendar-effect adjusted: 98.6%.

** First quarter of 2012

*** First half of 2012

**** March-May 2012

Sources of actual data: CSO, NBH, NGM