GKI Economic Research Co.
We analyse and forecast. You decide.

THE MODEST ADJUSTMENT IN THE FIRST HALF OF 2013 MAY BE FOLLOWED BY SOME LOOSENING IN THE SECOND HALF OF THE YEAR

According to GKI Economic Research Co. recession continued in Hungary, though less severely, in the first quarter of 2013. GKI forecasts that inflation will be depressed artificially to a lower level by reducing overheads. Although the growth of wages will adapt to this, real wages will increase slightly. Consumption, however, will hardly increase because of high unemployment, the household debt service burden and the uncertain future. Investments continue to decline and capital and labour are leaving Hungary as well. The European Commission is of the opinion that the 2013-2014 budget deficit will be equal to or greater than 3 per cent of GDP in Hungary. As a consequence, the announcement of some corrective actions can be expected in the next few weeks. However, they may be followed by loosening in the second half of the year due to the forthcoming parliamentary elections.

GKI projects that real earnings will grow by 1.5 per cent in 2013 (assuming 2.5 per cent inflation). The real value of pensions will go up by almost 2.5 per cent as pensions will be raised by 5.2 per cent in accordance with the government's original forecast of inflation. However, family allowances and other social benefits, as well as the real value of Cafeteria will drop. Incomes earned abroad and remitted home will mount. As a result, real incomes are expected to rise at least by 1.5 per cent. Households indebted for various reasons (bank or family loans, outstanding overheads), feeling uncertain about their work, the future value of their pensions, or the future in general, would hardly lift their consumption.

In 2013 investments will continue to decrease by 2 per cent, and the investment rate, which was around 20-25 per cent of GDP in the first decade of the new millennium will drop below 17 per cent in 2013. This is an extremely low rate, hardly covering the renewal of capital stocks. Following the interest rate cuts of the central bank and the announcement of low-interest loans, the best companies get access to loans cheaply. However, this will hardly cause an acceleration of economic growth in the extremely unfavourable business environment due to the unpredictable behaviour of the government and declining domestic demand.

Although inflation would slow down anyway, it may reach historically low levels due to drastic non-market based measures of the government (reduction of overhead costs). Price reductions financed by budgetary expenditures and exhausting the capital of service companies will induce a new wave of inflation in the second half of 2014.

According to the European Commission's country report published on 3 May, the Hungarian general government deficit will not be below 3 per cent of GDP neither in 2013 nor in 2014, thus the 2 per cent deficit of 2012 is unsustainable. However, the difference is not significant, and the government will probably take corrective measures within weeks (for example, tax increases). The government would like to convince the EU of its commitment to a strict budget, and at the same time to create room of manoeuvring for the spending related to the next parliamentary elections. As the EU is well aware of this, it is possible that the excessive deficit procedure for Hungary will only be "conditionally" lifted. In addition to possible EU sanctions, the reaction of financial markets and the weakening of the forint may impose limits to fiscal and monetary easing. As a result, GKI predicts a general government deficit of around 3.5 per cent of GDP in 2013. However, the deficit may be higher if there will be adverse EU court rulings against Hungary concerning the telecom tax, or the economic policy will be strongly influenced by the forthcoming elections.

THE FORECAST OF GKI FOR 2013

	Description	2011	2012	Jan-Feb 2013	2013 forecast
1.	GDP (%)	101.6	98.3	-	100
2.	Industrial production (%)	105.4	98.3	96.6	101
3.	Investments (%)	95.5	94.8	-	98
4.	Construction services (%)	92.2	94.1	101.6	100
5.	Retail trade turnover (%)	100.2	98.1	98	100
6.	Exports (current prices in euro, %)	112	100.2	101.5	103
7.	Imports (current prices in euro, %)	110.6	100.4	102.5	102.5
8.	Foreign trade balance (EUR billion)	7.1	6.9	1.0	7.5
9	Current and capital account balance (EUR billion)	3.6	4.2	-	4.5
10	Average exchange rate of euro (in HUF)	279.2	289.4	297.0**	295
11	General government deficit (HUF billion)*	1734.4	607.5	493.6***	850
12	Index of average gross earnings	105.2	104.6	102.6	104
13	Consumer price index	103.9	105.7	102.9***	102.5
14	Consumer price index at the end of the period (corresponding month of the previous year=100)	104.1	105.0	102.2	102.5
15	Rate of unemployment (at the end of the period, %)	10.7	10.7	11.8***	10.7

** Cash flow basis, without local governments*
*** January-April 2013*
**** First quarter of 2013*
Sources of actual data: CSO, NBH, NGM

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