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

## INTEREST RATES – A ROLLER COASTER IS COMING

**GKI Economic Research Co. forecasts that after the recession of last year, a minimal GDP growth, barely better than stagnation, can be expected in 2013, followed by only around 1.3 per cent growth next year well below the average of the CEE region. Owing to favourable financial market conditions, interest rates drop and the forint is getting stronger. However, this trend is expected to be reversed next year.**

As a result of the relief caused by the temporary agreement on the US budget and the continuation of the Fed's loose monetary policy, the forint is relatively strong and the Monetary Council stands by the regular interest rate reductions. However, US monetary policy will be tightened sooner or later, and as a result, the Hungarian risk premium will seem to be low, leading to the weakening of the forint and the stopping of the decrease of the base rate, triggering a rising interest rate cycle. Hungarian economic policy influenced by the elections (for example, the government's decisions concerning foreign currency loans) may exacerbate uncertainty and affect the expected return.

It is unfavourable that the Hungarian foreign exchange reserves amounted to only EUR30.2bn at the end of September 2013, representing a decrease of EUR7.5bn (20 per cent) compared to the end of 2011. It is already close to a perilously low level, thus it would be advisable to issue FX bonds this year as long as international interest rates are still relatively low. As a result, however, the government debt to GDP ratio would rise, leading to higher risks. The EUR/HUF exchange rate is expected to be around HUF300 before the parliamentary elections, and in the second half of 2014 (if economic policy becomes more predictable) it will likely to drop to around 290 (at a slightly higher interest rate).

The decrease in global commodity prices and the drop of inflation in the EU are favourable for inflationary trends in Hungary. The rate of inflation is reduced by overhead reductions, whereas it is raised by new taxes like the telephone tax, utility tax, e-tolling and transaction tax, as well as by the increased sales margin on tobacco. It is likely that prices will start to rise after the elections. Inflation in Hungary reached the EU average by the forced downward pressure on domestic inflation; however, this is unsustainable and has a lot of harmful side effects. GKI expects 1.9 per cent inflation in 2013, and 2.5 per cent in 2014.

Employment at companies with more than five persons and in the public sector (without those involved in workfare programs) declined by 0.5 per cent in the first eight months of 2013. No improvement can be expected in this regard as economic trends will not get better substantially. The number of those involved in workfare programs during the winter will continue to rise artificially (instead of the usual decrease), until the elections, statistically improving employment figures. Real earnings will rise by 2 per cent both in 2013 and 2014. However, consumption will increase only by 0.5 per cent and 1.5 per cent, respectively, due to the indebtedness of households and the cautious behaviour of people. Investments will grow only by 2 per cent next year following their stagnation this year due to the lack of business confidence basically as a result of public projects financed from EU funds. The investment rate has been the lowest in the CEE region for years. It has fallen below 17 per cent, limiting the growth potential in the coming years as well.

## GKI FORECAST FOR 2013-2014

| | Description | 2011 | 2012 | 2013. I-VIII. hó | 2013 forecast | 2014 forecast |
|---|---|---|---|---|---|---|
| 1. | GDP (%) | 101.6 | 98.3 | 99.8** | 100.3 | 101.3 |
| 2. | Industrial production (%) | 105.4 | 98.3 | 99.2 | 101 | 103 |
| 3. | Investments (%) | 95.5 | 94.8 | 98.8** | 100 | 102 |
| 4. | Construction services (%) | 92.2 | 94.1 | 107.5 | 105 | 105 |
| 5. | Retail trade turnover (%) | 100.2 | 98.1 | 99.9 | 100.5 | 102 |
| 6. | Exports (current prices in euro, %) | 112 | 100.2 | 100.9 | 103 | 105 |
| 7. | Imports (current prices in euro, %) | 110.6 | 100.4 | 101.1 | 103 | 106 |
| 8. | Foreign trade balance (EUR billion) | 7.1 | 6.8 | 4.5 | 7.0 | 6.3 |
| 9. | Current and capital account balance (EUR billion) | 3.6 | 4.3 | 2.8** | 4.5 | 4.7 |
| 10. | Average exchange rate of euro (in HUF) | 279.2 | 289.4 | 296.7*** | 297 | 295 |
| 11. | General government deficit* (HUF billion) | 1734.4 | 607.5 | 949.0*** | 1000 | 1000 |
| 12. | Index of average gross earnings | 105.2 | 104.6 | 103.4 | 103.5 | 104.5 |
| 13. | Consumer price index | 103.9 | 105.7 | 102.1*** | 101.9 | 102.5 |
| 14. | Consumer price index at the end of the period (corresponding month of the previous year=100) | 104.1 | 105.0 | 101.4*** | 101.5 | 103.3 |
| 15. | Rate of unemployment (at the end of the period, %) | 10.7 | 10.7 | 9.8*** | 10.2 | 10.7 |

** Cash flow basis, without local governments*
*** First half of 2013*
**** First three quarters of 2013*
*Sources of actual data: CSO, NBH, NGM*

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