APPEARANCE AND REALITY

GKI Economic Research Co. predicts that, in spite of the optimism prevalent among Hungarian economic actors not seen for a decade, the improvement in the economy is only relative, temporary and apparent. Although economic policy influenced by the elections has a short-term stimulating effect, it does not create the foundations for sustained growth without restoring capital-absorption potential.

The Hungarian general government deficit was below 3 per cent of GDP last year, too. This is an important result; however, the improvement compared to the average for 2008-2010 is essentially the result of channelling individual pension contributions to the budget (instead of pension funds). Government debt relative to GDP decreased slightly (to around 79 per cent), but this is a consequence of the tricky and transitional mitigation of year-end reserves. Moreover, in recent years the budget has used up the private pension fund assets amounting to 9 per cent of GDP. High employment figures not seen for more than ten years are caused by a surge in public work schemes and foreign employment; real domestic employment fell in 2013 (although it began to rise slightly in the autumn). Last year's GDP growth of around 1 percent was largely due to weather factors (relatively good harvest) and except construction and car manufacturing, there were no other dynamic sectors. Real earnings and real pensions increased by about 3.5 per cent as a result of forced price cuttings, and inflation in 2013 was just 1.7 per cent instead of 5.2 per cent projected by the government. In December inflation dropped to 0.4 per cent. Price trends on world markets were also conducive to price cuts in Hungary. However, the 3.3 per cent core inflation rate, the emphasis put on the non-profit nature of energy service providers, and the increase of real earnings well exceeding that of GDP indicate the unsustainability of the trend. In 2015, after the local government elections a new wave of price increases can be expected.

The increase in purchasing power affects consumption with a delay. Last year's stagnation will probably be followed by a temporary increase of about 1.5 per cent in 2014 (although a long-term weakening of the forint will mitigate this figure). In addition to the global recovery, this may also boost the sales opportunities of industries selling their goods and services in the domestic market. In spite of the introduction of the new Funding for Growth Scheme of the National Bank, large business investments exceeding the replacement of existing assets cannot be expected, mainly due to the lack of legal certainty and insufficient market demand. In the first three quarters of 2013 EUR1.1bn worth of foreign direct investments flowed out of the country and no substantive changes can be expected this year if economic policy remains unchanged. Investments rose last year by around 4 per cent due to infrastructure projects co-financed by the EU, whereas in 2014 a slowdown is likely.

Continuous reduction in the reference rate of the National Bank of Hungary took advantage of the favourable international financial situation existing until the autumn of 2013, making the financing of the general government cheaper. However, the Hungarian interest rate spread is even higher than the Romanian and Bulgarian ones, and the Hungarian CDS spreads are the third highest in the CEE region, only lower than those in Slovenia and Croatia. The low interest rate increases exchange rate volatility and the weakening of the forint (due to the irresponsible decisions of the National Bank of Hungary) is again the most significant in the CEE region. Last week's spectacular rate falls again questioned the credibility of monetary policy.

The external balance will be favourable in 2014 as well; however, the increasing inflow of EU funds can only offset the deterioration of the foreign trade balance. This latter will be caused by partly a deterioration of the Hungarian export capacity and competitiveness (except car manufacturing, there are no dynamic sectors willing to invest in new projects), and partly an increase in domestic demand. The flaw is that the increase in domestic demand will be the consequence of consumption growth rather than a revival of investments, which does not provide foundations for sustained and more vigorous recovery.

GKI FORECAST FOR -2014

	Description	2011	2012	2013 (est.)	2014 forecast
1.	GDP (%)	101.6	98.3	101	101.3
2.	Industrial production (%)	105.4	98.3	101	103
3.	Investments (%)	95.5	94.8	104	102
4.	Construction services (%)	92.2	94.1	110	105
5.	Retail trade turnover (%)	100.2	98.1	101	102
6.	Exports (current prices in euro, %)	112	100.2	102	104
7.	Imports (current prices in euro, %)	110.6	100.4	101.5	105
8.	Foreign trade balance (EUR billion)	7.1	6.8	7.5	6.8
9.	Current and capital account balance (EUR billion)	3.6	4.3	5.5	5.5
10.	Average exchange rate of euro (in HUF)	279.2	289.4	296.9**	300
11.	General government deficit* (HUF billion)	1734.4	607.5	929.2**	1000
12.	Index of average gross earnings	105.2	104.6	104	104.5
13.	Consumer price index	103.9	105.7	101.7**	101.5
14.	Consumer price index at the end of the period (corresponding month of the previous year=100)	104.1	105.0	100.4**	102.5
15.	Rate of unemployment (at the end of the period, %)	10.7	10.7	9.1**	9.8

** Cash flow basis, without local governments*
*** Actual figure*
Sources of actual data: CSO, NBH, NGM

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