2 MAY 2016

THE ECONOMY IS SLOWING DOWN

Growth data at the beginning of the year indicate a slowdown in the Hungarian economy. In recent months, international forecasting institutions have reduced their GDP forecasts for Hungary and economic expectations have also deteriorated slightly. The GDP forecast of GKI is unchanged: the annual average growth rate will only be around 2.3 per cent in 2016, after 2.9 per cent in 2015 and 3.7 per cent in 2014, especially due to the decrease in investments.

Although industrial production grew by 3 per cent in the first two months of 2016, it was the fourth consecutive month that it declined compared to the previous month. In 2016 its growth rate is expected to be about 5.5 per cent. The growth rate of construction fell both in January and February by 20 per cent over the previous year. In addition to the weak start at the beginning of 2016, it is alarming that at the end of February the volume of contracts concluded was 40 per cent lower than a year before. However, the volume of contracts for houses and offices was 40 per cent higher and that for other structures 60 per cent lower. Favourable effects for the construction industry of measures such as accelerating payments in connection with EU transfers or the home purchase assistance scheme (CSOK) leading to a growth in housing construction can be expected to materialize only in the second half of 2016, thus a decline of about 5 per cent can be expected in 2016 and an expansion of about 5 per cent in 2017. Compared to last year, the expansion of retail sales slowed down; however, it remained dynamic. This was primarily based on the significant increase in purchasing power and the very low inflation. The increase in the sale of daily articles was significantly less than average (only 1.7 per cent versus 4.4 per cent). Allowing again the opening of stores on Sundays will boost sales in 2016, whereas the phasing out of the whitening effects due to the direct connection of cash-registers to the National Tax and Customs Authority will dampen the rate of increase of sales. Deceleration of the growth rate of exports followed the changes in production; however, the growth rate of imports did not drop, thus it exceeded that of exports. However, a change can be expected during the year. The main reason for the slowdown of the Hungarian economy in 2016 is the about 5 per cent decrease in investments rather than the deceleration in exports. The drop in investments is the result of declining EU transfers and the low propensity to invest by the business sector.

Consumer prices rose by 0.3 per cent in the first quarter of 2016, they declined in March by 0.2 per cent (an increase of 0.1 per cent compared to February). In March mainly luxury and durable goods became more expensive over the previous year, whereas fuel prices fell by almost 15 per cent (although they increased by 1.2 per cent compared to February). The inflation rate is expected to be 0.8 per cent in 2016. Gross average earnings in the first two months of 2016 increased by 5.9 per cent, and net ones by 7,5 per cent (growth in the public sector was a lot faster than the average). Real earnings are expected to increase by over 5 per cent in 2016, and real incomes by over 3 per cent. This may boost consumption, whose growth rate will be at least 3 per cent in 2016 after last year's 2.6 per cent.

As a result of the decisions of the ECB, the National Bank of Hungary started an interest rate cut cycle in March. The base rate was 1.05 per cent at the end of April. The Monetary Council announced the possibility of a further reduction of the base rate. GKI expects that it will finally reach 0.9 per cent.

At the end of March, the Hungarian government raised the cash-flow based general government deficit to HUF1063bn from HUF762bn, probably mainly due to the significant advance payment requirements of EU transfers in 2016. This does not affect the so-called accrual-based deficit monitored by the EU; however, the general government debt to GDP ratio can only improve marginally. The 2.5 per cent general government deficit to GDP rate envisaged for 2017 (which is 0.7 percentage points higher than the rate promised earlier) and the scandals surrounding the foundations of the National Bank of Hungary can hardly improve Hungary's assessment by international credit rating agencies, that is, Hungary will not be any closer to an upgrade to investment categories.

THE FORECAST OF GKI FOR 2016

	Description	2013	2014	2015	01-02 2015	2016 forecast
1.	GDP (%)	101.9	103.7	102.9	-	102.3
2.	Industrial production (%)	101.1	107.7	107.5	103.0	105.5
3.	Investments (%)	107.3	111.2	101.9	-	95
4.	Construction services (%)	109.7	113.4	103.0	80.4	95
5.	Retail trade turnover (%)	101.6	105.2	105.8	104.4	103
6.	Exports (current prices in euro, %)	101.7	103.9	107.4	104.6	106
7.	Imports (current prices in euro, %)	102.0	104.3	105.6	105.7	105
8.	Foreign trade balance (EUR billion)	6.6	6.3	8.1	1.5	9
9.	Balance of the current and capital account (EUR billion)	7.6	6.0	9.5	-	8.0
10.	Average exchange rate of euro (in HUF)	296.9	308.7	309.9	312.0**	315
11.	General government deficit* (HUF billion)	929.2	825.7	1218.6	125.8**	1100
12.	Index of average gross earnings	103.4	103.0	104.2	105.9	104.5
13.	Consumer price index	101.7	99.8	99.9	100.3**	100.8
14.	Consumer price index at the end of the period (corresponding month of the previous year=100)	100.4	99.3	100.9	99.8**	101.6
15.	Rate of unemployment (at the end of the period, %)	9.1	7.1	6.2	6.0**	6

* *Cash flow basis, without local governments*
** *First quarter of 2016*
Sources of actual data: CSO, NBH, NGM

GKI ECONOMIC RESEARCH CO.

1092 Budapest, Ráday u. 42-44.

Phone: +36 1 318 1284 E-mail: gki@gki.hu

For more information: Andras Vertes, Laszlo Akar, Gabor Karsai