



1 AUGUST 2016

## SILENT DETERIORATION OF EQUILIBRIA STARTED

**Due to the decrease of EU transfers and hence public investments, the deceleration of GDP growth in 2016 (compared to 2.9 per cent last year) could have been foreseen. Nevertheless, in the light of the investment restraining effects of the Hungarian model that had been at work for six years the slowdown proved to be unexpectedly spectacular. In addition, in some segments of industry sales problems appeared, too. Although Brexit has not yet had a major effect on European economic expectations, Hungary's GDP growth in 2016 faster than 2 per cent projected by GKI is quite unlikely.**

Data already available for the second quarter, such as the continuous decline in construction by an average of 28 per cent in the past five months seem to support that investments will continue to drop, similarly to the first quarter, by around 8 per cent in 2016. However, due to the rapid increase in earnings, retail trade will also expand dynamically. Gross earnings increased by 6 per cent in the first five months of 2016, real earnings by 7.5 per cent (by more than 8 per cent without those involved in public employment schemes), and retail sales by 5 per cent. The price level remained basically unchanged in the first half of the year, thus the annual average rate of inflation will probably be lower than previously expected, around 0.5 per cent. All this may result in the acceleration of the expansion of consumption that grew by 4 per cent in the first quarter.

After five months of decline, industrial production rose in April compared to the previous month; however, it further decreased in May. In the first five months, industrial production rose by 3 per cent (on a yearly basis). It is expected to increase by 3.5 per cent in 2016. Faster economic development is impeded by mainly the shortage of skilled labour and capital to invest. Even if it will accelerate noticeably in 2016, it is unlikely that the growth rate of exports in volume terms will exceed that of imports. However, the foreign trade surplus is expected to grow due to improvements in the terms of trade. The unemployment rate dropped to 5.1 per cent in the second quarter, which is 1.8 percentage points lower than in the same period of the previous year, and much lower than the EU average. If two thirds of those involved in public workfare schemes are considered unemployed, Hungary's unemployment rate would be similar to the EU average.

In the past months, economic policy has set to change implicitly aiming at the deterioration of disequilibria. According to the budget for 2017, the general government deficit relative to GDP is planned to increase to 2.4 per cent in contrast to the reduction requirement to 1.7 per cent as it is enshrined in the convergence program. The planned loosening will have an impact on decisions to be taken in the rest of 2016. Therefore, although the general government deficit was very favourable in the first half of 2016, despite the significant deficit in May, it is likely to be higher than planned in 2016 (2.3 per cent instead of 2 per cent). Based on the favourable figures at the beginning of the year, the government modified the 2016 budget in June by distributing additionally about HUF500bn. According to calculations by GKI, additional revenues of this size could have reckoned with as well. In part due to various pressures and the preparations for the parliamentary elections in 2017, the government is likely to raise its expenditures in the remaining months of 2016. For example, a new stimulus package is also envisaged by the autumn, with obvious financial repercussions affecting mainly the year of 2017. The convergence program envisaged the reduction of government debt relative to GDP from 75.3 per cent to 74.5 per cent by the end of 2016. GKI reckons with a symbolic reduction of government debt with a ratio of about 75 per cent at year-end, since due to the increase of expenditures and the advance payments needed to accelerate the absorption of EU funds by the budget, the financing needs of the general government will be very high.

## Forecast of GKI for 2016

Description		2013	2014	2015	Jan-May 2016	2016 forecast
1	GDP (%)	101.9	103.7	102.9	100.9**	102
2	Industrial production (%)	101.1	107.7	107.5	103.0	103.5
3	Investments (%)	107.3	111.2	101.9	92.2**	92
4	Construction services (%)	109.7	113.4	103.0	72.1	85
5	Retail trade turnover (%)	101.6	105.2	105.8	105.1	105
6	Exports (current prices in euro, %)	101.7	103.9	107.4	103.2	104
7	Imports (current prices in euro, %)	102.0	104.3	105.6	101.4	103
8	Foreign trade balance (EUR billion)	6.6	6.3	8.1	4.2	9
9	Balance of the current and capital account (EUR billion)	7.6	6.0	9.5	2.2**	8.0
10	Average exchange rate of euro (in HUF)	296.9	308.7	309.9	312.7***	315
11	General government deficit* (HUF billion)	929.2	825.7	1218.6	402.1***	1100
12	Index of average gross earnings	103.4	103.0	104.2	106.1	106
13	Consumer price index	101.7	99.8	99.9	100.1***	100.5
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***	101.5
15	Rate of unemployment (at the end of the period, %)	9.1	7.1	6.2	5.1****	5.6

\* Cash flow basis, without local governments

\*\* First quarter of 2016

\*\*\* First half of 2016

\*\*\*\* Second quarter of 2016

Sources of actual data: CSO, NBH, NGM

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