Forecast for 2020

(Summary of the flash report of GKI Economic Research Co. prepared amidst the uncertainty surrounding the coronavirus outbreak, March 23, 2020.)

In the current situation, GKI considers it difficult to make any detailed forecasts. Therefore, it only undertakes to present the possible main trends based on two scenarios.

The COVID-19 is already a worldwide pandemic; however, **its depth and duration are completely uncertain**. While the Chinese economy is starting to show signs of recovery, COVID-19 is now spreading in Europe, and strict measures are being introduced to **restrict the movements of people**. The general downturn in the world's stock exchanges, with occasional positive corrections, illustrate a climate of general fear and uncertainty.

There is a widespread recognition across the world that stopping the outbreak can only be achieved by **radically limiting the movements of people**, which **necessarily entails** a temporary downturn in the economy as well as a **recession**, as it seriously affects both global production chains and consumer demand, both physically and through expectations. **Central banks** have begun to lower their key interest rates, governments to loosen their fiscal tightening and announce huge **rescue packages**. In addition, the **EU** has announced a major rescue package valued at some EUR40bn in the real economy. As Hungary has already provided companies with advance cohesion funds for this purpose, **this assistance cannot be used by the Hungarian government**.

International and domestic forecasters are **constantly reducing their growth projections**. Last week, the President of the **ECB** already forecast a **5 per cent decline in euro area economies**. International forecasts (such as JP Morgan) expect a severe downturn in the second quarter and then a significant rebound in the second half of the year. In mid-March, the **Ministry of Finance** assumed the expected growth (or shrinkage) of the Hungarian economy **in a very broad band** of +3.7 per cent to -0.3 per cent. Recent statements by the Minister of Finance **suggest a downturn**.

The main question now is whether the restrictions on the movements of people caused by the virus will affect only the second or third quarter, or even a longer period. Based on the January data and the still modest deterioration of the GKI's economic sentiment index in the first quarter, Hungarian GDP may have increased by **2-3 per cent in the first quarter**. **At the same time**, a nearly 20 per cent decline is possible in the second quarter due to the almost complete shutdown of the tourism, entertainment and automotive industries and the restrictions of trade. **Under Option A, the economy will stabilize in the second half of the year with 3 per cent GDP growth year-on-year. Option B expects only that the downturn will slow down to around 6 per cent in the second half of the year.** The **most significant difference between the two options is in household consumption**: while Option A only estimates a decline of around 1 per cent, Option B 4 per cent. **The volume of investments will be reduced by at least 8-10 per cent.**

The **biggest losers** among the sectors are **tourism and entertainment**. While the panic has temporarily increased the sale of daily articles, other **retail sales** have been significantly reduced due to import problems, domestic supply constraints, compulsory store closures and weakening retail purchasing power. A decrease can be expected in **transportation** (mainly in international transportation) due to the cessation of inward and outward deliveries to companies shutting down their operations. In **industry**, downtime is expected especially in companies integrated into global supply chains; however, this will inevitably affect the SME sector negatively as well. The sector is expected to decline by 5-10 per cent. In the **financial sector**, a moratorium on interest and capital repayments significantly worsens the situation and the liquidity of banks; however, this is still much less damage than would ensue the mass bankruptcy of otherwise viable businesses and the permanent crisis of many families. The downturn in the **construction** and **real estate** sectors, particularly in Option B, may be below average. Substantial **growth is expected only in the telecommunication sector** (due to the avoidance of personal movements and contacts), and some increase in **public administration, health care, etc. sectors** due to epidemic related expenditures. It may help in **increasing the growth rate** that after three weak years **agricultural production** may grow as well.

The **number of employees** will **contract** in 2020. Firms employing skilled labour that offer products or services that are normally marketable are likely to try different ways to reduce earnings and **keep** their workforce, whereas others, especially those without adequate capital, will **lay off**. Especially the employees of small businesses and the self-employed are at risk. The government has announced a radical overhaul of the 2020 budget, which will **provide companies in financial distress and temporary employment problems with resources** in order to minimize bankruptcies and to prevent a surge in unemployment. This is exacerbated by the fact that the **number of those employed in foreign countries** may be forced to **fall** due to redundancies there. The **unemployment rate** of 3.4 per cent (160,000 people) may temporarily **increase sharply**, to about 5 per cent in Option A (250,000 people), or to over 8 per cent in Option B (400,000 people).

Salary incentives will typically **narrow**, unpaid leaves and the payment of only availability fees will be more widespread. Companies will try to avoid the effects of the minimum wage increase by reduced working hours. **Gross earnings** will temporarily **decline** in a significant part of the national economy. This is expected to consolidate from the second half of the year, depending on the course of the outbreak. In the event of a prolonged outbreak, the **disbursement period of three months** of jobseekers' allowance, which is extremely short by international comparison, will be unsustainable.

GKI estimates the inflation rate to be **4 per cent** in 2020. In some sub-markets, such as meat and other foodstuffs and manufactured goods from Asian imports, **price increases are expected due to shortages or the reduction or elimination of import competition**, while the prices of other products are expected to **fall** due to the **global economic slowdown** (such as fuel). During the epidemic, a markedly different composition of the consumer basket will **distort** statistically reported inflation. As a result of its extremely loose monetary policy, the **National Bank of Hungary** has found itself in a **trap** as the **tightening** demanded by high inflation and the **easing** necessitated by the recessionary economy **are in conflict**. There is no good solution.

The world economy is undergoing structural changes in terms of diversifying global production chains, accelerating the creation of telework, e-governance, e-business management and e-learning, etc. Hungary may also be a beneficiary of this; however, there is a risk that Hungarian companies focusing primarily on the government and its resources, rather than on the market, **will not adapt properly**. This can only be slowed down by budgetary means.

In recent years, a highly **centralized system** has developed in Hungary, which has some **advantages** in crisis management. At the same time, the **disadvantages are enormous**, because the organizational framework of interest reconciliation and communication has dried up. In addition, centralization often involved a strong **bureaucratic** and PR-centred approach, a low level of expertise and a lack of access to real information. **Following the example of other EU countries, the government has rightly recognized that preserving the solvency of companies and the public is key to preventing or curbing the tragic spread of the crisis.** This requires significant resources raising the general government deficit above 3 per cent, now authorized by the EU. It is feared that the deficit will be much larger, requiring the **involvement of foreign financial sources** in addition to those provided by the banks hit by a moratorium and the households in distress.