The forecast of GKI Economic Research Co. for 2020

(Summary, 25 June 2020)

GKI currently expects the Hungarian economy to decline by 5-7 per cent in 2020 (assuming no second wave of the pandemic this year). In March, shortly after the announcement of the coronavirus emergency, GKI forecast two scenarios: one with a 3 per cent and another with a 7 per cent decline in GDP this year. Interestingly, in recent months **the Hungarian government and the IMF** published forecasts close to GKI's less pessimistic figure, whereas **the EU and the OECD** published forecasts with the **more pessimistic** variant. The 2.2 per cent GDP growth rate in the first quarter was in line with GKI's expectations. In **April**, industrial production fell by 37 per cent, exports (in euros) also by 37 per cent, retail sales by 10 per cent, guest nights by 97 per cent, whereas construction dropped by only 2.1 per cent (though its contract portfolio decreased by 15 per cent). These data foreshadow a marked decline in the second quarter. It is favourable that the **lifting of restrictions** could already be started in early May. Importantly, after the panic in April, the **GKI economic sentiment index** improved significantly in both May and June. However, the rise in the index could not eliminate **even half of its April fall** in May and June. Forecasts for EU member states are typically very pessimistic, which obviously **limits the demand for Hungarian exports**. The Hungarian government's **economic rescue** measures are **modest** in international comparison. Based on all this, it seems extremely unlikely that Hungarian GDP production would be able to exceed that of last year in the second half of 2020. However, this would be necessary to achieve the "only" 3 per cent decline. As a result, GKI **discarded** its less pessimistic scenario and **eased** the pessimism of its more "pessimistic" scenario somewhat. **The current GDP decline of 6 per cent in 2020 assumes a decline of around 15 per cent in the second quarter and around 5 per cent in the second half. The Hungarian economy will probably reach the GDP level of 2019 only in 2022.**

Data on **gross earnings** during the crisis are not yet available; however, it is indicative that personal income tax revenues rose by only 5.5 per cent in April after 9.1 per cent in March compared to the previous year. **Gross earnings temporarily declined in a significant part of the national economy.** This may consolidate from the second half of the year, depending on the course of the outbreak. On an annual average, **GKI expects an increase in average earnings of around 5 per cent and a near-stagnation or minimal increase in the volume of earnings (due to declining employment)**. Although real wages could rise by 1-2 per cent statistically, they will practically stagnate as the actual consumption structure differs from the inflation basket. In real terms, the volume of earnings will fall by around 3 per cent. Despite compliance with legal requirements, **pensions will not retain their real value even in statistical terms** in 2020 due to the lack of the pension premium this year and pensioners' higher-than-average price index. Household **borrowing fell sharply in April** (new housing loans by 18 per cent and personal loans by 74 per cent). GKI **expects a decrease in household consumption of about 2.5 per cent this year**.

This year's marked slowdown in gross fixed capital formation, which has been rising by 15-20 per cent for three years, was already expected, and it would have still resulted in a slight increase in the investment rate of 28.6 per cent in 2019. However, due to the pandemic, **investments are expected to fall faster than GDP (by 10 per cent this year)**, making a **reduction of the rate to 27.5 per cent** likely. Although significant amounts of cheap resources support the development of firms, **the size and structure of future demand are very uncertain, causing many firms to postpone** their previously planned investments. At the same time, the CEE region, including Hungary, **may benefit from the restructuring of global supply chains** in the medium term.

The main targets of **public investments** are road and rail construction. In addition, investments in tourism, the construction of sports facilities and the forced development of the armed forces can be highlighted. Preparations for the Paks-2 project have started. The **corporate programmes** of the central bank (MNB) and the Hungarian Development Bank (MFB) will only contribute to the restructuring of existing loans and company acquisitions, rather than to new investments.

The **unemployment rate** (according to labour force surveys in line with the rules of ILO) increased only slightly statistically, averaging 3.8 per cent in February-April, 0.5 percentage points higher than a year earlier. The number of **employees** fell by 1.2 per cent (and by 3 per cent in April). If we consider those who lost their jobs as they became inactive due to lockdown restrictions unemployed, **the unemployment rate already exceeded 6 per cent in April** (compared to the official rate of 4.1 per cent) and their number was 280,000 compared to the official 174,000. According to the Hungarian Public Employment Service, there were 331,000 people out of work at the end of April 2020, 26.5 per cent more than a year earlier. Unemployment certainly **rose** in May due to the expiration of notice periods and further company collapses. Domestic unemployment is increased by the return of some of those who lost their jobs abroad.

The three-month payment period of jobseekers' benefit for the unemployed is much shorter than necessary or standard in the EU. The government appears to envisage **providing employment** for the unemployed after the completion of this period as a task of various **workfare schemes**, as well as the **military services**, **state-owned enterprises** and **investment projects**, including partly government-subsidized investments. The first two methods, **with the exception people unskilled and having weak working culture**, are specifically a **dead end**. The unjustified employment expansion of state-owned enterprises worsens productivity. In times of crisis, the focus should be more on rescuing jobs that are temporarily endangered. GKI expects an average **employment decline of around 3 per cent in 2020 and a real unemployment rate of around 6 per cent**. However, by the end of the year the situation will be more favourable than in the middle of the year. **Productivity**, measured as GDP per employee, deteriorates by about 3-4 per cent on average in the national economy.

In view of the pandemic, the government raised the **general government deficit** from the planned 1 per cent to **3.8 per cent**. However, **the officially planned cash-flow deficit for 2020 has not changed**; the details have not been disclosed. GKI expects a higher-than-projected general government deficit of around 5 per cent of GDP, partly due to the need for higher budget expenditures and partly due to lower-than-expected government GDP; and expects **government debt** to be around 75 per cent by 2020, higher than last year's 66.3 per cent or the 72.6 per cent rate projected by the government for 2020. **Instead of developing and reforming health care and education, the government is contemplating militaristic solutions.**

GKI **expects inflation to be around 3 per cent by the end of 2020, with an annual average of 3.3 per cent**. (The **real price increase** may be greater than this as inflation is calculated on the basis of the so-called inflation basket, which corresponds to the consumption structure two years earlier, though the weight of each product group has obviously changed radically as a result of the pandemic.) The MNB **reduced the base rate** from 0.9 per cent **to 0.75 per cent** in June. The **exchange rate of the forint to the euro** weakens systematically in the long run, 1 euro averaged 275.4 forints in 2010 and 325.4 forints in 2019 (18 per cent depreciation). As the MNB further relaxes its monetary policy, the exchange rate will be **at least HUF345** in 2020 (another devaluation of at least 6 per cent).

The **current account balance** showed a deficit of EUR0.8 billion in the first four months of 2020, after a deficit of EUR1.2 billion last year, and the deficit could reach EUR3 billion for the year as a whole. Although with high uncertainties, EU transfers may reach a similar or slightly higher amount, thus the Hungarian financing capacity is expected to achieve a **minimal surplus**, below 0.5 per cent of GDP. **Foreign direct investments** slowed down extremely worldwide, and the postponement of several significant foreign investments in Hungary has already been announced this year.

Forecast of GKI for 2020

	2016	2017	2018	2019	2020	
	fact				March*	**June**
GDP	102.2	104.3	105.1	104.9	97-93	**94**
• Agriculture (1)	112.6	93.3	104.8	99.7	100	**100**
• Industry (2)	101.8	103.2	100.5	105.0	94.5-90	**90**
• Construction (3)	85.0	121.5	118.9	121.4	97-95	**95**
• Trade (4)	100.8	107.4	113.6	108.0	98-85	**90**
• Transport and storage (5)	105.1	102.0	103.7	105.3	93-85	**85**
• Information, communications (6)	104.9	111.3	111.1	106.3	105	**110**
• Financial services (7)	101.2	105.6	104.1	103.9	95	**98**
• Real estate services (8)	103.0	102.5	102.8	104.3	97-95	**95**
• Professional, scientific, technical activities (9)	106.1	109.8	111.6	106.7	97-90	**90**
• Public administration, education, healthcare (10)	101.9	99.3	100.4	98.6	101	**101**
• Arts, entertainment (11)	101.1	108.1	103.7	102.5	85	**85**
• Core growth (2)+(3)+(4)+(5)+(6)+(7)+(8)+(9)	101.8	106.0	106.5	107	96.5-91	**91**
GDP domestic demand	101.7	105.2	107.3	105.6	98-95	**96**
• Private consumption	104.2	104.2	104.0	104.4	99-96	**97.5**
• Gross fixed capital formation	89.4	118.7	117.1	115.3	92-90	**90**
Exports (goods and services)	103.8	106.9	104.3	106.0	90-85	**85**
Imports (goods and services)	103.4	108.2	106.8	106.9	90.5-87	**87**
Consumer price index (preceding year = 100)	100.4	102.4	102.8	103.4	104	**103.3**
Unemployment rate (annual average)	5.1	4.2	3.7	3.5	5-8	**6**
General government balance in per cent of GDP (ESA)	-1.6	-2.2	-2.3	-2.0	(-3.5)-(0.5)	**-5**
Balance of the current and capital accounts						
• EUR billion	5.2	4.0	3.0	1.4	-	**0.5**
• In per cent of GDP	4.5	3.2	2.2	1.0	-	**0.4**

*Scenarios “A” - “B” of GKI

Source: HCSO, GKI