GKI Economic Research Co.

We analyse and you take the decision.

Growth below 2 percent, stagnating consumption

According to the forecast of GKI Economic Research Co. the expected rate of GDP growth this year and next year will be significantly slower, only between 1.5 and 2 per cent, based on recent international and national statistical data. Weak domestic demand makes it difficult to achieve the budgetary targets; however, it improves the external balance and restrains inflation.

The deteriorating growth prospects of the Hungarian economy are in part a consequence of the worsening global economic environment. In addition to the deteriorating business climate, the Hungarian economy was particularly badly affected by the dramatic appreciation of the Swiss franc reducing the purchasing power of people due to the growing burden of loan repayment. However, economic policy played an important role as well. According to data of the second quarter in 2011, it prevented an increase in domestic demand more than previously envisaged. The increase in real wages experienced only by high-income people has not raised consumption, whereas the crisis taxes have curbed the current and investment demand of companies as well as their borrowing options. Deluding those having taken mortgage loans and putting the problems off until later seem to preserve them. The legal uncertainty and the lack of predictability also played a part in the fact that in the first quarter of the year the outflow of foreign direct investments surpassed the inflow.

Hungarian GDP stagnated in the second quarter of the year compared with the previous quarter, and it was one of the weakest results in the EU. In June Hungarian industrial output was 1.4 per cent lower than a year ago, while it increased by 1.7 per cent in the EU as a whole, despite the significant slowdown. It is alarming that while industrial exports have been the driving force of the economy in Hungary until now, its level has been declining since March compared with the preceding month, and the assessment of orders has also been deteriorating. The decline of sectors focusing on the domestic market continues, and no changes can be expected in the second half of the year either. Domestic sales of industry have been declining for four years. Retail sales have been going down for five years, and construction has been decreasing for six years. In agriculture, however, the bad harvest of last year will be followed by an excellent one this year, helping GDP, exports, and also dampening inflation.

In the first half of the year real wages, together with child tax discounts, increased by around 3 per cent. However, this increase was the result of significantly growing real wages of those with high incomes, who used this money typically for savings purposes, and the decreasing or stagnating real wages of those with low and average incomes. In addition, the burdens of amortising loans were already high in the first half of the year, while the fringe elements of real income did not rise or, as in the case of pensions, only increased by the rate of inflation. Thus retail sales declined slightly in the first half of the year. If the franc-forint exchange rate remains around HUF240, in the second half of 2011 the debt service payments of households would grow by HUF200bn-HUF250bn, which nearlycorresponds to the real yields to be paid by private pension funds. This in turn means that the expected increase in consumption in the second half year due to the disbursement of these real yields will certainly not take place. Investments may stagnate in the second half of 2011.

In the second quarter of the year the number of employees grew by about 30 thousand, and the number of unemployed decreased by 13 thousand compared with the previous year, which was attributed to the competitive sector. The number of people participating in public employment decreased, and three quarters of them worked only in part time. Without counting these people, the number of employees in the public sector was stagnating. Unemployment will increase slightly by the end of the year as there are less seasonal jobs in winter. No breakthrough has been achieved in employment.

As a result of subdued domestic demand, import demand was also reduced, lifting the trade surplus. The current and capital account surplus will be around 4 per cent of GDP. Inflation, however, will likely be less than expected: its annual average will be below 4 per cent. A decline in interest rates, however, is still unlikely to take place due to the uncertain international financial market situation.

The forecast of GKI Economic Research Co.: the Hungarian economy in 2011

	2008	2009	2010	Jan-Jun 2011	2011 (forecast)
1. Volume of GDP (previous year=100)	100.8	93.3	101.2	102.0	101.7
2. Industrial production (constant prices, previous year=100)	98.9	82.3	110.5	108.1	105
3. Investments in the national economy (constant prices, previous year=100)	100.4	93.5	94.4	96.0	98
4. Construction (constant prices, previous year=100)	94.9	95.7	89.9	90.4	92
5. Retail trade (volume index, previous year=100)	98.2	94.8	97.7	99.8	100.5
6. Exports (current prices in euro, previous year=100)	106.3	80.6	121.4	117.3	114
7. Imports (current prices in euro, previous year=100)	106.6	75.2	119.4	115.6	113.5
8. Trade balance (EUR billion)	-0.6	3.4	5.5	3.9	6.6
9. Balance of the current and capital account (EUR billion)	-6.8	1.4	3.8	1.3*	4.2
10. Average exchange rate of euro (in HUF)	251.2	280.6	275.4	269.4**	270
11. Deficit of the general government (cash flow basis, without local governments; HUF billion)	909	918.6	870	1495.5**	1190
12. Index of average gross earnings	107.5	100.5	101.4	103.6	104
13. Consumer price index	106.1	104.2	104.9	104.0**	103.8
14. Consumer price index at the end of the period (corresponding month of the previous year=100)	103.5	105.6	104.7	103.1**	103.5
15. Rate of unemployment (at the end of the period, previous year=100)	8.0	10.5	10.8	10.8***	11.0

* First quarter of 2011

** January-July 2011

*** May-July 2011

Sources of actual data: CSO, NBH, NGM