GKI Economic Research Co.
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Another about-face?

Three and a half months after the announcement of the resumption of contacts with the IMF no agreement has been reached, not even about the opening of official negotiations. GKI Economic Research Co. forecasts that Hungary's financial assessment, which has become more favourable in recent months, may plunge if Hungary's intentions to negotiate will not be followed by meeting the prerequisites specified by the IMF and the EU.

At the beginning of 2012 Hungary was threatened by a money market funding crisis. However, in February the forint strengthened by nearly 10 per cent against the euro, the treasury bill issues were more successful, their yields were lower, and the CDS premium decreased by more than 200 base points. This can be attributed to both international and national factors. On the one hand, investors' appetite for risk increased, thanks partly to measures taken by the world's central banks, including the ECB, to improve liquidity. On the other hand, markets priced a relatively quick agreement between Hungary and the IMF, based on the conciliatory rhetoric of the government. Hungarian GDP figures in the fourth quarter of 2011 were better than expected and better than the EU average; however, it was the weather being favourable for agriculture that played a crucial role in this success. In February 2012 interest rates were at a high level making the long-term financing of the Hungarian government debt impossible.

There are still no signs of any policy changes in Hungary that would be essential for restoring the legal standards to the norms of European market economies and for the long-term adjustment of fiscal processes. The incomprehension concerning the EU's criticism and even infringement procedures, the emphasis on pursuing the current economic policy, and the continuing practice of improvisation (from determining higher education student numbers to the one-year renewal of the exchange rate barrier for FX debtors) raise doubts about the honesty of intentions of quick reconciliation with international institutions. The confidence increasing effects of the government's stance supporting the independence of the Central Bank are eliminated by the more and more apparent divisions between the new and old members of the Monetary Council. The delay in the start of the negotiations with the IMF may cause another shock in the financial assessment of Hungary. There is still no alternative to an agreement with the IMF. Delaying tactics only deepen the crisis, forcing paradoxically the possible introduction of crisis management entailing increasing burdens.

The EU's latest forecast predicts a 0.3 per cent fall of GDP in 2012 in the euro area, and as far as the region's countries are concerned, it expects recession only in Hungary (0.1 per cent). GKI is more pessimistic, and it maintains its 1.5 per cent GDP decline forecast. The lack of last year's agricultural growth alone will reduce this year's GDP by about one percentage point. Although industrial export will be dynamic due to the start of production of some automobile industry projects, the rate will be reduced by the recession in Europe, and by the closing down of Nokia and Malév in Hungary. Domestic demand will drop significantly. Household consumption is expected to decline by 2.5 per cent due to the contraction of real earnings by 3.5 per cent, the stagnation of employment, and the decrease in social benefits, in spite of the easing burdens of FX-debtors making use of the preferential final repayment option and the exchange rate barrier. Investments continue to decline by 4 per cent due to the lack of markets and resources, legal uncertainties, and the shortage of capital.

In 2011, the so-called structural general government deficit was accounted for around 6 per cent of GDP. In order to reduce this deficit, restrictions were introduced in 2012. Fiscal reserves have already been largely allocated and resources for some promised improvements like increasing wages in health care or helping the Public Transport Company seem to be missing. The planned general government deficit of 2.5 per cent of GDP in 2012 is unlikely to be achieved. The government is under great pressure to keep the deficit below 3 per cent of GDP even in the case of a recession held improbable by the government. Therefore, the general government deficit will probably be around 2.9 per cent of GDP in 2012. In areas included in the negotiations with the IMF several adjustments totalling between HUF200bn and HUF300bn will be necessary in 2012.

The forecast of GKI Economic Research Co.: the Hungarian economy in 2012

		2009	2010	2011	2012
1.	Volume of GDP (previous year=100)	93.2	101.3	101.7	98.5
2.	Industrial production (constant prices, previous year=100)	82.3	110.5	105.4	105
3.	Investments in the national economy (constant prices, previous year=100)	93.5	94.4	95.5	96
4.	Construction (constant prices, previous year=100)	95.7	89.9	92.2	95
5.	Retail trade (volume index, previous year=100)	94.8	97.7	100.2	97.5
6.	Exports (current prices in euro, previous year=100)	80.6	121.4	111.7	110
7.	Imports (current prices in euro, previous year=100)	75.2	119.4	110.5	108
8.	Trade balance (EUR billion)	3.7	5.5	7.0	9
9.	Balance of the current and capital account (EUR billion)	1.4	2.8	3.5*	4
10.	Average exchange rate of euro (in HUF)	280.6	275.4	279.2	290
11.	Deficit of the general government (cash flow basis, without local governments; HUF billion)	918.6	870	1734.4	750
12.	Index of average gross earnings	100.5	101.4	105.2	103.2
13.	Consumer price index	104.2	104.9	103.9	105
14.	Consumer price index at the end of the period (corresponding month of the previous year=100)	105.6	104.7	104.1	104.5
15.	Rate of unemployment (at the end of the period, previous year=100)	10.5	10.8	10.7	10.8

* GKI forecast

Sources of actual data: CSO, NBH, NGM