GKI Economic Research Co.
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Recession continues uninterrupted during economic adjustments

GKI Economic Research Co. predicts that the termination of the excessive deficit procedure, which is a paramount goal of the Hungarian government, is uncertain due to the side-effects of the economic measures taken by the government. GKI forecast slight GDP growth (0.8 per cent) for 2013 following a decline of 1.5 per cent in 2012. In the wake of the new restrictions announced lately, however, only stagnation can be expected next year. Domestic demand continues to fall. The agreement with the IMF and the EU is more and more unlikely to materialize and this makes the financing of Hungary more expensive and riskier.

The structure of fiscal adjustments for 2013 announced by the government (including tax increases and especially the postponement of the promised halving of the bank tax) greatly destroys the business environment. The further weakening of legal certainty, shrinking domestic demand, and further decline in lending, threatening the day-to-day operation of companies, will cause more harm than benefit (which was expected from employment becoming cheaper for certain groups of workers). As a result, employment will grow only statistically, mainly due to the further expansion of public works, whereas it will continue to shrink in the private sector. The output of industries selling their goods and services in the domestic market will decline. The growth or stagnation of the economy will mainly depend on the agricultural sector, that is, on weather.

Gross and net wages are expected to rise by about 4 per cent as the effects of the elimination of the super-grossing and the abolishment of the ceiling on payroll taxes will roughly cancel each other. The annual inflation rate will increase to around 5.5 per cent due to the introduction of a public utility tax. This means that no reduction in inflation can be expected compared with this year's 5.9 per cent rate, and its acceleration cannot be excluded either. Real wages and incomes will shrink by 1.5 per cent, whereas consumption will drop by 1 per cent in 2013. Decline in investments will continue in 2013 by about 2 per cent due to the lack of investor confidence and the completion of major projects started in the past.

The government seems to consider its main task to avoid the excessive deficit procedure and keep next year's deficit below 3 per cent of GDP. The measures supporting this goal, however, hamper growth, are unsustainable and do not promote the structural transformation of the economy. Therefore, it is possible that no decision will be taken concerning the termination of the excessive deficit procedure. Although the danger of suspending Hungary's access to the cohesion funds remains looming, Hungary will probably have access to the 2013 EU funds as a result of the two already announced austerity packages and a promised third one. The conclusion of an agreement with the IMF and the EU, however, remains as distant as before, so far as the government insists on its economic policy that aggravates recession (the change of economic policy is a prerequisite for the agreement).

For this reason, the relatively good financiability of the Hungarian government debt at present (CDS spreads falling to around 300, the exchange rate of the forint to the euro being around HUF280, government bond yields are declining) is likely to be temporary. This favourable financial situation is largely a result of measures taken by major central banks to improve liquidity and the markets' pricing of the IMF agreement. The deterioration in external conditions and the dissolution of illusions concerning the IMF agreement may cause tensions in the money markets.

As a result, in 2013 the Hungarian economy continues to lag behind its regional competitors, the purchasing power of households will decline, and businesses will suffer from the lack of demand as well as credit shortage.

The forecast of GKI Economic Research Co.: the Hungarian economy in 2012-13

	2010	2011	Jan-Aug 2012	2012	2013
1. Volume of GDP (previous year=100)	101.3	101.6	99.0*	98.5	100
2. Industrial production (constant prices, previous year=100)	110.5	105.4	99.6	101	102.5
3. Investments in the national economy (constant prices, previous year=100)	94.4	95.5	92.9*	96	98
4. Construction (constant prices, previous year=100)	89.9	92.2	93.0	93	98
5. Retail trade (volume index, previous year=100)	97.7	100.2	98.6	98	98.5
6. Exports (current prices in euro, previous year=100)	121.4	112.0	101.1	102	107
7. Imports (current prices in euro, previous year=100)	119.4	110.6	101.4	101.5	106.5
8. Trade balance (EUR billion)	5.5	7.0	4.7	7.0	7.7
9. Balance of the current and capital account (EUR billion)	2.9	3.6	1.3*	3	2.5
10. Average exchange rate of euro (in HUF)	275.4	279.2	291.4**	290	285
11. Deficit of the general government (cash flow basis, without local governments; HUF billion)	870	1734.4	545.8**	700	800
12. Index of average gross earnings	101.4	105.2	104.7	104.5	104
13. Consumer price index	104.9	103.9	105.8**	105.9	105.5
14. Consumer price index at the end of the period (corresponding month of the previous year=100)	104.7	104.1	106.6**	105.7	105
15. Rate of unemployment (at the end of the period, per cent)	10.8	10.7	10.4***	11	10.8

* First half of 2012 **Jan-Sep 2012 *** Jun-Aug 2012
Sources of actual data: CSO, NBH, NGM