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## **2014 – SPECTACULAR START, UNCERTAIN CONTINUATION**

According to GKI Economic Research Co. positive growth and inflation data at the beginning of the year are largely due to temporary factors. However, in 2014 the economy may be somewhat more dynamic, and inflation may be lower than previously expected by GKI. The upswing of the European business cycle has a favourable impact on Hungarian exports. The purchasing power of households, together with the performance of companies selling their goods and services in the domestic market, is somewhat increasing as well due to the economic policy influenced by the elections. As a result of the large-scale absorption of EU transfers, investments are also increasing.

In the first two months of 2014 most sectors were able to increase their output, though in most cases compared to a very low base. Industrial production increased by 7 per cent (exports by more than 10 per cent), whereas domestic sales dropped as a result of a decline in energy production due to the unusually warm weather. Automobile industry continued to soar (+27 per cent), whereas electronics industry was shrinking (-8 per cent). Construction output rose by more than 20 per cent. It should be noted that the weather was very favourable. Retail sales increased by 6.5 per cent (they grew by 4 per cent if the changes in recording tobacco sales statistics were left out of consideration). In commercial lodgings foreign and Hungarian guest nights went up by more than 10 per cent. In the first quarter of 2014, the unemployment rate dropped dramatically to 8.3 per cent from 11.8 per cent a year earlier. The number of unemployed fell by 139 thousand a year, largely due to the increasing number of those participating in workfare programs by 112 thousand before the elections. However, the number of people employed in the business sector rose as well, by 1.6 per cent.

The average gross earnings grew by 1.3 per cent (by 6.4 per cent with the exclusion of people involved in public work schemes). As net earnings increased by the same amount and inflation practically stopped temporarily, real wages also were up by the same amount in the first quarter of 2014. Wage increases are likely to fall short of last year's due to a very low rate of inflation, and the proportion and number of those involved in workfare programs are going to decline. In the rest of the year the rise of market prices is inevitable; however, taking into account the planned overhead reductions in the autumn, the rate of inflation in 2014 is expected to be around 1 per cent. As a result, real incomes will increase by about 2 per cent, retail sales by 2 per cent and consumption by around 1.5 per cent. An artificial increase in the purchasing power like in 2014 is unlikely in 2015.

In order to keep interest rates low, the Monetary Council is ready to tolerate the weakening of the forint. However, the exceptionally high interest rate premiums in Hungary compared to other countries in the CEE region, the high yields required from long-term government bonds, and the continued weakening of the forint pose some questions about the practicality and sustainability of this policy. The latest actions of the National Bank of Hungary intend to promote, among others, the purchase of government securities by commercial banks. Its success depends largely on the willingness of the banks. The same is true for the easing of the credit conditions of the Funding for Growth Scheme of the National Bank. Without some sort of compromise with the banks, one of the important sources of economic dynamism will be missing.

In the first quarter, the general government deficit exceeded 70 per cent of the target amount for the whole year. Although this dramatic level of deficit is not an exceptional phenomenon, it always foreshadows inevitable corrections. Since avoiding the restart of the excessive deficit procedure, which is important for accessing EU transfers in the future, remains the primary goal of the government, it is almost certain that the general government deficit will be less than 3 per cent of GDP. Considering the two elections to be held later this year and the government's anti-austerity rhetoric, it is assumed that the burdens of this policy will affect the business sphere directly and households will only be affected indirectly (as companies will pass their extra costs to them sooner or later).

## GKI FORECAST FOR -2014

Description	2011	2012	2013	2014. I-II.	2014
					forecast
1. GDP (%)	101.6	98.3	101.1	-	101.9
2. Industrial production (%)	105.4	98.3	101.4	107.1	104
3. Investments (%)	95.5	94.8	107.2	-	104
4. Construction services (%)	92.2	94.1	109.6	122.5	107
5. Retail trade turnover (%)	100.2	98.1	101.9	106.5	102
6. Exports (current prices in euro, %)	112	100.2	102.5	104	104
7. Imports (current prices in euro, %)	110.6	100.4	101.8	101.6	105
8. Foreign trade balance (EUR billion)	7.1	6.8	7.0	1.2	6.8
9. Current and capital account balance (EUR billion)	2.7	3.4	6.3	-	6.3
10. Average exchange rate of euro (in HUF)	279.2	289.4	296.9	307.9**	308
11. General government deficit* (HUF billion)	1734.4	607.5	929.2	701.2**	1000
12. Index of average gross earnings	105.2	104.6	103.4	101.3***	103.5
13. Consumer price index	103.9	105.7	101.7	100.0	101
14. Consumer price index at the end of the period (corresponding month of the previous year=100)	104.1	105.0	100.4	100.1	102.5
15. Rate of unemployment (at the end of the period, %)	10.7	10.7	9.1	8.3**	9.6

\* Cash flow basis, without local governments

\*\* January-March 2014

\*\*\* Fostered workers

Sources of actual data: CSO, NBH, NGM

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