Monthly flash report for top executives

(April 2020)

The **coronavirus epidemic** and the related panic, the forced restrictive actions of governments, and the contraction of economic activity, which differs from country to country and sector to sector, have created a new situation for the economic processes of the world and Hungary. **The COVID-19 is already a worldwide pandemic and its depth and duration are completely uncertain.** While the economy is already recovering in China (industrial production may have already expanded in March), the epidemic is now spreading rapidly in Europe, mainly in Spain, Italy and the United Kingdom, despite measures to restrict the movement of the population. The general downturn in the world's stock exchanges in several waves, with occasional positive corrections, illustrate a climate of general uncertainty. **The epidemic can be stopped only by radically restricting the movement of people; this will necessarily lead to temporary freeze in some sectors, economic downturn as well as recession**, as it seriously affects both global production chains and consumer demand, both physically and through expectations. In the current situation, **GKI** outlines **two scenarios for 2020**, without making any forecast for 2021.

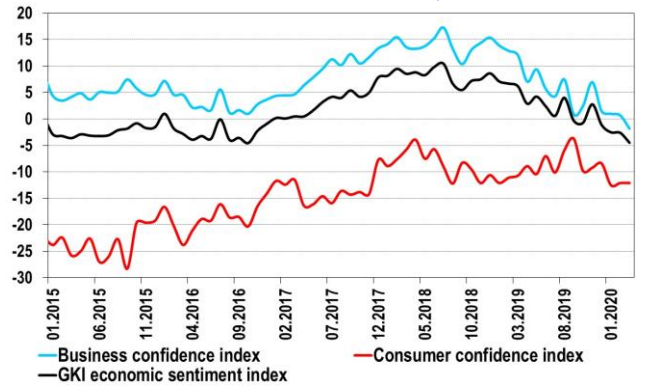
Summary figures, 2019-2020

	2019	2020 "A"	2020 "B"
GDP (previous year = 100)	104.9	97	93
Gross fixed capital formation (preceding year = 100)	115.3	92	90
Consumption (previous year = 100)	104.4	99	96
Current account balance (EUR billion)	-0.5*	-1	-2
Current account and capital account/GDP (per cent)	1.4*	1.4	1

* GKI estimate Source: HCSO, NBH. 2020: GKI

The Hungarian government perceives the threat of recession, though probably without realizing the magnitude of its actual severity and extent. (For example, even at the end of March, the central bank still expected an economic growth of 2-3 per cent for this year.) Therefore, economic protection measures have been announced in several waves, gradually "raising the stakes". **The government has announced a radical transformation of the 2020 budget**, providing a total of HUF9,200bn for economic protection, which may amount to 18-20 per cent of GDP. In this way, resources can be provided to companies having financial or temporary employment problems in order to minimize bankruptcies and prevent a surge in unemployment. The government is ready to take over 70 per cent of wage costs for three months in the event of switching to part-time work. The social contribution tax will be reduced, the tourism sector will be supported by HUF600bn, and the health industry will be supported prominently but in an unspecified way. The corporate sector will be supported by loan guarantees and capital programmes in the amount of nearly HUF2,000bn of preferential loans and more than HUF500bn of government guarantees. Preferential measures were announced in order to help small undertakings with preferential taxation operating in most vulnerable sectors. Sources of financing are still vague. In any case, special taxes in the retail and banking sector have been reintroduced.

GKI business confidence index, 2015-2020



Source: surveys of GKI

According to current information, **the epidemic affects mainly the following sectors: tourism, entertainment, car manufacturing, transport and trade of products not in daily use**. However, industrial companies integrated in supply chains and heavily dependent on Chinese or even European suppliers face high risks as well.

Trends in the real economy, 2019-2020
(Volume, the same period of the previous year = 100)

	2019	01-02 2020	2020 "A"	2020 "B"
Industrial production	105.4	103.2	95	90
Construction	121.7	---	97	93
Exports of goods	104.7	---	90	85
Imports of goods	105.7	---	90.5	87
Retail sales	106	107.6	102	97

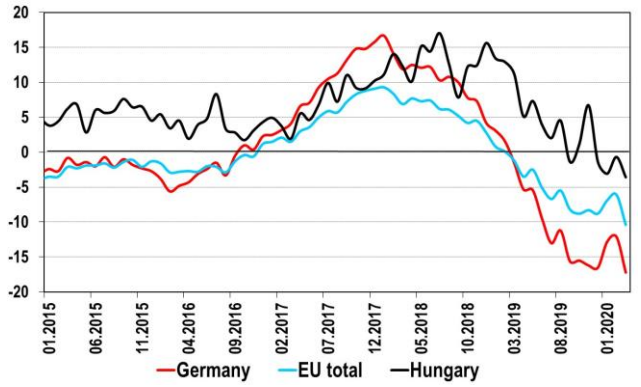
Source: HCSO, 2020: GKI

GKI has long expected a significant slowdown by 2020, mainly due to deceleration of investments generated by EU transfers and to a lesser extent a fall in consumption and external demand. In the current epidemic situation, **GKI questions only the extent of the decline in 2020**. Hungarian GDP may have grown by as much as 2 per cent in the first quarter. Owing to the almost complete shutdown in sectors such as tourism, entertainment and automotive industry, as well as various trade restrictions, plus a decline in consumption in key areas and the cessation of some investments projects, GDP may decline by around 20 per cent in the second quarter. The main question is whether restrictions in the movement of people caused by the virus would affect only the second or third quarter, or even a longer period. Based on this, two basic scenarios can be considered. Among these **GKI** scenarios, the less pessimistic **scenario "A" assumes that recovery may start in the third quarter and expects a 3 per cent annual decline**. However, in the event of a prolongation or a deeper epidemic, **scenario "B" predicts a recession of around 7 per cent**. The most significant difference between the two scenarios

concerns household consumption: scenario "A" only estimates a close-to-stagnation decline, scenario "B" projects a more significant and painful drop of 4 per cent. These scenarios are, of course, based on very uncertain assumptions, and **more unfavourable outcomes may also emerge**.

Discussions about the 2021-2027 budget have taken a back seat in EU decision-making bodies, and **epidemic-related firefighting has come to the fore**. Central banks have set to lower their key interest rates, governments to loosen their fiscal tightening and announce huge rescue packages. **In addition, the EU has announced a major rescue package valued at some EUR40bn in the real economy.** The essence of the measures is to manage government aid and budget spending rules with maximum flexibility, and to transfer huge amounts of EU funds to member states from the common budget. This means that EUR29bn of unspent cohesion funds from the 2014-2020 EU budgetary period can be spent on combating the coronavirus, and that member states will not have to repay an additional EUR8bn to the common coffers, which for various reasons would have been due by June. As Hungary has already provided companies with advance funds for this purpose, this assistance cannot be used by the government.

Industrial confidence indices in Hungary and the EU, 2015-2020



Source: EU, surveys of GKI

The **EU's economic sentiment index fell dramatically** in March, by almost 10 points. (Surveys were conducted in the first half of the month, thus the results are even relatively favourable.) The confidence indexes of industry and construction declined slightly, whereas those of business services and trade dropped significantly. Consumer expectations have also deteriorated sharply. The **German business confidence index** narrowed moderately by 5 points in March.

Surprisingly, the GKI economic sentiment index dropped hardly in March, business expectations worsened slightly, and consumer ones remained unchanged. This is obviously due to the fact that the survey was conducted at the usual time, between March 1 and 8 for consumers and between March 5 and 13 for businesses, before the coronavirus emergency was announced on March 11. However, for the first time in six and a half years, business expectations became again negative, meaning that slightly more companies expected the future to be worse than good. On the other hand, the **assessment of the Hungarian economy's prospects plummeted** similarly as they did in October 2008.

Labour market trends, 2019-2020

	2019	2020 "A"	2020 "B"
Unemployment rate (annual average)	3.5	5	8
Gross earnings**	111.4	106	102
Real earning **	107.7	102	98

Source: HCSO, 2020: GKI */ December 2019 – February 2020
**/ The same period of the previous year = 100

The **National Bank of Hungary** introduced a new instrument for commercial banks on 1 April, the one-week central bank deposit, with an interest rate much higher (0.9 per cent) than that of other instruments available on the market. On April 7, the use of five additional tools was announced. The Funding for Growth Scheme (FGS) programme is relaunched as FGS "Hajrá" (for which HUF1,000bn in new funds have been allocated), the FGS programme was extended to 20 years instead of the previous 10 and the contribution of the central bank was also increased, HUF250bn in dividends will be paid to the central budget, the minimum reserve for the banks will be lowered to zero, and the interest rate corridor was made symmetric, however, interest rates on one-week loans and one-week covered assets were raised to 1.85 per cent, thus lifting the interest rate corridor to 190 basis points.

Interest rates, 2019-2020
(per cent, at the end of the period)

	2019	03, 2020	2020 "A"	2020 "B"
NBH reference rate	0.90	0.90	0.90	0.90
Fed reference rate	1.75	1.00	1.00	1.00
ECB reference rate	-0.5	-0.5	-0.5	-0.5
Reference yield of one-year government securities	0.02	0.81	1	1.5

Source: NBH, 2020: GKI

The government **plans a deficit of only 2.7 per cent of GDP** by 2020, which will hardly be enough to manage the crisis. (The original budget assumed 4 per cent economic growth, and the likely recession in itself will cause a significant drop on the revenue side, thus reducing GDP in the denominator.) As a matter of fact, financing the higher deficit would presumably require foreign funding in addition to the resources of banks affected by the loan repayment moratorium and distressed households. And this is something, based on the experience of the last decade, the government wants to avoid in any case.

Financial indicators, 2018-2020

	2019	Q1 2020	2020 "A"	2020 "B"
Consumer price index	103.4	104.7*	104	104
EUR/HUF exchange rate	325.4	339.0	345	360
Foreign trade balance (EUR billion)	4.9	---	3.5	2.5
General government balance (cash flow, without local governments, HUF billion)	-1219	+90.4*	-1400	-2000

*/ January 2020 Source: HCSO, NBH, MoF, 2020: GKI.