

## Monthly flash report for top executives (July 2020)

The Hungarian economy already slowed down in the first quarter (compared to previous ones). There was a huge contraction in April. Although recovery began in May, it will be a long and difficult process with great sacrifices. Economic forecasts of various forecasting institutions for the world economy, including Hungary, **show unprecedented varieties**. The two extremes for 2020 are +0.3-2 per cent (National Bank of Hungary) and -8 per cent of GDP (OECD). Note that even the signs of the numbers are different. The divergences for 2021 are already smaller, and they are partly due to the different extent of the decline expected for 2020. The EU, the OECD, as well as Reuters and Consensus Forecast expect Hungary's GDP to reach the 2019 level by 2022, whereas the IMF and the Hungarian government by 2021. The National Bank of Hungary expects a significant acceleration of GDP growth in 2021. According to the **European Commission**, a 7.7 per cent drop of Hungary's GDP in 2020 could be followed by a 6 per cent increase next year.

### Summary figures, 2019-2021

	2019	Q1, 2020	2020	2021
GDP (previous year = 100)	104.9	102.2	94	104.5
Gross fixed capital formation (preceding year = 100)	115.3	97.4	90	106
Consumption (previous year = 100)	104.4	104.3	97.5	103
Current account balance (EUR billion)	-0.5	0	-3	-2.5
Current account and capital account/GDP (per cent)	1.4	1.8	0.4*	-1.5*

\* Without the EU's recovery fund.

Source: HCSO, NBH; 2020-2021: **GKI**

Due to its low probability, the optimistic version of our forecast is no longer maintained, thus **GKI expects an economic downturn of 6 per cent (between 5-7 per cent) in 2020**. (A decline of close to 15 per cent is likely in the second quarter and that of around 5 per cent in the second half.) **GDP is expected to grow by 4.5 per cent in 2021**. Faster growth is hindered by the weakening of international activity (and the related Hungarian export capacity), the sluggishness of investments (due to the phasing out of the boosting effects of EU transfers at the turn of two European 7-year budgets) and the uncertain business environment. However, the **consumption of households** in 2021 may even exceed its 2019 level, in view of the parliamentary elections due in 2022.

### Trends in the real economy, 2019-2021

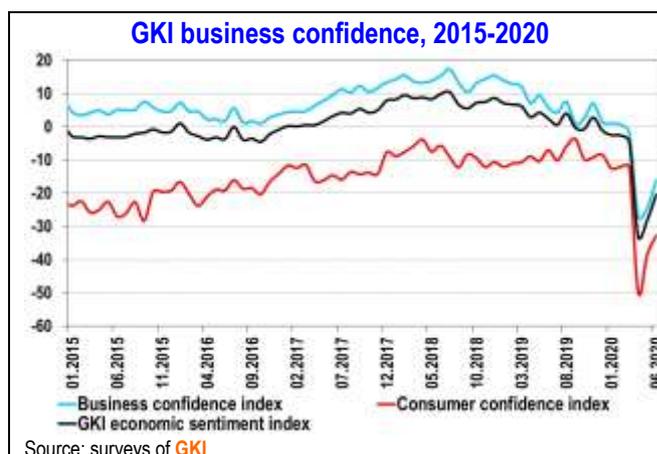
(Volume, the same period of the previous year = 100)

	2019	01-05, 2020	2020	2021
Industrial production	105.4	86.2	88	105
Construction	121.7	99.3*	95	106
Exports of goods	104.7	92.1*	85	107
Imports of goods	105.7	95.7*	87	107.5
Retail sales	106	101.5	103	103

\*/ January-April 2020

Source: HCSO, 2020-2021: **GKI**

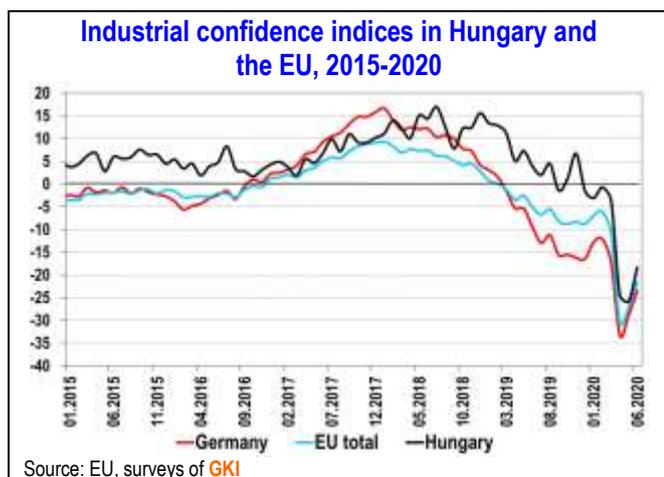
The **world economic system** poses both a demand and a supply shock, which affects national economies differently depending on their treatment of the pandemic, their economic structures and other factors. However, the emergence of a second wave of the pandemic, either this year or next, cannot be ruled out in countries where the containment of the virus has been very successful so far. **Political and economic decision-makers have to choose between health and humanitarian considerations on the one hand, and minimizing the economic damage caused by the pandemic on the other hand**. The world economy is expected to shrink by 3-4 per cent in 2020 and bounce back by around 3.2 per cent in 2021. World trade could fall by 11-12 per cent in 2020, and a growth of 7.5 per cent can be expected in 2021. The impact of the coronavirus pandemic on global value chains cannot be assessed yet. However, risk-sharing and the pursuit of security will intensify. According to the latest forecast of the European Commission, the **EU's aggregate GDP** will contract by 8.3 per cent this year and mount by 6.1 per cent next year.



After falling in March and April, the **EU's economic sentiment index** rose sharply in May and June. However, it is true that the index eliminated only about a third of its March-April fall during the last two months. **The European economic climate is still very unfavourable**. At the same time, it is good news that European employment expectations have been improving substantially for the second month in a row. **The German business confidence index rose markedly in June after May**.

**Although pessimism declined further in June, it remained very strong**. Although the **GKI economic sentiment index** increased by a larger extent in June than in May, it eliminated only a smaller half (44 percent) of its April fall. **The consumer confidence index was up to a greater extent in May and the business confidence one in June**. This is mainly due to the fact that industrial

expectations started to improve in June after continuing deterioration in May.



**Following the shock in April, industry was still “dizzy” in May:** the volume of production fell by 30.7 per cent year-on-year. There was a total decrease of almost 14 per cent in the first five months. Domestic industry was severely affected by the coronavirus pandemic, despite the fact that measures restricting industrial activities (e.g., mandatory factory closures) did not take place in Hungary. The main problems included the **disintegration of international value chains and supply networks on both the demand and the supply side, and the decline in demand.**

**Construction** suffered much less from the effects of the pandemic: production fell by only 2 per cent on an annual basis in April, thus essentially stagnating in the first four months. The main risks are more likely to emerge in the medium term, as a result of uncertainty in the construction demand of households and companies. The sector’s contract portfolio fell by 15 per cent year-on-year at the end of April.

**Retail is recovering:** in May, the volume of its turnover fell “only” by 2.1 per cent on an annual basis. The volume of turnover was 1.5 per cent higher in the first five months than last year. **Tourism** collapsed in March-April, and the situation did not improve in May either. **Foreign trade began to plummet in April, and this trend continued in May.** In the fifth month of the year exports fell by 29 per cent (in euro terms) and imports by 25 per cent on an annual basis, thus the monthly balance returned to the positive band.

#### Labour market trends, 2019-2021

	2019	01-04 2020	2020	2021
Unemployment rate (annual average)	3.5	4.1*	6	4.5
Gross earnings**	111.4	109.1	105	105
Real earning **	107.7	104.6	101.5	101

\*/ March-May 2020

\*\*/ The same period of the previous year = 100

Source: HCSO, 2020-2021: GKI

The **unemployment rate** increased only slightly statistically, averaging 4.1 per cent in March-May, 0.7 percentage points higher than a year earlier. The number of employees decreased by 2.7 per cent in the first four months of 2020. Although the **willingness of the business sector to employ** improved significantly in May and June, those expecting a reduction are still a significant majority, both in industry and construction. The **fear of unemployment of households eased substantially** in May and June; however, only a third of the April deterioration was eliminated, and this is by far the most negative factor for consumers.

#### Interest rates, 2019-2021 (per cent, at the end of the period)

	2019	06, 2020	2020	2021
NBH reference rate	0.90	0.75	0.60	1.00
Fed reference rate	1.75	0.25	0.25	0.25
ECB reference rate	-0.5	-0.5	-0.5	-0.5
Reference yield of one-year government securities	0.02	0.23	0.7	1

Source: NBH, 2020-2021: GKI

**Inflation picked up slightly in June** to 2.9 per cent on an annual basis. This was due, among other things, to a 7.8 per cent increase in food prices and a 3.6 per cent decrease in the prices of other goods and fuels. GKI estimates that the average increase of the price index will be around 3.5 per cent in 2020 and around 4 per cent in 2021.

To the general surprise, the **National Bank of Hungary** cut interest rates in June, thus the base rate fell to 0.75 per cent and a further summer cut to 0.6 per cent was promised. In 2021, if economic growth starts, an indicative increase may be necessary to achieve inflation targets and strengthen the credibility of the central bank. The **reference yield of one-year Hungarian government securities** fell significantly in June, by almost 60 basis points.

#### Financial indicators, 2018-2021

	2019	Q1-Q2 2020	2020	2021
Consumer price index	103.4	103.4	103.3	104
EUR/HUF exchange rate	325.4	348.9	350	357
Foreign trade balance (EUR billion)	5.0	1.4*	2.0	1.7
General government balance (cash flow, without local governments, HUF billion)	-1219	-1837	-2000	-2400

\*/ January-May 2020

Source: HCSO, NBH, MoF, 2020-2021: GKI.

The general government deficit in the first half of the year was five times higher than previously planned. This is obviously understandable as government measures in response to the pandemic have involved huge spending items. Until the end of June, for example, the government spent HUF520bn on health care purchases related to the pandemic. GKI forecasts a **general government deficit of 5 per cent of GDP in 2020 and 3.5 per cent in 2021**, and a government debt ratio of around 75 per cent and 72 per cent of GDP, respectively.