HUNGARY: Losing momentum

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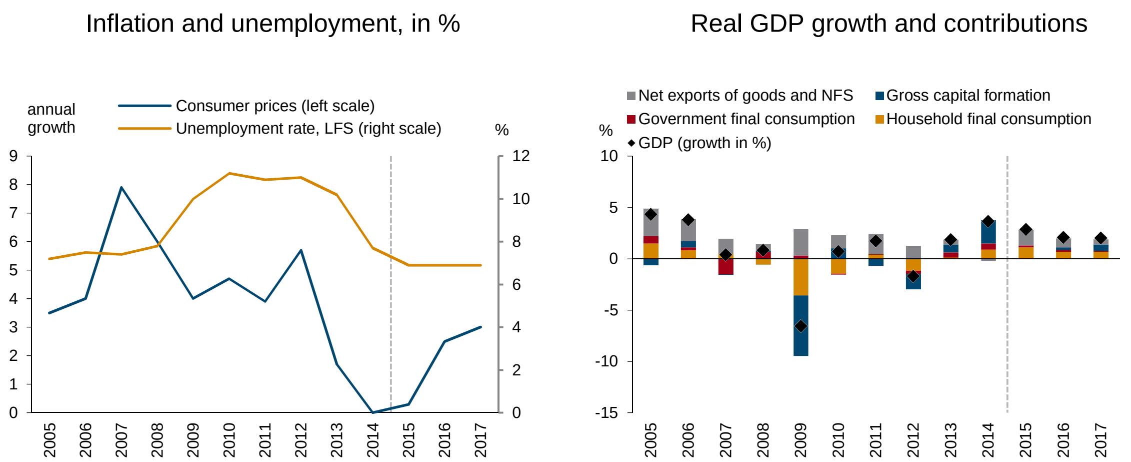
After six quarters featuring GDP growth rates higher than 3%, the second quarter of 2015 brought about a deceleration in the pace of economic expansion to 2.7% (all data here and later, if not otherwise indicated, are year-on-year). Both that slowdown and the preceding high quarterly growth rates are linked to the cyclical nature of cohesion policy transfers from the European Union. The marked upturn in investment experienced in 2014 will not be repeated this year; the economy appears to be returning to its earlier growth pattern characterised by net exports as the major contributors to economic expansion.

Figure 46 / Hungary: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

The Hungarian economy expanded by 3.1% in the first half of the year. The second-quarter growth rate was, however, 0.8 percentage points lower than that of the first quarter. Industry has been the main contributor to growth, though its increase has also become slower than it was in the first half of the previous year. Within manufacturing the automotive sector, dominated by foreign-owned enterprises, achieved an outstanding expansion of 15.7%. Growth performance of construction suffered a serious setback, dropping from well over 20% in the first half of 2014 to 8% in the first half of 2015. Agricultural output has shrunk substantially. In the services sector, gross value added increased by over 2% in the first six months of the year, with a higher than average expansion in retail trade, accommodation and food service activities, transportation and storage, computer programming and consultation. Below-average performance was recorded in financial and insurance activities, public administration, education and health services.

Household consumption continued to increase, approaching the GDP's expansion, while government consumption declined by about 3%. Gross fixed capital formation increased by a disappointing 0.4% in the first six months, a radical drop from the 19.2% growth rate recorded in the first half of the previous year. The near-stagnation of investments is the combined effect of still dynamically expanding outlays in various fields of environmental protection, storage, transport, public administration, and defence, i.e. mostly areas which are typical targets of EU co-financed projects. Simultaneously, investment in manufacturing, wholesale and retail trade, real estate activities and agriculture declined. The good news comes from foreign trade where the expansion of exports surpassed that of imports to a considerable extent, even if the large gap recorded in the first quarter narrowed somewhat in the second quarter. Nevertheless, net exports figured as the major driver of economic growth in the first half of 2015.

Employment kept increasing substantially, even if the pace dropped to half of that characterising the previous year. In the second quarter of 2015, 54% of the increment in employment was explained by domestic primary employment growth, 36% by an increase in public work employment, and 10% by growth of employed working abroad. In the first half of 2015, the unemployment rate dropped by close to one percentage point to 7.3% compared to the respective period a year earlier.

Consumer price inflation was slightly negative in the first half of the year, but with the diminishing effects of the regulated energy price reductions last year, inflation will be on the rise again in the second half of the year and may reach 2.5% in 2016. In the case of producer prices, 1% deflation was registered in the first six months, which makes real interest rates a burden even with credit lines at preferentially low interest rates of the central bank's 'Funding for Growth Programme'. The policy rate is currently 1.35%, and the Monetary Council is keen to keep this level as long as possible. At this policy rate the forint remains weak.

The general government balance is far better than the -3% requirement of the Stability and Growth Pact. That allows a modest reduction of the public debt/GDP ratio, what is important in order to avoid a relaunch of an Excessive Deficit Procedure against Hungary

By 2015 a long-standing goal by Prime Minister Orbán has been achieved, namely to gain Hungarian majority ownership in the banking sector. With the purchase of MKB and the Budapest banks, Hungarian ownership has surpassed 55.1% of the banking sector's combined balance sheet. This share was only 36.3% before the crisis, in 2008. The expansion of national ownership has not been reflected in better performance as yet. According to the central bank's Financial Conditions Index, which summarises lending developments in the corporate and household segments, the interbank rate and the exchange rate, the contribution of the banking sector to the GDP growth rate has oscillated between about -5% and +1% since early 2009, and was still negative in the first two quarters of 2015. In the second quarter of this year, the annual growth rate of outstanding borrowing by non-financial corporations declined by 3.4%, while sustainable growth would necessitate an about 5% expansion.

Up to 2005 Hungary's economic growth rate was very similar to that of its Visegrad peer countries but since 2006 it has been lagging behind. With the improving Hungarian economic growth performance in the past one and a half years, the question can be raised whether the future will see a catching-up of the Hungarian economy to the regional peers. What could bring about a turn to the better concerning the potential growth rate in Hungary? We think that the key is a lastingly elevated investment rate, principally through increased business sector investment. This change has though important preconditions in terms of policy reform. This reform, as a minimum, should ensure radically improved policy predictability as compared to the prevailing one, primarily but not only in the area of taxes and regulations. The business climate should be improved by breaking with the practice of discriminative sectoral taxes. The hostile government attitude towards foreign-owned firms outside the manufacturing sector should be dropped and a modus vivendi should be found with the financial sector in order to enable a revival of financial intermediation. The extreme centralisation of decisions should be reversed.

There is no perspective for such a policy reform in the current political constellation. With the forthcoming low tide of EU co-financed projects, aggregate demand may fall by 1% to 2% of the GDP in the next two years. There is only a very limited chance for a resolute new growth impulse coming from the financial sector through a significant upturn in lending. Thus Hungary's growth outlook is deteriorating in the medium run, even if the annual GDP growth rate will probably not fall below 2%. This rate, however, is insufficient for catching up either with the regional peers or the highly developed core countries of the EU. Even this moderate growth in the baseline scenario is endangered by substantial risks. The main risks to the current forecast are possible negative developments in the Germany-led Central European automotive cluster, which absorbs the bulk of Hungary's respective output as well. Such negative developments may derive, first, from a further slowdown of the economy in China and accordingly shrinking demand there for German cars and, second, from the far-reaching consequences of the Volkswagen scandal, where Hungary is prominently involved through the Audi factory in Győr and several component-producing firms.

Table 13 / Hungary: Selected economic indicators

	2011	2012	2013	2014 1)	2014	2015	2015	2016	2017
					January-June		Forecast		
Population, th pers., average 2)	9,972	9,920	9,893	9,863	.	.	9,830	9,810	9,800
Gross domestic product, HUF bn, nom. 3)	28,134	28,628	30,065	32,180	14,928	15,592	33,500	35,000	36,800
annual change in % (real)	1.8	-1.7	1.9	3.7	3.9	3.1	2.9	2.1	2.0
GDP/capita (EUR at exchange rate) 3)	10,100	10,000	10,200	10,600	.	.	10,800	11,300	11,900
GDP/capita (EUR at PPP) 3)	17,100	17,100	17,800	18,700	.	.	.	.	.
Consumption of households, HUF bn, nom. 3)	14,341	14,889	15,226	15,651	7,694	7,883	.	.	.
annual change in % (real)	0.8	-2.3	0.2	1.8	2.0	2.9	2.3	1.4	1.4
Gross fixed capital form., HUF bn, nom. 3)	5,569	5,548	6,160	6,971	2,826	2,895	.	.	.
annual change in % (real)	-1.3	-4.4	7.3	11.2	19.2	0.4	2.0	1.0	3.5
Gross industrial production									
annual change in % (real)	5.6	-1.8	1.1	7.7	9.4	7.3	6.0	5.0	4.0
Gross agricultural production									
annual change in % (real)	11.1	-10.0	12.2	9.6	.	.	.	.	.
Construction industry									
annual change in % (real)	-8.0	-6.6	8.4	13.6	21.6	8.0	.	.	.
Employed persons, LFS, th, average 4)	3,812	3,827	3,893	4,101	4,057	4,159	4,200	4,260	4,280
annual change in %	0.8	1.8	1.7	5.3	5.9	2.5	2.5	1.5	0.5
Unemployed persons, LFS, th, average 4)	468	473	441	343	362	329	310	320	320
Unemployment rate, LFS, in %, average 4)	10.9	11.0	10.2	7.7	8.2	7.3	6.9	6.9	6.9
Reg. unemployment rate, in %, end of period	12.4	12.7	9.2	8.7	9.7	8.2	.	.	.
Average monthly gross wages, HUF 5)	213,094	223,060	230,714	237,695	235,002	243,194	245,800	255,700	266,000
annual change in % (real, gross)	1.3	-0.9	1.7	3.2	3.1	3.9	3.1	1.5	1.0
Average monthly net wages, HUF 5)	141,151	144,085	151,118	155,690	153,926	159,293	161,000	167,500	174,300
annual change in % (real, net)	2.4	-3.4	3.1	3.2	3.1	3.9	3.1	1.5	1.0
Consumer prices (HICP), % p.a.	3.9	5.7	1.7	0.0	0.2	-0.3	0.3	2.5	3.0
Producer prices in industry, % p.a.	4.1	4.1	0.6	-0.4	-0.8	-1.0	-0.5	1.7	2.3
General governm.budget, EU-def., % of GDP									
Revenues	44.3	46.3	47.0	47.1	.	.	47.8	47.5	47.5
Expenditures	49.8	48.6	49.4	49.7	.	.	50.2	50.0	50.4
Net lending (+) / net borrowing (-)	-5.5	-2.3	-2.4	-2.5	.	.	-2.4	-2.5	-2.9
Public debt, EU-def., % of GDP	80.8	78.3	76.8	76.2	.	.	76.3	75.5	74.7
Central bank policy rate, % p.a., end of period 6)	7.00	5.75	3.00	2.10	2.30	1.50	1.35	2.00	3.30
Current account, EUR mn 7)	754	1,752	4,036	2,356	907	2,503	5,000	4,900	4,800
Current account, % of GDP 7)	0.7	1.8	4.0	2.3	1.9	4.9	4.7	4.4	4.1
Exports of goods, BOP, EUR mn 7)	71,793	69,961	72,000	74,768	36,897	40,260	81,900	86,400	91,600
annual change in %	8.6	-2.6	2.9	3.8	4.4	9.1	9.5	5.5	6.0
Imports of goods, BOP, EUR mn 7)	68,868	67,028	68,603	72,167	35,616	38,167	78,300	82,100	86,900
annual change in %	8.4	-2.7	2.4	5.2	5.4	7.2	8.5	4.9	5.9
Exports of services, BOP, EUR mn 7)	16,039	16,060	17,039	18,623	8,826	9,128	19,400	20,400	21,200
annual change in %	9.5	0.1	6.1	9.3	9.2	3.4	4.0	5.0	4.0
Imports of services, BOP, EUR mn 7)	12,752	12,263	13,047	13,514	6,458	6,466	13,800	14,400	14,800
annual change in %	6.2	-3.8	6.4	3.6	5.6	0.1	2.0	4.0	3.0
FDI liabilities (inflow), EUR mn 7)	4,429	4,405	4,834	6,309	1,395	246	3,000	.	.
FDI assets (outflow), EUR mn 7)	3,458	2,310	3,807	3,587	1,814	1,837	3,000	.	.
Gross reserves of NB, excl. gold, EUR mn	37,655	33,757	33,696	34,481	35,985	34,657	.	.	.
Gross external debt, EUR mn 7)	135,351	127,667	119,727	119,382	122,238	122,665	118,000	117,800	118,000
Gross external debt, % of GDP 7)	134.4	129.0	118.2	114.5	117.3	115.3	111	106	101
Average exchange rate HUF/EUR	279.37	289.25	296.87	308.71	307.00	307.43	315	315	315
Purchasing power parity HUF/EUR	165.43	168.30	171.19	174.77	.	.	.	.	.

1) Preliminary. - 2) According to census October 2011. - 3) According to ESA 2010. - 4) From 2012 according to census 2011. - 5) Enterprises with 5 and more employees. - 6) Base rate (two-week NB bill). - 7) BOP 6th edition, excluding SPE.

Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.