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Hungary:
Fiscal balance under control, economic growth yet to surface

Contrary to previous years when Hungary lagged behind its neighbours in terms of economic growth, last year the country's poor performance was similar to that of the other Central European economies. The annual rate of Hungary's GDP decline is estimated to have amounted to 6.5%.

As opposed to most other countries of the region, household consumption bore the main burden of the recession: it declined by about 7% in the full year 2009. Gross fixed investment contracted by about 5%, which is relatively mild as compared to the collapse of investments in Bulgaria, Slovakia, Slovenia or Romania. The change in inventories reached an exorbitant extent in 2009, contributing 4.5 to 10.9 percentage points (pp) to the GDP decline in individual quarters. Only developments in foreign trade were able to prevent an even stronger shrinkage of the economy. While in the last quarter of 2008 net exports still contributed negatively to GDP (-0.2 pp), from the first quarter of 2009 net exports played an important positive role in the country's economic performance. From the first to the third quarter net exports contributed positively to GDP with 2.9, 7.3 and 6 percentage points, respectively.

The primary and secondary sectors of the economy suffered more strongly from the recession than the services sector. In the first three quarters of 2009 the former two sectors (combined) declined by 16.5%, the services sector by 2.5% only. The services sector showed an uneven performance last year: catering and transport suffered strong negative growth rates, obviously due to contracting household expenditures and the drop in industrial and agricultural output as well as foreign trade transactions, while value added by financial services, real estates and all kinds of public services remained at the previous year's level. The strong decline in consumption originates in sinking real incomes plus falling employment and contracting loans for households. The relatively moderate decrease of gross fixed investment is a result of a stronger decline in corporate investment caused by the bleak profit outlook that was counterbalanced, to some extent, by a better performance of mainly EU co-financed public investment projects, primarily in infrastructure. EU transfers thus played an important role in supporting domestic demand, mainly via fostering investment. These unilateral transfers have all the positive effects of countercyclical fiscal measures but, contrary to these, they do not create new debt. Net inflows from the EU budget registered in the current account amounted to about 1.7% of Hungary's GDP last year, up from 0.7% in 2007 and 1% in 2008.

The fiscal consolidation that began in-mid 2006 continued in 2009. The deficit target envisaged in the latest update of the IMF/EU/World Bank stand-by agreement was achieved. The general government deficit relative to GDP amounted to about 3.7%. This is nominally the same proportion as in 2008 but due to diminishing tax revenues (caused by the recession) a considerable fiscal adjustment with painful procyclical effects had to be accomplished in order to fulfil this target.

Hungary's external financial position improved significantly in the second half of the year. The government managed to return to market-based financing of public debt. Yields on forint-denominated government bonds fell to pre-crisis levels. That enabled the government to stop drawing IMF/EU/World Bank resources while the stand-by agreement was prolonged up to October 2010 providing a potential life belt for the incoming government after the elections.

There has been an important turnaround in the current account. For the first time since the transition began Hungary's current account may have closed with a surplus in 2009. One of the explanations for this turn is the huge surplus emerging in trade in goods and services. While both export and import transactions declined compared to the previous year, imports decreased much more strongly than exports because of the sharp decline in demand for imports due to shrinking consumption and investment and the strong depletion of inventories. The smaller decline in exports than in imports may be explained by the lesser extent of the recession in main export markets as compared to Hungary and by the improving competitiveness of Hungarian exports due to depreciation of the forint. Although the Hungarian currency appreciated substantially in the second half of the year as compared to the weakest position in March 2009 (over 310 HUF/EUR), the annual average exchange rate 280 HUF/EUR was significantly below the 2008 annual average 252 HUF/EUR. Another reason for the current account improvement has been the diminishing deficit in the income balance caused by much smaller profits realized by foreign-owned companies. While the current account balance indicates an improvement in the country's external financial position, another important component of external financing, FDI, was disappointing with virtually no inflow of new resources.

Although bottlenecks in the banking system's liquidity have been eliminated over the last year, non-financial enterprises' stock of credits decreased in each month of 2009. The contraction was stronger in foreign exchange credits than in forint-denominated ones. Increased costs of borrowing and the bleak profit expectations in the business sector explain this ebb in lending activities.

Developments in 2010 will be decisively influenced by the outcome of the elections to be held in April this year. A victory of the right-wing populist FIDESZ party is very likely. The only question seems to be whether it will have a two-thirds majority with a mandate to amend the constitution or only a simple majority. Although the election campaign has already started, it is far from clear what FIDESZ intends to do about the economy, once in power. As an opposition party it had supported some of the most irresponsible decisions of the socialist-liberal government in the parliament (such as a 50% increase in public servants' salaries in one step and the introduction of the 13th month pension) which led to the fiscal disaster by 2006. Simultaneously FIDESZ was a fervent opponent of all government-initiated reforms aimed at attaining a sustainable fiscal stance in the medium and long run. It also viciously attacked the government's short-run fiscal stabilization measures starting from mid-2006 and the crisis management in the wake of the global financial and economic crisis. Though this may be seen as pure rhetoric, FIDESZ' current popularity is based on the very high expectations of the party's supporters concerning a painless way out of the crisis – without restrictive measures and unpleasant reforms.

The general government deficit will be the critical issue in 2010. The current government's budget reckons with a 3.8% deficit relative to GDP, a target approved by the IMF. This target is probably impossible to reach without improvized expenditure cuts as extraordinary support may prove necessary for the ailing state railways and the Budapest public transport company. Further, the Constitutional Court abolished the newly introduced tax on real estate which also leaves a hole in the projected revenues. Also, some hospitals and local governments may need a bailout. That means that the incoming government must begin with some restrictions in order to observe the official deficit target. A 7% new deficit target has already been mentioned by FIDESZ politicians, a proposal that was rejected by the IMF. Nevertheless, a somewhat higher deficit target (around 5%) than originally projected may possibly be agree upon. This would fit the prevailing general picture concerning budget deficits in the region and give some scope for the new government to fulfil at least a fragment of the inflamed expectations of those voting for FIDESZ.

The currently propagated vague ideas of FIDESZ on the economy – facilitating economic growth through radical tax cuts on the one hand, and leaving alone fiscal expenditures (only in the field of bureaucracy are there plans to diminish outlays) on the other – seems to be an equation without any known formula for solution if the budget deficit ought to remain under control. In the given international environment and in the current Hungarian circumstances, the most likely scenario for post-election economic policy in Hungary is one that foresees a willy-nilly continuation of fiscal stability oriented policies in accordance with the IMF stand-by agreement (which may possibly be renegotiated in some details). In another, less likely scenario, this pragmatic policy making will be preceded by a brief adventurous episode along the lines of FIDESZ pre-election rhetoric – which will most probably be sanctioned very soon by the international environment. A strong devaluation of the forint and rocketing spreads on or even denied access to the bond markets might follow.

In the baseline scenario, 2010 will be a year of stagnation on average, with a mild decline in the first and a moderate upturn in the second half of the year. Net exports will still make a positive contribution to GDP change, but much less so than in the previous year. The reason for closing the export/import gap will be the recovery of imports driven by a restocking of inventories. Consumption and investment will still decrease this year, even if to a moderate extent. The surplus on the current account in 2009 was a result of extraordinary circumstances and cannot be repeated in 2010. Nevertheless, the forecast deficit (1.3% of GDP) is far from the huge pre-crisis deficits. A strongly positive balance of goods and services trade is expected while still meagre profits realized by foreign-owned companies will lend, provisionally, a fancy look to the income balance. The sustainability of the trade surplus is explained by the lasting devaluation of the Hungarian currency compared to the pre-crisis levels (about 10%) and an improvement in Hungarian exporters' competitiveness through a diminished tax burden on labour. A recovery in FDI inflows is likely to follow, with at least one major project, the Daimler-Benz investment in Kecskemét. Foreign financing for revolving public debt seems secured. All in all, there seem to be no external constraints on the beginning recovery in Hungary.

Table HU

Hungary: Selected Economic Indicators

	2004	2005	2006	2007	2008	2009 1)	2010	2011 Forecast	2012
Population, th pers., average	10107.1	10087.1	10071.4	10055.8	10038.2	10022.3	10011	10005	10000
Gross domestic product, HUF bn, nom.	20803.8	21988.6	23755.5	25408.1	26543.3	25700	26400	27700	29200
annual change in % (real)	4.9	3.5	4.0	1.0	0.6	-6.5	0	3	3.5
GDP/capita (EUR at exchange rate)	8200	8800	8900	10100	10500	9100	.	.	.
GDP/capita (EUR at PPP)	13700	14200	15000	15600	16100	15300	.	.	.
Consumption of households, HUF bn, nom.	11029.5	11813.9	12436.5	13254.9	13919.4	13500	.	.	.
annual change in % (real)	3.0	3.2	1.9	0.3	-0.5	-7	-1.5	1	2
Gross fixed capital form., HUF bn, nom.	4677.8	5065.9	5161.3	5380.5	5559.1	5600	.	.	.
annual change in % (real)	7.9	5.7	-3.6	1.6	0.4	-5	-1	9	10
Gross industrial production									
annual change in % (real)	7.7	6.8	9.9	7.9	-0.2	-17.5	0	10	10
Gross agricultural production									
annual change in % (real)	24.1	-7.1	-2.9	-11.6	27.6	-10.6	.	.	.
Construction industry									
annual change in % (real)	4.3	15.7	-0.7	-14.0	-5.2	-2	4	10	10
Employed persons - LFS, th, average	3900.4	3901.5	3930.0	3926.2	3879.4	3775	3770	3810	3850
annual change in %	-0.5	0.0	0.7	-0.1	-1.2	-2.7	-0.2	1	1
Unemployed persons - LFS, th, average	252.9	302.2	316.7	312.0	329.1	420	.	.	.
Unemployment rate - LFS, in %, average	6.1	7.2	7.5	7.4	7.8	10.3	10.5	10	9.3
Reg. unemployment rate, in %, end of period	9.1	9.3	9.1	10.1	10.9	13.3	.	.	.
Average gross monthly wages, HUF 2)	145520	158343	171351	185017	198964	196000	.	.	.
annual change in % (real, net)	-1.0	6.3	3.5	-4.8	0.8	-2.3	.	.	.
Consumer prices (HICP), % p.a.	6.8	3.5	4.0	7.9	6.0	4.0	3.8	3.5	3.3
Producer prices in industry, % p.a.	3.9	3.1	6.6	0.3	4.6	4.5	.	.	.
General governm.budget, EU-def., % GDP									
Revenues	42.3	42.2	42.6	44.8	45.5	45.0	.	.	.
Expenditures	48.7	50.1	52.0	49.8	49.2	48.7	.	.	.
Net lending (+) / net borrowing (-)	-6.4	-7.9	-9.4	-5.0	-3.7	-3.7	-5.0	-4.0	-3.5
Public debt, EU-def., in % of GDP	59.1	61.8	65.6	65.9	72.9	79	81	82	80
Base rate of NB, % p.a., end of period	9.5	6.0	8.0	7.5	10.0	6.3	.	.	.
Current account, EUR mn 3)	-6838	-6380	-6762	-6845	-7519	500	-1200	-2300	-2600
Current account in % of GDP	-8.3	-7.2	-7.5	-6.8	-7.1	0.5	-1.3	-2.2	-2.4
Exports of goods, BOP, EUR mn 3)	44507	49672	58380	68178	72671	58900	62400	69300	76900
annual growth rate in %	17.4	11.6	17.5	16.8	6.6	-19	6	11	11
Imports of goods, BOP, EUR mn 3)	47369	51882	60433	67987	72730	54500	57200	63500	71100
annual growth rate in %	16.1	9.5	16.5	12.5	7.0	-25	5	11	12
Exports of services, BOP, EUR mn 3)	8672	10351	10876	12574	13648	13100	13800	14900	16400
annual growth rate in %	6.8	19.4	5.1	15.6	8.5	-4	5	8	10
Imports of services, BOP, EUR mn 3)	8188	9219	9643	11524	12795	11600	12200	13200	14500
annual growth rate in %	1.4	12.6	4.6	19.5	11.0	-9	5	8	10
FDI inflow, EUR mn 3)	3633	6172	15809	52327	42735	.	.	.	.
FDI outflow, EUR mn 3)	892	1756	14846	48915	41491	.	.	.	.
FDI inflow, excl. SPE, EUR mn	3633	6172	5887	4182	3067	0	2500	4500	4500
FDI outflow, excl. SPE, EUR mn	892	1756	3127	2598	568	800	500	1000	1000
Gross reserves of NB, excl. gold, EUR mn	11669	15670	16384	16305	23807	30601	.	.	.
Gross external debt, EUR mn	55615	67071	81898	99468	121769	125000	.	.	.
Gross external debt in % of GDP	65.8	77.1	86.8	99.3	122.3	131.5	.	.	.
Average exchange rate HUF/EUR	251.66	248.05	264.26	251.35	251.51	280.33	275	270	265
Purchasing power parity HUF/EUR	149.88	153.53	157.74	161.97	163.81	167.09	.	.	.

Note: Gross industrial production, construction output and producer price index refer to NACE Rev. 2.

1) Preliminary and wiiw estimates. - 2) Enterprises with 5 and more employees. - 3) From 2006 including Special Purpose Entities (SPE), 2009-2012 data are estimated excluding SPE.

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