
# HUNGARY: Moderate growth in 2013, moderate acceleration in 2014

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**The Hungarian economy attained moderate growth in 2013, to a large extent due to the outstanding agricultural output related to favourable weather. In the last months of 2013 investments began to recover from hibernation but consumption remained flat. 2014 will bring about a modest acceleration of GDP growth driven by an upturn of primarily EU co-financed investments and net exports. Institutional conditions for a more robust economic growth will likely remain unfulfilled.**

With the general elections to be held on 6 April 2014, the Orbán government will soon complete its four-year legislation period. By the end of the election cycle, very little has been achieved of the spectacular targets which helped Orban's Fidesz party achieve a super majority in the Hungarian parliament in 2010. The envisaged spectacular take-off in the economy with a 5% to 7% annual GDP growth rate turned out to be a half per cent average annual growth over the legislation period. Out of 400,000 promised new jobs, 158,000 have been realised, in a statistical sense. Public works schemes, employees appearing in domestic employment statistics though working abroad and a modest increase in other public sector employment are behind the proudly presented employment statistics, while the expansion was negligible in the business sector.

The promised reduction in bureaucracy, symbolised by a new, simplified tax report form to be introduced which is not bigger than a beer mat, has given way to overall and extreme centralisation of decisions and an increasing role of the executive power in the economy, education, arts and the private sphere of the citizens. Autonomous social bodies, both professional and civil ones, have been marginalised in decision-making processes. Declaring war against corruption was an ace in the hand of Fidesz four years ago when winning the elections. Nothing has changed here, if not to the worse: in the latest Eurobarometer survey 89% of Hungarians think that corruption is a widespread phenomenon in their country. Government-loyal firms and individuals win bids from tobacco concessions to state-owned arable land leasing.

Despite failing conspicuously on their promises and instead harming and offending several strata and groupings of Hungarian society, Orbán's Fidesz party managed to preserve a decisive part of its pre-2010 popularity. With the latest coup, a stepwise reduction of public utility tariffs for households and the related propaganda campaign, Orbán seems to keep a sufficient number of voters in his spell to win the forthcoming elections. Without doubt, in early 2014 the Hungarian economy displays features which, without being put into context, may give the impression of a successful development - very low inflation, growing investment, a lasting surplus in the trade balance, improving employment data. A closer look at these indictors' background, however, gives reason for concern.

The low inflation, at a level unprecedented since 1989, is to a large extent explained by the decrease of centrally regulated tariffs for electricity, gas, district heating and other public utilities for households in the last more than one year. The energy price cuts are only to a smaller part supported by a general decline in energy prices in the world market. They are to a large extent covered by an increased burden on producers and distributors. These were initially only multinational firms, but with widening the range of reduced prices to water, sewage, waste collection and canned gas, a growing number of smaller local government-owned suppliers are getting into financial difficulties as well. The question is left open how, under these conditions, daily operations and maintenance can be financed in these sectors in the medium term. While huge national and regional projects creating new facilities are often financed by EU resources, the latter are not available for the not less important maintenance investment, not to mention daily operation.

The collateral damage done by the Orbán government's innovation of sector-specific taxes (on energy, telecommunications, large retail trade businesses and, most prominently, financial institutions) is clearly seen in the investment statistics. While in the second and third quarters of 2013 overall investment took off, there was a considerable decline in the telecommunications, electricity, gas and steam supply sector and in financial intermediation. Beyond the sectors involved in the specific taxation, investment also declined in human health and social work activities, arts and recreation. It is remarkable that investment growth, from very low levels, was confined to specific areas of the economy. An especially strong expansion was recorded in water supply, sewerage, waste management, professional and scientific activities, road and railway construction and reconstruction, flood prevention, and public administration − i.e. areas where transfers from the EU's Cohesion Fund and the Structural Funds typically play a decisive role. In the manufacturing sector investment grew only marginally, within this segment, however, projects realised by the automotive cluster and the food industry resulted in an expansion of investment.

EU co-financed projects have played a prominent role in the recent upturn in investment and this will remain so this year and the next as well. Hungary is in delay with drawing the available cohesion policy related transfers from the 2007-2013 Multi-annual Financial Framework (MFF), and in order to avoid the final loss of huge potentially available EU resources an accelerated authorisation and implementation will be required. Payments from the 2007-2013 MFF will be possible until the end of 2015, and due to permanent reorganisation and poor management 38% of the total sum will have to be allocated in the remaining two years. From 2016 on only resources from the new 2014-2020 MFF will be available, but traditionally realised transfers drop after the closure of transfers from an outgoing financial framework period.

With a fiscal policy focused on observing the less than 3% GDP proportional budget deficit, economic growth stimulation has been delegated to the monetary policy, which is pursued by a government-dependent monetary council and central bank management. The central bank's policy rate has been cut in several steps to its historically lowest level of 2.7% on 19 February. Simultaneously the central bank launched its Funding for Growth Scheme, a project pumping, with the mediation of the commercial banks, credits to the SME sector with a subsidised fixed low interest rate. This tool in itself is a step into the right direction; nevertheless, without a growing domestic market plus a stable and foreseeable regulatory and taxation environment the impact may be much smaller than hoped for by the central bank and the government.

It is not at all obvious that the current low policy rate can be maintained. With the beginning tapering of the US Fed the risk appetite of investors may decrease, and in an environment turning less friendly to the emerging markets the exchange rate of the Hungarian currency may be weakened to such an extent that raising the policy rate may become unavoidable. High public and external debt, elements with questionable sustainability in the hardly achieved fiscal consolidation, a high share of non-performing loans and, last but not least, an even in the best case mixed reception of the Orbán government's 'unorthodox' economic policy all make Hungary's situation extremely fragile.

Hungary's total external debt further diminished last year, but partly due to the financial sector's deleveraging which negatively affects economic growth. The public debt to GDP ratio hardly dropped in the legislation period (from 82.2% in 2010 to an estimated 79.7% end of last year). That is all the more remarkable as the nationalisation of the obligatory private pension funds' assets, amounting to about 9% of the GDP, would have secured the means for a spectacular reduction. The reason why this did not happen is that a part of the confiscated resources was used to finance current fiscal expenditures; furthermore, the fiscal expansion in 2011 (without the one-off elements) negatively affected the debt/GDP ratio. A new EUR 10 billion credit planned to be raised in Russia for the financing of the refurbishment/enlargement of Hungary's ageing nuclear power plant Paks will not allow a decreasing public debt path in the years beyond our forecast horizon 2016 either. This coup of the government is a blow to Orbán's much-advertised war against indebtedness and also to the verbal 'freedom fight' fought, not so long ago, against Russia.

The modest GDP growth attained last year will somewhat accelerate in 2014 and 2015. This will mainly be the result of the climax of EU co-financed public investment projects and, to a diminishing extent, of net exports. By 2016 EU transfers from the previous financial framework will no longer be available while payments from the new 2014-2020 framework will not have a real momentum yet and this will be reflected in a slightly deteriorating growth performance. With no change likely in the economic policy pursued, the fundaments of a more robust growth such as legal security, a transparent and reliable institutional environment, fair competition and a take-off in business sector investment and employment will not be available.

## Table 1 / Hungary: Selected Economic Indicators

| | 2009 | 2010 | 2011 | 2012 | 2013 1) | 2014 | 2015 Forecast | 2016 |
|---|---|---|---|---|---|---|---|---|
| Population, th pers., average 2) | 10023 | 10000 | 9948 | 9920 | 9870 | 9850 | 9830 | 9810 |
| Gross domestic product, HUF bn, nom. | 25626 | 26513 | 27635 | 28048 | 29300 | 30500 | 32000 | 33500 |
| annual change in % (real) | -6.8 | 1.1 | 1.6 | -1.7 | 1.1 | 1.4 | 2.1 | 2.0 |
| GDP/capita (EUR at exchange rate) | 9100 | 9600 | 9900 | 9800 | 10000 | . | . | . |
| GDP/capita (EUR at PPP) | 15300 | 16100 | 16900 | 17000 | 17500 | . | . | . |
| Consumption of households, HUF bn, nom. | 13551 | 13665 | 14287 | 14903 | 15500 | . | . | . |
| annual change in % (real) | -6.8 | -3.0 | 0.3 | -1.8 | 0.6 | 0.8 | 1.0 | 1.0 |
| Gross fixed capital form., HUF bn, nom. | 5302 | 4920 | 4950 | 4881 | 5200 | . | . | . |
| annual change in % (real) | -11.1 | -8.5 | -6.0 | -3.6 | 3.0 | 3.0 | 6.0 | 5.0 |
| Gross industrial production | | | | | | | | |
| annual change in % (real) | -17.6 | 10.5 | 5.6 | -1.8 | 1.4 | 3.0 | 6.0 | 6.0 |
| Gross agricultural production | | | | | | | | |
| annual change in % (real) | -10.6 | -11.1 | 11.1 | -9.8 | 11.6 | . | . | . |
| Construction industry | | | | | | | | |
| annual change in % (real) | -4.3 | -10.4 | -8.0 | -6.7 | 9.7 | 5.0 | 5.0 | 7.0 |
| Employed persons, LFS, th, average | 3781.8 | 3781.2 | 3811.9 | 3877.9 | 3938.5 | 3980 | 4020 | 4060 |
| annual change in % | -2.5 | 0.0 | 0.8 | 1.7 | 1.6 | 1.0 | 1.0 | 1.0 |
| Unemployed persons, LFS, th, average | 420.7 | 474.8 | 467.9 | 475.6 | 448.9 | . | . | . |
| Unemployment rate, LFS, in %, average | 10.0 | 11.2 | 10.9 | 10.9 | 10.2 | 10.0 | 9.0 | 8.5 |
| Reg. unemployment rate, in %, end of period | 13.6 | 13.3 | 12.4 | 12.8 | 9.3 | . | . | . |
| Average monthly gross wages, HUF 3) | 199837 | 202525 | 213094 | 223060 | 231540 | . | . | . |
| annual change in % (real, gross) | -3.5 | -3.4 | 1.3 | -1.0 | 1.8 | . | . | . |
| Average monthly net wages, HUF 3) | 124116 | 132604 | 141151 | 144085 | 151580 | . | . | . |
| annual change in % (real, net) | -2.3 | 1.8 | 2.4 | -3.5 | 3.3 | . | . | . |
| Consumer prices (HICP), % p.a. | 4.0 | 4.7 | 3.9 | 5.7 | 1.7 | 2.9 | 3.0 | 3.0 |
| Producer prices in industry, % p.a. | 4.4 | 4.0 | 4.1 | 4.1 | 0.6 | . | . | . |
| General governm.budget, EU-def., % of GDP | | | | | | | | |
| Revenues | 46.9 | 45.6 | 54.3 | 46.6 | 46.9 | . | . | . |
| Expenditures | 51.4 | 50.0 | 50.0 | 48.7 | 49.6 | . | . | . |
| Net lending (+) / net borrowing (-) 4) | -4.6 | -4.4 | 4.2 | -2.1 | -2.7 | -3.0 | -3.0 | -3.0 |
| Public debt, EU-def., % of GDP | 79.8 | 82.2 | 82.1 | 79.8 | 79.7 | 79.5 | 79.0 | 78.5 |
| Central bank policy rate, % p.a., end of period 5) | 6.25 | 5.75 | 7.00 | 5.75 | 3.00 | . | . | . |
| Current account, EUR mn | -176 | 204 | 452 | 999 | 2000 | 1300 | 1000 | 700 |
| Current account, % of GDP | -0.2 | 0.2 | 0.5 | 1.0 | 2.0 | 1.3 | 0.9 | 0.6 |
| Exports of goods, BOP, EUR mn | 57397 | 66912 | 74475 | 75630 | 78500 | 84500 | 93800 | 106000 |
| annual change in % | -20.3 | 16.6 | 11.3 | 1.6 | 3.8 | 7.7 | 11.0 | 13.0 |
| Imports of goods, BOP, EUR mn | 55028 | 64468 | 71356 | 72099 | 74260 | 79700 | 88700 | 100200 |
| annual change in % | -24.9 | 17.2 | 10.7 | 1.0 | 3.0 | 7.3 | 11.3 | 13.0 |
| Exports of services, BOP, EUR mn | 13305 | 14578 | 15800 | 15868 | 15870 | 17500 | 19400 | 21900 |
| annual change in % | -3.6 | 9.6 | 8.4 | 0.4 | 0.0 | 10.0 | 11.0 | 13.0 |
| Imports of services, BOP, EUR mn | 11319 | 11704 | 12630 | 12459 | 12460 | 13500 | 15000 | 17000 |
| annual change in % | -7.9 | 3.4 | 7.9 | -1.4 | 0.0 | 8.0 | 11.0 | 13.0 |
| FDI inflow, EUR mn | 1475 | 1655 | 3840 | 10708 | -2000 | . | . | . |
| FDI outflow, EUR mn | 1365 | 881 | 3124 | 8621 | -600 | . | . | . |
| Gross reserves of NB, excl. gold, EUR mn | 30648 | 33667 | 37242 | 33783 | 33696 | . | . | . |
| Gross external debt, EUR mn | 137120 | 138343 | 132638 | 124153 | 115000 | . | . | . |
| Gross external debt, % of GDP | 150.0 | 143.7 | 134.1 | 128.0 | 116.5 | . | . | . |
| Average exchange rate HUF/EUR | 280.33 | 275.48 | 279.37 | 289.25 | 296.87 | 300 | 295 | 285 |
| Purchasing power parity HUF/EUR | 167.06 | 164.54 | 164.38 | 166.34 | 169.25 | . | . | . |

1) Preliminary and wiiw estimates. - 2) From 2011 according to census October 2011. - 3) Enterprises with 5 and more employees. - 4) In 2011 including one-off effects. Without those effects general government budget balance is estimated to have attained -4.6% of GDP (Source: Portfolio.hu). - 5) Base rate (two-week NB bill).

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