

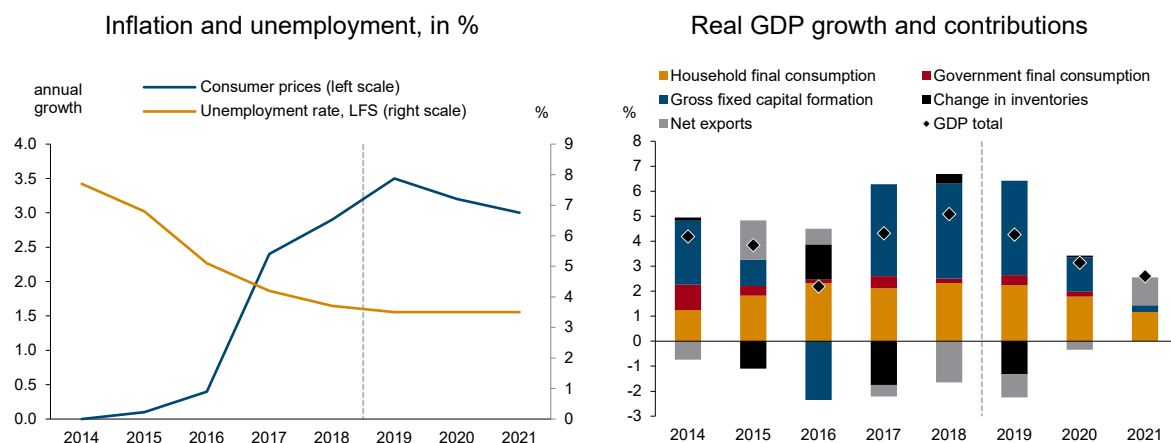


HUNGARY: Clear signs of decelerating growth

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Hungarian economic growth was strong in the first half of 2019, but the signs of a deceleration are already discernible. In Q2 compared to Q1, investment growth slowed notably, while the external environment deteriorated. From next year, EU transfers will drop by a substantial degree, further weighing on investment. Labour shortages will remain problematic, and put further upward pressure on wages. We expect a significant slowdown of economic growth over the forecast horizon, from 4.3% this year to 3.1% in 2020 and to 2.6% in 2021.

Figure 5.8 / Hungary: Main macroeconomic indicators



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

Hungarian economic growth increased dynamically in the first half of 2019, becoming one of the EU28 top performers, but the signs of a deceleration are already clearly discernible. The second quarter GDP growth (4.9%) was only 0.4 percentage points lower than that of the first quarter, but some key indicators of the current growth path show radical changes. Construction, a sector tightly related to EU co-financed projects, has decelerated from a 46.7% rate of Q1 growth to 27.9% in Q2. The growth rate of manufacturing nearly halved in the same period, from 5.8% to 3.1%. It was the services sector which saved the day with a steady growth performance over the two quarters. Within the services sector, each segment increased except 'public administration, education and health and social work activities' where the value added has been stagnating for at least four years.

On the demand side the important change can be seen in gross fixed capital formation: here the Q2 growth rate was a formidable 16.4%, but much smaller than in Q1, 23.4%. The increase of both household and government consumption has become slightly less dynamic. There are unfavourable developments in foreign trade. According to national accounts statistics, the 7.7% increase of exports in Q1 fell to 2.8% in Q2. Import growth has also been slower in Q2 compared to Q1 but the fall was more moderate and that led to a 1.6 percentage points higher imports than exports growth rate in Q2. After continuously decreasing over the past months of the year, in September the GKI Business Confidence index dropped to its lowest level since early 2017.

Labour shortage is a serious challenge further on, but labour migration comes to the rescue.

While the government propaganda is dominated by bombastic anti-immigration rhetoric, the government tacitly opened the door to labour migration. According to Eurostat, the permission for labour migrants from non-EU countries has more than doubled. Migrants are arriving primarily from the Ukraine and also from Vietnam, Mongolia and India, i.e. non-Middle East countries. The stock of these migrants is assumed to range between 150 000 and 200 000 persons. The limit set for permissions for new foreign workers is 57 000 this year, up from 55 000 in 2018.

Since the end of August 2019, the Hungarian currency gradually devalued reaching its historically weakest level of 336 HUF/€ on September 27. The central bank communicates every other day that it is not concerned because of the weakening HUF and sees no reason to modify its extremely loose monetary policy. Indeed, the inflationary pressure increasing in the first half of 2019 subdued from the middle of summer, with a year-on-year CPI of 3.9 in May (core inflation 4%) and only 3.1 % (core inflation 3.7%) in August. Most probably the HUF/€ exchange rate will not return to its 310-320 HUF/€ level which it sustained in the last few years. The main Hungarian exporters are a part of production chains and are main players as importers as well, gaining only marginally due to a weak HUF. The SME sector will, however, suffer from a weakening forint. While the SMEs provide 44% of the gross value added of the business sector, their share of the exports is only 20%. That means that SME's gains are modest on the export side, while higher costs of imports due to a weak HUF may painfully increase production costs and curb investment.

A weak forint is less risky for the budget than it was a few years ago. The foreign currency denominated share in public debt of Hungary has fallen from the immediate post-crisis level of close to 50% to below 20% to date. The government further encourages the purchase of HUF denominated government bonds by households with the help of the Hungarian Government Security Plus. The yield on this security of 5 year maturity is 4.95%, while the central bank's policy rate is 0.9%. No wonder people are queuing up to buy this security. Nevertheless, the high yield on this very popular financial investment makes the financing of the government debt more expensive compared to alternative solutions.

The most important question in the autumn of 2019 is how strong and how lasting the slowdown of the economic growth will be in the coming years. From next year on the EU transfers will drop by a substantial degree, largely reducing public investment and, to some extent, business investments as well. Labour shortages will prevail which implies some pressure for further substantial wage increases. While lending activity of the financial institutions has been dynamically increasing, the negative cost side-effects (rocketing wages, more expensive imports) will curb expansion in the business sector. The time has come for a major take off in productivity, however, government policy has created legal

uncertainty, favouritism, centralisation, corruption, furthered the hostility of the government toward autonomous entities and repugnance towards educational and scientific institutions which makes this turn around currently unachievable. The wiiw expects a significant slowdown of economic growth over the forecast horizon: from 4.3% to 3.1% next year and to 2.6% in 2021. Main downward risks are, first, a radical cut or even disruption of EU transfers due to political quarrels with the EU and, second, a crisis in the automotive sector due to global trade disputes. An upward risk is the positive impact of lending activities enjoying a rebirth after a long period of stagnation.

Table 5.8 / Hungary: Selected economic indicators

	2015	2016	2017	2018 ¹⁾	2018 January-June	2019	2019 Forecast	2020 Forecast	2021
Population, th pers., average	9,843	9,814	9,788	9,776	.	.	9,720	9,700	9,670
Gross domestic product, HUF bn, nom.	34,785	35,896	38,835	42,662	19,750	21,675	45,900	48,900	51,800
annual change in % (real)	3.8	2.2	4.3	5.1	4.9	5.1	4.3	3.1	2.6
GDP/capita (EUR at PPP)	20,000	19,800	20,600	22,000	.	.	.	.	.
Consumption of households, HUF bn, nom.	16,418	17,253	18,497	19,970	9,681	10,499	.	.	.
annual change in % (real)	3.7	4.9	4.4	4.9	5.0	4.8	4.8	3.8	2.5
Gross fixed capital form., HUF bn, nom.	7,750	7,058	8,632	10,739	4,344	5,669	.	.	.
annual change in % (real)	4.8	-10.6	18.7	17.1	14.3	20.6	15.0	5.5	1.0
Gross industrial production									
annual change in % (real)	7.4	0.9	4.7	3.5	3.5	5.4	4.5	5.0	4.0
Gross agricultural production									
annual change in % (real)	-2.4	9.3	-4.1	3.6	.	.	.	.	.
Construction industry									
annual change in % (real)	3.0	-18.9	29.7	21.2	16.9	35.2	.	.	.
Employed persons, LFS, th, average	4,211	4,352	4,421	4,470	4,455	4,504	4,510	4,520	4,520
annual change in %	2.7	3.4	1.6	1.1	1.4	1.1	0.8	0.3	0.1
Unemployed persons, LFS, th, average	308	235	192	172	172	161	160	160	160
Unemployment rate, LFS, in %, average	6.8	5.1	4.2	3.7	3.8	3.5	3.5	3.5	3.5
Reg. unemployment rate, in %, eop	7.6	6.1	5.6	5.2	5.2	5.4	.	.	.
Average monthly gross wages, HUF ²⁾	247,924	263,171	297,017	329,943	324,408	359,462	365,400	395,900	413,900
annual change in % (real, gross)	4.4	5.7	10.3	8.3	9.2	6.9	7.0	5.0	1.5
Average monthly net wages, HUF ²⁾	162,391	175,009	197,516	219,412	215,731	239,042	243,000	263,300	275,300
annual change in % (real, net)	4.4	7.4	10.3	8.3	9.2	6.9	7.0	5.0	1.5
Consumer prices (HICP), % p.a.	0.1	0.4	2.4	2.9	2.4	3.5	3.5	3.2	3.0
Producer prices in industry, % p.a.	-1.1	-1.7	3.3	5.6	4.4	2.7	4.0	3.2	3.0
General governm.budget, EU-def., % of GDP									
Revenues	47.6	44.6	44.2	43.6	.	.	44.5	44.0	45.0
Expenditures	49.5	46.2	46.3	45.8	.	.	46.2	45.6	47.9
Net lending (+) / net borrowing (-)	-1.9	-1.6	-2.2	-2.2	.	.	-1.7	-1.6	-2.9
General gov.gross debt, EU def., % of GDP	75.8	75.1	72.5	69.9	.	.	69.1	68.2	67.5
Stock of loans of non-fin.private sector, % p.a.	-12.3	-1.3	5.5	10.6	8.7	11.4	.	.	.
Non-performing loans (NPL), in %, eop ³⁾	13.6	10.8	7.5	5.4	6.6	4.9	.	.	.
Central bank policy rate, % p.a., eop ⁴⁾	1.35	0.90	0.90	0.90	0.90	0.90	0.90	1.20	1.50
Current account, EUR mn ⁵⁾	2,648	5,209	2,830	-717	728	-66	-200	-200	-100
Current account, % of GDP ⁴⁾	2.4	4.5	2.3	-0.5	1.2	-0.1	-0.1	-0.1	-0.1
Exports of goods, BOP, EUR mn ⁵⁾	78,477	78,588	85,555	88,626	44,710	47,199	92,900	97,500	103,400
annual change in %	6.3	0.1	8.9	3.6	3.7	5.6	4.8	5.0	6.0
Imports of goods, BOP, EUR mn ⁵⁾	74,425	74,630	83,646	90,280	44,458	47,505	96,200	101,700	107,800
annual change in %	3.8	0.3	12.1	7.9	6.8	6.9	6.6	5.7	6.0
Exports of services, BOP, EUR mn ⁵⁾	20,286	21,878	23,862	24,991	12,026	12,235	25,500	26,800	28,400
annual change in %	8.1	7.9	9.1	4.7	6.7	1.7	2.0	5.0	6.0
Imports of services, BOP, EUR mn ⁵⁾	15,378	15,753	16,618	17,466	8,401	8,496	17,800	18,700	19,800
annual change in %	8.4	2.4	5.5	5.1	7.0	1.1	2.0	5.0	6.0
FDI liabilities, EUR mn ⁵⁾	7,192	-5,851	7,208	8,469	3,124	2,831	5,000	.	.
FDI assets, EUR mn ⁵⁾	5,753	-8,414	5,044	5,657	2,582	1,679	5,000	.	.
Gross reserves of NB excl. gold, EUR mn	30,226	24,384	23,261	26,273	23,955	25,807	.	.	.
Gross external debt, EUR mn ⁵⁾	119,339	110,940	105,583	107,218	106,395	110,907	111,000	111,000	111,000
Gross external debt, % of GDP ⁵⁾	106.4	96.3	84.1	80.1	79.5	78.8	78.8	75.1	72.0
Average exchange rate HUF/EUR	310.00	311.44	309.19	318.89	314.09	320.39	326	331	336

1) Preliminary. - 2) Enterprises with 5 and more employees. From 2019 data according to tax administration. - 3) From 2016 broader definition of NPL (90 days criteria plus loans unlikely to be paid). - 4) Base rate (two-week NB bill). - 5) Excluding SPE.

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