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Hungary: first impacts of the austerity programme

The general government deficit in 2006 was somewhat smaller (below 10% of the GDP) than forecast by the government in the updated Hungarian convergence programme: tax revenues were higher than assumed during the elaboration of the economic policy measures aimed at achieving a turn in fiscal policy. Growth of domestic demand has been decelerating, in parallel with exports expanding at a considerably higher rate than imports.

The GDP grew by 4.2% in the first three quarters, with no substantial deceleration over the year. With more effects from the austerity package to be expected for the last quarter, annual growth may have amounted to 4%. Significant shifts, however, took place in the components of growth. The growth rate of household consumption halved over the year and fell below 1% in the third quarter. This is in line with the required rearrangement set out in the updated convergence programme. But there was also a surprising decline in gross fixed capital formation: while in the first quarter the expansion was close to 10%, it dropped below zero in the second and third quarters. Thus net export figured as the real engine of growth in 2006.

Industry managed to preserve its growth momentum. Based on rapidly increasing export sales, industrial output expanded by an estimated 10% in 2006. Transport vehicles, with a share of more than one quarter in manufacturing exports, may have recorded a foreign sales expansion of up to 30%; the other Hungarian 'flagship' branch, the manufacture of electrical and optical equipment, providing 40% of manufacturing exports, may have increased by 13%. Labour productivity in industry was more than 10% higher than in the previous year. The good news is that the industrial growth rate in two 'problem regions', Northern Hungary and the Northern Great Plain, was above the national average. The bad news is the decline of investment in the manufacturing sector (by 6% in the first three quarters of the year).

Value-added produced in agriculture and construction declined. Apart from output also investments fell in these two sectors in 2006. In the services sector output expanded; the most rapid expansion took place in financial intermediation and real estate, renting and business services.

The foreign trade performance has remained impressive. In the first eleven months the growth rate of exports of goods surpassed that of imports by 4 percentage points in real terms. Due to a nearly 2% deterioration in the terms of trade, caused by higher energy prices, the difference between export and import growth rates is smaller in current euro terms but still considerable. In 2006 the trade deficit was 26% less than in 2005. The services trade surplus increased in the first three quarters of 2006, with an export growth

rate close to 3 percentage points higher than that of imports. In tourism, the main component in services trade, the balance improved as a result of a substantial drop in Hungarian tourists' spending abroad.

The current account position improved in the third quarter. The deficit was 22% smaller in the first three quarters of 2006 than it was in the respective period of the previous year. The net financing requirement of the economy (the current account and the capital account combined) amounted to EUR 3.7 billion, 12% less than in the first three quarters of 2005.

The exchange rate of the forint has shown a curious cycle in the past 12 months. Starting with a HUF/EUR rate of 250-253 in early 2006, it weakened to above 260 in mid-March and further to 280 in the summer. In a turnaround, the forint strengthened to below 270 in mid-October and below 260 in mid-November, only to return to its level just a year earlier in January 2007. While the autumn turnaround in the exchange rate development is understandable due to the submission (and approval) of the updated Hungarian convergence programme to the EU and a partial restoration of confidence of international investors, the current strength of the forint cannot be easily explained. The convergence programme itself reckoned with an exchange rate of 272.5 HUF/EUR throughout the period 2007-2009. The possible explanation is that with the stabilization programme in place and the street demonstrations over, the forint exchange rate is again driven by global factors with an impact on all currencies of the region rather than by home-made factors.

The public finance reform started with breaking old taboos. First, the system of subsidization of household gas consumption was changed. Earlier, each household's consumption had been subsidized. In the new system principally each household pays the full price for the whole amount of gas consumed, but low-income families may apply for subsidy. The new regime tries to focus support on the most needy strata of the society, but due to the unreliable income statements and the high share of unreported incomes the new system is far from being fair in practice, with administrative costs much higher than under the old system. Second, a fee for medical checks was introduced, support for operating costs of hospitals was cut and subsidies on medicine were reduced. Though curbing the ever increasing costs in the healthcare sector is seen as unavoidable, there are emotionally heated debates concerning each detail of the changes announced and the reforms have come under fire from all directions. The unsatisfactory impact assessment, the missing reconciliation with those involved and the miserable communication of the targets and means of the reform leave the impression that implementation according to the original plans cannot be seen as guaranteed.

2007 is supposed to bring about further public finance reforms. The pension system is planned to be reconsidered in terms of contributions, retirement age and indexation of benefits. Decisions will have to be made about the new institutional system of health

insurance and the reform of invalidity pensions. The principles of a tax on real estate will have to be elaborated and discussed together with the abolition of the local sales tax, both changes being of utmost importance for the financing of local governments.

In 2007 household consumption will marginally decline, in line with real wages. There will be a considerable decrease in public consumption. Gross fixed capital formation will moderately increase, but the main driving force of growth will be net export, as exports are expected to rise faster than imports by about 3 percentage points. Exports of goods and services may surpass the value of imports for the first time since transition began. Nevertheless, this positive development may only moderate the deceleration of economic growth, to about 2.7% from 4% in 2006. Inflation will be high in the first half of the year due to price rises related to the economic policy measures introduced in the second half of 2006, but it will decline by the end of the year so that average annual inflation will amount to about 6-6.5%. Unemployment will be somewhat higher than in 2006. The stabilization in public finances will continue, the general government balance is likely to be somewhat better (6.5% of the GDP) than the cautiously set target of the convergence programme. The forint may keep its currently strong position unless serious political unrest appears and the suspension of the stabilization and the launched reforms becomes a real danger.

Table HU

Hungary: Selected Economic Indicators

	2000	2001	2002	2003	2004	2005	2006 ¹⁾	2007	2008
								forecast	
Population, th pers., end of period	10200.3	10174.9	10142.4	10116.7	10097.5	10076.6	10067	.	.
Gross domestic product, HUF bn, nom. ²⁾	13150.8	15274.9	17203.7	18935.7	20712.3	22026.8	23900	26200	28000
annual change in % (real) ²⁾	5.2	4.1	4.3	4.1	4.9	4.2	4.0	2.7	3.1
GDP/capita (EUR at exchange rate) ²⁾	4953	5841	6970	7374	8142	8803	8979	.	.
GDP/capita (EUR at PPP - wiiw) ²⁾	10530	11860	12720	13230	13930	14670	15790	.	.
Gross industrial production									
annual change in % (real)	18.1	3.6	2.8	6.4	7.4	7.0	10	8	9
Gross agricultural production									
annual change in % (real)	-6.5	15.8	-4.1	-4.5	22.9	-8.5	.	.	.
Construction industry									
annual change in % (real)	7.9	7.7	17.5	2.2	6.8	18.8	-1.6	.	.
Consumption of households, HUF bn, nom. ²⁾	6689.2	7901.6	9076.6	10229.7	11003.8	11827.0	.	.	.
annual change in % (real) ²⁾	4.4	6.3	10.6	8.3	2.9	3.7	2.0	-0.3	1
Gross fixed capital form., HUF bn, nom. ²⁾	3179.8	3499.7	3941.5	4156.0	4631.2	4995.3	.	.	.
annual change in % (real) ²⁾	7.7	5.1	10.1	2.1	7.7	5.6	2.0	3	4
LFS - employed persons, th, avg.	3856.2	3868.3	3870.6	3921.9	3900.4	3901.5	3932	.	.
annual change in %	1.2	0.3	0.1	1.3	-0.5	0.0	0.8	.	.
Reg. employees in industry, th pers., avg. ³⁾	844.8	833.9	817.9	801.8	785.4	762.9	751	.	.
annual change in %	1.3	-1.3	-1.9	-2.0	-2.0	-2.9	-1.5	.	.
LFS - unemployed, th pers., average	263.7	234.1	238.8	244.5	252.9	303.9	317	.	.
LFS - unemployment rate in %, average	6.4	5.7	5.8	5.9	6.1	7.2	7.5	7.9	7.8
Reg. unemployment rate in %, end of period	8.6	8.0	8.0	8.3	9.1	9.3	9.0	.	.
Average gross monthly wages, HUF ³⁾	87645	103553	122482	137193	145521	158343	170600	.	.
annual change in % (real, net)	1.5	6.4	13.6	9.2	-1.0	6.3	3.2	0	1
Consumer prices, % p.a.	9.8	9.2	5.3	4.7	6.8	3.6	3.9	6.3	3.5
Producer prices in industry, % p.a.	11.6	5.2	-1.8	2.4	3.5	4.3	6.8	7	4.5
General governm. budget, EU-def., % GDP ⁴⁾									
Revenues	43.6	44.0	43.0	42.8	43.5	43.4	.	.	.
Expenditures	46.5	47.4	51.2	49.1	48.8	49.9	.	.	.
Deficit (-) / surplus (+)	-3.0	-3.5	-8.2	-6.3	-5.3	-6.5	-9.7	-6.5	-4
Public debt, EU-def., in % of GDP ⁴⁾	55.4	52.2	54.0	55.8	56.3	57.7	.	.	.
Refinancing rate, % p.a., end of period	11.0	9.8	8.5	12.5	9.5	6.0	8.0	.	.
Current account, EUR mn	-4352.4	-3576.5	-4929.2	-5933.0	-6915.5	-6002.3	-5600	-5000	-4600
Current account in % of GDP	-8.6	-6.0	-7.0	-7.9	-8.4	-6.8	-6.2	-4.9	-4.1
Reserves total, excl. gold, EUR mn	12038.4	12163.7	9887.4	10108.3	11670.9	15678.4	16349.2	.	.
Gross external debt, EUR mn	32571.5	37387.0	38559.3	46041.1	55150.1	66297.6	75958.5 ^{ix}	.	.
Gross external debt in % of GDP	64.4	62.8	54.5	61.6	67.0	74.7	.	.	.
FDI inflow, EUR mn	2998.4	4390.7	3185.1	1887.5	3633.3	5558.9	4500	.	.
FDI outflow, EUR mn	664.4	398.5	295.7	1463.4	892.1	1422.0	1000	.	.
Exports of goods, BOP, EUR mn	31277.5	34697.1	36820.7	37906.9	44779.1	50119.9	57900	65700	73600
annual growth rate in %	30.0	10.9	6.1	2.9	18.1	11.9	16	13.5	12
Imports of goods, BOP, EUR mn	34457.1	37192.8	39024.1	40804.5	47232.3	51579.9	57800	63600	70000
annual growth rate in %	32.0	7.9	4.9	4.6	15.8	9.2	12	10	10
Exports of services, BOP, EUR mn	6429.2	7864.7	7820.0	8122.5	8769.5	10313.0	10600	11870	13300
annual growth rate in %	30.9	22.3	-0.6	3.9	8.0	17.6	3	12	12
Imports of services, BOP, EUR mn	5194.8	6203.3	7233.1	8074.6	8532.5	9584.5	9600	10400	11200
annual growth rate in %	26.9	19.4	16.6	11.6	5.7	12.3	0	8	8
Average exchange rate HUF/USD	282.27	286.54	258.00	224.44	202.63	199.66	210.51	.	.
Average exchange rate HUF/EUR (ECU)	260.04	256.68	242.97	253.51	251.68	248.05	264.27	255	250
Purchasing power parity HUF/USD	107.37	109.89	114.72	119.60	124.05	124.90	126.39	.	.
Purchasing power parity HUF/EUR	122.35	126.47	133.11	141.31	147.12	148.89	150.26	.	.

Note: The term 'industry' refers to NACE classification C+D+E.

1) Preliminary. - 2) According to ESA'95, from 2001 FISIM-adjusted and real change based on previous year prices. - 3) Enterprises with more than 5 employees. - 4) According to ESA'95, excessive deficit procedure.

Source: wiiw Database incorporating national statistics; Eurostat; wiiw forecasts.