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Hungary:
Leaving the excessive deficit procedure behind

In Hungary GDP data (year-on-year) for the first quarter show a further decline in consumption and investment. Only foreign trade has contributed positively to the change in GDP. Over the year, good performance in agriculture and construction may help to secure zero growth. The major obstacles to a return to a higher growth rate are uncertainties in the legal and fiscal environment and the lack of confidence among domestic and foreign investors, as well as faltering financial intermediation.

On 21 June, ECOFIN decided for the abrogation of the excessive deficit procedure (EDP) for Hungary. With this decision, a nearly decade-long process comes to an end this summer for Hungary. The country entered the EDP upon its accession to the EU in 2004 and, contrary to other new members in the same situation, Hungary proved unable to get out of it. Populist policies kept fiscal deficits high until mid-2006, thereafter the results of the first fiscal consolidation efforts were annihilated by the consequences of the global financial crisis from late 2008 on. The currently ruling Fidesz party had fiercely criticised the consolidation programmes of the previous two governments, then from the opposition. Once in power after the 2010 spring elections, Fidesz tried to stimulate economic growth by relaxing fiscal rigour. In response to this attempt, the Commission announced the possible partial suspension of Cohesion Fund transfers for Hungary, unless the government made resolute steps to bring down the budget deficit below 3% of the GDP. Those transfers have been a vital source of public investment in the past few years. As that loss would have been unbearable for the economy, from that point on the government has had no other choice but to re-start fiscal consolidation. In the past two years several deficit cutting packages have been introduced, but up to the latest series of measures announced as late as early May 2013 the Commission did not consider the Hungarian government's efforts sufficient to keep the fiscal deficit below the Treaty threshold of 3%.

In the first quarter of 2013 Hungary emerged from technical recession, as GDP increased by 0.7% compared to the last quarter of 2012. This was the first positive growth rate after a four-quarter period characterised by shrinking quarterly GDP and can be explained by the exceptionally strong growth (27.6%) of value added in agriculture at the beginning of 2013.

But year-on-year GDP data give no reason for optimism as they show a further decline (0.9%). Of the main branches of the economy, expansion was registered only in agriculture and construction, and in both cases the basis for comparison (first quarter data in 2012) was very low. Value added in industry dropped by 3.2%, in the services sector by 0.2%. On the distribution side of the GDP both private and public consumption have shrunk, the former by 0.6%, the latter by 2.6%. The most disappointing data were reported for gross fixed capital formation (investment): here the extent of the contraction amounted to 5.6%, indicating that there is no turnaround in the country's growth prospects. Foreign trade data display near-stagnation, nevertheless the marginal expansion of exports was somewhat stronger than that of imports.

Financial intermediation has remained a sore spot of the economy. The stock of credits for businesses is 20% smaller than it was before the crisis. In the first quarter of 2013 (year-on-year) the stock of credits to households dropped by 4% while the number of non-performing loans for households increased by 15%. Decreasing repayment discipline has been recorded for forex as well as HUF credits, and for both mortgage and unsecured loans. Moreover, the share of loans in moderate (less than 90 days) payment delay has been rising as well. All in all, in the first quarter of this year not more than 64.1% of loans were amortised as scheduled in the contract.

The process of deleveraging has carried on. Though the stock of foreign currency loans has significantly declined in the past two years, their share in important aggregates has remained high (55% of total loans or 25.7% relative to the GDP). The Hungarian banking sector has had negative profit indicators in the past two years, and the outlook is bleak for 2013 as well. The banks have to cope with the impact of the persisting bank levy and the newly introduced transaction tax, hostile government rhetoric has been continued and the crowding out or withdrawal of one or more foreign-owned banks from the Hungarian market has become an option.

According to survey results of the research institute Tárki, inequality in Hungary has increased over the past three years.[1] Average household incomes dropped in real terms. Incomes of households in the lowest household income decile declined more strongly than the average while those in the top decile increased even in nominal terms. Per capita income in the highest decile relative to that in the lowest decile jumped from 7.2:1 to 9:1. Simultaneously the share of the lowest decile in total income dropped to 1.6% from 3.1%.

1 Egyenlötlenség és plarizálódás a magyar társadalomban. Tárki Monitor Jelentések 2012, http://www.tarki.hu/hu/research/hm/monitor2012_teljes.pdf

In 2007 12.6% of the population lived in relative poverty; this share increased by over 1 percentage point in 2008-2009 and by a further 3 percentage points in 2010-2012. The 17% poverty rate in 2012 is higher than the historically measured peak indicator of 1996.

Now that the sword of Damokles in the form of a suspension of Cohesion Fund transfers has been removed, the room for manoeuvre has become wider for the government. Nevertheless this increased freedom will probably not be large enough for the usual large-scale election pledges expected to be made prior to the forthcoming general elections in early 2014. Although the EDP has been lifted, an abrupt change in the cautious fiscal policy may lead to an unfavourable Commission forecast for Hungary, followed by recommendations for a policy change to be adopted within six, in justified cases within not more than three months. In case of non-compliance a new EDP may be launched, as it occurred in the case of Malta. That means that fiscal stimulation of economic growth will continue to be a limited option in Hungary, unless structural reforms release resources in public finance areas characterised by inefficiency.

As for providing a growth stimulus, the focus is currently on monetary policy. A wave of gradual cuts brought the policy rate to its historically lowest value of 4.25% on 26 June 2013. The central bank, under the new governor György Matolcsy, the former Minister of Economy, has started an offensive to step up crediting the SME sector. The programme, reproducing a Bank of England design, secures loans with zero interest rate for the commercial banks, which in turn may volunteer for providing credits to enterprises in the SME sector at a maximum interest rate of 2.5%. The loans from the package may finance investments, operational costs, may be used to co-finance EU projects and for the conversion of forex credits to HUF-denominated credits.

This step in the right direction will, most probably, be not enough to turn around the downward trend in depressed financial intermediation. Non-preferential interest rates have remained high (in January around 8% for loans to businesses, at 1.4% industrial producer price inflation), and both the supply of and the demand for loans is weak. The uncertainty in the banking sector is high concerning the duration of the extraordinary burdens (bank levy, the costs of financial transactions). The business sector is reserved due to flat domestic demand, the bleak growth outlook for the main export markets and, last but not least, the uncertainties of the regulatory and taxation environment in the Hungarian economy. Households have remained cautious concerning both consumption and investment just as about raising new credits. High debt service burden after forex loans, the feared negative impact of a possible deterioration of the forint exchange rate at this juncture, and shaken job security explain this behaviour.

Although there are several positive indicators in the economy – such as the reduced costs of revolving public debt, the decreasing risk surcharge, a likely good harvest this year in agriculture, a turnaround in construction output after a long and steep decline – the recent development in and future prospects for the main components of the GDP and the outlook for external demand do not give hope for more than stagnation of the GDP this year. An exceptionally good agricultural output, and a stronger than currently expected expansion of exports may result in a higher growth performance in the range of 0.3% to 0.5%.

Our scenario for 2014 and 2015 assumes that Hungary gradually returns to a higher, investment- and export-driven growth path. A precondition for that is a political and legal consolidation period, a restoration of domestic and foreign investors' confidence, reconciliation with the banking sector based on observed agreements and fair and feasible burden sharing, and an easing of the extreme centralisation of government decisions. These unavoidable changes will have a minimum probability of implementation unless the currently ruling Fidesz party headed by Viktor Orbán is replaced by an alliance of the democratic opposition parties following the next elections in April 2014. If Mr Orbán remains in power for a further four years, the wiiw reckons with a protracted crisis of confidence and marginal economic growth in a depressed society.

Table HU

Hungary: Selected Economic Indicators

	2009	2010	2011	2012 [1)]	2012	2013	2013	2014	2015
					1st quarter			Forecast	
Population, th pers., average [2)]	10023	10000	9945	9919	.	.	9920	9900	9880
Gross domestic product, HUF bn, nom.	25626	26607	27886	28276	6350	6438	29500	31000	32800
annual change in % (real)	-6.8	1.3	1.6	-1.7	-0.6	-0.9	0.0	1.2	2.3
GDP/capita (EUR at exchange rate)	9100	9700	10000	9900	.	.	.	.	.
GDP/capita (EUR at PPP)	15300	15900	16500	16500	.	.	.	.	.
Consumption of households, HUF bn, nom.	13551	13665	14360	14883	3533	3605	.	.	.
annual change in % (real)	-6.8	-3.0	0.5	-1.4	-0.3	-0.6	0.0	0.0	0.0
Gross fixed capital form., HUF bn, nom.	5302	4867	4987	4851	879	835	.	.	.
annual change in % (real)	-11.1	-9.6	-3.6	-3.9	-4.5	-5.6	-2.0	0.0	5.0
Gross industrial production									
annual change in % (real)	-17.6	10.5	5.6	-1.8	-0.1	-3.1	1.0	3.0	5.0
Gross agricultural production (EAA)									
annual change in % (real)	-10.6	-11.1	10.7	-9.2	.	.	.	.	.
Construction industry									
annual change in % (real)	-4.4	-10.4	-7.8	-6.0	-11.1	1.4	1.5	2.0	5.0
Employed persons, LFS, th, average	3781.8	3781.2	3811.9	3877.9	3791.3	3817.7	3890	3900	3920
annual change in %	-2.5	0.0	0.8	1.7	1.6	0.7	0.2	0.2	0.5
Unemployed persons, LFS, th, average	420.7	474.8	467.9	475.6	504.1	508.7	.	.	.
Unemployment rate, LFS, in %, average	10.0	11.2	10.9	10.9	11.7	11.8	11.0	10.8	10.6
Reg. unemployment rate, in %, end of period	13.6	13.3	12.4	12.8	13.3	13.9	.	.	.
Average gross monthly wages, HUF [3)]	199837	202525	213094	222990	219131	225566	.	.	.
annual change in % (real, net)	-2.3	1.8	2.4	-3.5	-3.9	1.3	.	.	.
Consumer prices (HICP), % p.a.	4.0	4.7	3.9	5.7	5.6	2.7	2.5	2.9	3.0
Producer prices in industry, % p.a.	4.4	4.0	4.1	4.1	6.8	0.6	.	.	.
General governm.budget, EU-def., % of GDP									
Revenues	46.9	45.4	53.8	46.5	.	.	.	.	.
Expenditures	51.4	49.8	49.6	48.5	.	.	.	.	.
Net lending (+) / net borrowing (-) [4)]	-4.6	-4.4	4.2	-2.0	.	.	-3.0	-3.0	-3.0
Public debt, EU-def., % of GDP	79.8	81.8	81.4	79.2	.	.	78.0	77.5	77.0
Central bank policy rate, % p.a., end of period [5)]	6.25	5.75	7.00	5.75	7.00	5.00	.	.	.
Current account, EUR mn	-176	1063	816	1594	-22	.	1500	1300	500
Current account, % of GDP	-0.2	1.1	0.8	1.6	-0.1	.	1.5	1.2	0.4
Exports of goods, BOP, EUR mn	57397	68964	75238	76554	18858	.	78900	83200	92400
annual change in %	-20.3	20.2	9.1	1.7	-0.1	.	3.1	5.5	11.0
Imports of goods, BOP, EUR mn	55028	65749	71838	72497	17976	.	74200	77500	86000
annual change in %	-24.9	19.5	9.3	0.9	1.6	.	2.4	4.5	11.0
Exports of services, BOP, EUR mn	13305	14634	15800	15868	3519	.	16700	18400	20400
annual change in %	-3.6	10.0	8.0	0.4	1.4	.	5.0	10.0	11.0
Imports of services, BOP, EUR mn	11319	11704	12630	12459	2842	.	13000	14000	15500
annual change in %	-7.9	3.4	7.9	-1.4	-6.0	.	4.0	8.0	11.0
FDI inflow, EUR mn	1475	1626	3771	10478	3823	.	2000	.	.
FDI outflow, EUR mn	1365	871	3141	8183	3337	.	.	.	.
Gross reserves of NB, excl. gold, EUR mn	30648	33667	37242	33640	34697	35344	.	.	.
Gross external debt, EUR mn	137120	138233	132343	124005	131067	.	.	.	.
Gross external debt, % of GDP	150.0	143.1	132.6	126.9	.	.	.	.	.
Average exchange rate HUF/EUR	280.33	275.48	279.37	289.25	296.76	296.58	295	290	285
Purchasing power parity HUF/EUR	166.78	167.48	169.65	172.86	.	.	.	.	.

Note: Gross industrial production, construction output and producer prices refer to NACE Rev. 2. Gross agricultural production refers to Economic Accounts for Agriculture (EAA).

1) Preliminary. - 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 Database incorporating Eurostat and national statistics. Forecasts by wiiw.