

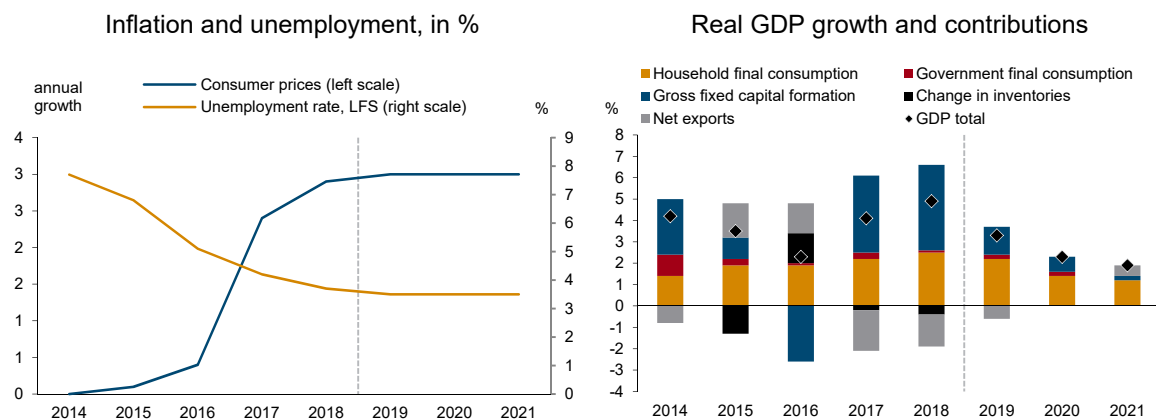


HUNGARY: Strong domestic demand driven growth on the back of EU transfers

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Economic growth has been driven by domestic demand. Beside strong investment growth also household consumption expanded more rapidly than the GDP. In trade of goods the expansion of imports exceeded to a large extent that of the exports. The strong dependence on EU transfers, a characteristic feature of the current growth path, makes it likely that the expected huge drop in EU supported investments in 2019-2022 will significantly deteriorate Hungary's growth prospects.

Figure 6.8 / Hungary: Main macroeconomic indicators



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

Thanks mainly to EU cohesion policy transfers, 2018 was a year of dynamic expansion of economic activities in Hungary. According to preliminary data GDP growth amounted to 4.9%, the highest rate since 1996. Important indicators however reveal the one-sidedness of this growth, which is strongly determined by the accelerated allocation of transfers from the EU's cohesion policy. On the output side, the pace of expansion in industry and agriculture remained below the average growth rate of the economy. Construction output may have increased by 22%, related to a large extent to EU transfers (and also helped by a long due upturn in the construction of dwellings). On the final use side of the GDP, the growth rate of investments was impressive, around 18%, but detailed data reveal the strong dependence on EU transfers. In the first three quarters of 2018 investments increased by a mere 1.2% in manufacturing and 2.6% in agriculture. In contrast, investment in the category public administration and defence; compulsory social security grew by 72%. A relatively dynamic investment expansion was reported for transportation and storage and retail activities.

Economic growth was driven primarily by domestic demand in 2018. Beside strong investment growth, household consumption expanded more rapidly than overall GDP, while public consumption practically stagnated. Foreign trade figures reflect this process: imports of goods may have outperformed exports by over 3 percentage points. The rapidly shrinking trade balance of goods was to some extent compensated by the improving balance of trade in services. With regard to the threat of a global trade war and the exposure of the automotive industry, an upturn in exports is questionable. After a long period of shrinking, a take-off in lending to both corporations and households by the reinvigorated financial sector fostered the expansion of economic activities.

The current account surplus had been shrinking over the last year, likely to below 2% of the GDP. The EU's important role is clearly visible here as well: net transfers may have amounted to +3% of GDP, and transfers of Hungarian workers from abroad, predominantly from Western European EU countries, may have accounted for 2% of GDP. In January 2019 tax-filtered core inflation reached 3% (year on year). This is seen as a signal for the central bank to start with a cautious phasing out of its loose monetary policy.

Last year the strong increase in real wages continued. Altogether, in the period 2016-2018 real wages may have increased by about 28%, much faster than GDP (about 11.5%). Recent analysis raises doubts about the validity of the wage growth data for methodological reasons, referring to a possible bias in the sample employed by the Central Statistical Office. The sample does not include (among others) wage increase data at firms employing less than 5 persons, although about half of all firms belong to this category. In these micro-enterprises, wages are typically lower than at the larger firms, and for micro-enterprises it is also more difficult to raise wages. Altogether net wages may have increased substantially more slowly than officially reported.

Labour shortages are a big problem for firms. The problem of skills mismatch is reflected in the statistics, according to which despite labour shortages some 240,000 persons were looking for a job at the end of 2018, a figure corresponding to 5.2% of the active population. Agitating fervently against immigration as a potential solution to ease the labour shortage, the government announced a programme to increase the birth rate. A central element of it is an interest-free credit (equivalent to about EUR 50,000 in purchasing power terms) for all married women younger than 40 years. The credit can be turned into a grant if the prescribed three children are 'delivered'. (If not, the credit must be paid back with interest.) The implied costs of the whole programme are estimated to amount to 0.3% of the GDP this year and 0.5% in the next year. Nevertheless, even if the programme reaches its goal, it would take at least two decades to ease the shortages in the labour market.

There have been continuous protests in Budapest and in several other cities in Hungary against controversial labour law changes. These changes enable employers to raise the threshold of overtime hours from 250 to 400 per year. The time frame for paying out overtime compensation was extended to 36 months. As an alternative to paid compensation, employers may opt for providing leave days. The so-called 'Slave Law' is extremely unpopular: according to polls 83% of the employees do not agree with the new regulation. For one, the extension is extreme – it potentially allows the re-introduction of the six-day working week. Although overtime can be ordered only with the consent of the employees, there is a widespread fear that employees are at the mercy of employers in practice. While no general strike seems to be in the making, isolated strikes have been reported, the most prominent one at Audi Hungaria, although this was focused on wages. In the next three years wages may continue to grow,

even if to a smaller extent than so far, in the foreign-owned enterprises with high productivity and profitability, but a further strong wage growth will become more and more unfeasible in the predominantly Hungarian-owned SME sector. That, apart from shrinking EU transfers, will put a major constraint on growth.

wiiw expects a slowdown of economic growth in Hungary during the forecast period. The government is optimistic: in a medium-term forecast published by the Ministry of Finance at the end of 2018, it reckoned with a mild deceleration of economic growth from this year on, but even so GDP is expected to expand by around 4% on average in the coming years. This rate of growth is expected to ensure a steep decline of the public debt to GDP ratio, to below 60% by 2022. We think that this scenario is not feasible. EU co-financed investments will sharply decrease from the next year. With the mounting uncertainties due to Brexit and the likely conditionality related to the proper functioning of democratic institutions and the rule of law in each beneficiary Member State, a full-scale revival of EU transfers, especially for the EU's 'black sheep' Hungary, is highly questionable. Even if that were to occur, then probably not before 2023 and to a substantially smaller extent than in the current seven-year financing period.

Table 6.8 / Hungary: Selected economic indicators

	2014	2015	2016	2017	2018 ¹⁾	2019	2020	2021
						Forecast		
Population, th pers., average	9,866	9,843	9,814	9,788	9,750	9,720	9,700	9,670
Gross domestic product, HUF bn, nom.	32,583	34,379	35,474	38,355	41,500	44,200	46,700	49,100
annual change in % (real)	4.2	3.5	2.3	4.1	4.9	3.3	2.3	1.9
GDP/capita (EUR at PPP)	18,800	19,800	19,500	20,300	21,700	.	.	.
Consumption of households, HUF bn, nom.	15,875	16,428	17,033	18,281	19,880	.	.	.
annual change in % (real)	2.8	3.9	4.0	4.7	5.3	4.6	3.0	2.5
Gross fixed capital form., HUF bn, nom.	7,223	7,744	6,961	8,528	10,400	.	.	.
annual change in % (real)	12.3	4.7	-11.7	18.2	18.0	6.0	3.0	1.0
Gross industrial production								
annual change in % (real)	7.6	7.4	0.9	4.7	3.6	4.5	5.0	4.0
Gross agricultural production								
annual change in % (real)	11.4	-2.4	9.3	-4.1	3.1	.	.	.
Construction industry								
annual change in % (real)	13.6	3.0	-18.9	29.7	22.2	.	.	.
Employed persons, LFS, th, average	4,101	4,211	4,352	4,421	4,470	4,490	4,490	4,490
annual change in %	5.3	2.7	3.4	1.6	1.1	0.5	0.1	0.1
Unemployed persons, LFS, th, average	343	308	235	192	172	160	160	160
Unemployment rate, LFS, in %, average	7.7	6.8	5.1	4.2	3.7	3.5	3.5	3.5
Reg. unemployment rate, in %, eop	8.9	7.6	6.1	5.6	5.2	.	.	.
Average monthly gross wages, HUF ²⁾	237,695	247,924	263,171	297,017	329,943	356,800	378,500	395,700
annual change in % (real, gross)	3.2	4.4	5.7	10.3	8.3	5.0	3.0	1.5
Average monthly net wages, HUF ²⁾	155,690	162,391	175,009	197,516	219,412	237,300	251,800	263,200
annual change in % (real, net)	3.2	4.4	7.4	10.3	8.3	5.0	3.0	1.5
Consumer prices (HICP), % p.a.	0.0	0.1	0.4	2.4	2.9	3.0	3.0	3.0
Producer prices in industry, % p.a.	-0.3	-1.1	-1.7	3.3	5.6	3.0	3.0	3.0
General governm.budget, EU-def., % of GDP								
Revenues	46.9	48.2	45.1	44.7	47.5	47.4	47.2	47.0
Expenditures	49.5	50.1	46.8	46.9	49.5	49.7	50.4	50.4
Net lending (+) / net borrowing (-)	-2.6	-1.9	-1.6	-2.2	-2.0	-2.3	-2.7	-2.9
General gov.gross debt, EU def., % of GDP	76.6	76.6	75.9	73.3	70.9	70.4	70.1	69.9
Stock of loans of non-fin.private sector, % p.a.	-0.3	-12.3	-1.3	5.5	10.5	.	.	.
Non-performing loans (NPL), in %, eop	16.7	11.1	7.2	4.2	3.5	.	.	.
Central bank policy rate, % p.a., eop ³⁾	2.10	1.35	0.90	0.90	0.90	1.15	1.30	1.50
Current account, EUR mn ⁴⁾	1,587	3,127	7,071	3,947	1,645	1,600	1,300	1,700
Current account, % of GDP ⁴⁾	1.5	2.8	6.2	3.2	1.3	1.2	0.9	1.1
Exports of goods, BOP, EUR mn ⁴⁾	73,826	78,477	80,106	85,566	90,172	94,700	99,400	105,400
annual change in %	5.1	6.3	2.1	6.8	5.4	5.0	5.0	6.0
Imports of goods, BOP, EUR mn ⁴⁾	71,701	74,425	75,482	83,662	90,972	97,000	102,400	108,500
annual change in %	7.2	3.8	1.4	10.8	8.7	6.6	5.6	6.0
Exports of services, BOP, EUR mn ⁴⁾	18,727	20,229	22,114	23,746	24,490	25,700	27,000	28,600
annual change in %	10.2	8.0	9.3	7.4	3.1	5.0	5.0	6.0
Imports of services, BOP, EUR mn ⁴⁾	14,120	15,302	15,338	16,394	16,459	17,100	18,000	19,100
annual change in %	6.7	8.4	0.2	6.9	0.4	4.0	5.0	6.0
FDI liabilities, EUR mn ⁴⁾	7,134	6,966	-6,158	6,546	5,850	.	.	.
FDI assets, EUR mn ⁴⁾	4,186	5,753	-8,467	4,911	2,469	.	.	.
Gross reserves of NB excl. gold, EUR mn	34,481	30,226	24,384	23,261	26,273	.	.	.
Gross external debt, EUR mn ⁴⁾	121,129	119,339	110,637	104,941	106,000	105,000	101,000	99,000
Gross external debt, % of GDP ⁴⁾	114.8	107.6	97.1	84.6	81.5	77.0	71.2	66.9
Average exchange rate HUF/EUR	308.71	310.00	311.44	309.19	318.89	324	329	332

1) Preliminary and wiiw estimates. - 2) Enterprises with 5 and more employees. - 3) Base rate (two-week NB bill). - 4) Excluding SPE.

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