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Hungary: waiting for the spring elections

Hungary's economic performance was improving over the year 2005. GDP growth accelerated from 3.2% in the first quarter to 4.5% in the second and third quarters. The annual growth rate in 2005 must have surpassed 4%. This performance, while substantially better than that of the 'old' EU members (about 1.4%), is less impressive in comparison with other new EU member states. The interpretation of macroeconomic indicators has become the battlefield of pre-election political struggles, with the government pointing at a robust performance of the economy and the opposition seeing malfunction and failure everywhere. This completely different evaluation of the country's economic performance is rooted in a really existing duality, namely the 'co-habitation' of a flourishing business sector with ailing public finances.

Contrary to the period 2000-2003, exports and investment are the engines of growth, with net exports showing the best result since 2000. Consumption increased by 2.3% in the first three quarters of the year, substantially below the pace of GDP growth.

Due to speeded-up highway construction the expansion of construction activities (17.4% in the first three quarters) exceeded growth in any other segment of the economy. Though this acceleration must certainly be seen as part of the election campaign, the remarkably strong correlation of foreign investments with easy accessibility of the chosen site via highways shows that the programme is worth being pushed, even if part of the public finance problems are caused by the related high financing requirements. Industrial output increased by 7.3% in the first eleven months of the year, with exceptionally high growth rates in northern Hungary and central Transdanubia and weak performance in the earlier growth centres western Transdanubia and Budapest. Export sales expanded more than twice as dynamically as domestic sales. Productivity increased by 10% in the first ten months of the year. In October 2005 the volume of new orders was up one quarter against a year earlier, in chemical products and electrical and optical equipment new orders even rose by more than 40%. The performance of the services sector expanded at the same pace as did GDP, with transport, storage and communication far above the sectoral average, and public administration, education, health and social work far below that average.

Economic growth was increasingly supported by export expansion. From the third quarter of 2003 exports increased more rapidly than imports; in the first eleven months of 2005 the difference in growth rates made up 3.4 percentage points in favour of exports. The trade deficit was nearly one third smaller than in the respective period in 2004. The geographical destination/source of trade flows has undergone a remarkable shift: trade with the EU-15 stagnated while that with the new EU members and the rest of the world expanded dynamically. Machinery and transport vehicles accounted for 61% of total exports. In this commodity group, exports to the 'old' EU members exceeded imports from that country group by 36%, while the balance with non-EU members in machinery and transport vehicles trade was negative. The improving trade performance is reflected in the balance of payments. Though the current account deficit in the first three quarters of 2005 amounted to EUR 5053 million, only about 6% less than in the respective period of 2004, the (BOP) trade of goods balance improved dramatically, showing only half the deficit registered a year earlier. The positive impact of goods trade was counterbalanced by the deterioration of the income balance (mainly due to significant profit repatriation of foreign-owned companies). In the first three quarters of 2005 non-debt generating financing was substantially less than in 2004; however, with the sale to British Airport Authority of the exclusive rights to operate the Budapest airport in December 2005 (the value of the deal amounts to about EUR 1.8 billion) the picture will change completely in the statistics embracing the whole year 2005.

Public finance has remained the problem number one in 2005. Although in 2005 the general government deficit remained below the planned figure for the first time in the past four years, this was possible only with the help of one-off revenues and some 'creative' book-keeping. Even so the public deficit amounted to 6.1% of the GDP, more than double the entrance requirement to Euroland. There is a broad consensus in the research community that the general government deficit target for 2006 (4.7% of the GDP) cannot be attained.

It is obvious that the targets of the revised convergence programme (3.4% deficit/GDP ratio in 2007, 1.9% in 2008) cannot be achieved with expenditure cuts here and there and streamlining of the state administration. Hungary badly needs a series of fiscal reforms, in particular in health care, education and local governments. The current system is swallowing enormous resources while producing outputs which leave the consumers of these outputs deeply unsatisfied. Reforms have continuously been postponed since 1997, the last major reform (transformation of the pension system) and are to be introduced apart from the requirements for the introduction of the euro in 2010, the date envisaged by the government. Regretfully reforms are not among the central issues in the emerging election campaign. Stabilization, despite the obviously positive outcome of the so-called Bokros package in 1995 has remained taboo not only for the biggest opposition party FIDESZ but for the Socialist Party as well, the senior partner in the present government and the erstwhile initiator (together with the Free Democrats) of the successful 1995 stabilisation. With regard to the irresponsible promises to various groups of the population one has the impression that both big political parties are apparently convinced that the 2006 elections can be won only by populist programmes.

While no reforms or measures to consolidate the fiscal stance may be expected before the elections, thereafter the likelihood of a resolute turn in the management of fiscal problems is high. Repeated warnings from the EU, the downgrading of Hungary's foreign currency debt rating by Fitch last December and the weakening of the forint over 2005 are warning signs, and all hint at the lurking risk of a major currency crisis. That risk may turn into acute danger unless immediate steps are taken by the incoming government towards consolidation of the budget, with or without maintaining 2010 as target date for the euro introduction. The critical issues to be addressed in the first hundred days will be launching reforms in health care, education and local government, reconsidering initiated or promised tax reforms which reduce the government's revenues, a new design for the financing of highway construction, and painful decisions about the future of the state-financed institutions. Whether a comprehensive reform package has already been elaborated either by the government parties or the parties in opposition, will most probably remain a well-guarded secret until after the elections.

The likely turn in fiscal policy will have an impact on the exchange rate resulting, by the end of 2006, in an exchange rate below 250 HUF/EUR and a central bank base rate of 5% or less. Inflation will be around 2% due to lowering of the top VAT rate from 25% to 20%, but an element of uncertainty with respect to energy prices. Fiscal policy changes will have no major impact on economic growth in 2006. The GDP will increase by more than 4%, exports and investment remain the driving force behind the output expansion. The current account deficit will grow, but will remains unchanged in relation to the GDP. The fiscal corrections will mainly affect the year 2007; the impact for 2006 may merely be an overshooting of the official deficit target – yet to a smaller extent than would be the case without the corrective measures (up to 6% of GDP versus 4.7%).

Table HU

Hungary: Selected Economic Indicators

	1999	2000	2001	2002	2003	2004	2005 [1]	2006 forecast	2007 forecast
Population, th pers., end of period	10221.6	10200.3	10174.9	10142.4	10116.7	10097.5	10065	10040	10020
Gross domestic product, HUF bn, nom. [2]	11393.5	13150.8	14989.8	16915.3	18650.8	20413.5	22000	23400	25000
annual change in % (real) [2]	4.2	5.2	4.3	3.8	3.4	4.6	4.2	4.2	4.0
GDP/capita (EUR at exchange rate) [2]	4402	4953	5732	6853	7263	8025	8800	.	.
GDP/capita (EUR at PPP - wiiw) [2]	9740	10550	11640	12510	12890	13620	14490	.	.
Gross industrial production									
annual change in % (real)	10.4	18.1	3.6	2.8	6.4	7.4	7.5	8	7
Gross agricultural production									
annual change in % (real)	0.4	-6.5	15.8	-4.1	-4.5	22.8	.	.	.
Construction industry									
annual change in % (real)	9.0	7.9	7.7	17.5	2.2	6.8	17	.	.
Consumption of households, HUF bn, nom. [2]	5826.6	6689.2	7816.9	8904.2	10066.5	10844.9	.	.	.
annual change in % (real) [2]	5.4	4.4	6.1	10.8	8.5	3.2	2.5	3.2	2.5
Gross fixed capital form., HUF bn, nom. [2]	2724.5	3179.8	3493.0	3916.9	4141.3	4616.0	.	.	.
annual change in % (real) [2]	5.9	7.7	5.9	9.3	2.5	8.4	8.5	7	8
LFS - employed persons, th, avg.	3809.3	3856.2	3868.3	3870.6	3921.9	3900.4	3901.5	.	.
annual change in %	0.6	1.2	0.3	0.1	1.3	-0.5	0.0	.	.
Reg. employees in industry, th pers., avg. [3]	834.0	844.8	833.9	817.9	801.8	785.2	762	.	.
annual change in %	0.8	1.3	-1.3	-1.9	-2.0	-2.1	-3	.	.
LFS - unemployed, th pers., average	285.3	263.7	234.1	238.8	244.5	252.9	303.9	.	.
LFS - unemployment rate in %, average	7.0	6.4	5.7	5.8	5.9	6.1	7.2	7.2	7.3
Reg. unemployment rate in %, end of period	9.3	8.6	8.0	8.0	8.3	9.1	9.1	9.1	9.2
Average gross monthly wages, HUF [3]	77187	87645	103553	122482	137193	145521	158600	.	.
annual change in % (real, net)	2.5	1.5	6.4	13.6	9.2	-0.7	6	.	.
Consumer prices, % p.a.	10.0	9.8	9.2	5.3	4.7	6.8	3.6	2	3
Producer prices in industry, % p.a.	5.1	11.6	5.2	-1.8	2.4	3.5	4.3	3	3
General governm.budget, EU-def., % GDP [4]									
Revenues	44.4	44.6	44.9	44.1	44.0	44.5	43.4	.	.
Expenditures	49.9	47.7	48.5	52.6	50.4	49.9	49.5	.	.
Deficit (-) / surplus (+) [5]	-5.5	-3.0	-3.5	-8.5	-6.5	-5.4	-6.1	-5.9	-4.3
Public debt, EU-def., in % of GDP [4][5]	61.2	55.4	52.2	55.5	57.4	57.4	57.2	.	.
Refinancing rate, % p.a., end of period	14.5	11.0	9.8	8.5	12.5	9.5	6.0	5.0	4.5
Current account, EUR mn	-3531.4	-4352.4	-3576.5	-4929.2	-6381.7	-7136.1	-7000	-7400	-7800
Current account in % of GDP	-7.8	-8.6	-6.1	-7.1	-8.7	-8.8	-7.9	-8.0	-7.7
Reserves total, excl. gold, EUR mn	10845.3	12038.4	12163.7	9887.4	10108.3	11670.9	15640.3	.	.
Gross external debt, EUR mn	29230.9	32571.5	37387.0	38559.3	46041.1	55061.7	64446.2 [IX]	.	.
FDI inflow, EUR mn	3106.4	2998.4	4390.7	3185.1	1887.5	3707.6	5000	4000	4000
FDI outflow, EUR mn	234.7	664.4	398.5	295.7	1463.4	856.0	1300	1000	1000
Exports of goods, BOP, EUR mn	24058.8	31277.5	34697.1	36820.7	38376.9	45074.0	49600	54560	60000
annual growth rate in %	14.3	30.0	10.9	6.1	4.2	17.5	10	10	10
Imports of goods, BOP, EUR mn	26102.4	34457.1	37192.8	39024.1	41274.5	47520.0	50850	55430	60400
annual growth rate in %	14.8	32.0	7.9	4.9	5.8	15.1	7	9	9
Exports of services, BOP, EUR mn	4910.2	6429.2	7864.7	7820.0	7673.8	8294.5	9400	10340	11370
annual growth rate in %	2.1	30.9	22.3	-0.6	-1.9	8.1	13	10	10
Imports of services, BOP, EUR mn	4093.9	5194.8	6203.3	7233.1	8074.7	8343.2	9500	10450	11500
annual growth rate in %	9.6	26.9	19.4	16.6	11.6	3.3	14	10	10
Average exchange rate HUF/USD	237.31	282.27	286.54	258.00	224.44	202.63	199.66	.	.
Average exchange rate HUF/EUR (ECU)	252.80	260.04	256.68	242.97	253.51	251.68	248.05	252	246
Purchasing power parity HUF/USD	99.96	107.43	110.13	114.72	121.84	126.65	127.55	.	.
Purchasing power parity HUF/EUR	114.24	122.11	126.46	133.14	142.85	148.28	150.59	.	.

Notes: 1) Preliminary. - 2) From 2001 revised data (FISIM adjustment). - 3) Enterprises with more than 5 employees. - 4) According to ESA'95, excessive deficit procedure. - 5) After corrections related to the pension reform.

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