

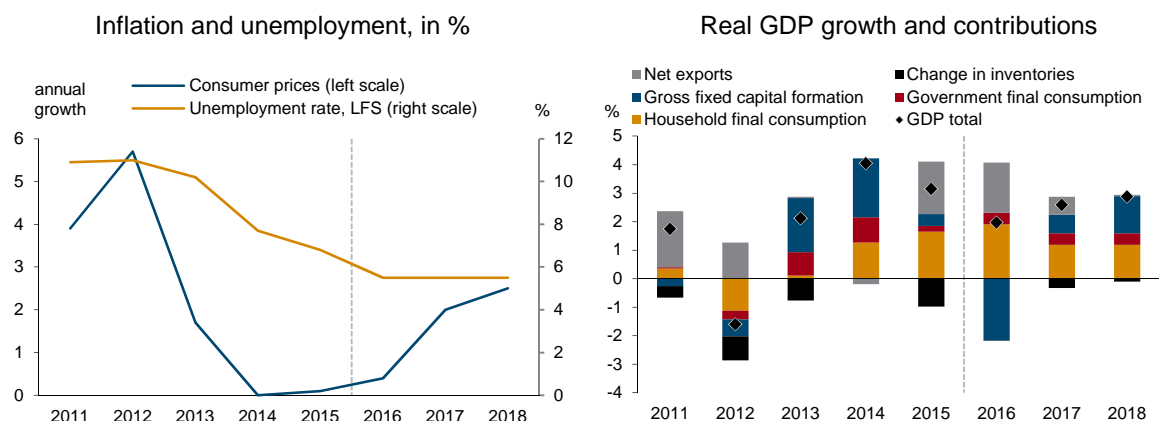


HUNGARY: Investments implode – consumption and net exports come to the rescue

SÁNDOR RICHTER

Economic growth is expected to slow down to 2% in 2016 on account of a major decline in investments. Household consumption and net exports will contribute positively to growth. Economic growth is expected to accelerate in 2017 thanks to a turnaround in investment, with many more EU transfers being disbursed than in the current year. Parliamentary elections are scheduled for spring 2018. A substantial fiscal stimulus to growth is a likely scenario for the election year.

Figure 30 / Hungary: Main macroeconomic indicators



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

After relatively strong growth in 2014 (4.0%) and 2015 (3.1%) the expansion of the economy is slowing down this year. GDP increased by only 1.9% in the first six months (year on year). Even if the government initiates fiscal stimulation in the last quarter of the year, economic growth will most probably not surpass 2% in 2016.

The most important development in the first half of 2016 was the implosion of investments (-15.4% year on year) due to the phasing out of EU projects under the 2007-2013 Multiannual Financial Framework (MFF) and the protracted kick-off of the disbursement of the transfers from the 2014-2020 MFF. The decline is especially strong in the public sector where EU transfers have been utilised intensively, but business sector investments contracted as well in the first two quarters. The only positive news is that in

manufacturing (accounting for over one third of all investments) an 11% growth was registered. Two major FDI projects, a greenfield tyre factory and another one in toy production, delivered a major contribution to manufacturing outlays.

Household consumption expanded strongly, by 5% in the first half of 2016. This figure reflects the impact of a rapid increase (7.6%) of net real wages. The unexpected rise in wages is a consequence of labour shortage becoming a more and more serious problem due to ongoing outward migration. Migration helps household consumption growth from another aspect as well: migrants' remittances from abroad have been increasing in the past few years, accounting for an inflow corresponding to over 2% of GDP. According to a recent survey of the Central Statistical Office, outward migrants are better educated and younger than the average population; skilled workers and persons with tertiary education are overrepresented. There are more male than female outward migrants. About three quarters of outward migrants choose Germany, the UK and Austria as destination countries.

Foreign trade has been, apart from consumption, the other driver of economic growth this year. In the first six months the export growth rate was 3.6 percentage points higher than the import growth rate. The slow expansion of imports is explained by the steep fall in investment. The import-inducing effect of the ongoing household consumption boom has not appeared as yet in the statistics. Though this large difference in favour of the export growth rate will not be sustainable, net exports will become a considerable component of economic growth in 2016.

Agriculture achieved high growth rates in the first two quarters of the year and the odds are good that the positive performance of this sector will substantially support this year's GDP growth. All other sectors showed a much less formidable performance. Growth rate in industry shrank to one third of the respective figure a year earlier. The relatively highest expansion of value added was reported for the manufacture of computer, electronic and optical products, while the performance of the manufacture of machinery and equipment figured the worst. Construction, the main loser of the 'evaporation' of EU transfers, declined by over 25% in the first half of the year. With the exception of financial services, the sub-sectors of the services sector expanded, with above-average dynamism in wholesale and retail trade, accommodation and food service activities, information and communication, as well as transportation and storage.

The fiscal deficit in the first six months of the year was well below 3% of GDP. If the current trend continues, an annual fiscal deficit below 2% of GDP could be achieved. Nevertheless, the good record may tempt the government to reconsider the expenditure side of the budget in the last months of the year. A fiscal stimulus would push the deficit above 2%, but it could safely remain below the 3% threshold while replacing part of the lost aggregate demand due to the implosion of investments. Acceleration of disbursement of EU transfers via elevated advance payments from the budget from the 2014-2020 MFF would be the cheapest version of growth stimulation but the implementation of this measure has been lagging far behind the originally very ambitious plans in this field.

In September Standard & Poor's raised its credit rating for Hungary to BB+/B, i.e. to investment grade. Thus, out of the three leading credit rating agencies, Moody's remains the only one to leave Hungary in junk grade. Standard & Poor's mentioned the following key issues explaining their decision: improving economic performance; stronger external financial profile (lasting current account surplus, reduction in the share of foreign currency debt); diminishing public debt to GDP ratio; completed conversion of

foreign-currency-denominated loans into forint loans; and rising employment and real disposable income of households. In contrast to the upgrading by Standard & Poor's, Hungary's position in the international competitiveness ranking of the World Economic Forum deteriorated by six notches this year, to rank 69, the worse ever result achieved by the country. Looking at the detailed ranking, Hungary's assessment was devastating concerning the institutional system (place 114); in this field, policy instability, corruption, tax regulations, inadequately educated work force, inefficient government bureaucracy and insufficient capacity to innovate were mentioned as the main problems.

For the full year 2016, economic growth is projected to slow down to 2%. The fall in investment may decelerate in the second half of the year, and the annual change will be around -10%, with strong downward risks. Household consumption will expand dynamically and net export will be significantly positive. These latter two components of GDP will 'save the day' for the Hungarian economy this year.

In 2017 economic growth is expected to accelerate due to a turnaround in investment with much more EU transfers disbursed than this year. The government pushes hard for early disbursement of the EU funds but the already mentioned stepped-up advance payments for beneficiaries may prove to be unacceptable for the EU. Household consumption and net export will continue to play a positive role, but less so than in 2016.

Parliamentary elections are scheduled for spring 2018. A substantial fiscal stimulus to growth is a likely scenario in the election year as the current and the medium-run fiscal stance provide sufficient room for that. Consequently, both investment and consumption will increase in 2018, however, at the expense of stronger import than export growth. The fiscal deficit may deteriorate to nearly 3% of GDP. As before, low priority will be given to education and health care, with devastating consequences to be expected in the long run. A major concern for the medium- and longer-term outlook of the Hungarian economy is the planned construction of the Paks II nuclear power station envisaged to be financed by Russian credits. The profitability of this huge project is considered to be highly questionable by independent experts. Another giant project over the longer time horizon is the 2024 Olympic Games for which Budapest applied as host. If Budapest should happen to win, this would probably lead to a serious misallocation of the country's resources.

Table 13 / Hungary: Selected economic indicators

	2012	2013	2014	2015 ¹⁾	2015 January-June	2016	2016 Forecast	2017 Forecast	2018
Population, th pers., average	9,920	9,893	9,866	9,843	.	.	9,810	9,800	9,780
Gross domestic product, HUF bn, nom. ²⁾	28,661	30,127	32,400	33,999	15,749	16,309	35,500	37,400	39,600
annual change in % (real)	-1.6	2.1	4.0	3.1	3.1	1.9	2.0	2.6	2.9
GDP/capita (EUR at exchange rate)	10,000	10,300	10,600	11,100	.	.	11,700	12,100	12,700
GDP/capita (EUR at PPP)	17,200	17,800	18,800	19,700	.	.	.	.	.
Consumption of households, HUF bn, nom. ²⁾	14,922	15,207	15,730	16,205	7,898	8,278	.	.	.
annual change in % (real)	-2.2	0.2	2.5	3.4	3.1	5.0	4.0	2.5	2.5
Gross fixed capital form., HUF bn, nom. ²⁾	5,548	6,308	7,064	7,367	2,958	2,518	.	.	.
annual change in % (real)	-3.0	9.8	9.9	1.9	0.8	-15.4	-10.0	3.0	6.0
Gross industrial production									
annual change in % (real)	-1.8	1.1	7.7	7.4	7.1	2.3	2.5	6.0	7.0
Gross agricultural production									
annual change in % (real)	-10.0	12.4	11.1	-3.1	.	.	.	.	.
Construction industry									
annual change in % (real)	-6.5	8.4	13.5	3.0	7.7	-25.3	.	.	.
Employed persons, LFS, th, average	3,827	3,893	4,101	4,211	4,159	4,302	4,320	4,340	4,360
annual change in %	1.8	1.7	5.3	2.7	2.5	3.5	2.5	0.5	0.5
Unemployed persons, LFS, th, average	473	441	343	308	329	253	250	250	250
Unemployment rate, LFS, in %, average	11.0	10.2	7.7	6.8	7.4	5.6	5.5	5.5	5.5
Reg. unemployment rate, in %, end of period	12.7	9.3	8.9	7.6	8.3	6.5	.	.	.
Average monthly gross wages, HUF ³⁾	223,060	230,714	237,695	247,924	243,370	258,003	261,400	273,300	287,100
annual change in % (real, gross)	-0.9	1.7	3.2	4.4	4.0	5.9	5.0	2.5	2.5
Average monthly net wages, HUF ³⁾	144,085	151,118	155,690	162,391	159,408	171,573	171,200	179,000	188,100
annual change in % (real, net)	-3.4	3.1	3.2	4.4	4.0	7.5	5.0	2.5	2.5
Consumer prices (HICP), % p.a.	5.7	1.7	0.0	0.1	-0.3	0.2	0.4	2.0	2.5
Producer prices in industry, % p.a.	4.1	0.6	-0.4	-0.9	-1.0	-1.8	-1.5	1.0	2.0
General governm.budget, EU-def., % of GDP									
Revenues	46.2	46.9	47.2	48.3	.	.	47.5	47.5	47.5
Expenditures	48.6	49.5	49.5	50.3	.	.	49.8	50.4	50.4
Net lending (+) / net borrowing (-)	-2.3	-2.6	-2.3	-2.0	.	.	-2.3	-2.9	-2.9
Public debt, EU-def., % of GDP	78.2	76.6	75.7	74.7	.	.	74.4	74.0	73.7
Central bank policy rate, % p.a., end of period ⁴⁾	5.75	3.00	2.10	1.35	1.50	0.90	0.90	1.00	1.30
Current account, EUR mn ⁵⁾	1,752	3,892	2,181	3,714	2,052	3,302	5,000	4,900	5,000
Current account, % of GDP ⁵⁾	1.8	3.8	2.1	3.4	4.0	6.3	4.4	4.1	4.0
Exports of goods, BOP, EUR mn ⁵⁾	69,961	70,243	74,423	79,604	39,257	41,250	84,400	90,300	96,600
annual change in %	-2.6	0.4	6.0	7.0	6.8	5.1	6.0	7.0	7.0
Imports of goods, BOP, EUR mn ⁵⁾	67,028	66,912	72,051	75,237	37,073	38,317	78,600	84,100	90,600
annual change in %	-2.7	-0.2	7.7	4.4	4.2	3.4	4.5	7.0	7.7
Exports of services, BOP, EUR mn ⁵⁾	16,060	16,993	18,640	19,957	9,468	9,929	21,000	21,600	22,500
annual change in %	0.1	5.8	9.7	7.1	7.1	4.9	5.0	3.0	4.0
Imports of services, BOP, EUR mn ⁵⁾	12,263	13,232	13,732	14,562	6,823	7,024	15,100	15,600	16,200
annual change in %	-3.8	7.9	3.8	6.0	4.1	2.9	4.0	3.0	4.0
FDI liabilities (inflow), EUR mn ⁵⁾	4,405	4,986	6,868	5,964	1,306	-8,984	1,000	.	.
FDI assets (outflow), EUR mn ⁵⁾	2,310	3,848	4,035	5,565	2,316	-8,753	1,000	.	.
Gross reserves of NB, excl. gold, EUR mn	33,757	33,696	34,481	30,226	34,657	24,668	.	.	.
Gross external debt, EUR mn ⁵⁾	127,667	119,963	120,077	116,937	123,900	114,419	113,900	110,900	107,800
Gross external debt, % of GDP ⁵⁾	128.8	118.2	114.4	106.6	113.0	99.9	99.5	93.4	87.1
Average exchange rate HUF/EUR	289.25	296.87	308.71	310.00	307.43	312.70	310	315	320
Purchasing power parity HUF/EUR	168.07	171.31	174.90	175.65	.	.	.	.	.

1) Preliminary. - 2) Half-year GDP data unrevised. - 3) Enterprises with 5 and more employees. - 4) Base rate (two-week NB bill). - 5) Excluding SPE.

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