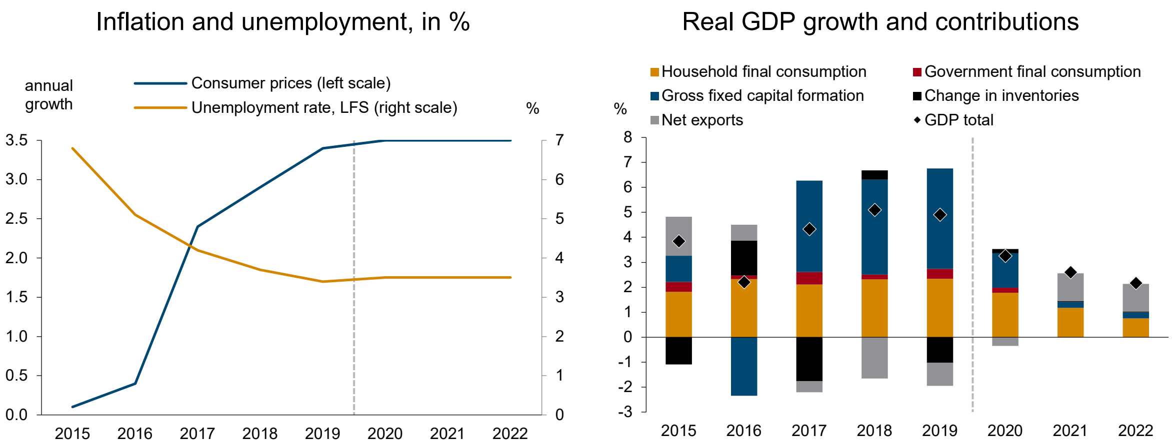
HUNGARY: After three years of high growth, what next?

SÁNDOR RICHTER

With GDP growing last year by 4.9%, the Hungarian economy turned in one of the best performances in the EU. This expansion was driven by domestic demand, primarily investments. But sustainability is the critical issue highlighted here: the economy faces reduced EU transfers, uncertainties and fragile growth in the export markets, labour shortages, rapidly rising wages and a weakening of the national currency.

Figure 6.8 / Hungary: Main macroeconomic indicators



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

Over the past three years, the Hungarian economy has moved up a gear or two, following its weak performance in the seven years after the 2008/2009 crisis. If we take the compound growth rate over the period 2017-2019, GDP expanded by 15%, at an equal pace to private consumption; and gross fixed capital formation increased by over 60%. External equilibrium gradually deteriorated over the same period, with the current account balance sliding from a surplus of over EUR 5 billion in 2016 to a (modest) deficit by 2018/2019. Net real wages (except for in small businesses with fewer than five employees) grew by close to 30% over those three years. This acceleration in growth was facilitated primarily by the heavily front-loaded utilisation of EU transfers, by a revival in domestic lending to both businesses and households and (last but not least) by a supportive international environment.

But over the forecast horizon, the outlook is much less rosy. EU transfers will plummet, due to the disproportionately heavy early utilisation of the resources from the 2014-2020 Multiannual Financial Framework of the EU and the unavoidable delay in the availability of money from the forthcoming 2021-2027 EU budget. That means that the ‘EU transfer’-component in aggregate demand (which amounted to 3.5-4% of GDP on average in the period 2017-2019) will drop by about 2 percentage points (on average) over the next three years, with 2022 being the most critical year in this respect. The consequences will show up primarily in gross fixed investments: here only a very modest expansion is forecast. The growth of private consumption is expected to slow to half of the rate experienced in the boom years. One positive side-effect of this moderating trend will be a halt to the deterioration in the external equilibrium. The relatively strong expansion of employment in recent years – an important driver of the growth we have witnessed – has reached its limit. Altogether, the compound GDP growth over the next three years will be about 8% – just over half of the increase recorded in 2017-2019.

We can expect some moderation of real wage growth over the forecast period. A strong deceleration in investment and a general slowdown in economic activity will go some way toward easing labour shortages on the demand side. However, a possible new wave of outward migration could mitigate this effect. After the soaring real wages of the past three years, it is almost inconceivable that many privately owned small and medium-sized enterprises (SMEs) could withstand a further strong rise in wages.

The shortage of labour has been and, despite of some expected relief, will remain a serious challenge. Back in 2018, the government amended the labour law to enable employers to increase the maximum number of overtime hours from 250 to 400 a year. The time frame for paying overtime compensation was also extended to 36 months. And as an alternative to paid compensation, employers could opt to provide days of leave. The move was quite extreme, as it potentially allows the reintroduction of a six-day working week. This so-called 'Slave Law' was extremely unpopular, but the (initially fierce) protests died down within a few weeks. A further response by the government to the shortage of labour has been to offer tacit support to inward labour migration. While the government's propaganda machine continues to deploy strong anti-immigration rhetoric, the government itself has opened the door wider to labour immigration. Foreign workers have been arriving mainly from the non-Middle East countries (this area being the main target for the government's anti-migration campaigns) – above all from Ukraine and Serbia, followed by China, Vietnam and India.

The primary reaction of enterprises in sectors where the labour shortage is most acute has been to increase per capita working time. The proper strategic response ought to be to increase productivity, but here the traditional 'duality' of the Hungarian economy plays an important role. Research by the Budapest-based Centre for Economic and Regional Studies shows that in the export-oriented part of the economy (export-oriented industries and business services) productivity has increased greatly since 1995, whereas in the domestic-oriented segment (mainly Hungarian-owned SMEs), after a dynamic increase between 1995 and 2008, productivity has stagnated.

The weakening of the Hungarian currency has hampered the domestic-oriented sector. In order to raise productivity, these firms would need to import machinery and production inputs – but such things have become increasingly expensive. The weak forint is assisting the export-oriented sector, in as much as rising forint wages are less of a burden for firms that calculate their revenues and costs in euro terms.

The forint weakened further in the first two months of 2020. There were several reasons for this: extremely low (actually negative) real interest rates (a policy rate of 0.9% and 4.7% CPI inflation in January); the evaporation of the current account surplus; and global uncertainties leading to increased risk aversion. The low interest rates promote the use of HUF in carry trade transactions, where Hungarian resources are invested in countries with high yields (e.g. Mexico). The volatility of the exchange rate has been underpinned by the central bank's rigid adherence to its ultra-loose monetary policy. Nevertheless, when the exchange rate passed HUF 340 to the euro on 12 February, the central bank took a first step towards a less relaxed monetary policy, initiating liquidity-reducing operations via FX swap tenders, leading to higher interbank rates.

This year, we forecast that GDP growth will amount to 3.3%. This will be followed by a further moderation to 2.6% in 2021, and then 2.2% in 2022. In particular gross fixed capital formation will be much less robust than it was in the previous three years. The current account will be close to balanced. The current acceleration in inflation will moderate over the year, and the CPI is expected to remain at around 3.5% over the forecast horizon. Uncertainties concerning the global automotive industry could influence growth prospects in either a negative or a positive way.

Table 6.8 / Hungary: Selected economic indicators

	2015	2016	2017	2018	2019 1)	2020	2021 Forecast	2022
Population, th pers., average	9,843	9,814	9,788	9,776	9,720	9,700	9,670	9,620
Gross domestic product, HUF bn, nom.	34,785	35,896	38,835	42,662	46,200	49,200	52,100	54,900
annual change in % (real)	3.8	2.2	4.3	5.1	4.9	3.3	2.6	2.2
GDP/capita (EUR at PPP)	20,100	19,800	20,600	21,900	23,500	.	.	.
Consumption of households, HUF bn, nom.	16,418	17,253	18,497	19,970	21,640	.	.	.
annual change in % (real)	3.7	4.9	4.4	4.9	5.0	3.8	2.5	1.6
Gross fixed capital form., HUF bn, nom.	7,750	7,058	8,632	10,739	12,860	.	.	.
annual change in % (real)	4.8	-10.6	18.7	17.1	16.0	5.5	1.0	1.0
Gross industrial production								
annual change in % (real)	7.4	0.9	4.7	3.5	5.4	5.0	4.0	4.0
Gross agricultural production								
annual change in % (real)	-2.4	9.4	-4.1	2.7	-0.7	.	.	.
Construction industry								
annual change in % (real)	3.0	-18.9	29.7	21.2	22.0	.	.	.
Employed persons, LFS, th, average	4,211	4,352	4,421	4,470	4,512	4,530	4,535	4,540
annual change in %	2.7	3.4	1.6	1.1	1.0	0.3	0.1	0.1
Unemployed persons, LFS, th, average	308	235	192	172	160	160	160	160
Unemployment rate, LFS, in %, average	6.8	5.1	4.2	3.7	3.4	3.5	3.5	3.5
Reg. unemployment rate, in %, eop	7.6	6.1	5.6	5.2	5.1	.	.	.
Average monthly gross wages, HUF 2)	247,924	263,171	297,017	329,943	367,400	399,300	422,400	443,700
annual change in % (real, gross)	4.4	5.7	10.3	8.3	7.7	5.0	2.2	1.5
Average monthly net wages, HUF 2)	162,391	175,009	197,516	219,412	244,300	265,500	280,800	295,000
annual change in % (real, net)	4.4	7.4	10.3	8.3	7.7	5.0	2.2	1.5
Consumer prices (HICP), % p.a.	0.1	0.4	2.4	2.9	3.4	3.5	3.5	3.5
Producer prices in industry, % p.a.	-1.1	-1.7	3.3	5.6	2.1	3.2	3.0	3.0
General governm.budget, EU-def., % of GDP								
Revenues	48.7	45.4	44.6	44.4	44.5	44.0	45.0	45.0
Expenditures	50.6	47.2	47.0	46.7	46.2	45.6	47.9	47.9
Net lending (+) / net borrowing (-)	-2.0	-1.8	-2.4	-2.3	-1.7	-1.6	-2.9	-2.9
General gov.gross debt, EU def., % of GDP	76.1	75.5	72.9	70.2	69.1	68.2	67.5	67.0
Stock of loans of non-fin.private sector, % p.a.	-12.3	-1.3	5.5	10.6	13.2	.	.	.
Non-performing loans (NPL), in %, eop 3)	13.6	10.8	7.5	5.4	4.5	.	.	.
Central bank policy rate, % p.a., eop 4)	1.35	0.90	0.90	0.90	0.90	1.20	1.50	1.70
Current account, EUR mn 5)	2,648	5,209	2,830	-717	-359	-200	0	200
Current account, % of GDP 5)	2.4	4.5	2.3	-0.5	-0.3	-0.1	0.0	0.1
Exports of goods, BOP, EUR mn 5)	78,477	78,588	85,555	88,626	92,563	96,700	102,500	107,600
annual change in %	6.3	0.1	8.9	3.6	4.4	4.5	6.0	5.0
Imports of goods, BOP, EUR mn 5)	74,425	74,630	83,646	90,280	94,757	99,900	105,900	111,200
annual change in %	3.8	0.3	12.1	7.9	5.0	5.4	6.0	5.0
Exports of services, BOP, EUR mn 5)	20,286	21,878	23,862	24,991	25,887	27,200	28,800	30,200
annual change in %	8.1	7.9	9.1	4.7	3.6	5.0	6.0	5.0
Imports of services, BOP, EUR mn 5)	15,378	15,753	16,618	17,466	17,753	18,600	19,700	20,700
annual change in %	8.4	2.4	5.5	5.1	1.6	5.0	6.0	5.0
FDI liabilities, EUR mn 5)	7,192	-5,851	7,208	8,469	3,655	5,000	.	.
FDI assets, EUR mn 5)	5,753	-8,414	5,044	5,657	543	3,000	.	.
Gross reserves of NB excl. gold, EUR mn	30,226	24,384	23,261	26,273	27,010	.	.	.
Gross external debt, EUR mn 5)	119,339	110,940	105,583	107,218	107,000	107,000	107,000	107,000
Gross external debt, % of GDP 5)	106.4	96.3	84.1	80.1	75.3	72.9	69.8	67.2
Average exchange rate HUF/EUR	310.00	311.44	309.19	318.89	325.30	335	340	345

1) Preliminary and wiiw estimates. - 2) Enterprises with 5 and more employees. From 2019 based on tax administration data, survey data before. - 3) Loans more than 90 days overdue, and from 2016 also including loans unlikely to be paid. - 4) Base rate (two-week NB bill). - 5) Excluding SPE.

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