
# HUNGARY: Cold turkey after EU bonanza?

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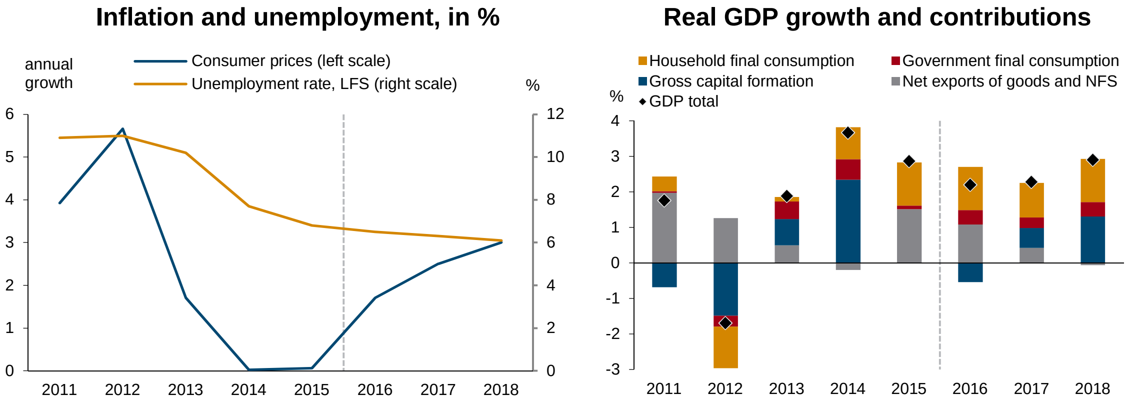
**In 2015 Hungarian GDP increased by 2.9%, aided by a peak inflow of cohesion policy transfers from the EU. In 2016, EU transfers will decline sharply. Despite government measures to offset the anticipated negative impact, the outcome will be deceleration of economic growth in the current year, followed by slow recovery in 2017 and 2018.**

**Figure 43 / Hungary: main macroeconomic indicators**




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

The Hungarian GDP increased by 2.9% in 2015. This is a much better result than the last five years' average performance, but it lags behind the 3.7% GDP expansion in 2014 and it is also less impressive than the growth rates in the Visegrad group peer countries. Also the nature of economic growth in 2015 was different from that in the previous year. In 2014 gross capital formation had been the most important driver of expansion, followed by private consumption, and the contribution of net exports turned slightly negative. In 2015 private consumption remained as relevant as in the previous year, but the role of net exports shifted strongly to the positive field, while gross fixed capital formation did not contribute to economic growth at all. Provisional data indicate that economic growth was broadly based last year, encompassing all major branches except for agriculture.

Developments in the Hungarian economy in 2013-2015 were heavily influenced by the inflow of EU transfers: The typical cyclicality of cohesion policy related disbursement of EU transfers has been especially strong in the case of Hungary. After very modest beginnings due to the reorganisation of the institutional background of EU payments, there came a highly successful finish in 2013-2015. Net transfers from the EU amounted to 5.4% and 5.3% of GDP in 2013 and 2014, respectively, and may have reached 6% in 2015. The exceptionally high GDP growth in 2014 was fostered by the coincidence of EU co-financed investments with an investment boom in the predominantly foreign-owned automobile cluster. In 2015 this latter component was missing, and the attitude towards investing of the predominantly domestically owned firms in the SME sector remained as reluctant as in the past five years. EU co-financed capital transfers for the public sector have financed at least half of public investment in Hungary since 2011; the respective share in the private sector has remained below 10%. According to central bank estimations, EU transfers disbursed to the government in 2015 amounted to about 3% of the GDP (central government 1.7%, municipalities 1.3%). Further transfers, amounting also to close to 3% of GDP, were absorbed by the non-financial business sector (2.2%) and the non-profit sector plus households (0.7%). These figures also reveal how EU transfers helped keep the general government deficit at about 2% relative to GDP last year. *Ceteris paribus*, the budget deficit would have been around 5% of GDP without the EU transfers, while keeping the deficit at the 2% level would have required cancelling about half of the public investment projects.

The expected decline in EU transfers by 1.5% to 2.5% of GDP will have a decisive influence on growth in 2016. The key question therefore is to what extent the government will be able to offset this loss by economic policy measures.

The government announced an unusual plan to mitigate the problem: all potentially available EU resources under the 2014-2020 MFF will have to be allocated by early 2019. That means that the potential disbursement period 2016-2022 will be compressed to three years (2016-2018). As the EU transfers cannot be drawn so quickly, beneficiaries would receive payments from the national budget and the respective sum would be collected later from the EU budget. Whether the realisation of this plan would allow keeping the general government deficit below 3% in the critical years remains an open question, just as whether the administrative capacities are prepared for the efficient management of such an accelerated pace of disbursements. Not less important are the doubts concerning the capacity of the economy to absorb and efficiently utilise such an immense inflow within a very short period. The biggest problem, however, will emerge in the medium term: the ‘cold turkey’ effect that will set in unavoidably in the years 2020-2022 when practically nothing would be left of the EU resources. However, this problem lies beyond the horizon of the current legislative period.

The government also has other weapons to deploy against the negative impact of the low tide of EU transfers. The first is a new family housing allowance. Those undertaking to have three children may receive a HUF 10 million (about EUR 32,000) grant for buying a new home or buying or refurbishing used apartments. Beyond that grant, families with three or more children will have access to a state-subsidised housing loan of up to HUF 10 million with an interest rate of 3% at most. Applicants are expected to have a job or another insured status and may have no criminal record. Important details of the scheme are not cleared yet, but it may give a boost to real estate transactions and the construction industry. A big unknown of the generous scheme is its impact on the budget.

By another measure aimed at boosting growth, the levy on banks has been lowered from 0.53% to 0.31% in 2016, resulting in an approximately 40% decrease of the respective burden on the banks. The government also promised to refrain from policy measures with a negative impact on banking sector profitability, including any new debt relief schemes. In addition, the central bank initiated its new Market-Based Lending Programme, which will prize actively lending banks with higher deposit interest rates, preferential capitalisation requirements and high interest rate swaps (HIRS). The central bank expects an 8% to 10% upturn in loans for the SME sector; this would be a better performance than the one achieved through its earlier Credit for Growth Scheme.

The situation in the labour market is fairly complex. Employment has been on the rise and the unemployment rate is sinking. While this is to a considerable extent explained by the increasing number of participants in public workfare and by counting a part of the persons working abroad as a constituent of the domestically employed, there has in fact been a significant expansion of employment in the business sector as well. A relatively new but rapidly growing concern is the chronic shortage of labour. In 2015, more than 20% of enterprises/institutions in the manufacturing and health care sectors reported that they could not fill vacancies due to the insufficient number and/or qualification of available labour force. Over 10% is the respective rate in the transport, construction, tourism and catering sectors.[48] This is especially critical for regions relatively close to the Austrian border, where commuting is easy and attainable wages in Austria are much higher. Due to low intra-country mobility, job vacancies in the West of Hungary are not filled by migrants from the Eastern part of the country. The low wages in Hungary, which may attract foreign investment, induce well-skilled persons to seek better-paid jobs abroad. The Hungarian educational system (both the secondary and the tertiary levels) produces young adults with a knowledge that is in many cases inconsistent with the needs of the business sector. There is no sign of the hoped-for deceleration of outward migration, and this, coupled with the unfavourable demographic trends and the government’s strong opposition to inward migration, projects growing tensions on the Hungarian labour market in the years ahead.

Despite all the government programmes, economic growth in 2016 will be 0.7 percentage points lower than the year before, at around 2.2%. In 2017 and 2018 investment will gain momentum as again more EU transfers will arrive. This will help attain a somewhat higher GDP growth rate in both years. Nevertheless, we deem the extreme acceleration of cohesion policy related disbursements envisioned by the government as unrealistic. As to foreign trade, 2015 was an exceptionally good year in this respect, with a record trade surplus thanks to the favourable external environment, good performance of the foreign capital dominated automotive cluster and improving terms of trade due to depressed prices of imported energy. In 2016 net exports will remain an important pillar of growth, even if to a smaller extent than last year. Household consumption may grow at the same pace as in 2015 on account of modestly expanding employment, lower credit burden on households after the settlement of foreign exchange loans and the continuous increase in transfers from Hungarians working abroad.

A downward risk to medium-term growth is the government’s recently announced intention to approach a zero budget deficit in 2017. The 2015 convergence programme still projected a GDP-proportional deficit of 1.7% for 2017 and 1.6% for 2018. Not even the IMF urges the government to achieve a zero deficit as early as 2017. Any steps taken to realise this plan would have a negative impact on aggregate demand, employment and economic growth.

[48] Index, 2 November 2015.

## Table 12 / Hungary: selected economic indicators

| | 2011 | 2012 | 2013 | 2014 | 2015 1) | 2016 | 2017 Forecast | 2018 |
|---|---|---|---|---|---|---|---|---|
| Population, th pers., average | 9,972 | 9,920 | 9,893 | 9,863 | 9,830 | 9,810 | 9,800 | 9,780 |
| Gross domestic product, HUF bn, nom. | 28,134 | 28,628 | 30,065 | 32,180 | 33,600 | 35,200 | 37,000 | 39,200 |
| annual change in % (real) | 1.8 | -1.7 | 1.9 | 3.7 | 2.9 | 2.2 | 2.3 | 2.9 |
| GDP/capita (EUR at exchange rate) | 10,100 | 10,000 | 10,200 | 10,600 | 11,000 | 11,400 | 12,000 | 12,700 |
| GDP/capita (EUR at PPP) | 17,100 | 17,200 | 17,700 | 18,600 | 19,800 | . | . | . |
| Consumption of households, HUF bn, nom. | 14,341 | 14,889 | 15,226 | 15,651 | 16,300 | . | . | . |
| annual change in % (real) | 0.8 | -2.3 | 0.2 | 1.8 | 2.5 | 2.5 | 2.0 | 2.5 |
| Gross fixed capital form., HUF bn, nom. | 5,569 | 5,548 | 6,160 | 6,971 | 7,120 | . | . | . |
| annual change in % (real) | -1.3 | -4.4 | 7.3 | 11.2 | 0.5 | -3.5 | 3.0 | 6.0 |
| Gross industrial production | | | | | | | | |
| annual change in % (real) | 5.6 | -1.8 | 1.1 | 7.7 | 7.5 | 4.5 | 6.0 | 7.0 |
| Gross agricultural production | | | | | | | | |
| annual change in % (real) | 11.1 | -10.0 | 12.4 | 11.1 | -3.1 | . | . | . |
| Construction industry | | | | | | | | |
| annual change in % (real) | -8.0 | -6.6 | 8.4 | 13.6 | 3.0 | . | . | . |
| Employed persons, LFS, th, average 2) | 3,812 | 3,827 | 3,893 | 4,101 | 4,211 | 4,250 | 4,270 | 4,290 |
| annual change in % | 0.8 | 1.8 | 1.7 | 5.3 | 2.7 | 1.0 | 0.5 | 0.5 |
| Unemployed persons, LFS, th, average 2) | 468 | 473 | 441 | 343 | 308 | 300 | 290 | 280 |
| Unemployment rate, LFS, in %, average 2) | 10.9 | 11.0 | 10.2 | 7.7 | 6.8 | 6.5 | 6.3 | 6.1 |
| Reg. unemployment rate, in %, end of period | 12.4 | 12.7 | 9.2 | 8.7 | 7.5 | . | . | . |
| Average monthly gross wages, HUF 3) | 213,094 | 223,060 | 230,714 | 237,695 | 247,784 | 257,500 | 270,500 | 286,700 |
| annual change in % (real, gross) | 1.3 | -0.9 | 1.7 | 3.2 | 4.3 | 2.2 | 2.5 | 2.9 |
| Average monthly net wages, HUF 3) | 141,151 | 144,085 | 151,118 | 155,690 | 162,300 | 168,900 | 177,500 | 188,100 |
| annual change in % (real, net) | 2.4 | -3.4 | 3.1 | 3.2 | 4.3 | 2.3 | 2.5 | 2.9 |
| Consumer prices (HICP), % p.a. | 3.9 | 5.7 | 1.7 | 0.0 | 0.1 | 1.7 | 2.5 | 3.0 |
| Producer prices in industry, % p.a. | 4.1 | 4.1 | 0.6 | -0.4 | -0.9 | 0.5 | 1.5 | 2.0 |
| General governm.budget, EU-def., % of GDP | | | | | | | | |
| Revenues | 44.3 | 46.3 | 47.0 | 47.4 | 48.2 | 47.5 | 47.5 | 47.5 |
| Expenditures | 49.7 | 48.6 | 49.5 | 49.9 | 50.2 | 50.0 | 50.4 | 50.4 |
| Net lending (+) / net borrowing (-) | -5.5 | -2.3 | -2.5 | -2.5 | -2.0 | -2.5 | -2.9 | -2.9 |
| Public debt, EU-def., % of GDP | 80.8 | 78.3 | 76.8 | 76.2 | 75.5 | 75.3 | 74.0 | 73.0 |
| Central bank policy rate, % p.a., end of period 4) | 7.00 | 5.75 | 3.00 | 2.10 | 1.35 | 1.35 | 1.70 | 2.00 |
| Current account, EUR mn 5) | 754 | 1,752 | 4,036 | 2,356 | 5,474 | 4,900 | 4,800 | 5,000 |
| Current account, % of GDP | 0.7 | 1.8 | 4.0 | 2.3 | 5.0 | 4.4 | 4.1 | 4.0 |
| Exports of goods, BOP, EUR mn | 71,793 | 69,961 | 72,000 | 74,768 | 80,868 | 86,500 | 92,600 | 99,100 |
| annual change in % | 8.6 | -2.6 | 2.9 | 3.8 | 8.2 | 7.0 | 7.0 | 7.0 |
| Imports of goods, BOP, EUR mn | 68,868 | 67,028 | 68,603 | 72,167 | 76,544 | 81,400 | 87,200 | 93,900 |
| annual change in % | 8.4 | -2.7 | 2.4 | 5.2 | 6.1 | 6.3 | 7.1 | 7.7 |
| Exports of services, BOP, EUR mn | 16,039 | 16,060 | 17,039 | 18,623 | 19,481 | 20,500 | 21,300 | 22,300 |
| annual change in % | 9.5 | 0.1 | 6.1 | 9.3 | 4.6 | 5.0 | 4.0 | 4.5 |
| Imports of services, BOP, EUR mn | 12,752 | 12,263 | 13,047 | 13,514 | 13,926 | 14,500 | 14,900 | 15,400 |
| annual change in % | 6.2 | -3.8 | 6.4 | 3.6 | 3.0 | 4.0 | 3.0 | 3.5 |
| FDI liabilities (inflow), EUR mn | 4,429 | 4,405 | 4,834 | 6,309 | 966 | 1,000 | . | . |
| FDI assets (outflow), EUR mn | 3,458 | 2,310 | 3,807 | 3,587 | 1,665 | 1,000 | . | . |
| Gross reserves of NB, excl. gold, EUR mn | 37,655 | 33,757 | 33,696 | 34,481 | 30,226 | . | . | . |
| Gross external debt, EUR mn 5) | 135,351 | 127,667 | 119,727 | 119,382 | 117,600 | 112,900 | 109,200 | 105,800 |
| Gross external debt, % of GDP | 134.4 | 129.0 | 118.2 | 114.5 | 108.5 | 101.0 | 93.0 | 85.0 |
| Average exchange rate HUF/EUR | 279.37 | 289.25 | 296.87 | 308.71 | 310.00 | 315 | 315 | 315 |
| Purchasing power parity HUF/EUR | 165.46 | 168.07 | 171.31 | 174.90 | 172.63 | . | . | . |

1) Preliminary and wiiw estimates. - 2) From 2012 according to census 2011. - 3) Enterprises with 5 and more employees. -
4) Base rate (two-week NB bill). - 5) Excluding SPE - valid for all BOP items and gross external debt.

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