HUNGARY: EU co-financed investment boom, surging wages, shrinking trade surplus

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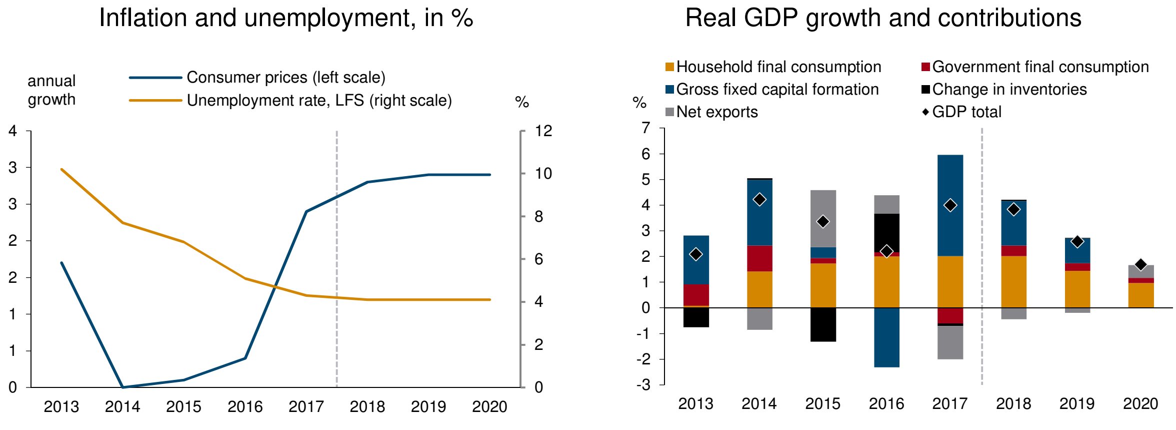
Economic growth in 2017 amounted to 4%, with household consumption growing quicker than GDP, reflecting the dynamic expansion of real wages. Investments increased by about 20% as a direct consequence of the accelerated allocation of EU cohesion policy-related resources to recipients. The other side of the coin was the strong deterioration in the foreign trade balance. Economic growth remains dynamic this year, though a deceleration is expected from 2019 on, closely related to the depletion of EU resources due to a deliberate excessive utilisation of the respective resources in 2017-2019.

Figure 47 / Hungary: Main macroeconomic indicators



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

According to preliminary data, economic growth in 2017 amounted to 4%, Hungary's best result since 2014, although somewhat weaker than the EU-CEE average. As in 2015 and 2016, the pace of increase in household consumption exceeded that of GDP. In part, this reflects the very dynamic growth in real wages in the last two years. Gross fixed capital formation recorded a huge turnaround: from a decline of over 10% in 2016, investments increased by about 20% in 2017, as a direct consequence of the accelerated allocation of EU cohesion policy-related resources to recipients. The EU resources-driven expansion of investment, complemented by a revival in long-flagging homebuilding, is reflected in the outstanding performance of the construction sector as well. Investment growth was well below the national average in the business sector. In industry, a much less EU resources-dependent sector of the economy, growth in value added was around 7%; but in weather-dependent agriculture, a strong decline was registered. The services sector expanded in line with GDP growth, with laggard sub-sectors like public administration, education and health care recording a decline.

Strong expansion of investments and household consumption left a visible impact on foreign trade. In goods trade, the growth rate of exports lagged about 3 percentage points behind that of imports. The discrepancy may have been smaller in foreign trade in services. All in all, the balance of goods and services is assumed to have deteriorated by about EUR 1.5 billion. Despite this deterioration, the trade balance remained highly positive (about EUR 10 billion). Nevertheless the contribution of foreign trade to GDP growth has turned negative (-1.3 percentage points).

In 2018, the dynamic increase in wages will continue for a third consecutive year. The compound growth rate of net real wages in 2016-2018 will be around 28%. Behind this development, we find the effect of compulsory minimum wage rises in the previous year and this year, and the ever-increasing shortage of labour, particularly skilled labour. Respondents in company surveys name the labour shortage as the most important obstacle to expansion of their businesses. Obligatory minimum wage rises make the life of SMEs operating with low productivity difficult, especially in less developed regions of the country, where the share of employees on the minimum wage is especially high and where the increase in purchasing power of households and businesses alike does not keep pace with that in the more developed parts of the country.

Inflation, though, accelerated from nearly zero in 2014-2016, and will remain close to 3% annually over the forecast horizon. Meanwhile, the impact of the strong wage rises has been relatively small. The reason for this is that, with the higher mandatory minimum wage, there has been no proportional increase in the disposable income of a considerable part of those employees affected: what was previously often an unreported part of employee compensation has now started to be reported, appearing in the wage statistics for the first time, but not increasing actual demand. This is also one reason why the expansion of household consumption lags far behind that of wages. Furthermore, increased purchasing power was matched mostly by increasing imports, narrowing the trade surplus but reducing inflationary pressures. A reduction in the VAT rate on a few important items and a cut in the social contribution tax rate for employers in both 2017 and 2018 have helped curb inflation.

While a general election is just around the corner (8 April) macroeconomic topics have been missing from the election campaign. The ruling Fidesz party's campaign is organised around combating fabricated enemies: George Soros, 'Brussels', illegal migrants/refugees. It involves agitation, relying on fear-based hostility toward those 'enemies', as well as the opposition parties and NGOs critical of the government. The opposition parties are preoccupied with addressing the government's increasingly autocratic tendencies, the declining state of health care and education, 'status-enhancing' projects and, above all, signs of increasing corruption. Public opinion polls suggest a victory for Viktor Orbán's Fidesz, perhaps even with a constitutional (two-thirds) majority, and therefore a continuation of current economic policy is the likely scenario in the short run. Nevertheless, in 2019 or 2020 at the latest, a low-water mark for EU cohesion policy transfers will be reached, posing a challenge for the Hungarian government. A significant part of aggregate demand will drop out, requiring a fiscal and monetary policy response. A similar low level occurred in 2016, leading to a deceleration of economic growth and a deep fall in investment. A considerable difference between the two episodes is that the 2016 event lasted only about a year, and the subsequent continued influx of EU transfers had already been secured. This time, though, the forthcoming episode will be less condensed in time, due to the forced allocation of EU co-financed resources in the first half of the seven-year planning period. The 'lean years' will be 2019, but mainly 2020 and 2021. Moreover, in this case, a revival of EU resources coinciding with the start of the new seven-year financing period of the EU in 2021 is far from assured. Less ample resources after Brexit, possible new spending priorities, dissatisfaction with Hungary's (and other Visegrad countries') compliance with EU policies regarding refugees, and last but not least, the issue of corruption may substantially reduce the available resources from the EU budget. That may mean no return to the comfortable expansion of aggregate demand with EU support.

Summarising our forecast, after relatively strong GDP growth in 2017 and 2018 (4.0% and 3.8%) driven by both strong expansion of investment and household consumption, economic growth is projected to lose momentum. As a consequence of substantially diminished cohesion policy resources from the EU budget and constraints on further strong expansion of household consumption, the pace of economic growth will decelerate to 2.6% in 2019 and 1.7% in 2020. The trade surplus will further shrink this year. The slowdown in economic growth will help curb a further deterioration in the trade balance; by 2020 net exports will again become a driver of expansion. Inflation will remain at around 3% over the forecast horizon, with the risk of upward movement. The general government budget deficit will be kept below the 3% Maastricht threshold, and public debt is expected to decrease marginally.

Table 17 / Hungary: Selected economic indicators

	2013	2014	2015	2016	2017 1)	2018	2019 Forecast	2020
Population, th pers., average	9,893	9,866	9,843	9,814	9,780	9,750	9,720	9,700
Gross domestic product, HUF bn, nom.	30,247	32,592	34,324	35,420	37,900	40,700	43,100	45,200
annual change in % (real)	2.1	4.2	3.4	2.2	4.0	3.8	2.6	1.7
GDP/capita (EUR at PPP)	18,000	18,800	19,800	19,700	20,600	.	.	.
Consumption of households, HUF bn, nom.	15,311	15,874	16,377	17,020	18,250	.	.	.
annual change in % (real)	0.2	2.8	3.6	4.2	4.2	4.2	3.0	2.0
Gross fixed capital form., HUF bn, nom.	6,308	7,223	7,525	6,812	8,445	.	.	.
annual change in % (real)	9.8	12.3	1.9	-10.6	20.5	9.0	5.0	0.0
Gross industrial production								
annual change in % (real)	1.1	7.7	7.4	1.0	4.8	5.0	4.0	4.0
Gross agricultural production								
annual change in % (real)	12.5	11.4	-2.4	9.3	-6.1	.	.	.
Construction industry								
annual change in % (real)	8.4	13.5	3.0	-18.8	29.5	.	.	.
Employed persons, LFS, th, average	3,893	4,101	4,211	4,352	4,421	4,440	4,440	4,440
annual change in %	1.7	5.3	2.7	3.4	1.6	0.5	0.0	0.0
Unemployed persons, LFS, th, average	441	343	308	235	192	190	190	190
Unemployment rate, LFS, in %, average	10.2	7.7	6.8	5.1	4.2	4.1	4.1	4.1
Reg. unemployment rate, in %, eop	9.3	8.9	7.6	6.1	5.6	.	.	.
Average monthly gross wages, HUF 2)	230,714	237,695	247,924	263,171	290,300	319,300	338,400	358,700
annual change in % (real, gross)	1.7	3.2	4.4	5.7	7.6	7.0	3.0	3.0
Average monthly net wages, HUF 2)	151,118	155,690	162,391	175,009	197,700	219,500	232,600	246,500
annual change in % (real, net)	3.1	3.2	4.4	7.4	10.2	8.0	3.0	3.0
Consumer prices (HICP), % p.a.	1.7	0.0	0.1	0.4	2.4	2.8	2.9	2.9
Producer prices in industry, % p.a.	0.6	-0.4	-0.9	-1.7	3.3	2.0	1.0	1.0
General governm.budget, EU-def., % of GDP								
Revenues	46.6	46.8	48.2	44.8	48.3	47.5	47.7	47.7
Expenditures	49.3	49.5	50.2	46.7	50.4	50.4	50.4	50.4
Net lending (+) / net borrowing (-)	-2.6	-2.7	-2.0	-1.9	-2.1	-2.9	-2.7	-2.7
General gov.gross debt, EU def., % of GDP 3)	76.0	75.2	74.7	73.9	72.9	73.2	72.4	71.9
Stock of loans of non-fin.private sector, % p.a.	-4.4	-0.3	-12.3	-1.3	5.4	.	.	.
Non-performing loans (NPL), in %, eop	17.7	16.7	13.5	8.9	6.0	.	.	.
Central bank policy rate, % p.a., eop 4)	3.00	2.10	1.35	0.90	0.90	1.00	1.50	2.00
Current account, EUR mn 5)	3,892	1,587	3,838	6,967	4,637	4,100	3,500	3,800
Current account, % of GDP 5)	3.8	1.5	3.5	6.1	3.8	3.2	2.6	2.7
Exports of goods, BOP, EUR mn 5)	70,243	73,826	79,638	80,188	88,203	94,800	100,500	105,500
annual change in %	0.4	5.1	7.9	0.7	10.0	7.5	6.0	5.0
Imports of goods, BOP, EUR mn 5)	66,912	71,701	75,236	75,482	85,284	93,000	99,500	104,500
annual change in %	-0.2	7.2	4.9	0.3	13.0	9.0	7.0	5.0
Exports of services, BOP, EUR mn 5)	16,993	18,727	20,289	21,659	22,367	24,000	25,400	26,700
annual change in %	5.8	10.2	8.3	6.8	3.3	7.5	6.0	5.0
Imports of services, BOP, EUR mn 5)	13,232	14,120	14,885	14,892	15,714	17,100	18,300	19,200
annual change in %	7.9	6.7	5.4	0.0	5.5	9.0	7.0	5.0
FDI liabilities, EUR mn 5)	4,986	7,134	6,667	-7,140	5,430	.	.	.
FDI assets, EUR mn 5)	3,848	4,186	5,574	-9,052	3,299	.	.	.
Gross reserves of NB excl. gold, EUR mn	33,696	34,481	30,226	24,384	23,261	.	.	.
Gross external debt, EUR mn 5)	119,963	121,129	118,613	109,411	109,000	107,000	105,000	101,000
Gross external debt, % of GDP 5)	117.7	114.7	107.1	96.2	88.9	82.3	77.2	71.3
Average exchange rate HUF/EUR	296.87	308.71	310.00	311.44	309.19	313	317	319

1) Preliminary and wiiw estimates. - 2) Enterprises with 5 and more employees. - 3) Data until 2017 exclude debt of Eximbank, from 2018 including debt of Eximbank. - 4) Base rate (two-week NB bill). - 5) Excluding SPE.

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