China-CEE Institute
中国—中东欧研究院

ISSN: 2560-1601

Vol. 2, No. 2 (HU)

December 2017

Weekly Briefing

Hungary Economy briefing:

Briefing on Hungarian Economy in 2017

Csaba Moldicz

China-CEE Institute

Kiadó: Kína-KKE Intézet Nonprofit Kft.

Szerkesztésért felelős személy: Chen Xin

Kiadásért felelős személy: Huang Ping

1052 Budapest Petőfi Sándor utca 11.

+36 1 5858 690

office@china-cee.eu

china-cee.eu

The fundamentals of the Hungarian economy have further improved over the last eleven months. Sound public budget, relatively fast economic growth rate, slowly decreasing public debt have featured the Hungarian economy, however, labor shortages are new phenomena in Hungary, and inflation is slowly picking up, thus forcing the Central Bank of Hungary to raise interest rates and creating a different economic environment in the medium and long-term.

The Hungarian economy grew rapidly in the first three quarters of 2017. During this nine months, economic growth was mainly driven by two determinants: the robust growth of the private consumption and investment fueled gross domestic product, while net export decreased slightly in comparison to last year's first three quarters, reflecting strong and growing domestic demand. According to the first estimates of the Hungarian Statistical Bureau (KSH), the economy accelerated by 3.8 percent in the first three quarters of 2017. According to other forecasts, the Hungary economy will grow by around 3.8 percent in 2017. That economic growth rate would surpass the EU and CE regional average, however, Polish, Romanian, Latvian and the Czech economy would accelerate faster in 2017. The output of manufacturing (105 percent, 100 percent=previous year's output), construction (122 percent), retail trade (106 percent), and tourism would be higher than the Hungarian average, while agriculture, mainly due to the weather, would underperform over the last year, thus its output would fall by around 10 percent in 2017 according to the GKI Zrt.'s forecast.

Looking at the consumption side of the gross domestic product (GDP), private consumption and investment were the main driving forces behind the extremely fast expansion of the Hungarian economy, whereas import growth (8.0 percent compared to last year) would be slightly higher than the rise in

export (6.5 percent), thus decreasing surpluses on the external trade balance, the GKI Zrt. maintains. Data corroborate this forecast until August 2017, since export grew by 10 percent, while import expanded by 14 percent on a year on year basis over this period. In September 2017, trade surpluses reached 928 billion euros while the same indicator was 36 billion larger a year before.

In 2017, the rapid economic development of the Hungarian economy was bolstered by the favorable world economy trends and regional economic environment conditions. In spite of a positive outlook on the world economy growth, there are clear downside risks with regard to future developments (unpredictable foreign policy of the Trump-administration and its implications on the foreign trade and investment, the need for a reshaped euro zone, the state of the Greek and Italian public finances, internal political tensions between Eastern and Western European countries of the EU etc.), however for the time being, these risks do not have adverse implications on growth rates.

According to different estimates, gross wages would increase by 13 percent in 2017, while real wages would improve by 10-11 percent. These increases are mainly driven by labor shortages, in particular, in manufacturing, but in many other sectors as well. Wages pressures also come from the public sector. In addition, minimal wages were increased by 25 percent in 2017, while guaranteed minimum wages were raised by 15 percent. Due to the positive developments in the labor market, unemployment rate fell to a never-seen 4.2 percent. The record low unemployment rate can be explained by migration, not shown in the statistics, leading to the labor shortages, and the robust economic growth. The Hungarian government introduced a public work scheme in 2013, which did not allow for automatic unemployment benefits, but required public work from the jobless. Back then, these measures were criticized heavily by economic analysts. In 2017, as a result of government measures, the number of public workers significantly dropped, and the difference was absorbed by the private labor market which vividly shows the scheme reached its purpose, goals were achieved and brought unemployed people back to the labor market. At the

same time, it must be clearly stressed that labor shortages and increases in wages will restrain future perspectives of growth in the years to come. Along with wages, prices are on the rise, in the first half of the 2017, HICP inflation accelerated to 2.3 percent on year on year bases. The inflation rate is about to pick up further, since that increase is generated by strong domestic demand.

Until now, the Central Bank of Hungary has not raised key interest rates, but it continued its liquidity enhancing measures, and that has two goals: the decrease of the BUBOR (Budapest Interbank Offered Rate) to minimize interest rates costs to Hungarian enterprises when lending money from banks and to turn deposited cash on banking accounts into investments in state bonds.

Gross capital formation is to grow by 20 percent according to different estimates. After the Global Financial Crisis, the gross capital formation kept dwindling for four consecutive years; since 2013, gross investments increased by around 10 percent due to the resumed EU-transfers every year. Besides the EU funds, lowered corporate taxes, and housing credits with more favorable interest rates supported the gross capital formation. However, investment rate compared to GDP is still low in Hungary, if compared to the country's economic development. (2017: 20.5 percent).

As we could see, the economic development of Hungary still depends on external transfers, whereas before 2008-200, these external transfers were private credits and foreign direct investments, nowadays EU transfers have the same function in the Hungarian economy. The key role of EU transfers in the Hungarian economy is a strong reminder to the managers of the Hungarian economic policy that reliance on West Europe is strong, and it would most likely influence the development of the Hungarian economy for many years.

Public budget would reach around 1.8 percent of GDP in 2017, which is only a slight increase compared to 2016 (1.6 percent). Despite this rise, public deficits stayed below the 3-percent-threshold in six consecutive years. This success has a price, since some policy measures, necessary to reach the low

deficits, do not boost economy activity. The most obvious element is the very high value added tax rate (27 percent). Other measures of this new policy mix have been often criticized by analysts as well, however, the economic policy after 2010 has different priorities than the former one. The crisis in 2009 created a new external and internal environment, which led to the revaluation of the country's previous economic model. The following conclusions were drawn from the economic shock.

Firstly, experience demonstrated the need to build economic development less on external debt generating funds in order to prevent an unsustainable current account position in times of unstable international financial liquidity.

Secondly, it became clear that the economic growth must be based on a broader basis. International trade and the domestic demand factors – both investments and consumption – must be included into the growth model in a more balanced way, including active labor market interventions and sustainable credit financing.

The third conclusion was that the macroeconomic balance must be restored by controlling the budget deficit and decreasing public and private indebtedness at any cost.

These elements are still the cornerstones of the Hungarian economic policy. The focal point of these conclusions is to lessen the one-sided dependence on Western Europe and thus widen the room for the maneuvering of domestic fiscal and monetary policies. From this point of view, it is more understandable why the managers of the Hungarian economic policy do not intend to abolish sectoral and individual corporate taxes, but they view them as integral and long-term parts of the Hungarian economy policy.

Different GDP growth rate estimates forecast a similarly fast GDP growth rate in 2018. The GKI Zrt. forecasts 3.8 percent, the European Commission 3.7 percent, and the Századvég Zrt. 3.8 percent. These three forecasts also agree on the continuation of the sound public budget policy and the slow rise of consumer inflation index.

Table 1. GDP forecasts

	2017	2018
Századvég Zrt.	3.8	3.7
GKI Zrt.	3,8	3.8
European Commission	3.7	3.7

Among the future risks, following points must be mentioned: higher inflation, tightening labor market conditions along with loosening budget deficit are clear signs for an overheating economy. These conditions are most likely to prevail in the next year, since EU funds are available, and the election year is not the right moment to change the course of the economic policy significantly. Loose budget policy means in the Hungarian context, that the budget deficit is most likely to increase 2.1 percent of the GDP. This rise can be led back to more favorable tax regulations. From 2018 on, social security contributions, corporate tax will be lower in Hungary, but at the same it must be stressed, that not only revenue, but expenditures increasing measures contribute to deteriorating fiscal conditions. The right question is to raise how managers of the Hungarian economic policy can manage problems of an overheating economy without suppressing growth and stopping the catch-up process of the Hungarian economy with the Western European countries.