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Weekly Briefing

Hungary Economy briefing:
Hungarian Economy Outlook in 2018

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2017 was one of the best years in the Hungarian economy after 1990, **however 2018 is expected to be characterized by more favorable economic indicators**. 2018, challenges are slowly shifting emphasis to questions how the Hungarian economy can be upgraded since it has entered a new period when reliance on cheap labor force is not sustainable any more, and new competitive advantages must be found.

Gross Domestic Product (GDP) growth of the first three quarters of 2017 was 3.9 percent in Hungary – according to the latest announcement of the Hungarian Statistical Bureau (KSH). But during this year, the data were raised several times last year. As it seems to happen this as well, since last week the Ministry for National Economy published 4.1 percent GDP growth estimate for 2017.

The latest revision of the economic outlook published by the World Bank came in January 2018 that raised its forecast from 3.7 percent to 3.8 percent in 2018. Other forecasts are in line with this very positive assessment of the Hungarian economy in 2018. As Table 1 vividly demonstrates, **all forecasts are very optimistic about the future economic growth;** although the forecasts of the IMF, European Commission and Focus Economics anticipate a slower growth rate. That has two reasons: the estimate is lower partly because the IMF forecast was not revised in the second half of 2017, and partly because the declining net export – as the Commission argues in its analysis – will turn into negative, weakening the Hungarian GDP growth. **As a result of these trends, current account surpluses are slowly fading away, but because the predictability and slowness of this trend there is still room for maneuvering next year.**

Current account and capital balance are 7 billion Euro in 2017. Based on the estimates of the GKI, the balance is still 6.2 percent of the country's GDP. Previous year, the current account and capital balance had the same amount of surplus, which then equaled to 8.2 percent of the GDP. The difference is due to rapidly growing GDP. The stability is provided by the inflow of significant amounts of EU-funds.

Table 1 GDP forecasts for the Hungarian economy				
	2017	**2018**	**2019**	**2020**
World bank	3.9	3.8	3.1	2.9
GKI	3.8	3.8	-	-
OECD	3.9	3.6	2.8	-
IMF	2.9	3.0	-	-
European Commission	3.5	3.2	-	-
Focus Economics	3.5	2.9	-	-
Századvég	3.9	3.7	-	-
Average of forecasts	3.63	3.42	-	-
Source: World Bank GKI Előrejelzés 2018-ra; OECD Economic Outlook Volume 2017, Issue 2; IMF Country Report 2017; European Commission Winter 2017 forecast, Focus Economics 2018 January. Századvég, 18 November 2017.				

The underlying reasons behind deteriorating export data are accelerating inflation and worsening competitiveness of Hungarian firms. Currently, inflation is being fueled by **labor market tensions** (i.e. shortage of qualified labor force) and increasing wages and salaries. As we pointed out in our former analysis, the rise of salaries and wages is only partly induced by government measures. Slowly declining net export is the reason why the European Commission forecasted **worsening of terms of trade in goods** for 2017 and 2018 by 0.1 percent and 0.2 percent in Hungary, while it projected improvement of terms of trade in goods in the EU during the same period. (2017: -0.7 percent, 2018: -0.1%)

The Hungarian economic growth rate was and is expected to be one of the highest in the European Union in 2017 and 2018. According to the European Commission, all member states of the EU are excepted to grow in 2017 and 2018, for the first time in a decade. It is important to stress that the global and regional economic environment is stable, favorable and in all European economies, GDP growth is robust. The average GDP growth of the EU was 1.8 percent in 2017, only Luxembourg (4.0 percent) and Romania (4.4 percent) could grow faster than the Hungarian economy last year. On the expenditure side, there are four elements contributing to the GDP growth: private consumption, government consumption, investment and net export.

1. The increase in Hungarian private consumption expenditure demand was outstanding in European comparison (4.8 percent) and Romania (6.7 percent), while the EU-average only reached 1.5 percent. Whereas private consumption is fueled by growing incomes, **the question Hungarian decision-makers must deal with, is how long this rise in incomes can be sustained without jeopardizing competitiveness**. (In this environment, importance of exchange rate policy will be grow in coming years.)

2. The second contributor of the GDP growth is the change in government consumption. The growth of government spending was very moderate in Hungary (1.0 percent) while the EU-average was 1.4 percent. **These moderate numbers show sustainability of the Hungarian economic policy**.

3. As for the total investment, data corroborate **the extensive path of Hungarian economic growth**, since total investment increased by 10 percent (change on preceding year), while the EU average only grew by 2.9 percent. If we narrow the perspective, data show investments in construction were stronger than investments in equipment.

4. The European Commission estimated net exports don't contribute to the Hungarian GDP growth in 2017 (-1.0 percent) and 2018 (-0.1 percent). (Data of the European Commission).

Potential output shows the output of the economy by full capacity of labor force, natural resources, technology, management skills and capital of the given economy. The extension of the potential output can lead to accelerating inflation in the given economy, while falling behind the potential output usually leads to low inflation and declining GDP growth rates. According to the analysis of the European Commission, the potential GDP output of the Hungarian economy is definitely lower (2.8 percent) than the actual economic growth rate of the Hungarian economy. It can be discussed whether the potential output is that low and it might be higher than calculated by the European Commission, however, it is clear, that the **actual growth is above the potential GDP growth in Hungary, leading to higher inflation.**

Table 2 Inflation forecasts for the Hungarian economy			
	2017	**2018**	**2019**
GKI	2.4	3.0	-
OECD	2.3	2.7	3.4
IMF	2.5	3.2	-
European Commission	2.2	3.2	-
Századvég	2.4	3.0	-
Average of forecasts			
Source: GKI Előrejelzés 2018-ra; OECD Economic Outlook Volume 2017, Issue 2; IMF Country Report 2017; European Commission Winter 2017 forecast, Századvég, 18 November 2017.			

The Central Bank of Hungary similarly forecasted a slow pick-up of inflation, reaching 3 percent in 2018. See other forecasts in Table 2, the predications might be slowly different, but all point to accelerating inflation. **The same trend is showed by the increase in ULC (unit labor costs).** The Hungarian rise in costs are predicted to be the highest in the EU (2017: 3.0 percent, 2018: 2.6 percent) whereas the EU-average is significantly lower (2017: 1.3; 2018: 1.4.) However, if analyzing the real ULC (excluding inflation differences, and exchange rates changes), a more positive picture emerges, since the growth of real ULC is set to be lower in 2018 in Hungary than in the EU.

In April 2018, parliamentary elections are to take place, which might influence public spending of the country. According to different estimates, **public deficit will only increase slightly, however, the rise in deficit won't change the current stable situation of the public finances**. According to GKI, Századvég, public deficit in terms of GDP is expected to be between 2.5 and 2.9 percent. **Although the decline in net export will deteriorate current account balance, the inflow of EU funds will still contribute to the financial stability of the country.**

In this aspect, it must be underlined that the debate on the new Multiannual Financial Framework of the European Union already started in 2017 and it is to be concluded summer 2018. Even though one cannot see the results aforehand, it is most likely, **EU funds – intended to help the Hungarian economic**

development – are expected to decrease significantly. According to our predictions, the change after 2021 is going **to alter the course of the Hungarian economic policy, which by 2020 must be capable to rely on self-finance and FDI.** The reason for this predictable change can be traced back to the Global Financial Crisis that demonstrated how easily and swiftly economic vulnerability of a country can increase if being dependent on external financing. The definite change that took place was that Hungary could take advantage of the EU-funds increasingly, however, these funds are still external ones. Until now the stability the Hungarian economy has enjoyed, has been secured by the fact, that these funds haven't been from private capital markets. Therefore, over the last years, the Central Bank of Hungary made significant steps in encouraging domestic saving, **it is predictably that further measures are to be taken in 2018 and 2019.**

The structure of the economic growth won't change in 2018 significantly, since investments (partly EU-transfers induces public investments, and partly housing investments generated by government policies) and private consumptions will boost further the economy in 2018. As we indicated in our earlier analyses, the course of the present Hungarian economic policy is not likely to change before April 2018 when elections are due in Hungary. However, the second part of the year can bring changes in economic policies, **leading to temporary cooling Hungarian economy, since accelerating inflation, slowly declining net export, abating EU transfers are to usher in a new era of the Hungarian economic development, in which policies leading to an upgrade of the economy will be needed.**