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Weekly Briefing

Hungary Economy briefing:

Hungarian Economy trends

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

It is still in the third month of the year, however, there are already economic forecasts which base their predictions on this year data. According to the GKI forecasts and the new data, there are more and more signs of an impending change in economic conditions: the inflow of EU-transfers and the expansion of purchasing power of the private households are still on the rise, however, the economic growth rate is about to slow down. Last year, public investment rose by around 60 percent, and private corporate investments by 14 percent. It is very likely that this growth rate cannot be achieved this year. A slowdown is excepted in the investment. According to estimates, last year's 30 percent growth is to decrease to 10 percent. Similarly, salaries and wages cannot repeat the 13 percent expansion of the previous year, according to the GKI it will slow down to 7 percent which is still fast, but the change will be palpable to the population. After a surprisingly low budget deficit in 2017, a significant rise is to be expected this year. The estimation of the GKI is 2.4 percent as of GDP. The GKI predicts further contracting external trade surpluses for this year. (7.5 billion euro)

This analysis focuses on this latter trend this time, the development of export and import. The Hungarian Statistical Bureau (KSH) published its newest data on external trade this week. The final export and import figures in December 2017 showed a stronger import and a weaker export again. As a result of this, the final balance of external trade became 8.1 billion euro in 2017, which is a massive surplus, however it shows a declining trend compared to 2016 (9.7 billion euro) and 2015 (8.6 billion euro) Looking at the breakdown of trade, it is clear that external trade balance towards EU28 countries could further improve over 2017 significantly, while our trade balance towards not EU 28 countries worsened. (Although the preliminary data for January 2018 again show an increase in surpluses, the long-term trend seems to be a decline in surpluses.) So, what are the lessons, which can be drawn from this trend?

The Hungarian Economic Policy set the goal of trade and investment diversification a few years ago. These efforts were expressed in the announcement of the so-called Eastward and Southward Opening Policies of the Hungarian government. Back then, most of the criticism was directed towards these diversification efforts, arguing the government policy measures wouldn't alter the course of Hungarian export too much, since most of the export is generated by Hungary based multinational firms which are headquartered in Western Europe or in North America. This criticism rightly referred to the inability of the Hungarian government to influence investment and business decisions of Western businessmen. They argued the Hungarian economy is deeply imbedded in the European division of labor, where nodes of the value chain are to be found in Western Europe and the linchpins are scattered around in Eastern Europe. That is the reason they argued why the EU-relation is still the most important trade relation to Hungary, and it is most likely that it will remain for a very significant time as well. There are two aspects which can be underlined in this context:

- The original plan of trade and investment diversification did only address the export of small and medium enterprises, which are mostly owned by Hungarians, so, in this sense the plan was feasible, however it never intended to reshape the main directions of the Hungarian trade as many maintained.
- The second aspect is, if we really wanted to induce changes and modify the relations of the Hungarian trade, the Hungarian government must achieve more than access to new loans for infrastructural projects (from the Chinese and Russian partners and any other partners), but it also needs foreign direct investments, that choose Hungary as their European center and operate their businesses from here.

Given the slow changes in the Eastern trade and investment relations, there might be a slow turn away from Asia in the future. (Maybe not in the rhetoric, but in the facts.) Looking at these Hungarian export- and import trends, it might be clear that after 2018, the new government must slowly alter the main course of the Hungarian economic policy, since the economic growth potential is low in the Hungarian economy. Decisions on the EU-transfers between 2020 and 2016 will also contribute to strategic decisions of the Hungarian economic policy-makers as well.

The Governor of the Hungarian Central Bank speaking in front of PhD students, stressed that budget policy was reformed between 2010 and 2013, monetary policy started to use a new approach from 2013. And now from 2018, competitiveness must be focused more closely. In the speech, there is definite turn-away from the GDP as economic indicator. Instead of the GDP, he underlined the relevance of happiness, economic complexity and education in the evaluation of the economy. At the same, he made many references to Scandinavian economic success stories, and Asian and Chinese success stories were not used frequently which might indicate a change in the 'success models', however, it is more important the way how the importance of alternative economic indicators and the attitude of the Hungarian related to doing business and making money was underlined.

In our understanding, the new period of the Hungarian economic policy (focus on competitiveness) indicates that education, research and development might be more focused in the future than until now. It is most likely that it won't mean a total reshaping of priorities rather an adjustment of economic policy in an era that increasingly can be characterized by labor shortages, innovative technologies. The Hungarian political elite can answer with two basic alternatives treating this problem.

- It can encourage the migration of skilled young workers to come to Hungary and work in the country for a longer time and alleviate these problems by enhanced levels of migration. In our understanding, this solution only postpones the problems and recreate them in the future. In the first years of migrations, economic benefits of the migration, when young and educated people can work, might be higher than the costs. However, later, migrants also increase financial expenditures in the Hungarian health care system, the

Hungarian pension system. In other words, the distribution of benefits and costs are very uneven over time, if looking at these trends in the longer perspective. Economic benefits prevail in the first part of the migration life cycle, whereas costs tend to rise after the first 5-10 years. This latter part would generate economic and social tensions in the society. Secondly, the Hungarian society is not prepared and willing to handle the question of growing social diversity, but that is the other side of the same coin, more of political nature.

- The other solution is to encourage the spread of modern technologies (robots, other elements of the so-called fourth industrial revolution). The same strategy has been used in Japan over the last decades, where labor productivity could be increased because technological advancements were preferred over increased migration and that was the way to solve the problems of aging population and labor shortages. The opposite strategy of an encouraged migration has been used in the US traditionally over decades, or centuries however, nowadays, the signs of change are clear in the US as well.

It is very clear Hungary cannot choose one of these strategies, only a mixture of them. Although the Japanese solution would be close to preferences of the Hungarian society, Hungary is no island, it is – as mentioned earlier – deeply imbedded in the European economy and it doesn't possess the capital and technology to pursue the Japanese strategy and at the same time, it can be added that the Japanese solutions also faces its limitations despite the very strong reform efforts of the Abe-governments. However, the ideal and preferable solution would be the pursue of a restrictive migration policy while making all efforts to upgrade the Hungarian economy and enhance added value produced in Hungarian enterprises. That is the moment when investment from the Asian region would be highly appreciated in the Hungarian economy.

To sum it up, the slowly declining export surplus and other indicators of worsening competitiveness are very important signs for need to change the Hungarian economic policy. The period after 2018 will most likely be an era when the approach to the Hungarian economic policy must be adjusted to the new reality since the decline goes back to slowly increasing domestic consumption. The increased consumption can be explained by growing Hungarian incomes, and it can only be balanced or offset by the increase in exports. The real threat to this otherwise feasible policy strategy can arrive from the US since for the time one cannot evaluate the real effects of the announced American tariff raises on the Hungarian economy yet. There is already news in the media that refer to adverse effects on the Hungarian car making industry. Along with this logic, it is obvious Hungarian efforts to attract foreign capital will only increase over time while diversity of capital stock must be enhanced as well.