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Weekly Briefing

Hungary Economy briefing:
The External Conditions of the Hungarian Economy
-A Slow Change for the Worse?

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The External Conditions of the Hungarian Economy
-A Slow Change for the Worse?

This short briefing on the Hungarian economy looks first how the external economic conditions have been changing over the last months and how this change will likely impact the state of the Hungarian economy and its basic economic trends.

1. Change in the external conditions

Over the last months, external conditions of the Hungarian condition have been changing slowly. One of the main factors is the US economy, that has grown rapidly 2017 and 2018 and the changed American economic policies (as for trade, and investments) must be mentioned in this context as well.

1.1. Recent trends

The US GDP growth will very likely grow to 2.8 percent in 2018, that's according to the most recent forecast released at the Federal Open Market Committee meeting on June 13, 2018. This estimate also takes into account Trump's economic policies. At the same time, inflation has been accelerating (annual rate: 2-7 percent through August), and unemployment rate dropped to 3.9 percent. As a result of that, the Fed raised the interest rate to 2.0 percent in June 2018 and there are forecasts predicting definite increases in the interest rates to 2.4 percent in 2018, 2.9 percent in 2019, and 3.4 percent in 2020.

Thus, it cannot come as a surprise, that emerging rates (such as the Hungarian and other Eastern European ones) are under pressure since the Hungarian interest rate is still 0.9 percent. In other words, the former typical gap between the Hungarian and American interest rates disappeared. Of course, it doesn't mean the yields on Hungarian 10 years bonds would be lower, but the marge between the American and the Hungarian bond yields has been closing over the last months. (Hungary 10Y increased to 3.64 on Friday September 14 2018, while the US 10Y was 2.99 the same day.) Obviously this change will definitely impact the financing of the Hungarian public debt in the long-term, along with that investment opportunities might also narrow. That is one of the reasons why the pressure on the Hungarian currency has been growing during this summer. The pressure can be easily observed in the weakness of the Hungarian currency. Between the 1st January and the 13th September 2018, the Hungarian Forint weakened by around 5 percent.

1.2. Future trends

Whereas positive trends in the US economy might attract capital into the American economy (worsening the financing position of emerging countries), there are more and more signs of a sudden financial meltdown in the world economy as well. If only looking at the reasons of the 2008-2009 financial crisis, we can see that too much would have changed since then. Back then, the financial problems were created by the American investment banks and it originated from the subprime mortgage market. After the crisis, one might has assumed that the share of investment banks will decrease, however, the American investment banks not only dominate the world market, but they have also expanded their influence (if looking at the number of trades, profit levels, their stock market prices etc.) One of the underlying reasons behind this success was the Brexit, that significantly narrowed the maneuvering room of British banks. No wonder, that New York and Chicago overtook London as financial hub, exchange market.

The other main reason of the 2008-2009 crisis was how they regulated, or to put it more correctly deregulated or didn't regulate the shadow banking system before the crisis. The term shadow banking is used to describe financial institutions, that provide financial services to customers, but they are not regulated as banks, thus they are being assessed as entities posing higher risks to the financial system than traditional banks. After the financial crisis 2008-2009, regulatory authorities made attempts to tightly regulate this part of the finance sector. Back then, the shadow banking system had a value of 28 billion USD, today the same figure is 45 billion USD. In contrast to the 1980s credit scandals in the US, when hundreds of law suits followed the financial crisis, and tried to find the culprits, there was no real legal persecution of those who could be blamed for the crisis, only a few were punished (see the case of LIBOR rates manipulation).

2. Basic trends in the Hungarian economy

Despite this mixed international background, the Hungarian economy performed very well in the last months, however, one cannot exclude the slow-down of the economy in the next period. Preliminary GDP data indicated that the Hungarian economy's growth accelerated in Q2, growing at the fastest speed in four years. The second-quarter expansion was likely supported by the dynamics of private consumption. This is traceable to the resilient growth of retail sales and higher than earlier consumer confidence. What stands behind this good performance, is a double-digit growth in real earnings, what was supported by minimum wage and public sector wage increases. No surprise the strengthening labor market saw decreasing unemployment rates. (a new all-time low in the second quarter of 2018: 3.6 percent) One must also add that Hungarian trade sector stronger contributed given the acceleration in goods exports. In June 2018 the trade surplus reached 0.58 billion euro. Now let's look at the data more in details!

2.1. Growth

The Hungarian economy could grow faster than the majority of EU countries in the second quarter of 2018, (see table) however the dynamics is slowing. Most of the forecasts predict an annual GDP growth over 4 percent. Not only investments financed by EU-transfers, and the demand of private households partly generated by government measures before elections will have less impact on future GDP growth, but deteriorating external conditions, f. ex. Turkish currency crisis, floundering Italian economy, trade war, US interest rates hikes also add to the worsening sentiment on the Hungarian economy.

GDP growth rate (%, yoy)									
2016 Q1	2016 Q2	2016 Q3	2016 Q4	2017 Q1	2017 Q2	2017 Q3	2017 Q4	2018 Q1	2018 Q2
1.3	3.1	2.5	1.9	4.3	3.3	3.9	4.4	4.4	4.8
Source: KSH database									

2.2. Structure of Growth

The consumption of private households has expanded by 5.9 percent in Q1 2018 and 5.3 percent in Q2 2018, while fixed investments have grown by 17.1 percent in Q1 2018 and 15 percent in Q2 2018. In the first two quarters of the year, construction (23.3 percent), agriculture (1.6 percent), info-communication (5.2 percent) and retail trade, tourism and motor vehicle maintenance sector (7.7. percent) have been the economy sectors that could expand rapidly. Growth in manufacturing will be modest in the first half of the year (4.0 percent) and it will be very likely slower than last year.

2.3. Wages, salaries

The growth of real wages and salaries is still very high reaching 7 and 8 percent this year. In June 2018, the gross average wage was 329.576 HUF (net 219.167 HUF), including public and private sector as well. This figure is by 11.2 percent than in June 2017. The expansion of private consumption is tightly linked to the increase in wages. As mentioned before, the unemployment rate further decreased this year, however, it is very obvious that this figure (3.6 percent) is unlikely to go down further and rapidly. At the same time, it must be highlighted that the number of public workers has been decreasing rapidly that shows healthy labor market trends.

2.4. Inflation and public budget issues

The inflation has been accelerating over the last five months, the consumer prices index reached 3.4 percent in August 2018. This inflation is one of the highest recorded in the European Union, however, given the fast GDP growth it should not be surprising. The other factor pushing the Hungarian inflation rate higher is the relativele weakness of the Hungarian currency as well. In the first seven months, public budget balance deficit reached 110 percent of the sum projected and planned for the entire year. One of the basic reasons for the higher deficit is the EU-transfer that will inflow later this year but it was paid by the Hungarian government in advance. At the same time, it is worth underlining that tax revenues are high, thus in our opinion, the 110 percent deficit will go back to the originally planned ratio.

3. Summary

Given worsening international conditions, the decision makers of the Hungarian economy policy sooner or later have to respond to the new economy policy challenges, however, in our opinion it will only lead to a smooth and slow tuning of the economy policy tools used until now in the Hungarian economy, no sudden changes in the economy policy are to be expected. (I out opinion, relatively low interest rates, support for families, former tax allowances will be very likely kept). The outcome of the trade war, the effectiveness of Trump' policies on the American economy and of course their overall effect on the world economy will likely to influence the maneuvering need of the Hungarian economy. At the same time, it is worth highlighting the effectiveness of Hungarian economy policy makers since 2010 in this aspect.

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