Hungary economy briefing:
Hungarian Economic Trends in 2019
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This economic briefing’s focus is set on the future economic trends of the Hungarian economy based on the forecasts of research institutes, the European Commission, and other international organizations, such as the IMF, and the OECD. The analysis starts with a short overview of the recent changes in the external economic environment, since this aspect is extremely important for the analysis of the Hungarian economy, given the fact that it is one of the most globalized or internationalized economies in the world. Hungary ranked the 12th on the globalization index of the KOF in 2018, while China was the 79th in the ranking. As a result of this economic openness and the size of the economy, every small change in the world economy can significantly influence the main trends in Hungary. After this overview, the analysis focuses on the interpretation of the 2019 forecasts.

(1) The external economic and political environment in 2019

Over the course of the last year, the external economic environment became clearly more uncertain than in the preceding years, due to some of these elements:

- the Brexit negotiations, that could not be concluded yet,
- the emerging trade war between the US and China, that has dampened the mood of exporting firms,
- the negative impact of higher interest rates in the US on the international investment opportunities that has led to money inflow into US Treasury bills, contributing to more volatile money market conditions and the weakening currencies in some of the emerging markets.
- political uncertainties – such as the growing political tensions in the Korean peninsula, Russian-Ukrainian disputes, the announced plans to withdraw American troops from Syria, and the growing military expenditures in many countries etc. – also made the unstable markets more volatile.
- What the implications of the Italian economy policy as for the bank problems cannot be seen yet, either.
Given the geopolitical and political uncertainty and the globalized conditions of the Hungarian economy, it is more understandable that the year 2019 will require careful economic policy planning from the Hungarian government, and even rapid policy measures can be taken, if the deterioration of the external economic conditions would require that. Particularly, the question of how public debt will be financed is of utmost importance. The higher international interest rates and the slowly rising domestic inflation might force the Central Bank of Hungary to slightly raise the key interest rate and thus dampen the fast economic growth.

The economic forecasts very much agree on a slower 2019 growth rate in Hungary (see more later in detail), and they most very likely are right about this trend, however, in our understanding the slower growth rate will be induced rather by the change in external conditions, than internal conditions. The change in the domestic economy would not necessarily lead to more sluggish growth.

(2) Economic forecasts

The European Commission published its semiannual economic forecasts for the member states in autumn 2018. The economic analysis underscored that there are three main reasons why the economic growth is bound to decline in the next year (2019).

- First of all, as we delineated above, uncertainty in the world economy is not conducive to the development of the Hungarian economy. Headwinds will most likely affect the financing conditions of the Hungarian economy.
- Secondly, the forecast argues, that the short-term boost from public finances will fade away over the course of the next year while manufacturing most likely will stagnate and the construction sector faces capacity bottlenecks. At this point, the analysis refers to sharply rising constriction costs as signs of the capacity problems.
- While the corporate investment is still strong due to the private demand, the paper argues, the demand of private households will slowly weaken since the employment growth in the labor market will slow down.

Based on these premises, the European Commission forecasts a further decrease in the general government budget to 1.9 percent. According to the analysis the real GDP growth is expected to grow by 3.4 percent in 2019, though it must be underscored that the forecast of the
European Commission for 2018 was well below the actual number. (4.9 percent) The OECD’s forecast underlined similar key factors of next year’s economic development:

- the strong private consumption will be supported by raises in real wages,
- and investment will still rely on EU structural funds,
- while the strong demand can increase the inflation to 4.0 percent.

The GKI predicts 3.2 percent real GDP growth for 2019, and it argues, that the rapid growth of the last year was induced by EU transfers, wealth measures of the government before the elections (April 2018) and this growth rate (GDP) cannot be maintained in 2019. While the GKI predicts a slower growth rate of private consumption, the investment in terms of GDP is expected to increase from 24.5 percent in 2018 to around 25 percent in 2019. The public investment will be based on EU transfers, while the growth rate of the private investment will be below the average. The research institute forecasts 3.5 percent inflation, though it was underlined that the rise of world oil prices, the stronger private household demand due to higher wages and salaries, and a weakening currency might lead to higher inflation rates.

The Central Bank of Hungary published its Inflation report in December 2018. The report predicts 3.5 percent real GDP growth for 2019 and it also traces the slower growth to a more sluggish growth of wages, salaries, and investment. The analysis emphasizes the positive effects of the BMW investment, arguing that it will significantly raise the Hungarian growth rate, according to the Ministry of Finance’s estimate by 0.3 percent between 2009 and 2021, including multiplication effects an excluding import. As it could be seen, the economic forecasts basically agree on two points, the growth will be robust in 2019, however, the rapid growth of the last year most likely cannot be repeated again.

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<th>Table 1. Summary of Economic Forecasts for 2019</th>
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<td>GDP growth</td>
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<td>European Commission</td>
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<td>International Monetary Fund</td>
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Besides the economic forecasts, it is worth taking a brief look at policy measures, particularly taxation and capital attraction measures since these can efficiently boost the development of the economy.

- Fiscal and monetary policies have been expansionary in 2018 and they will be in 2019 as well since further tax cuts are scheduled for 2019. The specifications of the tax form, KIVA (special taxation for small companies) were amended and made more favorable to the firms, similarly, tax allowances were extended as well.

- As we pointed out earlier, the Hungarian economy is one of the most globalized economies, and that makes it more exposed to external threats, but on the other hand the economy’s development can capitalize on relatively easy access to foreign direct investments creating jobs, moving up the added value chain, and attracting cutting-edge technologies. The last year’s data clearly shows that Germany is still the largest investor in Hungary. Twenty-eight of the ninety-eight large investments were made by Germany investors in 2018, the US was second on this list, even the Eastern Opening policy was successful since seventeen large investments were carried out by Chinese, Japanese, Indian and Korean firms last year. 2018 was the most successful year as for the attraction of foreign direct investments, and that is for certain that the Hungarian government will push these activities vehemently in 2019 as well, since Hungarian export largely depends on Hungary-based multinational firms.

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<th>OECD</th>
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<td>Source: own compilation based published data</td>
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(3) Summary

To sum it up, it can be argued that economic development will be slower and the real GDP growth is bound to decline, however, the positive trends in the labor market (plenty of jobs, growing wages, and salaries) will create strong domestic demand. At the same time, the rate of investment growth can be maintained, moreover slightly increased. There are three real threats to the Hungarian economy for the time being:

- External changes such as the escalation of international political and economic tensions can lead to weakening Hungarian Forint, and force the Central Bank of Hungary to raise the interest rates;
- Along with that, the rising inflation can add to the problems, significantly changing the financing conditions of the Hungarian economy.
- The third threat is of long-term nature it is linked to the recent technological changes that evaluate the importance of added value and technological advancements. This requires taking the long view and invest in infrastructure and education.

Basically, it can be argued, that the first risk factor cannot be influenced by the Hungarian economy policy but the two-second factors can be modified, influenced by the domestic policymaking. Based on communication, interviews, both the Central Bank of Hungary and the Hungarian government are much aware of these threats and in the recent months they have already been preparing for the necessary changes and according to the Hungarian prime minister relevant policy measures are to be announced in February.