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Hungary economy briefing:

The Hungarian Economy in 2020

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The Hungarian Economy in 2020

Apart from the first three months of the year, the development of the Hungarian economy has been severely affected by the global pandemic. The global economy is expected to shrink by 4.4 percent, while the advanced economies have been forecasted to slow down by 5.8 percent according to the World Economic Outlook of the International Monetary Fund. Even Hungary's most important trade and investment partner, the German GDP, is expected to decline by 6.0 percent according to the same report. The Hungarian economy is less exposed to the external economic shock this time compared to 2008-2009, but this reduced vulnerability is due to the more self-sustaining financing of the economy, lower debt level and a more solid debt structure. At the same time, the deep integration in terms of trade and investment has not changed significantly, so the significant decline in Hungarian GDP cannot be avoided. This briefing looks at the development of the main indicators of the Hungarian economy over the course of this year and puts the Hungarian development in a European context.

1. The main economic indicators in 2020

Gross Domestic Product (GDP) shrank by 4.6 percent in the third quarter of 2020 compared to the corresponding period in 2019. The penultimate quarter of the year showed a strong recovery as economic activity increased by 11.4 percent compared to the previous quarter of the same year. We must not overlook the link between the lifting of restrictions on economic activities and the recovery of the economy, which is the reason why the new dip in the Hungarian economy in the last quarter can be easily predicted. Looking at the performance of the sector in comparison to the corresponding period in 2019, the new slump of the Hungarian economy in the last quarter will occur in the areas of

- construction,
- transportation and storage,
- accommodation and food service activities,
- professional, scientific, technical, and administrative activities and
- arts, entertainment, and other services

We predict, since these in areas are where shrinkage has been greater than the national average. At the other end of the spectrum were information and communications, finance and insurance, health and social services, as their output in 2019 was higher than in the corresponding quarter. Although the decline in output in the services sector was slightly higher than the average for the economy, one-third of the GDP decline came from this sector, due to its relative size in GDP (2.2 percentage points), while construction accounted for 1.0 percentage point and industry for 0.4 percentage points of the 4.6 per cent fall in GDP.

Table 1. Contribution to GDP volume (2020, Q3)		
Production approach		
	Agriculture and fishing	-0.2
	Services	-2.2
	Industry	-0.4
	Net taxes on production	-0.8
	Construction	-1.0
Expenditure approach		
	Gross capital formation	-2.8
	Final consumption	-1.7
	External balance of goods and services	-0.1
Source: Hungarian Central Statistical Office		

As far as the expenditure approach is concerned, we have seen over the course of the year that gross capital formation fell by 13.7 percent in the third quarter of 2020. This is the area that has suffered the most due to the economic crisis. Actual final consumption fell by 2.5 percent, which is a much smaller decline than investment. Looking at the two elements of final consumption, it can be observed that the actual final consumption of the government (-4.8 percent) decreased more than the actual final consumption of households (-2.2) compared to the same period of the previous year.

Against this background, it should come as no surprise that investment suffered in the first three quarters of the year, and no improvement is expected in the fourth quarter. Compared to the previous quarter, the investment volume in the third quarter fell by 2.1 percent, while the decline compared to the same period of the previous year was 12 percent. The decline was seen in most sub-sectors, with the exception of healthcare, where investments doubled over the same period. Moderate growth was also observed in other, relatively less important sectors such as trade (6.3 percent), information, communication (3.4 percent), public administration (2.1 percent). Small and medium-sized Hungarian private companies fared relatively better in terms of investment, as the sharp decline in investment that we attribute to foreign-owned and state-owned companies weakened. This trend also underlines the importance of domestic manufacturing and other enterprises in the services sector.

The export and import of goods declined in the first ten months of the year. Exports fell by 1.5 percent compared to the corresponding period in 2019, while imports of goods shrank by 6.8 percent in € terms. As a result of the difference between the decline in exports and imports, the balance of trade surplus in goods improved to € 4.56 billion. The trade surplus amounted to € 3.90 billion in January-October 2019. The trend of the decreasing trade surplus reversed, but it was due to falling domestic demand rather than the improvement in the competitiveness of the Hungarian economy. Comparing the trade data for the first ten months with the corresponding period of the previous year, the picture is less rosy, with exports down by 7 percent and imports by 8 percent.

The trends in trade in services were similar, but the impact of Covid-19 was more profound. In the third quarter, exports of services fell by 33 percent, while imports of services contracted by 31 percent. The surplus in this balance sheet amounted to € 1.6 billion, but this is € 0.9 billion less than in the previous year. The slump can be explained by the decline in tourism which accounts for 50 percent of the decrease in the surplus. Nevertheless, business services account for 47 percent (3rd quarter 2020) of total services exports.

Table 2
Annual consumer prices in 2020
(percent compared to the corresponding month of the previous year)

January	4.7
February	4.4
March	3.9
April	2.4
May	2.2
June	2.9
July	3.8
August	3.9
September	3.4
October	3.0
November	2.7

Source: Hungarian Central Statistical Bureau

Prices soared during the course of the year. Food prices (6.2 percent) and prices for alcohol, beverages and tobacco (6.4 percent) rose above the average for the economy, which increase was by 2.7 percent in 12 months compared to November 2019. Looking at the inflation trend, it is clear that the falling demand during the first wave of the pandemic dampened inflation rates and they rose again after the lifting of restrictions on the economy. The second slowdown in the annual inflation rate can be explained in a similar way. It is clear that in both cases it took a while until the effect of the relaxation of restrictions could be reflected in the figures. The positive effect of falling demand is that the Hungarian Central Bank (MNB) does not need to focus on fighting inflation at the moment. For the same reason, the MNB was able to lower interest rates twice during the year. At the end of May the interest rate was lowered from 0.90 percent to 0.75 percent and in June to 0.60 percent. In addition to securing liquidity, the central bank also focused on facilitating new loans to companies. The Funding for Growth Scheme - originally launched in 2019 with a ceiling of 1.000 Billion HUF – was extended by 1.000 Billion HUF in November as the loans issued exceeded the original ceiling of the financing program.

Given the global economic environment and the direct impact of the pandemic on the Hungarian economy, the rising budget should not come as a surprise. The cumulative net government borrowing was 1,218 Billion HUF, while the government budget showed a surplus in the corresponding period of the previous year. However, on the positive side it should be noted that the deficit soared due to government expenditure (12.6 percent) and not due to a significant drop in revenues. Revenues remained fairly stable, with the revenue decline amounting to only 1.4 Billion HUF.

3. Summary

The Covid 19 pandemic affected the Hungarian economy at all levels. The timing of the restrictions on economic activities coincided with the timing of the restrictions on the day to day life of citizens. It is expected that the decline in GDP will be between 6 and 7 percent, which is basically very close to the contraction of GDP that the Hungarian economy suffered in the wake of the Global Financial Crisis (2008-2009). However, the resilience of the economy is better, as the initial level of debt was lower before the outbreak of the global pandemic and other financial indicators ensured a smoother economic landing than in 2008-2009. In our understanding, the changed debt characteristics (such as the abolition of foreign currency loans) allowed monetary policy to lower interest rates in 2020 and also to respond to the crisis with several other instruments. Just as a reminder, about a month after the collapse of Lehman Brothers in 2008, the central bank was forced to raise the interest rate from 8.50 percent to

11.50 percent in order to secure debt financing. Raising interest rates during the collapse of the economy is the opposite of what should have been done, and now that the decision-makers of the Hungarian economic policy are aware of this, they should be able to do the right thing.