Forecast for 2018

(13 December 2017)

The Hungarian economy is proceeding on a path indicated in the September 2017 forecast of GKI. Economic growth accelerates due to the surge in EU transfers as well as the increase in consumption driven by steadily rising wages due to the forthcoming elections and a shortage of labour. After 2.2 per cent in 2016, GDP will grow by 3.8 per cent both in 2017 and 2018. Although this rate is well above the EU average, it is one of the lowest in the CEE region, and no major changes can be expected in 2018 in this regard. At the same time, GKI lifted its projection for consumption growth by 0.5 percentage points for both 2017 and 2018 (to 4 per cent and 3.5 per cent, respectively), leading to faster import growth than previously thought. Inflation is likely to accelerate as expected. However, it will not reach the inflation target range of the National Bank of Hungary. The general government deficit will grow as well. Although both consequences are acceptable, the deficit ratio is among the highest within the EU. However, the decline in government debt may be more pronounced than expected. Foreign trade and current account surpluses as well as the external financing capacity of the economy are also falling. However, they are still very favourable thanks to substantial EU transfers. Hungary's credit rating is quite weak, though it is improving. More and more international institutions call the attention of the Hungarian government to the necessity of establishing the foundations of sustainable economic growth during these relatively favourable years. However, there are no signs of this, and only squandering with opportunities and consuming the resources of the future can be observed.

Although **global** economic growth is expected to continue both in 2017 and 2018, its rate will be slower than before the crisis. Although risks associated with geopolitical trouble spots, terrorism and the foreign policy of the US president have negative impacts, they seem to have no tangible influence on economic trends. The future of the EU is mainly shaped by its own modernization, the timing and method of Brexit, as well as the Greek and Italian financial and economic situation. The strengthening of the **German-French axis** is pointing towards multi-speed European integration (becoming more and more independent of the US), and towards the strengthening and extension of the euro area. The present trends in the world economy, such as very low interest rates and energy prices, are fading away very slowly.

Economic expectations are very favourable in Europe, including Hungary. In November, the EU's economic sentiment index was at its **ten-year peak**, and the **GKI's economic sentiment index** was again near to its **historic peak** reached in September.

The main features of the **Hungarian model**, such as the loyalty-based central control of institutions and market actors that are theoretically independent of the government and the perceived right to receive EU transfers that are considered entitlements by the Hungarian government if the set conditions are met have **remained unchanged for many years**. At the same time Hungary's government is trying to become independent from the EU. During the period of **2017-2018**, election considerations such as pinpointing enemies, wage increases and some fiscal easing will **influence** economic policy. The source of this is largely the inflow of EU transfers, and the price to be paid is lagging behind the CEE region, and the deterioration of competitiveness. The yield of the **"eastern opening"** is small and economically very questionable. In addition, Hungary's transatlantic relations deteriorate. In the changing EU, it will be indispensable for Hungary to **reconsider** its **policy towards Europe**, including the introduction of the **euro**.

In 2017, the more than 10 per cent growth in **real earnings** was primarily caused by the forced minimum wage increase, the pre-election salary increase of employees of the public sector and the labour shortage. Actual purchasing power, however, will rise at a slower rate due to the whitening of the economy and the slower growth rate of other incomes. The 4 per cent increase in the final **consumption** of households will only slightly exceed its rate of 3.8 per cent in 2016. Real wages will increase by 4 per cent **in 2018**. However, the growth rate of consumption will decrease to a lesser extent due to the "smoothing effect", to around 3.5 per cent. If the minimum wage increase exceeds the rate envisaged in the wage agreement, it would raise consumption.

As a result of the resumption of the EU investment cycle in 2017, a 20 per cent **increase in the volume of investments** can be expected in 2017 after its 25 per cent increase in the first half of the year. Investments are likely to ascend by near 10 per cent in 2018. Although the investment rate of around 19 per cent in 2016 will rise to 22 per cent in 2017 and 23 per cent in 2018, it is behind the rates of the Visegrad countries.

Trends in the Hungarian economy of the first half of the year have continued in the past few months. The contribution of **construction** to GDP grew **extremely fast** in the first three quarters of 2017 (by 27 per cent), and some slowdown is likely later due to statistical base effects. Of the most important sectors, **industry** grew by about 4.5 per cent and **trade** by 6 per cent. In these latter sectors, some acceleration can be expected in the last quarter of the year. The 10 per cent **drop** in **agriculture** due to weather conditions will hardly change noticeably during the rest of the year. **Core growth** (GDP growth without agriculture and public services) will be much faster (5.5 per cent) than GDP growth due to the decline in both sectors. There will be some slowdown in **investments** (20 per cent per annum) and some acceleration in **consumption** (4 per cent on an annual basis). **Domestic consumption** will rise by 6 per cent, faster than GDP, and, accordingly, **imports** will increase by 9.5 per cent compared to the 6.5 per cent growth rate of **exports**.**The investment-driven growth of the Hungarian economy will continue in 2018 and domestic consumption will continue to grow much faster (by 5.5 per cent) than GDP (by 3.8 per cent).** Construction, trade and the info-communications sector are expected to expand the fastest; however, core growth (4.7 per cent) will exceed GDP growth to a lesser extent.

The number of **employees** will increase by 1.8 per cent in 2017 and by around 1.5 per cent in 2018, with a significant **shortage of labour**. The **unemployment rate** is expected to fall to slightly above 4 per cent in 2017, and it will be similar in 2018 as well. Although this rate is the fourth smallest in the EU, if those employed in public workfare schemes were taken into account, the rate would hardly be better than the EU average. Emigration boom of recent years also plays a major role in this.

Corporate and retail **loans are rising**, the quality of loan portfolios is improving, and the profitability of banks is favourable, mainly due to one-off factors.

The **general government deficit** will be **below 3 per cent** of GDP in 2017 for the sixth consecutive year, with the **government debt on a declining path**. This trend is likely to continue in 2018 as well. However, the general government deficit will be significantly higher than the EU average, and only the Romanian deficit will be higher than that in the CEE region. The widespread domestic advancement of EU transfers could jeopardize the reduction of public debt. Hopefully, EU transfers will resume in December. However, the **deterioration of the structural balance** threatens the **permanent reduction** of public debt. **The external financing capacity relative to GDP will decrease to 5.7 per cent of GDP in 2017 and 2018 from 6.2 per cent in 2016 (foreign trade surpluses will decline, whereas EU transfers will increase again).**

Inflation will **accelerate** slowly and its rate is expected to reach 2.4 per cent in 2017 and around 3 per cent in 2018, which is among the high rates in the EU. However, rapid wage increases have not yet been reflected in prices either on the demand or on the cost side. Although the National Bank of Hungary is **not expected to change the 0.9 per cent base** rate until the end of 2018, it continues to use some unconventional measures. The continuation of Fed's interest rate rises will lead to the **tightening** of these tools. The tendency of the depreciation of the forint has stopped in 2017 and this year, and in the annual average **euro exchange rate to the forint is expected to be HUF309-HUF310 in 2017 and 2018**.

GKI forecasts **GDP to grow by 3.8 per cent** in 2018. The **actual figure may be slightly lower** as the growth rates of investments and consumption will decline, and it is questionable as to what extent the foreign trade surplus could offset it. As far as **inflation** is concerned, a slightly lower than 3 per cent rate in 2018 seems to be more likely as for the time being neither external nor internal inflationary pressures appear to be very strong. Regarding the medium-term outlook of the Hungarian economy, it is important to note that if the government's European policy remains unchanged, Hungary **may be pushed to a position of marginal importance in the European Union**.

The forecast of GKI for 2017-2018

	2014	2015	2016	2017	2018	
	fact			estimate	September	December
GDP	104.2	103.4	102.2	**103.8**	103.8	**103.8**
• Agriculture (1)	117.4	95.9	109.9	**90**	105	**105**
• Industry (2)	105.8	108.1	101.0	**104.5**	105	**105**
• Construction (3)	110.7	102.5	89.5	**125**	112	**110**
• Trade (4)	103.8	104.2	101.2	**106**	105	**105**
• Transport and storage (5)	102.7	101.3	105.5	**103**	103	**103**
• Information, communications (6)	104.4	101.3	105.7	**106**	104	**106**
• Financial services (7)	96.7	101.5	100.4	**101**	102	**102**
• Real estate services (8)	101.8	100.0	103.1	**102.5**	102	**102.5**
• Professional, scientific, technical activities (9)	105.5	102.8	107.5	**106**	104	**104**
• Public administration, education, healthcare (10)	101.0	100.2	101.7	**99.5**	101	**100**
• Arts, entertainment (11)	106.0	100.8	102.9	**102**	102	**102**
• Core growth (2)+(3)+(4)+(5)+(6)+(7)+(8)+(9)	104.4	104.6	102.1	**105.5**	104.5	**104.7**
GDP domestic demand	105.5	101.2	101.6	**106**	104.5	**105.5**
• Private consumption	102.4	103.4	103.8	**104**	103	**103.5**
• Gross fixed capital formation (investments)	112.3	101.9	89.4	**120**	109	**109**
Foreign trade						
• Exports	109.1	108.5	103.4	**106.5**	106	**106**
• Imports	111.0	106.4	102.9	**109.5**	107	**108**
Consumer price index (preceding year = 100)	99.8	99.9	100.4	**102.4**	103	**103**
Balance of current and capital account						
• EUR billion	5.5	8.9	7.0	**7.0**	8.3	**7.5**
• In per cent of GDP	5.2	8.1	6.2	**5.7**	6.4	**5.7**
Unemployment rate (annual average)	7.7	6.8	5.1	**4.2**	4	**4**
General government balance in per cent of GDP (ESA)	-2.8	-2.0	-1.9	**-2.5**	-2.9	**-2.8**

Source: HCSO, GKI