GKI Economic Research Co.

Forecast for 2016
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1. Executive Summary

Due to the decrease of EU transfers and hence public investments, the deceleration of GDP growth in the first quarter of 2016 could have been foreseen. Nevertheless, in the light of the investment restraining effects of the Hungarian model that had been at work for six years the slowdown proved to be unexpectedly spectacular. In addition, in some segments of industry sales problems appeared in the first quarter. Because of the figure that was much worse than expected, GKI downgraded its GDP growth forecast for this year from 2.3 per cent to 2 per cent, but even a lower growth rate is feasible. The fall of investments may be deeper than predicted earlier, it may reach about 8 per cent. Nevertheless, as a result of rapid increase in earnings, the growth rate of consumption may be by one percentage point higher than forecast earlier and may total 4 per cent. The growth rate of exports will hardly exceed that of imports. More favourable economic development is impeded mainly the shortage of skilled labour and capital to invest.

In 2016, the **world economy** is likely to grow more slowly than projected earlier. With the leave of the EU by the United Kingdom, **political uncertainty** is going to pick up. **Brexit is economic catastrophe for the United Kingdom, and a political catastrophe for the EU.** Compared to direct economic losses, a more serious problem for the EU is that **national endeavours may intensify** that may lead even to the breakup of the integration. Nevertheless, the option cannot be excluded either that this danger compels those committed to integration for more successful actions. The refugee problem and the Ukrainian crisis remain still on the agenda. **The increase of economic risks** is related mainly to the more moderate GDP growth rate in China, the US and the EU, to the recession in Latin America, and to the gradual fading away of the favourable growth effects of low crude oil prices. **In the US,** the pace of monetary tightening is expected to be slower. In order to **promote GDP growth and combat deflation**, countries in the rest of the world are characterized furthermore by loose monetary policy. **EU** institutions and member states have not found efficient response to the refugee crisis yet.

The **business sentiment index** of the EU increased slightly not only in April, but in May as well, nonetheless, it did not reach the level of early 2016. As far as Hungary is concerned, in January the **GKI** business sentiment index started the year from a high level not seen since the parliamentary elections in 2014. The index deteriorated somewhat until April, and stagnated basically in May and June. **Since the beginning of the year, expectations of businesses have deteriorated almost continuously, but those of consumers have recovered slightly since the nadir of April,** but they were still lower in June than at the beginning of the year.

In the past months, **economic policy** has set to change implicitly aiming at the deterioration of disequilibria. The **loosening** envisaged in the 2017 budget, too, will have an impact on decisions to be taken in the rest of 2016. **The reorganisation of ownership relations and markets by active government involvement** continues. Fresh examples include the tightening of the position of voluntary pension and health funds due to the reorganization of the cafeteria system, the nationalization of the account management of local, governments, the promotion and later the blocking of the expansion of the FHB bank group involved in the integration of savings cooperatives by legal rules, the involvement in the latter the theoretically independent banking supervisory authority. **Important objective of monetary policy** is the weakening of the exchange rate of the forint to the euro, thereby the realization of profits by the National Bank of Hungary. The price of this monetary policy is the devaluation of the Hungarian economy as a whole. **The National Bank of Hungary exceeds by far** the frames allowed by the law on the central bank, its decisions destroy public confidence. In May, Fitch Ratings **upgraded** Hungary. Because of the unpredictable economic policy**, S&P does not intend to do so**, and the intensions of Moody's are uncertain.

The growth strategy based on cheap Hungarian labour seems to be failed. Since more than half a million Hungarians work abroad, the shortage of skilled labour limits domestic growth perspectives

significantly. Keeping the skilled segment of labour force remaining at home, too**, compels substantial wage increases in both the public sector and the competitive sphere**, whereas a tiny fraction of those involved in public workfare schemes can be employed in the business sphere. The compulsory raise of the minimum wage by 5.7 per cent, too, causes great problems in many undertakings. In 2016, growth earnings are likely to grow by 6 per cent. As a combined result of the 0.8 per cent inflation rate and the reduction of the personal income tax rate by 1 percentage point, **real earnings** are predicted to **mount by 6.5-7 per cent** amidst enormous differentiation. The real value of pensions will rise slightly. Due to sharply increasing incomes of a specific part of households, decreasing credit burdens and intensifying propensity to purchase, **consumption is set to recover, leading to a 4 per cent increase in 2016.**

Following the huge contraction recorded between 2009 and 2012**, gross fixed capital formation** is likely to expand by 6-7 per cent annually in the average of 2013-2015. Nevertheless, within this time frame, the gross rate of investments was a mere 0.6 per cent in 2015. With **the decline of EU transfers and the lack of confidence of the business sphere**, investments are expected to **contract by 8 per cent**. **Efforts aiming at the acceleration of GDP growth have proved to be unsuccessful until recently.** From the EU funds allocated for the 2014-2020 budgetary period, only HUF100 billion were disbursed until early June; this corresponds to less than 5 per cent of the total of HUF2,140 billion planned by the government for 2016. The **investment rate** was about 21-22 per cent of GDP in 2014-2015, it will drop below 20 per cent in 2016, to a very low ratio in a country with medium level of economic development.

In the first quarter of 2016, the rate of GDP growth **accelerated** from 0.3 per cent to 0.5 per cent quarter-on-quarter **in the EU**. In contrast to this, with a **0.8 per cent decline Hungary's figure** was the **worst** in the EU. The rate of Hungary's GDP growth year-on-year according to EU methodology was only 0.4 per cent. With the exception of two Baltic states, GDP growth rates of Hungary's competitors in the CEE region were at least 2 per cent, with 3 per cent in the Czech Republic, 3.7 per cent in Slovakia and 4.2 per cent in Romania. Because of the figure that was much worse than expected, **GKI downgraded its GDP growth forecast for this year from 2.3 per cent to 2 per cent, but even a lower growth rate is feasible.** Nevertheless, **GKI reckons with a spectacular improvement in GDP growth compared to the first quarter.** In 2016, **contraction** is likely only in construction, but the growth rate of industrial production and foreign trade, too, is **slowing down**, whereas that of services is slightly **accelerating**. As the combined result of the decline in 2015 and the favourable weather conditions in the first half of 2016, **the rate of GDP growth in agriculture** may reach 10 per cent.

In March, **industrial production** had decreased for five consecutive months. Production in the **motor industry** accounting for nearly one third of total industrial output dropped by 1.6 per cent in the first quarter of 2016. The problems hit first of all Audi. The **general trend of slowdown** is indicated by the fact that in this time period the performance of 7 branches out of 13 decreased in manufacturing. Nevertheless, **in April** industrial production **was up** by 5.4 per cent compared to March. **Gross industrial production is expected to increase by 3.5 per cent** in the average of 2016 compared to the 1.5 per cent growth recorded in the first four months of the year. The performance of **construction** is highly dependent on demand generated by the inflow of EU funds, the increase of funding triggered the spectacular growth of the past years and its sudden stop the fall of this year. The slight increase of the disbursements at the expense of the 2014-2020 budgetary period of the EU and the recovery of home building as a result of government promotion measures will be sufficient to **brake the contraction** of this year, in 2016 **production is likely to plummet by 15 per cent**.

In 2016, **GDP in services** is projected to grow by about 3 per cent representing **slight acceleration** compared to the 2.8 per cent increase in 2015. GDP in **public services** is likely to go up by about 1 per cent, the increase of the whole branch will be nurtured by growth in **business services**. In **public administration**, the communicated huge staff reduction based on the winding up of a great number of background institutions has died away (in the lack of appropriate conceptual foundations), in part it took

the form of incorporating institutions in the administration. **Red tape is the inherent accompanying part of the state-centred Hungarian model. Business services** are likely to grow more rapidly than the whole service sector. This is promoted by the rise of **consumer** demand (retail turnover is expected to increase by about 5 per cent, and domestic tourism, too, is flourishing), whereas the contraction of investments **narrows** demand for services associated with investment projects. In 2016, the performance of **freight transport** will increase by 2-3 per cent, mainly due to the expansion of road transport. In the telecommunications market, the driving force of growth is mobile internet. In the **real estate market**, recovery that started last year is picking up. **Exports of services** will increase further, particularly in transport, in the service centres outsourced to Hungary and in tourism.

In 2016, **the number of employees** will grow by **1.5 per cent**, at a slower rate than in the previous years. Labour force shortage and unemployment (that is higher than that pointed out by statistics) are present simultaneously. Sums allocated for **public workfare schemes** were raised further. The ideas aiming at drastic reduction of employees in state administration **decelerate in practice only the growth rate of employment in the public sector**. **Employment abroad** is spreading further. In 2016, the **unemployment rate** is likely to drop to 5.8 per cent. In Hungary's most developed regions **employment is only of frictional nature** (in the western part of the country this is mitigated by commuting across the border). In certain parts of underdeveloped regions, such as in Heves and Tolna counties, the unemployment rate decreased significantly to about 5 per cent. This indicates that **market based employment creation** relying on economic recovery is much more successful than that based on artificial government measures. **Productivity** measured by GDP per employee is improving by a mere 0.5 per cent.

At the end of the first quarter of 2016, the **loan stock** of undertakings and households was **smaller** than one year earlier, that of households smaller than as of the end of 2015. **The portfolio quality of banks improved,** and as a result of the reduction of the tax rate imposed on banks, the **profitability** of the sector increased as well. The shortage of demand is still the major limiting factor of lending, nevertheless, this year **some increase** may be feasible in the **corporate segment**. Although the **liquidity and the capital adequacy ratio** of the banking system is **outstandingly good**, the transfer of the major part of the sector into Hungarian ownership, the **not transparently changing roles assumed by the government and the bank supervising authority constitute risk and uncertainty factors.**

In the first five months of 2016, trends in **general government** revenues and equilibria were excellent. Nevertheless, by the modification of the 2016 budget, the government has already tied the additional sum exceeding the planned one by HUF500 billion. Therefore, achieving the planned deficit amounting to 1.9 per cent of GDP is uncertain since, in part due to various pressures and the preparations for the parliamentary elections in 2017, the government is likely to **raise its expenditures** in the second half of 2016. **GKI reckons with a deficit of 2.3 per cent of GDP.** The convergence program envisaged the reduction of **government debt relative to GDP from** 75.3 per cent to 74.5 per cent by the end of 2016. **GKI reckons with a symbolic reduction** of government debt with a ratio of about 75 per cent since due to the increase of expenditures and the **advance payments** needed to accelerate the absorption of EU funds by the budget, the financing needs of the general government will be very high and its level relative to GDP lower than that expected by the government.

The rate of inflation is likely to accelerate slightly, totalling **0.8 per cent** in the average of 2016 and 1.5 per cent at the end of the year, year on year. The **0.9 per cent reference rate** of the National Bank of Hungary will hardly change in the course of 2016, the exchange rate of the forint to the euro is projected to average HUF315. With Brexit, money market volatility is on the rise.

Hungary's combined current and capital account has produced surpluses in almost every year since 2009; the surplus reached EUR9.5 billion in 2015. **In 2016, this surplus will drop to EUR8 billion due to the reduction of EU funds** in spite of **sharply growing current account surplus**. In the past seven years, **Hungary's capital stock** (apart from the enforced recapitalisation of the banking sector) did not

change as the net result of international capital movements. This is a sharp critic of the domestic international investment environment. FDI has been replaced by EU transfers. In 2015, **net FDI figures reflected capital withdrawal of around EUR0.2 billion**, and **no turnaround can be expected in this trend**. Other countries of the CEE region did not substitute but complemented FDI by EU funds.

The financing surplus that is outstandingly high by even international standards makes incomprehensible the policy of the NBH aiming at the continuous weakening of the exchange rate of the forint to the euro. In fact, a slight and **cautious appreciation would be justified**. This may help the gradual catching up of wages to the EU average and keeping the skilled labour force in Hungary. It is true, however, that it would not bring hundreds of billions of euros to the central bank that it could invest in a non-transparent way.

Compared to the projection of **GKI**, **slower rates are most probable than higher ones regarding GDP growth and inflation**, However, the **effects** of the management of **several political risks**, such as the refugee crisis and the direction of the future development of the EU may be **much more significant than those of other usual economic risk factors**.

Table 1

The forecast of GKI for 2016

	2012	2013	2014	2015	**2016 forecast**			
	fact				September	December	March	**June**
Production of GDP	98.3	101.9	103.7	102.9	102	102.3	102.3	**102**
• Agriculture (1)	79.0	115.3	113.9	87.1	100	105	105	**110**
• Industry (2)	97.8	97.5	106.7	106.3	104	104	104	**102**
• Construction (3)	93.7	105.8	112.3	102.9	102	100	95	**85**
• Trade (4)	99.4	106.3	104.3	105.7	101	103	103	**106**
• Transport and storage (5)	101.1	101.0	102.4	101.7	101.5	101.5	101.5	**102**
• Information, communications (6)	101.0	103.9	101.4	102.9	102	103	103	**103**
• Financial services (7)	97.2	95.2	97.1	99.8	100	102	102	**101.5**
• Real estate services (8)	98.2	100.3	99.6	101.1	102	102	102	**102**
• Professional, scient., techn. and adm. activities (9)	100.7	103.6	105.8	105.6	103	103	103	**105**
• Public administration, education, healthcare (10)	101.6	106.7	97.8	100.6	100	100	100	**101**
• Arts, entertainment (11)	97.3	100.0	104.8	106.0	102	102	102	**102**
• Core growth (2)+(3)+(4)+(5)+(6)+(7)+(8)+(9)	98.7	101.0	104.5	104.4	102.5	103	103	**102**
GDP domestic demand	97.0	101.2	104.2	101.5	100.3	101	101	**101.5**
• Private consumption	97.7	100.6	101.5	102.6	101.5	102.3	103	**104**
• Gross fixed capital formation (investments)	95.6	107.3	111.2	101.9	95	95	95	**92**
Foreign trade in goods								
• Exports	100.9	104.8	107	108.4	105.5	106	106	**106**
• Imports	100.0	105.0	108.5	107.8	104	105	105.5	**106**
Consumer price index (preceding year = 100)	105.7	101.7	99.8	99.9	102.5	101.7	100.8	**100.8**
Balance of current and capital account								
• EUR billion	4.3	7.7	6.3	9.5	7.5	7	8	**8**
• In per cent of GDP	4.3	7.5	6.0	8.7	6.8	6.2	7.2	**7.2**
Unemployment rate (annual average)	11	10.2	7.7	6.8	7	6.7	6.5	**5.8**
General government balance in per cent of GDP (ESA)	-2.3	-2.4	-2.5	-2.0	-2.3	-2.3	-2.3	**-2.3**

Source: HCSO, **GKI**

2. Economic expectations

Although the EU-wide sentiment index rose slightly in April and also in May, it has not yet reached its level at the beginning of 2016. Compared to April, May survey results show that expectations stagnated in industry and construction, whereas they improved in trade and services. Consumer expectations became slightly more optimistic as well. As far as Hungary is concerned, in January the GKI business sentiment index started the year from a high level not seen since the parliamentary elections in 2014. The index deteriorated somewhat until April, and stagnated basically in May and June. Since the beginning of the year, expectations of businesses have deteriorated almost continuously, but those of consumers have recovered slightly since the nadir of April, but they were still lower in June than at the beginning of the year.

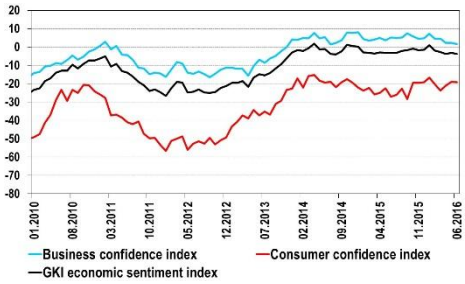
In the EU, industrial expectations have been improving steadily since February, though in very small steps, and they have not yet reached their January level. The **German business confidence index** has improved since March, and it is more favourable than at the beginning of 2016. Expectations in other sectors in the EU also improved slightly in May, and they are somewhat more favourable in construction, trade and services than at the beginning of the year.

In Hungary business and consumer expectations declined in June compared to May; however, changes were within the statistical margin of error, particularly in the case of consumers. The mood improved slightly in industry and construction. The industrial confidence index was close to its peak reached in January 2016 and especially the assessment of the stock of orders improved significantly. Compared to their lowest level in May, expectations in construction also improved. The trade confidence index fell, still reflecting a very optimistic mood. However, optimism of service companies declined considerably.

Intentions to employ strengthened slightly in all sectors in June, with the exception of service companies, and their levels were quite high (with the exception of construction). Employment intentions in trade reached their peak of all times both in May and June. In contrast, fear of unemployment intensified among households. Although **price expectations** were moderate in all sectors, perhaps with the exception of home building companies, inflationary expectations of consumers increased slightly. In June the assessment of the perspectives of the **Hungarian economy** deteriorated in all sectors and among consumers as well, and, with the exception of households and already pessimistic construction, quite spectacularly.

Figure 1

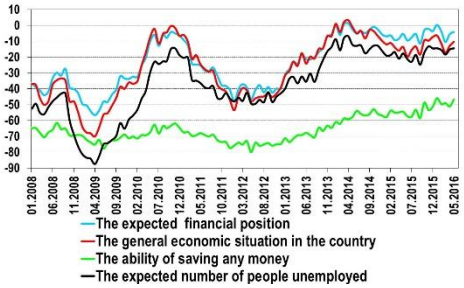
GKI economic sentiment index, 2010-2016



Source: GKI

Figure 2

The components of GKI consumer confidence, 2008-2016



Source: GKI

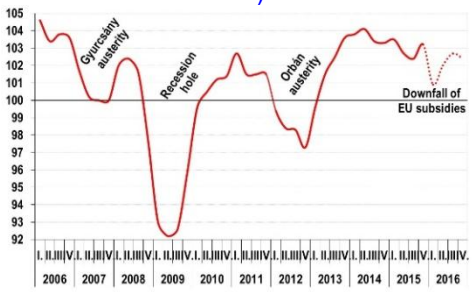
3. Economic policy

In the past months, economic policy has set to change implicitly aiming at the deterioration of disequilibria. The loosening envisaged in the 2017 budget, too, will have an impact on decisions to be taken in the rest of 2016. Internal and external equilibria remain favourable. The reorganisation of ownership relations and markets by active government involvement continues. Due to the decrease of EU transfers and hence investments, the deceleration of GDP growth in the first quarter of 2016 could have been foreseen. Nevertheless, in the light of investment restraining effects in the Hungarian model that had been at work for six years the slowdown proved to be unexpectedly spectacular. In addition, in some market segments sales problems appeared in the first quarter due to a downturn in economic activities. The main message of the less than 1 per cent growth is that the growth capacity of the Hungarian economy is minimal without EU transfers.

Figure 3

Quarterly GDP growth, 2006-2016

(The same period of the previous year = 100)



Source: HCSO, GKI

The **external and internal equilibria** of the Hungarian economy have improved significantly since 2011, when all credit rating institutions downgraded Hungary to "not recommended for investment". As a result, Hungary was exempted from the excessive deficit procedure in 2013, CDS spreads were declining for years, and the upgrading of the government debt also started in 2016 (by Fitch). Thus, Hungary is coming closer to its 1996 credit rating level (this was the first time its debt was qualified as investment grade). The S&P is not planning any upgrading due to Hungary's unpredictable economic policy, and Moody's decision is doubtful due to slower-than-expected GDP growth, the more relaxed 2017 budget and the scandals surrounding the National Bank of Hungary.

According to the new assessment of the European Commission published in spring, **there are no macro-economic imbalances** in Hungary, and risks associated with external factors and liabilities decreased (although refinancing needs related to external debt and the high rate of non-performing loans remain a problem). In addition to this positive assessment, however, international organizations, such as the EU, the IMF and the OECD repeatedly call attention to the importance of improving the business environment (making competition and public procurement more transparent, tackling corruption, reducing sectoral taxes), the predictability of economic policy and the reduction of the role of the state in order to **strengthen the growth potential of the economy**.

Both national and international factors played a role **in the improvement of external and internal equilibria**. The improvement in the current account was largely due to **strengthening Hungarian export capacity**, thanks to automotive investments pending at the time of the previous government, and the **reduction in the interest burden**. The reduction of the general government deficit was achieved by **strict fiscal policy** applying measures

curbing economic growth and entailing **negative** social consequences. However, this policy has undoubtedly achieved significant results in the **whitening of the economy** as well.

However, improvement in external financing capacity was **mainly due to EU transfers** as a much larger part of the surplus came from this source between 2011 and 2015. In addition, **low international energy prices and low interest rates also had a positive impact**. National tax revenues were increasing due to EU transfers. Rising foreign exchange reserves and low international interest rates greatly helped the rate cuts of the National Bank of Hungary and the decline of the yields of government securities (as well as the conversion of FX debt to HUF debt).

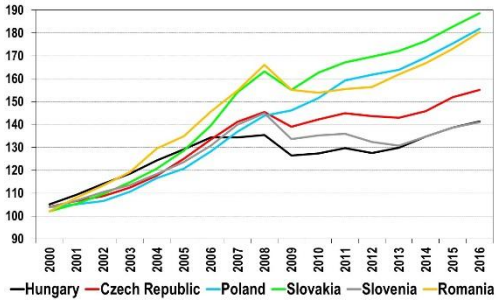
The growth rate of the Hungarian economy was below 0.7 per cent between 2011 and 2013, it **temporarily rose to 3.2 per cent in 2014 and 2015**, and **plummeted once again below 1 per cent** in the first quarter of 2016. The **rise and fall of EU transfers** played a crucial part in this. The government was undoubtedly successful in using EU transfers available until the end of 2015, as well as in avoiding penalties. However, it is unclear what will the utilization of EU sources make more effective in the next cycle.

Owing to this reduction in EU transfers, the government predicted a drop in investments already a year ago in the 2016 budget, and this forecast was even further reduced in the 2016 Convergence Programme. (Interestingly, the National Bank of Hungary predicted a slight increase in investments in the spring.) In order to brake the downturn, in 2015 the government announced the **accelerated utilization of EU transfers** by means of assigning the whole amount, in a unique way in the EU, until 2018-2019. However, **GKI has doubts about the viability of this concept**. In particular, the government planned the utilization of more than HUF2,000bn in 2016. The facts so far, that is, less than HUF100bn were paid to applicants until the beginning of June, makes the achievement of this goal unlikely.

In order to **promote economic growth**, the government took measures to support home building; however, these measures will have meaningful effects only from next year. The government also plans the **speeding up** of the preparation of public investments. However, this may even worsen the situation if the government continues to ignore the utilization of impact studies and collective bargaining in the decision-making process. In addition, the already announced large public investments, such as the Castle

Figure 4

GDP growth in selected Central European EU member states, 2000-2016 (1999=100)

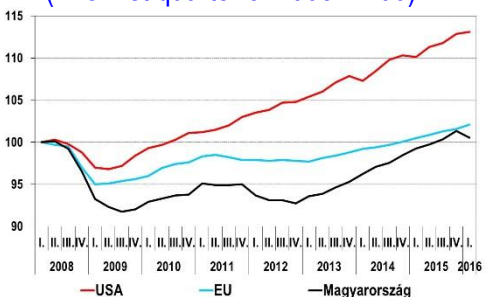


Source: European Commission, GKI

Figure 5

GDP, 2008-2016

(The first quarter of 2008 = 100)



Source: HCSO, European Commission, GKI

Hill and City Park projects in Budapest, the Paks II nuclear plant, the Olympics, and the Budapest–Belgrade railway line, are all **economically unviable projects**. In the interest of the future it would be justified to rethink these projects.

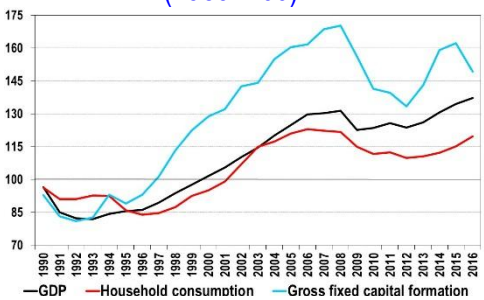
Restrictions on competition and **ownership rearrangement controlled by the state** continue vigorously. Examples can be found among cases of public procurement, such as the renovation of Russian subway cars, authorization of companies previously dismissed on account of cartel charges, some companies always winning in the past becoming certain losers, and the birth of new conglomerates almost from nothing. An example of the rearrangement of the markets was the strange privatization of MKB after the purchase of this loss-making bank by the government, or most recently, the **promotion and later the blocking** of the expansion of the **FHB bank group** involved in the integration of savings cooperatives by legal rules, and the involvement in the latter the theoretically independent banking supervisory authority. Further examples include the tightening of the position of voluntary pension and health funds due to the reorganization of the cafeteria system, the reorganization of chimney-sweeping and waste collection, the hostile takeover of the Zsolnay Porcelain Factory facilitated by the state, the plan for the conversion of the capital's tourist bus market into concessions, and the continuous changes in awarding public advertising orders in the media market. The domestic financing activity of Eximbank is also quite specific (or, so to say, strangely targeted). The centralization of local government financing has also started. The government is trying to **obscure the budget and the decisions of public companies** by legal means, and one of the latest ideas is to entrust the company register to the Chamber of Commerce instead of the independent court of registration. According to the country report of the European Commission, "competition in procurement remains limited." All this makes the whitening results achieved quite relative and the institutional environment anti-growth.

The Hungarian model has a negative impact not only on financial capital but human capital as well. **The growth strategy of the government based on cheap Hungarian labour seems to be failed.** Since more than half a million Hungarians work abroad, the shortage of skilled labour also limits domestic growth perspectives.

Keeping the skilled segment of labour force remaining at home, too, **compels substantial wage increases** in both the public sector and the competitive sphere, whereas

Figure 6

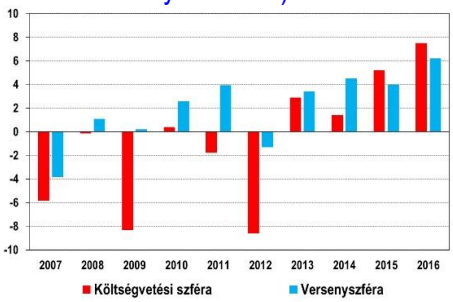
GDP, investments and consumption, 1990-2016
(1989=100)



Source: HCSO, GKI

Figure 7

Real earnings, 2008-2016
(including public employees, previous year =100)



Source: HCSO, GKI

only a tiny fraction of those involved in public workfare schemes can be employed in the business sphere. In the first quarter of 2016, real earnings grew by almost 7 per cent in the corporate sector, and by more than 11 per cent in the public sector (without those employed in public workfare schemes) and further significant wage increases have been announced for some in the public sector for 2016 and 2017. This will reduce the competitiveness of companies affected by these measures and enhance the expenditure requirements of the central government. However, households' demand for consumer goods may increase.

The problem is that this will mainly **boost imports** due to the weak adaptation ability of Hungarian production.

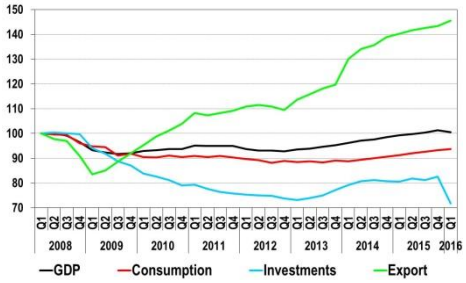
The government announced a comprehensive **anti-bureaucracy package** in 2015, promising the cessation of a number of institutions and the radical reduction of the number of employees. Since this concept did not question state-centred economic policies and economic management, it could not formulate ground-breaking proposals. Thus, it not only became blocked by various government agencies due to their disincentives but encountered obvious professional criticism as well. Therefore, the great initial enthusiasm is expected to diminish and result in a few **merger of institutions and hiring freeze**.

Until now, the loose, interest rate cutting and forint weakening policy of the **National Bank of Hungary** has failed to boost lending. However, the forint weakening policy devalues the whole Hungarian economy. The activities of the National Bank of Hungary continue to **far exceed** the scope of monetary policy and even activities permitted by the Central Bank Act. As a result of **the self-financing program** of the NBH, the liquid assets of the banks are embodied increasingly in government securities. This is completely different from the European trend according to which the financial intertwining of banks and governments should be avoided as in the case of any uncertainties in the solvency of the government it would be difficult for the banks to acquire external sources. (In the balance sheets of Hungarian banks the share of government securities exceeds the level recommended by the EU.) In addition, it is a **highly exaggerated assumption** that in case of an internal or external shock domestic economic actors will not buy foreign currency and take it out of Hungary, similarly to foreign economic actors. The stock of government securities held by the foundations of the National Bank of Hungary is substantial, which may trigger accusations of **prohibited**

Figure 8

GDP, consumption, investments and exports, 2008-2015

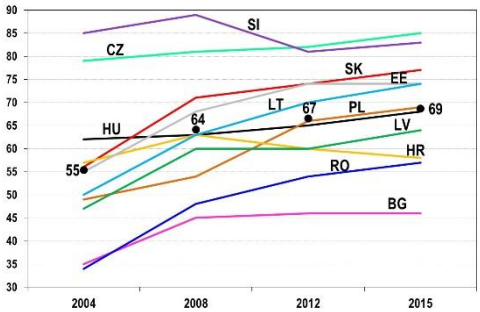
(The first quarter of 2008 = 100)



Source: HCSO

Figure 9

CEE11 countries' GDP measured in PPP in percentage of EU average 2004-2015



●: Average of CEE countries
Source: EU

monetary financing. Presumably, mainly as a result of the ECB's criticism, the National Bank of Hungary paid slightly more than one quarter of its 2015 profits (HUF50bn) into the budget, and its foundations started to prepare a policy change of investing in real estate instead of government securities. However, this is also **outside the usual scope of central bank activities**.

The fiscal spending of the profits of the National Bank of Hungary is already a problem theoretically, whereas its actual execution ignoring market economy rules is **legally questionable**, which also provoked criticism by the ECB. The establishment of MARK Zrt. for the **purchase of bad loans** can be helpful in principle; however, the obscurity accompanying the nationalization and subsequent sale of MKB Bank and the scandals associated with the foundations of the National Bank of Hungary can cause understandable mistrust in connection with this activity, too.

4. Household income, savings and consumption

Due to sharply increasing incomes of a specific part of households, decreasing credit burdens and intensifying propensity to purchase, consumption is set to recover, leading to a 4 per cent increase in 2016. There are labour shortages in many professions due to work abroad and the obsolescence of the educational system resulting in a strong pressure for wage increases. However, the minimum wage increase of 5.7 per cent is causing great concern in other areas as well. In 2016, growth earnings are likely to grow by 6 per cent. As a combined result of the 0.8 per cent inflation rate and the reduction of the personal income tax rate by 1 percentage point, real earnings are predicted to mount by 6.5-7 per cent amidst quite enormous differentiation. The real value of pensions will rise slightly.

In 2015 real earnings grew by 4.3 per cent (by 4.6 per cent with the exclusion of those employed in public workfare schemes). Real earnings increased by an average of 4 per cent in the competitive sector and by 5.2 per cent in the public sector, which was the result of nominal wage increases in a few occupation groups such as teachers, family doctors and policemen. As a result of repeated surprise inflation, real pensions grew by 1.9 per cent; according to the estimation of GKI real incomes by 3 per cent. The growth rate of consumption was similar to that, amounting to 2.6 per cent. Average gross earnings increased by 6.1 per cent **in the first four months of 2016**. This increase included the raise of the minimum wage and the guaranteed minimum wage, the carryover effects of wage increases from the previous year, the increase of the salaries of the armed forces in the public sector and the additional bonus paid to workers in the social sphere. Owing to the reduction of the personal income tax rate, net earnings grew faster, by 7.8 per cent, and real earnings by 7.5 per cent.

From 1 January 2016, the **minimum wage** of full-time employees totals HUF111 thousand, the wage minimum of those with at least medium degree of education HUF129 thousand. Thus, in 2016 both types of minimum wage will mount by 5.7 per cent, this is the highest rate in the past four years. While the shortage of skilled workers is leading to wage competition in a number of private sector companies, particularly in manufacturing and trade, raising the minimum wage so much causes problems in many undertakings. Until 2011, the minimum wage accounted for 35-36 per cent of average gross wage, later on it grew to 42-43 per cent. This strong jump has not accelerated the increase of gross average wages. Companies **try to adjust** to the changes by other means such as extension of part-time employment, reduction of the share of officially declared wages, etc. While in certain segments of the economy the **wage level is low even in regional comparison** and allows for wage increases without impairing competitiveness, this is not impossible in other segments.

Table 2

Earnings, incomes and consumption of employees, 2013-2016

(the same period of the previous year = 100)

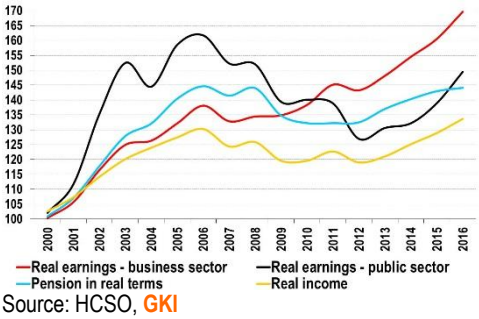
	2013	2014	2015	2016
Minimum wage	**105.4**	**103.6**	**103.4**	**105.7**
Gross earnings	**103.4**	**103**	**104.2**	**106**
- Competitive sector	103.6	104.3	103.9	105.5
- Public sector	103.6	101.2	105.1	107
Net earnings	**104.9**	**103**	**104.2**	**107.5**
- Competitive sector	105.2	104.3	103.9	107
- Public sector	104.6	101.2	105.1	108.5
Real earnings	**103.1**	**103.2**	**104.3**	**106.7**
- Competitive sector	103.4	104.5	104	106.2
- Public sector	102.9	101.4	105.2	107.5
Real pension	**103.4**	**102.4**	**101.9**	**100.8**
Real income	**101.7**	**103.4**	**103**	**104**
Consumption	**100.2**	**101.5**	**102.6**	**104**

Source: HCSO, GKI

In 2016 the personal income tax rate decreased by 1 percentage point, to 15 per cent, raising the gap between net and gross earnings by 1.5 per cent. Thus, in addition to the rise of gross earnings by around 6 per cent in 2016 that will be faster than in the previous year, net earnings will increase by 7.5 per cent. Provided that the inflation rate is 0.8 per cent, **real earnings will go up by 6.5-7 per cent** (by more than 6 per cent in the private sector). In the public sector significant wage increases can be expected in subsectors with **career models**, for example, in healthcare from 1 September.

Figure 10

Real earnings and real pensions, 2000-2016 (1999 = 100)



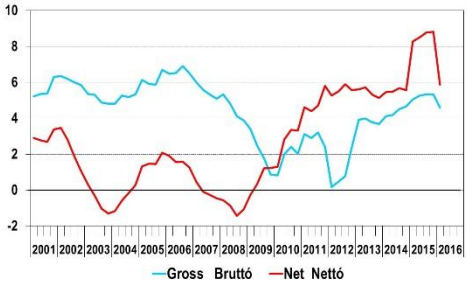
Source: HCSO, GKI

The government increased **pensions** by 1.6 per cent from 1 January 2016 (that is, by the rate of inflation projected by the government, though this rate is most probably overestimated by about one percentage point). Thus, the real pension will rise again, that is, **the 13th month pension was recovered in four years**. The nominal value of family allowances and other social benefits will remain unchanged in 2016 as well. Business incomes as well as the nominal value of family tax benefits will rise. The actual number of employees (including those involved in public workfare schemes) may increase slightly; incomes earned abroad and remitted home will also rise. **In 2016 the growth rate of real incomes will be around 4 per cent. Consumption** will expand similarly, **by around 4 per cent**.

Figure 11

Net monetary savings of households (without private pension funds) in per cent of GDP, 2001-2016

(Change of stock in 4 quarters)



Source: NBH, GKI

The **net financing capacity of households** was 6.1 per cent of GDP during the year ended by the first quarter of 2016, and 5.7 per cent of GDP in the first quarter of 2016. (In 2015 this rate was increased by the conversion and settlement of FX loans and the resulting decline in the retail loan portfolio.) **The amortisation of households' debts continues to exceed their borrowings in 2016, too.** However, new borrowings are slightly increasing, and precautionary savings may gradually drop. The net financing capacity of households was outstanding in 2015 (8 per cent). In 2016 it will remain within the former range of 5-6 per cent of GDP (in the lower zone).

After three years of growth, this was **the first time that households' cash holdings decreased** on a quarterly comparison. This was probably due to a rise in "households' other equity", since some of the limited liability companies implemented a mandatory capital increase at that time. The interest rate level of bank deposits that are the primary means of savings is hardly higher than zero. In addition, considering the costs of cash withdrawal, the interest rate may be negative in some cases. **Deposits are decreasing, whereas the proportion of government securities is rising.**

5. Investments, capital formation

Following the contraction recorded between 2009 and 2012, gross fixed capital formation is likely to expand by 6-7 per cent annually in the average of 2013-2015. Nevertheless, within this time frame, the gross rate of investments was a mere 0.6 per cent in 2015. With the decline of EU transfers and the lack of confidence of the business sphere, investments are expected to contract by 8 per cent. With the Funding for Growth Scheme(s) of the National Bank of Hungary (NHB), the average credit cost of investments dropped somewhat, but it is still rather high (especially in light of the declining producer price index), and the major part of businesses does not want to borrow from the banks. On the other hand, SMEs with good perspectives are able to obtain relatively cheap funding. Thanks to the support of the EU, zero per cent interest loan options have been open for investment purposes since early 2016. The investment rate was about 21-22 per cent of GDP in 2014-2015, it will drop below 20 per cent in 2016, to a very low ratio in a country with medium level of economic development.

In the first quarter of 2016 investments stagnated or declined in almost two-thirds of sectors. This decline has been particularly substantial in sectors affected by EU transfers, such as transport (more than 40 per cent drop) or manufacturing (close to 4 per cent). Investments grew in the following sectors: electricity (200 per cent), construction (6 per cent), trade and repair (3 per cent), hotels and restaurants (16 per cent), information and communication (11 per cent) and arts, entertainment and recreation (32 per cent) and other community services (190 per cent). The total volume of investments fell by 9.6 per cent, whereas gross fixed capital formation, having a slightly wider scope, by 7.8 per cent.

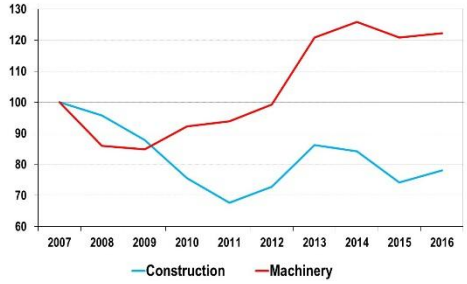
In 2005, **construction investments** fell by 2.3 per cent, whereas **machinery investments** grew by 4.1 per cent. In 2016 investments are expected to contract by 12 per cent in construction and by 4 per cent in machinery.

In the second half of 2016 the housing market will pick up. Hungary continues to be unable to attract large investors (the volume of announced new projects is small, with significant government support) and domestic-owned SMEs are typically unable to come up with big ideas. Some of them are specifically afraid of rapid growth, so as not to attract attention, which could lead to becoming another victim of nationalization or state-controlled ownership rearrangements.

Although the government began to advertise the **tenders** of the new EU budget period started in 2014, the announcement of the results typically requires six or more months instead of the promised one month. Project targets of new tenders are fragmented and unclear; **the main objective is invariably to spend money fast**. This can be seen from the fact that the government wishes to announce all calls for tenders until 2017. However, **there is no substantial acceleration** compared to the previous period, given the fact that two and a half years have

Figure 12

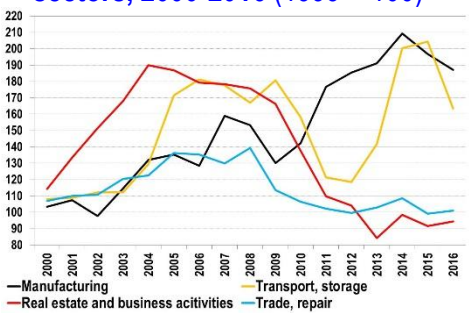
Investments in construction and machinery, 2008-2016 (2007 = 100)



Source: HCSO, GKI

Figure 13

Investments according main sectors, 2000-2016 (1999 = 100)



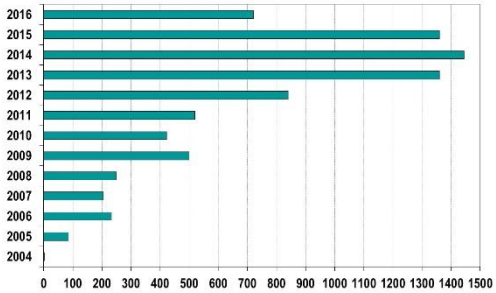
Source: HCSO, GKI

already elapsed from the current period as well. From the EU funds allocated for the 2014-2020 budgetary period, only HUF100 billion were disbursed until early June; this corresponds to **less than 5 per cent** of the total of HUF2,140 billion planned by the government for 2016.

The amount disbursed until now is only 5-6 per cent of the sums awarded (approximately HUF1700bn), and just over 1 per cent of the total funds (together with Hungarian co-financing). **The adoption of costs exceeding the price calculated in advance is typical** of investment projects irrespective of the fact that they are financed by EU transfers or by domestic sources. In the case of certain projects, it is no longer required to submit expense invoices.

Figure 14

EU transfers spent on investments, 2004-2016 (HUF billion)

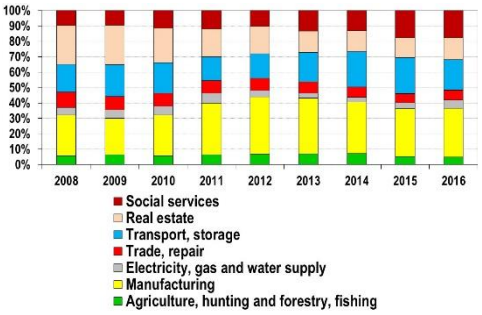


Source: GKI

In 2016, investments in the electricity industry are expected to grow by about 40 per cent (in connection with the expansion of Paks, regardless of the fact that anything of it will materialize or not). Investments in manufacturing increased by 3-5 per cent in 2012 and 2013, and jumped by 10 per cent in 2014. However, this was limited to a small number of companies in the motor industry and their suppliers such as Mercedes, Audi, Opel, Hankook, Bridgestone and Bosch. In 2015 a fall by 6 per cent took place in part due to the high statistical base. In 2016 a 5 per cent drop is likely. The volume of investments has fluctuated in recent years in the real estate and business services: the 7 per cent fall in 2015 may be followed by a 3 per cent increase in 2016 due to the boost in housing construction. A similar increase in construction investments is also likely.

Figure 15

Sectoral breakdown of investments, 2008-2016



Source: HCSO, GKI

Investments dropped by 9 per cent in trade in 2015, and they may increase by 2 per cent in 2016 due to growth in purchasing power and the reapproval of the opening of stores on Sundays. In the past three years, investments grew by an average of 20 per cent per annum. Primarily as a result of the fall of EU transfers, they will decrease by 20 per cent in 2016. Fixed and mobile broadband development continues in the info-communications sector. After fluctuating investment activity of recent years, a 10 per cent increase can be expected in 2016. New hotel and spa capacities were introduced in the commercial lodgings and catering sector. This sector grew by 35 per cent in 2014, it plummeted by 18 per cent in 2015, and stagnation can be expected in 2016.

Investments by central and local governments rely almost exclusively on EU transfers. The central authorization of borrowing further reduced the scope of action for local governments. The debt of municipal companies reached HUF1,300bn, and it continues to grow

this year as a result of overhead reductions in previous years. **The near-bankruptcy situation of the utility companies of municipalities being affected by overhead reductions indicates that they are no longer golden mines but rather bottomless money pits.**

Further problems arise from investment projects aiming at the development of institutions (mainly in tourism and sports) since there are no financial sources for running them.

Problems are exacerbated by imprudent and forced nationalization in healthcare and education.

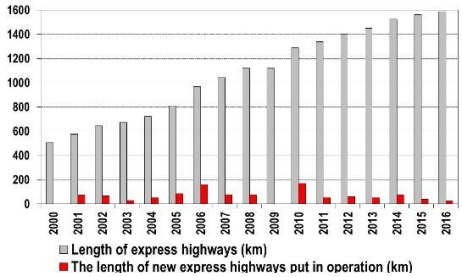
Since it is more and more difficult to obtain EU transfers for achieving objectives **preferred by the government**, in the 2016 budget far-fetched projects related to road construction, sports and culture were included partly to counterweight declining EU transfers. Thereby, the expected plummet of investments can be mitigated.

Business investment lending is uncertain. Fresh public funds are available for companies (loans, guarantees) to assist the implementation of corporate investments from EU funds. The phasing out of the Funding for Growth Program starts this year, nevertheless, there are commitments by banks to revive the investment credit market. In May 2016 MFB started to offer **zero per cent interest rate investment credits** to SMEs, based on EU sources. As a result of the expected interest rate increases in the US, at the end of 2016 rates in Hungary are also likely to increase in corporate lending. In principle, the cleaning of the portfolios of banks may raise the lending activity of banks. Nonetheless, the **genuine demand for loans is rather low** in the corporate sector (those who would need loans are not credit-worthy, and those who would be awarded loans do not need them).

The FGP+ program, which also assumes some part of the credit risks of banks, will probably only achieve the replacement of bank credits by loans provided by the resources of the National Bank of Hungary. This results in excessive bank liquidity, which flows to the government securities market and the fortnightly deposit market of the National Bank of Hungary (and also decreasing the former parent bank funding).

Figure 16

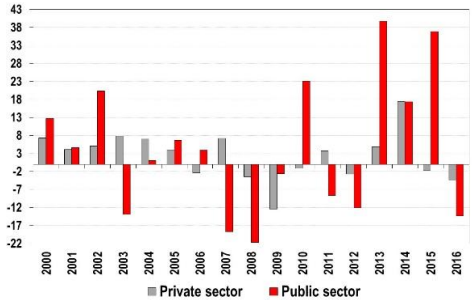
Length of express highways 2000-2016



Source: HCSO, GKI

Figure 17

Public and private investments, 2000-2016



Source: GKI

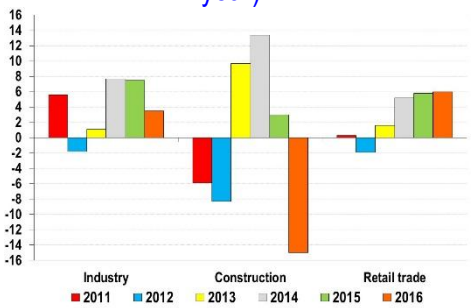
6. Real economic trends

In the first quarter of 2016 only the GDP growth rate of Greece was slower than that of Hungary. Because of the figure that was much worse than expected, GKI downgraded its GDP growth forecast for this year from 2.3 per cent to 2 per cent, but even a lower growth rate is feasible. In 2016, contraction is likely only in construction, but the growth rate of industrial production and foreign trade, too, is slowing down, whereas that of services is slightly accelerating. As the combined result of the decline in 2015 and the favourable weather conditions in the first half of 2016, the rate of GDP growth in agriculture may reach 10 per cent.

Figure 18

Sectors, gross output, 2011-2016

(Changes in per cent of the previous year)



Source: HCSO, GKI

While **the growth rate in the EU increased** from 0.3 per cent to 0.5 per cent compared to the previous quarter, it **declined by 0.8 per cent in Hungary** (the worst in the EU). (Compared to the previous quarter, there was a decline only in Greece and Poland but only by 0.1 per cent). The rate of Hungary's GDP growth year-on-year according to EU methodology was only 0.4 per cent. With the exception of two Baltic states, GDP growth rates of Hungary's competitors in the CEE region were at least 2 per cent, with 3 per cent in the Czech Republic, 3.7 per cent in Slovakia and 4.2 per cent in Romania.

However, the decline in construction may abate significantly during the rest of 2016, industrial growth already picked up in April, sectors providing households with goods and services may grow, and agricultural production has also good prospects. **As a result, GKI reduces its 2016 growth forecast from 2.3 per cent to only 2 per cent, though the actual rate might easily be lower than this.** Although the new forecasts are typically identical or similar, **for the time being the government and the central bank maintain** their forecasts of 2.5 per cent and 2.8 per cent, respectively, whereas the **OECD, for example, already lowered its 2016 forecast from 2.4 per cent to 1.6 per cent**.

Table 3

Industrial production, 2012-2016

(The same period of the previous year = 100)

	2012	2013	2014	2015	2016
First half	99.0	98.4	109.5	107.7	102
Second half	96.7	104.4	105.4	107.4	105
Year, total	98.3	101.4	107.6	107.5	103.5

Source: HCSO, GKI

6.1. Industry

In March, industrial production had decreased for five consecutive months. Production in the motor industry accounting for nearly one third of total industrial output dropped by 1.6 per cent in the first quarter of 2016. The problems hit first of all Audi. The general trend of slowdown is indicated by the fact that in this time period the performance of 7 branches out of 13 decreased in manufacturing. Nevertheless, in April industrial production was up by 5.4 per cent compared to March. Industrial production is expected to increase by 3.5 per cent in the average of 2016 compared to the 1.5 per cent growth recorded in the first four months of the year.

In the EU, industrial expectations have been improving steadily since February, though in very small steps, and they have not yet reached their January level. The German business confidence index has improved since March, and it is more favourable than at the beginning of 2016.

Although in recent months car sales have been favourable on the continent, the slowdown in emerging countries curbs European industrial exports. The decline in the Russian and Latin American demand and the drop in Chinese growth entail serious problems in the automotive industry. However, the poor performance can be explained by **domestic reasons** as in the first quarter of 2016, industrial GDP decreased by 0.7 per cent over the previous year in Hungary, whereas it rose by 1.7 per cent in the EU. Based on the unfavourable data of the first quarter, **GKI reduced its growth forecast for gross industrial production from 5.5 per cent to 3.5 per cent**.

In the first quarter of 2016, industrial production grew by 0.7 per cent, and manufacturing output was 0.9 per cent higher than in the previous year. The output of the automotive industry decreased by 1.6 per cent. The largest decline was registered in mining (38 per cent), probably because of the fall in construction material needs. The production of machines and equipment also dropped considerably (by 13 per cent), and the performance deteriorated in several areas. The production of chemicals and chemical products and the output of the pharmaceutical industry also decreased. **The 13 per cent expansion of the electronics industry is encouraging.** It was partly driven by the 36 per cent growth in parts production and partly by the 21 per cent increase in the production of consumer goods. Of the subsectors, only computer and peripheral production dropped, though by more than 10 per cent.

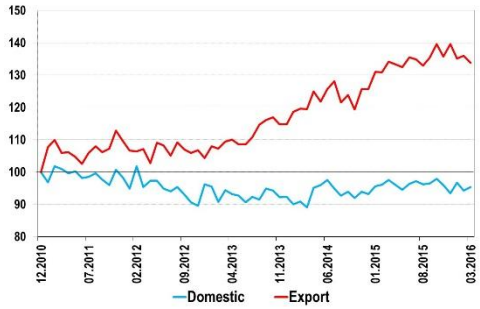
Sales almost stagnated in the first quarter of 2016, **exports** grew by 1.1 per cent, while **domestic sales** fell by 1.7 per cent. The same subsectors were able to grow both in exports and domestic sales. The value of exports made up two-thirds of the value of total sales.

GKI survey results show that capacity utilization in the manufacturing industry have been over 80 per cent for more than a year. This would justify an increase in investments. In contrast, investments in manufacturing were declining for the fourth consecutive quarter compared to the same period of the previous year. No further intentions to expand were indicated by the surveyed companies either. Compared to the expected demand, the majority of respondents considered their

Figure 19

Industrial sales, 2011-2015

(December 2010 = 100)

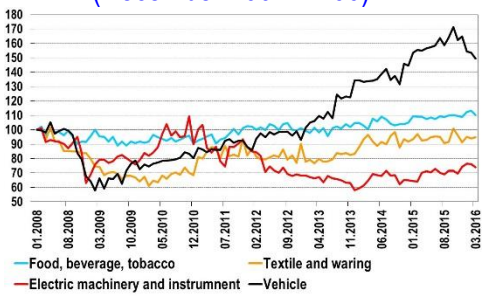


Source: HCSO

Figure 20

Hungarian industries, 2008-2016

(December 2007 = 100)



Source: HCSO

capacities sufficient, or even superfluous, thus manufacturing investments cannot be expected to pick up in 2016 either. Investments of some large international companies are in progress, of which the largest one is the Apollo Tyres factory.

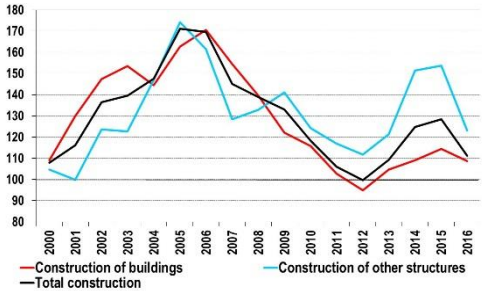
In 2016 the Hungarian government announced the **Irinyi Plan**, which will focus on industries where Hungary has comparative advantages.

However, economic research shows that there are competitive enterprises capable of growth in all sectors, thus any preliminary decision on winners is unjustified. Recent ideas concerning domestic bus manufacturing suggest that these concepts are shaped mainly by lobbying interests, and thus they do not improve the competitiveness and growth capability of the economy. Interestingly, the government's idea of **reviving domestic bus manufacturing** was compatible with emphasizing the risks of overdependence on the automotive industry based on experience in the first quarter. (International experience shows that it is viable to manufacture buses only for large countries.)

Figure 21

The volume of construction output by construction groups, 2000-2016

(1999 = 100)



Source: HCSO

In the first quarter of 2016, the **number of employees** increased by 3.3 per cent **in industry** and by 3.1 per cent in manufacturing compared to last year. Within manufacturing, the highest growth was registered in the electronics industry and other manufacturing (mainly in the production of furniture, sports goods and toys). The only subsector where employment declined was the food industry. **GKI** survey results show that companies **plan further recruitment and one of the biggest problems is the shortage of skilled labour**. However, it seems that **financing ceased to be a serious problem for companies**.

In 2015 the **energy consumption** of the Hungarian economy increased by 4-5 per cent, mainly due to the 9 per cent expansion of fuel consumption (driven by price drops). In normal weather conditions, taking into account the slower economic growth, no significant increase can be expected in energy consumption in 2016. Gas consumption may decrease, electricity consumption will stagnate, and only fuel consumption can increase by 4 or 5 per cent.

6.2. Construction

The performance of construction is highly dependent on demand generated by the inflow of EU funds, the increase of funding triggered the spectacular growth of the past years and its sudden stop the fall of this year. The planned increase of the disbursements at

the expense of the 2014-2020 budgetary period of the EU and the recovery of home building as a result of government promotion measures will be sufficient to brake the contraction of this year, in 2016 production is likely to plummet by 15 per cent.

The construction industry fell in early 2016: after a strong increase in the previous three years, **in the first four months of 2016 production dropped by 28.3 per cent** compared to the same period of the previous year. The decrease in **structural engineering** was not dramatic (–11.5 per cent), whereas **civil engineering** practically collapsed (–47 per cent) in connection with the drying up of payments from the funds of the 2007-2013 EU budget period.

Although construction investments in the national economy decreased by 19.2 per cent in the first quarter, the sector's own investments were up by 6.1 per cent.

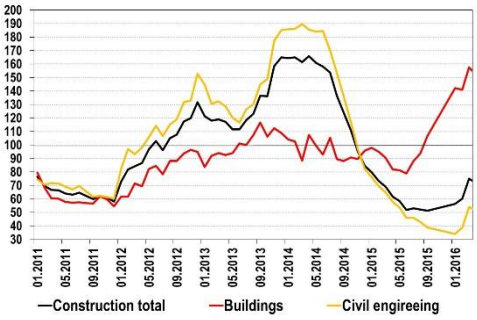
In the first quarter of 2016, **20 per cent less construction companies were wound up than a year earlier**. However, this decline is mainly technical in nature, as there was a great surge in company liquidations in 2015. The number of new entrants remains low. The legal and regulatory environment is constantly changing; this does not enhance confidence among stakeholders in the sector. **GKI's construction confidence index** has decreased steadily and significantly since February, and in May it reached its lowest point in the past 32 months. Expectations of home building companies were significantly more favourable than the industry average.

The **stock of contracts** in construction indicates a substantial decline: in March 2016 it was **25 per cent lower** than a year earlier. The volume of new contracts concluded in the given month, however, has decreased only in a single month since last September. Although this cannot be interpreted as a signal of growth, **a reduction in the rate of decline** can be expected. The two main categories in construction are in opposite situation: while the volume of **new contracts** dropped by 47 per cent in civil engineering, it increased by 58 per cent in structural engineering. The demand for construction declined significantly in the **public sector** in 2016, especially in the fields of transport, as well as in environment and water management. As a result of the combined effects of the VAT rate cut and the home purchase assistance scheme (CSOK), **housing construction** may pick up in the second half of the year, however, substantive effects can be expected only from 2017. Construction demand of the business sector cannot be expected to recover mainly due to the unpredictable economic policy of the government

Figure 22

Stock of contracts in construction, 2011-2016

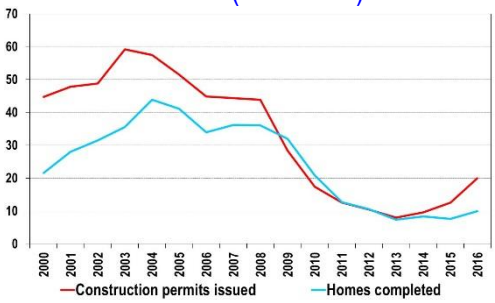
(Volume index, corresponding period of previous year = 100)



Source: HCSO

Figure 23

Housing construction and permits 2000-2016 (Thousand)



Source: HCSO, GKI

(often changing its priorities and tools). There is hardly any greenfield investment in manufacturing. In 2016 only the magnitude of the fall in construction output could be in question. If housing construction picks up in the second half of the year and demand for investments in the public sector recovers significantly, the decline might be limited to 15 per cent in 2016.

Producer prices in construction were 2.5 per cent higher in the first quarter of 2016 than a year before. This rate of price increases may continue in 2016 as well.

Table 4

Grain harvest, 2013-2016

(Thousand tonnes)

	2013	2014	2015	2016
Wheat	5,058	5,262	5,500	5,600
Maize	6,756	9,315	6,500	7,000
Total grain	13,610	16,614	14,000	14,000

Source: HCSO, GKI

6.3. Agriculture

Although good agricultural harvests can be expected due to favourable weather, sales difficulties may intensify. GKI expects that agricultural GDP will increase by about 10 per cent in 2016.

The International Grains Council predicts that **the world's second highest grain harvest of all times (2 billion tons) can be expected in the 2016/2017 season**. The crop outlook improved primarily in the European Union, the US and Russia, whereas it deteriorated slightly in Asia and North Africa due to the dry weather. The growth of corn consumption keeps pace with the expansion of production, whereas that of wheat lags behind it. Accordingly, the **world market price of corn** is expected to **rise** by about 5 per cent in 2016, and that of **wheat** will **stagnate**.

Table 5

Livestock, 2013-2016

(end of year, million)

	2013	2014	2015	2016
Swine	3.0	3.1	3.1	3.3
Cattle	0.78	0.80	0.82	0.85
Poultry	29.5	30.5	32.4	32.0

Source: HCSO, GKI

Thanks to the favourable **weather** so far, a good grain harvest is likely in Hungary. The warm, humid weeks, however, provide favourable conditions for the multiplication of pests, and may cause severe yield losses for farmers who tried to save on professional pest control. The possibility of draughts not uncommon in July and August poses similar risks as the proportion of **irrigated** land is still low. According to 2014 data, only 130 hectares of Hungary's 5300 hectares of agricultural land were irrigated. Spring frosts caused significant damage to the fruit growing industry.

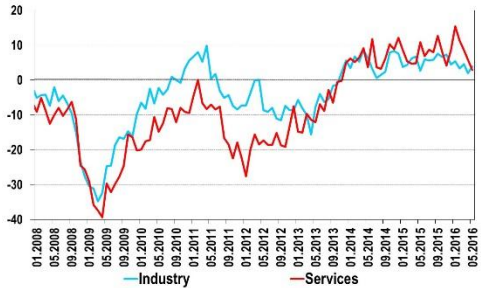
Recently, the government has promised major efforts to **stimulate** the declining **livestock farming**. The results have been modest. The crisis of **milk production**, which started years ago, intensified in 2016. The purchase price of milk decreased by 13 per cent in the first quarter of 2016 compared to last year, which is higher than the 2-2.5 per cent decline in the world market prices of milk. The competition intensified in the milk market of the EU due to the Russian embargo. This problem was exacerbated by the elimination of an element of the former system of agricultural subsidies, the milk production quotas, in 2015

(announced more than ten years before). The lifting of restrictions led to overproduction. The EU tried to solve this problem by voluntary production restrictions, without success. Although the domestic cow population increased last year, **the Hungarian dairy farmers are not able to stand the competition**. Although the volume of milk purchased in the first four months of 2016 increased by 2.4 per cent compared to last year, and the volume of imports also decreased by 14 per cent in the first quarter, **producers call attention to constant problems in selling their products**. In 2016 oversupply will characterize the world market and in particular the European market, thus the prospects of the sector are poor.

In the first quarter of the year, **live pig** imports dropped by 22 per cent, and exports decreased by 14 per cent. This is due to the whitening effects of the reduction of the VAT rate. The number of registered pigs remained essentially unchanged in 2015.

Figure 24

Business confidence indicators, 2008-2016



Source: GKI

6.4. Services

In 2016, GDP in services is projected to grow by about 3 per cent representing slight acceleration compared to the 2.8 per cent increase in 2015. GDP in public services is likely to go up by about 1 per cent, the increase of the whole branch will be nurtured by growth in business services, especially in the commercial and tourism sector.

Last year the government announced a **reorganization of the public administration system** in 2016, entailing huge layoffs. The winding up of a great number of background institutions has died away (in the lack of appropriate conceptual foundations), in part it took the form of incorporating institutions in the administration, which hardly entail any layoffs automatically. The situation is not yet clear, however, it is likely that **the number of employed in public administration will not decline, only the rate of increase will slow down**, and reorganizations will cause temporary disruptions. The number of those involved in public employment schemes will not decline year on year; a slight increase of it is more likely. The **government's increasing role** in economic governance and acquiring ownership in private assets entail the creation of further institutions, which may lead to an increase in employment, in addition to that in public workfare schemes.

Table 6

Number of people in public services,2011-2016

(preceding year = 100)

	2011	2012	2013	2014	2015	2016
Public administration	96.5	104.6	113.5	110	110.9	104
Education	97.8	99.3	98.1	104.5	98.4	98
Healthcare	101.4	105.1	99.1	102.1	100.9	102

Source: HCSO, GKI

In education the number of teachers is expected to contract slowly due to the fall in the number of pupils and budget cuts. The promised summer reforming of KLIK (the

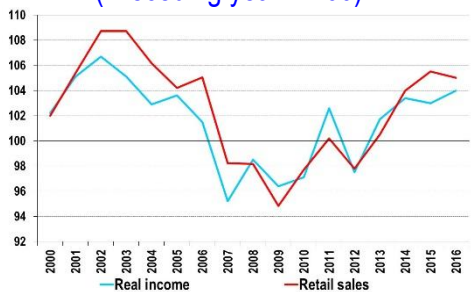
mammoth institution managing public education) will not change the essence of the system. **The quick and ill-considered reforming of the organisation that cannot function properly does not exclude the further intensification of chaos.**

In connection with the use of EU transfers further restructuring can be expected in **healthcare**: hospital closures and expansions, construction of a new hospital and mergers of existing ones. Although the introduction of a **chancellor system** aims at reducing the costs, one-sided centralization (exacerbated by the planned elimination of NHIF) causing lack of transparency can only lead to the spreading of processes known from the era of shortage economy. The concept of reforming healthcare, which seems to be no more than brainstorming, is constantly changing, and in everyday practice centralizing efforts simply mean anarchy. **Healthcare is becoming less accessible to the average citizen**, and dissatisfaction of the public with healthcare is increasing. **Remuneration of health professionals is extremely low in all kinds of comparison**, and their workloads often reach intolerably high levels.

Figure 25

Real income and retail trade turnover, 2000-2016

(Preceding year = 100)



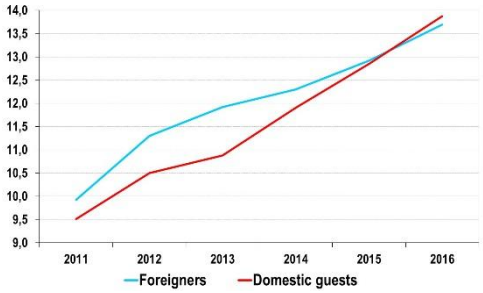
Source: HCSO, GKI

This is behind the huge outflow of labour in this sector, which further increases the workload. The considerable **wage increases** for 2016 and 2017 announced in June **can improve the situation**; however, they will probably be sufficient only to **mitigate the outflow**. The **private sector** is gaining ground in health care and education, whereas the quality of public services is deteriorating rapidly. This further enhances the already excessive social differentiation and freezes mobility.

Figure 26

Performance of commercial lodgings according to the origin of guests, 2011-2016

(Overnight stays, million



Source: HCSO, GKI

The GDP of **business services** grew more rapidly than the whole service sector in 2015. The same can be expected in 2016. This is promoted by the rise of consumer demand, whereas the contraction of investments narrows demand for services associated with investment projects. Exports of services will increase further, particularly in transport, in the service centres outsourced to Hungary and in tourism.

Retail sales increased by 4.7 per cent in the first four months of 2016. Fuel sales mounted most strongly (by over 5 per cent), and daily articles the least (by 2.3 per cent). The trade confidence index has been fluctuating at quite high levels for more than a year and a half. This, together with **growth in purchasing power** may justify the **fast increase of turnover (about 5 per cent)**. The whitening of the economy triggered by online cash registers, too, must have played a part in the higher growth rates of 2015. With the increase of purchasing

power, demand for more expensive and higher quality goods tends to go up slowly. The number of small shops is continuously decreasing, and discount chains are expanding at the expense of hypermarkets. **Online trade** was also able to substantially increase its market share. The reapproval of the **opening of stores on Sundays** primarily serves the convenience of customers; however, it contributes to the dynamic increase of turnover as well.

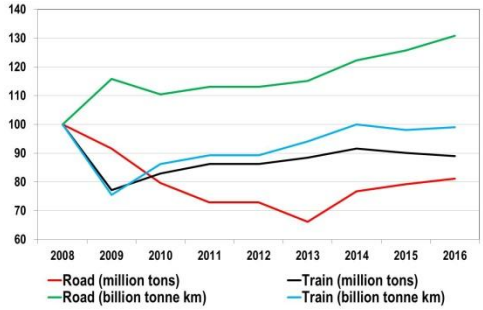
In the first four months of 2016, overnight stays in **commercial lodgings** increased by 7.2 per cent, whereas revenues by 8.5 per cent compared to the same period of 2015. Overnight stays of domestic guests increased by 8.6 per cent, those of foreign ones by 5.9 per cent. Owing to the rapidly growing demand of domestic guests, 2016 will be the first year since 2010 that **domestic guests will dominate** in Hungarian commercial lodgings. Total overnight stays are expected to increase by 7-8 per cent in 2016 due to the rapidly growing purchasing power, the relatively weak forint and small terrorist threat.

The performance of **transport of goods** (measured in freight ton kilometres) increased only by 1 per cent in 2015, whereas it grew by 3 per cent in the first quarter of 2016 compared to the same period of the previous year. The increase was mainly due to the 4 per cent growth in road transport. **Road transport** has been increasing since 2010, and it is the growth engine of the sector. Its share in the total performance of the sector was 70 per cent, while the share of rail was only 16 per cent (the proportion of rail transport in the EU was 18 per cent). The performance of **rail transport** essentially stagnated in the first three months of this year (due to the decline in domestic transport), and the volume of goods transported decreased by about 2 per cent. Water transport increased by 2 per cent due to favourable water levels, and pipeline transport expanded by 4 per cent. In 2016, the performance of transport **may increase by 2-3 per cent**, mainly due to the considerable expansion of road transport.

Regarding telecommunications, in 2014 slow decline started in the **voice call market** due to the spread of online services. In contrast, data traffic services are expanding dynamically. In 2016, the number of subscriptions to traditional fixed-line telephone services is likely to stagnate, or more probably to decrease continuously, whereas the strong shift in favour of VoIP (IP based voice) will go on. The mobile phone market is saturated; the number of active SIM cards is not expected to change significantly. At the end of 2015, the number of **internet subscriptions** was over 8 million, it may reach

Figure 27

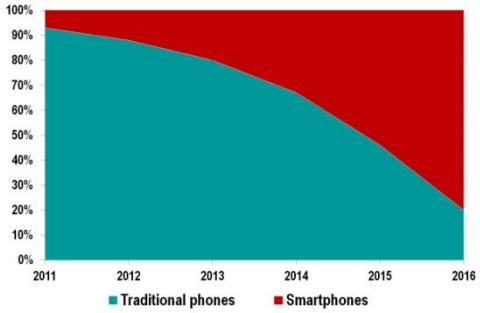
Road and rail transport, 2009-2016 (2006 = 100)



Source: HCSO, GKI

Figure 28

Changes in the proportion of smart devices to total mobile devices, 2011-2016 (per cent)



Source: HCSO, GKI Digital

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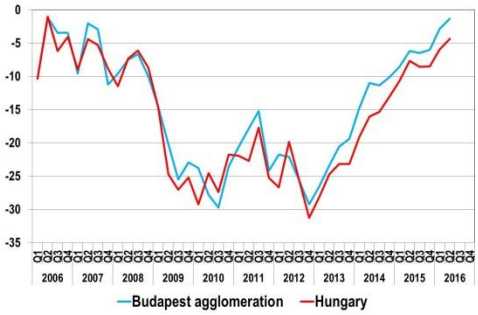
8.7 million by the end of 2016. In the telecommunications market the engine of growth will continue to be mobile internet; compared with the nearly 5.4 million subscribers at the end of 2015, even 6 million mobile internet subscriptions can be expected by the end of 2016. Although the rate of growth will steadily decline, it will remain above an annual average of 10 per cent. Although the rate of expansion in mobile internet subscriptions will be reduced by the saturation of the market, the further increase in the number of smartphones with internet access subscriptions purchased with them can ensure stable growth.

Figure 29

MGYOSZ-GKI real estate market index, 2006-2016



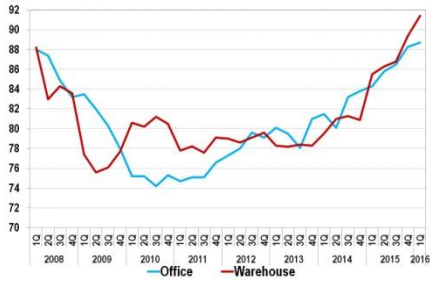
Source: GKI

Real estate activities grew by 1.2 per cent in the first quarter of 2016, whereas investments in the sector stagnated. The progress will be steady; however, no spectacular changes can be expected in the near future. Participants of the real estate market continue to be optimistic, and the **GKI-MGYOSZ real estate index** continued to **rise** in April, albeit only modestly. Prospects improved more or less in all segments, with the exception of the commercial real estate market. Housing has not yet gained momentum; the number of homes completed declined by about 10 per cent in the first quarter.

However, the number of new construction permits issued has doubled, and it also increased significantly in Budapest, by almost 80 per cent. All this and the expected impact of the government's package of measures **anticipate a future upturn in housing construction**. However, in view of the time necessary to respond to the new subsidy system and the long lead times of housing projects, **GKI** expects that no more than 9-10 thousand new homes will be completed in 2016. Refurbishment activities may also gain momentum as more financing support options are becoming available, such as the "Otthon melege" (Warmth of Home) Programme, offering grants from the second half of the year, and the MFB's preferential interest loan programme.

Figure 30

Utilisation rates (per cent), 208-2016 (per cent)



Source: BIEF

The **turnover in the market of used homes picked up considerably in 2015** (according to the estimates of Duna House, by approximately 20 per cent). **This slowed down at the beginning of 2016**, and the turnover grew by only 2.5 per cent in the first five months. The increase in demand **resulted in rising prices**, and according to HCSO data, the price of used homes increased by 9 per cent last year. Prices rising spectacularly are hampering the further strengthening of demand. Housing policy measures that came into force at the beginning of the year are expected to have positive effects; however, these effects will only be felt in the long run. **GKI** survey results

show that expectations of households for purchasing and constructing residential homes continued to strengthen in April. However, the number of those inquiring about possibilities was much higher than the number of those having specific plans. The expectations of households are still far less optimistic than they were before the crisis. According to GKI, the number of transactions may continue to grow; however, the growth rate will slow down compared to last year. House prices may rise further, by 3 or 4 per cent according to realtors (or significantly faster in popular areas).

The domestic commercial **real estate market** clearly left its lowest point last year. Market segments started to revive, though to varying degrees. The favourable pricing in Hungary will hardly be able to neutralize the significant country risk in the near future, thus no fresh foreign capital is expected to arrive. However, investors already here may be more active than before, and new ones may arrive to participate in certain projects.

Rented space in the **office market** grew by almost 30 per cent in the first quarter of 2016 compared to a year before. **Utilization also improved**, this ratio was 88.7 per cent for rented offices in the Budapest agglomeration. Development plans count on a high rate of preliminary orders, though this is usually also required by the financing banks. In the next period rents may start to decline modestly (by 2-3 per cent) in some areas.

Despite the growth of retail sales, there is little incentive for creating new capacities due to overdevelopment. A refreshing exception is the investment of IKEA in Soroksár. In the near future, rents can only be expected to rise only around the capital. Demand is recovering in the **logistics real estate market** and capacity utilization is improving. According to respondents of the GKI survey, the utilization of warehouses was 85 per cent in Budapest, 90 per cent in western Hungary, and 72 per cent in eastern Hungary. In most cases, investments are realized from EU sources. Significant investments were started mainly in rural areas, although in 2016 one of them was close to the M0 motorway. In the near future, rents can only be expected to rise only around the capital.

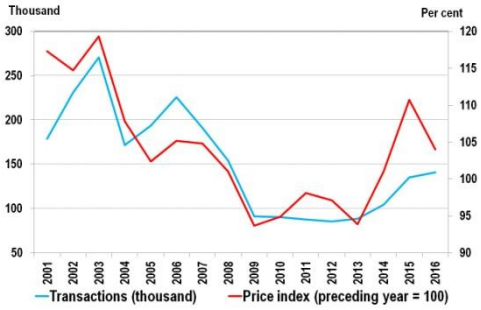
6.5. Foreign trade

In 2016 Hungary's exports of goods and services expand similarly to imports, by 6 per cent, but slower than in 2015 (8.4 per cent). The foreign trade surplus will rise significantly, and the terms of trade will further improve after their 0.8 per cent rise in 2015. The foreign trade balance will increase by about

Figure 31

Real estate transactions and price index, 2001-2015

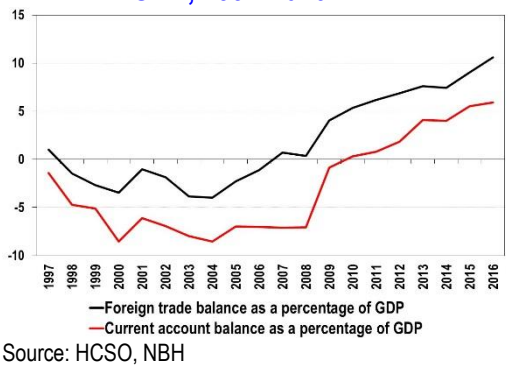
(preceding year = 100)



Source: GKI

Figure 32

Foreign trade and the current account balance as a percentage of GDP, 1997-2016



Source: HCSO, NBH

EUR1bn to EUR9bn, whereas the services balance may rise by EUR0.5bn to over EUR5.5bn. Exports of goods were driven by the motor industry, and services by tourism, transport and "other" activities (i.e., call centres).

The volume of the **Hungarian exports of goods** increased by 7.9 per cent **in 2015**, imports by 7.1 per cent, and the terms of trade improved by 0.8 per cent. **In the first quarter of 2016**, the volume of exports of goods grew by only 3 per cent, imports by 6.2 per cent, however, the **terms of trade** improved by 2.3 per cent due to the very low oil prices. As a result of industrial growth becoming stronger during the year, export growth, too. is expected to accelerate to around 6 per cent. The main reason for the lower rate is the decrease in investments supporting the growth in production. The terms of trade are improving similarly to the extent they increased last year, that is, by a lower rate than they did in the first quarter due to rising global oil prices. The foreign trade surplus will increase to EUR9bn in 2016 from EUR8.1bn in 2015. Hungary's export growth is driven by the motor and machinery industries in general, and by the manufacture of road motor vehicles in particular **in terms of both volume and dynamics**, the major sales markets of Hungarian exports are the EU in general and in Germany in particular. The most important risk of the expansion of exports is the slowdown of China's GDP growth that would affect the exports of multinational companies having affiliates in Hungary and their local suppliers. The growth ability of the Volkswagen group is questionable as well.

Table 7

Average annual real revaluation of the Hungarian economy, 2008-2016

(per cent)

	HUF/EUR exchange rate index	Hungarian consumer price index	EU-27 consumer price index	Real depreciation
2008	100.0	6.1	3.7	-2.3
2009	111.7	4.2	1.0	8.3
2010	98.2	4.9	2.1	-4.4
2011	101.4	3.9	3.1	0.6
2012	103.7	5.7	2.6	0.6
2013	102.6	1.7	1.5	2.4
2014	104.0	-0.2	0.6	4.9
2015	100.3	-0.1	0.0	0.4
2016	101.6	0.8	0.3	1.1

Note: A negative number indicates appreciation, whereas a positive one depreciation.
Source: HCSO, Eurostat, GKI

Export of services increased by 5.2 per cent (in euros) in 2015, imports grew by 5.4 per cent, and the surplus was EUR5.8bn. However, in the first quarter of this year exports grew by 0.5 percentage points faster, and the surplus of EUR1.3bn was slightly higher than a year earlier. Thus **the surplus may reach EUR5.5bn in 2016** (after EUR5.1bn in 2015). Tourism, transport and other services (including call centres) account for one quarter of the total exports of services. More than half of the surplus can be attributed to tourism (including the decreasing travels of Hungarians abroad), and nearly 40 per cent to transport services.

GKI estimates that the **consumption price index based real exchange rate** of the forint will be depreciated by 0.4 per cent in 2015 and by 1.1 per cent in 2016. In 2016, a slightly higher rate of depreciation can be expected in the Czech Republic, and a lower rate in Poland and Slovakia. As a result, the relative cost competitiveness of Hungary will improve against these two latter countries.

7. Employment

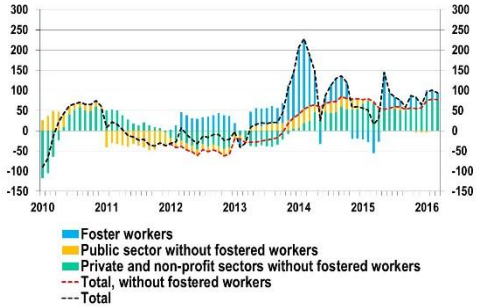
In 2016, the number of employees will grow by 1.5 per cent, at a slower rate than in the previous years. The shortage of skilled labour is a growing problem, whereas several hundred thousand people involved in public workfare schemes hardly perform useful work. Sums allocated for public workfare schemes were raised further. The ideas aiming at drastic reduction of employees in state administration decelerate in practice only the growth rate of employment in the public sector. Employment abroad is spreading further. In 2016, the unemployment rate is likely to drop to 5.8 per cent.

In the first quarter of 2016, **the number of employees** increased by 3.5 per cent, at a higher rate than one year before (2 per cent). In the first three months of the year, employment grew by 2.6 per cent in industry and by 3.9 per cent in services, the latter posting a substantially higher rate. (In 2015 the ranking was the opposite.) **Employment** mounted most sharply, by **13.6 per cent (!) in state administration, defence and compulsory social security services**. In the first quarter, the number of those involved in public workfare schemes jumped rapidly implying the aggressive expansion of this labour market segment. The 11.2 per cent jump in agricultural employment is outstanding. The employment capability of industry and construction ascended at a rate below the average of the national economy. On the other hand, high dynamics in some branches with a rather limited weight such as info-communications, accommodation services, restaurants and catering, finances, real estate services and artistic activities contributed to the overall growth of employment.

Figure 33

Changes in the number of employees, 2010-2016

(Change against the same period of the previous year, thousand persons)

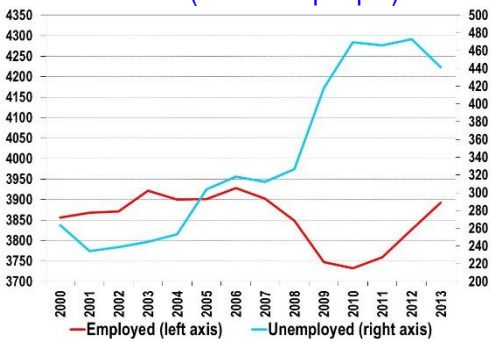


Source: HCSO

In companies with at least five persons and in institutions funded by the general government, employment increased by 3.4 per cent (by 2.8 per cent excluding those involved in public workfare schemes) in the first quarter of 2016 year-on-year. This was a pronounced acceleration against the 1.5 per cent rate a year before. Within the total, employment went up by 3.5 per cent in the competitive sphere, by 1.8 per cent in the public sector and by 14.1 per cent in the non-profit one (in the latter probably because of changes in classification and public workfare). Spectacular differences in the number of jobholders and employees in the public sector refer to the rapid diffusion of small-sized private undertakings.

Figure 34

Employment and unemployment, 2000-2016 (thousand people)



Source: HCSO, GKI

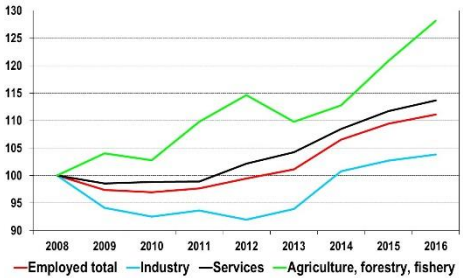
In the first quarter of 2016, the number of **unemployed** based on the labour force survey dropped to 273 thousand persons, and the unemployment rate totalled 6 per cent (in the February-April period only 5.8 per cent). This was a substantial decrease by 75 thousand persons and 1.8 per cent compared to the same period of the previous year. According to the records of the National Labour Office, 338 thousand people were registered as

job seekers at the end of April 2016, which was a decline by 77 thousand persons and 18.5 per cent compared with the same period of the previous year. Newly launched public workfare programs, too, contributed to the reduction of unemployment.

Figure 35

Changes in the number of employees by sectors, 2008-2016

(The same period of the previous year = 100



Source: HCSO, GKI

Labour supply is determined by demographic trends and the education system. Since several years including 2016 as well, the increase of the employment rate has been statistically enabled by a decrease in the number of working-age population in the denominator (population aging). This trend will continue, and it cannot be offset by the permanent lift of the retirement age. The planned reduction of the compulsory school attendance age and stricter quotas set by the government on the number of students admitted in state-funded higher education through the tightening of entry criteria will also raise labour supply, but this will not compensate for the decrease of the number in the 15-24 age cohort due to demographic trends. However, growth in the number and proportion of older workers and in the number of under-educated young people actually contributes to **the further escalation of tensions in the labour market**.

In the course of 2016, **labour demand** may grow more modestly than in the first quarter, **only by 1.5 per cent** due to the delayed effects caused by the slowdown of GDP growth. The number of employees including those involved in public workfare schemes is likely to increase by about 1.5 per cent, that excluding them by only 1.3 per cent. **The improvement of the employment capability of the competitive sphere** weakens, on the other hand, skilled labour is not available either. Companies are forcing some of their employees to return to bogus part time employment or to black employment. Demand can be expected particularly for skilled and younger workers (with lower wages).

Table 8

Productivity, 2013-2016

(GDP per person employed, preceding year = 100)

	2013	2014	2015	2016
Total economy	100.3	98.5	100.2	100.5
Industry	95.6	99.0	105.1	101.2
Construction	104.4	106.7	97.8	84.2
Agriculture	119.9	110.9	81.3	103.8

Source: HCSO, GKI

Productivity measured by GDP per employee is **improving** by a mere 0.5 per cent. The weak performance of industry and construction that has not improved for years is particularly worrisome. Productivity in terms of the number of jobholders increases by 0.7 per cent at the level of the national economy, i.e. by a higher rate than productivity in terms of GDP per employee because this indicator does not include the negative effect of smaller employers with lower productivity. The productivity indicator that excludes those involved in public workfare with low efficiency is likely to improve by 1 per cent.

The interim cyclicality of the **unemployment rate** has discontinued since 2013 with steadily declining rate quarter-on-quarter. The main reason for this was the

increase in the number of those enrolled in public workfare schemes. The rejection of involvement in public workfare resulted in the cancelation of the person in question from the register.

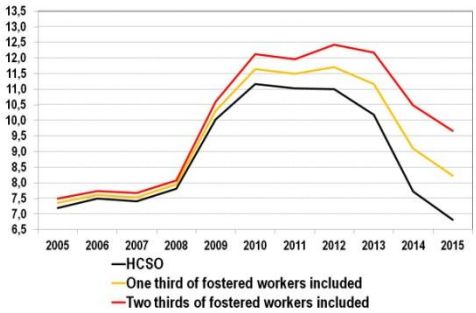
The trend of forcing down unemployment aggressively is expected to continue in 2016. Consequently, the annual average unemployment rate will be around 5.8 per cent. Active tools managing unemployment have been eliminated; **resources are devoted almost exclusively to financing public work schemes**. The tasks related to public workfare schemes have been fully transferred to the Interior Ministry. By this measure, the government has demonstrated that it **handles the reduction of unemployment as a policing issue rather than an employment policy one**.

The **regional differences in unemployment** in the first quarter of 2016 show a 3.3-fold difference, a significant increase compared to the value of 2.4 in the previous year, while the national unemployment level decreased. With an unemployment rate of 3.2 per cent, Western Hungary continues to be in the most favourable situation, whereas the northern Great Hungarian Plain in the least favourable one with a rate of 10.7 per cent. The unemployment rate fell in all regions of Hungary; by a higher level in the more developed regions than in the underdeveloped ones. In the most developed areas of Hungary only some frictional unemployment can be observed (Western and Central Transdanubia and Central Hungary), in part thanks to the option of commuting to Austria for those living near the border. However, in certain parts of underdeveloped regions, such as in Heves and Tolna counties, the unemployment rate decreased significantly to 5 per cent, or even below it. This indicates that **market based employment creation is much more successful** than that based on artificial government measures.

Figure 36

Unemployment rate in the statistics and in reality, 2005-2015

(per cent)



Source: HCSO

Table 9

The annual average number of people participating in public workfare schemes and their expenditure, 2011-2016

Year	Thousand people	Previous year=100%	HUF billion	Previous year=100 %
2011	59	-	64	-
2012	91	154	120	180
2013	129	142	180	150
2014	183	142	230	128
2015	213	116	270	117
2016*	260	122	340	125

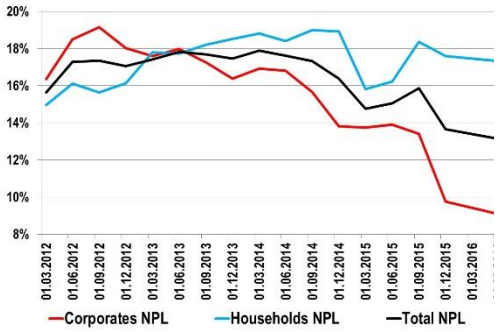
Source: www.kozfoglalkoztatas.kormany.hu, HCSO
*Estimate

8. Financial sector

At the end of the first quarter of 2016, the loan stock of undertakings and households was smaller than one year earlier, that of households even smaller than as of the end of 2015. The portfolio quality of banks improved, and as a result of the reduction of the bank tax rate, the profitability of the sector increased as well. However, the redirection of the financing of the local government sector from banks to the treasury will again reduce bank incomes. The shortage of demand is still the major limiting factor of lending, nevertheless, this year some increase may be feasible in the corporate segment. The transfer of the major part of the sector into Hungarian ownership, the not transparently changing roles assumed by the government and the bank supervising authority constitute risk and uncertainty factors. The major risk is the unlawful functioning of the National Bank of Hungary.

Figure 37

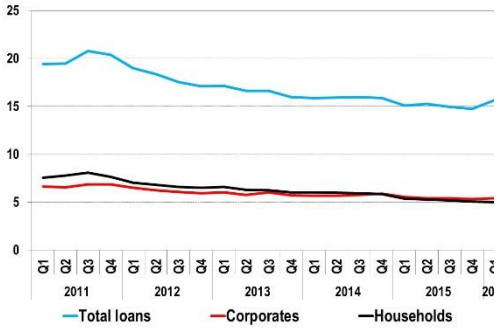
Share of non-performing loans, 2012-2015 (per cent)



Source: NBH, GKI

Figure 38

Loan portfolio on a quarterly basis, 2011-2015 (thousand billion forints)



Source: NBH, GKI

In the first quarter of 2016, the corporate loan stock **increased by HUF110bn quarter-on-quarter.** The loan stock of micro and medium-sized companies declined, whereas that of small and large companies mounted. The loan increase of small companies is characterised by the stagnation of investment loans and the decrease of current account ones. Through the pickup of liquidity problems, this may refer to deteriorating loan portfolios. Nonetheless, the loan stock of **households fell** by HUF60bn compared to the **end of the year**. **At the end of the first quarter of 2016, the loan stock of undertakings and households was smaller than one year earlier.**

According to the contracts made in the second phase of the **Funding for Growth Scheme**, loans valued at HUF180bn were placed, in its third phase the NBH plans to offer loans in the amount of another HUF600bn. (The sum of the latter was raised by HUF100bn in early June.) This was surprising because the NBH has communicated the phasing out of this tool since last year. After the pashing out of the Funding for Growth Scheme this year, the new tool to promote lending by the NBH based on market conditions is the **Market Loan Program** and the interest rate swap transaction that is tied to lending activity. As a result of the tenders, participating banks made commitments to expand their loan stock by HUF180bn in 2016. **The planned increase of the loan stock by more than HUF1,000bn is favourable for SMEs.** The loan stock of small companies is likely to grow by 5 per cent this year, whereas that of medium-sized firms is expected to stagnate or decrease somewhat.

The significant fall in the proportion of non-performing loans at the end of 2015 continued in the first quarter of 2016 (by 0.5 percentage points), **improving the portfolios and profitability of banks**. The share of performing loans, too, went up by 1 percentage point to 87.7 per cent. The proportion of nonperforming loans held by households dropped as well (by 0.3 percentage points).

Nevertheless, the share of performing loans of households was down by 0.5 percentage points (to 71.6 per cent), in other words, these loans became delayed in less than 90 days.

Following a pause of some months, the NBH **continued monetary easing**, and it reduced its reference rate to 0.9 per cent in three steps. Its declared major objective was to step up lending activity by banks and thereby to support economic growth. However, the measures are primarily symbolic, as they do not address the real reasons arising from the Hungarian model. **Low borrowing activity is primarily the result of insufficient loan demand originating in uncertainty.**

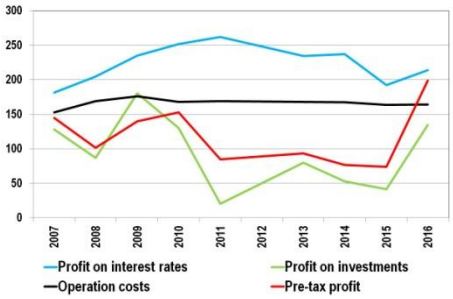
In its former programs, the NBH assumed significant **interest rate risks** in its balance sheet, and with decreasing interest rates, it made huge profits. As a consequence of low interest rates even by international standards, the exchange rate of the forint to the euro depreciated sharply, this, too, resulted in **enormous profits** for the NHB. The NBH did not pay these profits to the budget or did not allocate them as reserve. Instead, it started **quasi fiscal activity** through its foundations and it used part of the profits for **funding the general government**. All this triggered wide-spread critics, inter **alia from the part of the European Central Bank as well.** These steps of the NBH involve **serious political risks** that may result in growing financing costs.

The **phasing out of bank levies** takes place gradually according to an agreement signed with the EBRD. According to the bill, in 2016 the bank levy may not exceed 45 per cent of the levy collected in 2015. Thus, in 2016 banks have to pay HUF80bn less, namely about HUF65bn bank levy, therefore their profitability may improve significantly. **Net profits** of the banking system were **outstanding** in the first quarter of 2016 compared with previous years. Since in a falling interest rate environment the short part of the yield curve decreases more, as a consequence, net interest incomes grow. The dividend income of the first quarter is remarkable due to investments in risky assets and to the low interest rate environment. Noninterest profits of this size were recorded in 2009 the last time. Operational costs in nominal terms have been practically unchanged since 2008 (because of the reduction of staff inter alia), this fact, too, contributed to the increase of profits. In 2016, the number of **employees** is expected to increase in financial institutions in general and in state-owned ones in particular.

MARK Zrt. wished to clean the banks' balance sheets according to market principles, which market participants

Figure 39

Profit components of banks, 2007-2016 (first quarters, bn HUF)

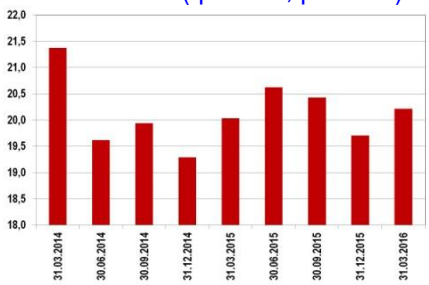


Source: NBH

cannot do or do not wish to do. According to the evaluation of the European Commission, the organisation will not provide banks with state aid that is otherwise prohibited. For the time being, the perception of banks is rather mixed. **Worries** surrounding the National Bank of Hungary and its foundations relate to the fate of the purchased assets as well.

Figure 40

The total capital requirement indicator for domestic banks, 2014-2016 (quarters, per cent)



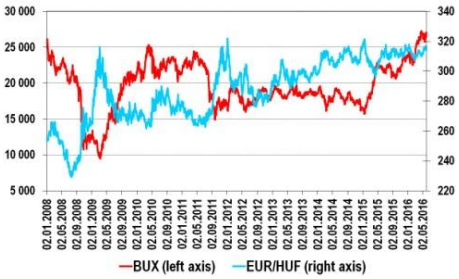
Source: NBH

With the assets of MKB Bank and Budapest Bank obtained by the **state** and the system of saving cooperatives around FHB Bank, half of Hungary's banking system was transferred to Hungarian ownership, in line with the objectives of the government. This way, on paper, foreign exposure deceased, although in difficult situations **banks in Hungarian ownership would behave according to their natural interests**, in other words, they may change forints to foreign exchange and transfer them abroad. In addition, as regards Hungarian owners, **the risk of capital shortage and liquidity problems intensifies**. In the context of the integration of savings cooperatives, Hungarian legislation, the government administration and the banking supervisory system initially promoted, later inhabited the operation FHB Group perceptibly according to the interests of various pressure groups. This introduces **uncertainty** in the system and erodes public confidence.

The liquidity and the capital adequacy ratio of the banking system are outstanding, following the slight decrease at the end of last year, the capital adequacy ratio went up to more than 20 per cent.

Figure 41

BUX and EUR/HUF exchange rate, 2008-2016



Source: NBH

In 2016**, the NBH** became the largest shareholder of the **Budapest Stock Exchange.** The European Central Bank, too, raised doubts concerning the decision, since it involves monetary financing. **It is doubtful in principle** whether or not the integration of monetary policy, the supervision of financial institutions and the stock exchange in one organisation is appropriate. **In order to revive the Budapest Stock Exchange**, the NBH plans the introduction of new shares. The government, too, intends to help new introductions. The realisation of these plans is **rather doubtful** since the attempts having done so far led to modest results. In the next two-three years, **GKI** does not expect breakthrough either. Appropriate Hungarian medium-sized companies whose shares could be quoted in the stock exchange are in short supply. In the present domestic regulatory environment (including the supply of loans with zero interest rate) companies do not need to raise capital through the stock exchange. There is some chance mostly for the debut of companies that obtained capital in the framework of the Jeremy programs.

9. General government, government debt

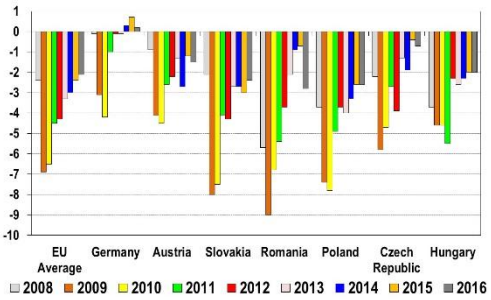
Although in the first five months trends in general government revenues and deficit were excellent, but achieving the 1.9 per cent deficit relative to GDP planned for 2016 is uncertain, since, in part due to various pressures and the preparations for the parliamentary elections in 2017, the government is likely to raise its expenditures in the second half of 2016. GKI reckons with a deficit of 2.3 per cent of GDP. The convergence program envisaged the reduction of government debt relative to GDP from 75.3 per cent to 74.5 per cent by the end of 2016. GKI reckons with a symbolic reduction of government debt with a ratio of about 75 per cent at year-end, since due to the increase of expenditures and the advance payments needed to accelerate the absorption of EU funds by the budget, the financing needs of the general government will be very high.

In 2015, the general government deficit relative to GDP totalled 2 per cent, the government debt ratio decreased by 0.9 percentage points to 75.3 per cent (as a result of the usual "transactions" such as the temporary reduction of the general government reserve). However, **Eurostat** attached **limiting codicil** to the relevant report of the Hungarian Central Statistical Office (HCSO), which is unprecedented in the case of Hungary, since according to its opinion Eximbank should be considered part of the general government. According to the calculations of Portfolio.hu, this decision would raise continuously the general government ratio retrospectively, in 2015 by 2 percentage points of GDP. The size of the improvement would be lower annually by a few tenth percentage points both in the past and in the future. The HCSO does not agree with the opinion of Eurostat, the dispute may drag on. The European Commission indicated that the general government deficit planned for 2017 **does not meet** the requirements of the deficit planned for the medium-term (but no sanction may be attached to this failure.)

In the first five months of 2016, the general government deficit in cash flow terms amounted to only HUF13.2bn that is an exceptionally low figure. As a result of the increase in earnings and purchased consumption, tax and duty revenues grew sharply. The rise in corporate tax revenues is outstanding, this is the consequence of the introduction of the **tax credit for growth**. According to the communication of the Ministry for National Economy, more than 70 companies wish to make use of the delayed payment possibility for two years on taxes valued at some HUF542bn. Nevertheless, the annual amount of HUF270bn is related almost exclusively to General Electric. If this sum does not originate in the tax base resulting from its economic activity pursued in Hungary, as it can be assumed, it can be classified as state aid that is prohibited by the legal rules of the EU and compensation can be requested from Hungary.

Figure 42

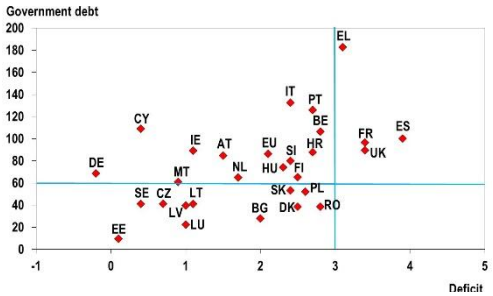
General government balances of EU member states in per cent of GDP, 2008-2016



Source: European Commission, GKI

Figure 43

The general government deficit and government debt in per cent of GDP in the EU, 2016



Source: European Commission

Table 10

Major tax revenues, 2016

(HUF billion)

Revenues	Original appropriations	April 2016		Forecast of GKI
		Fact	Percentage of original appropriations	
Central government	10,185	3,183	31.3	10,700
Vat	3,352	923	27.5	3,400
Excise tax	952	295	30.9	1,050
Personal Income Tax	1,658	571	34.4	1,900

Source: NGM, GKI

According to the convergence program for 2016, government revenues are expected to exceed the estimates by 2.3 per cent of GDP, and general government expenditures will be higher by 2.2 per cent of GDP in 2016.

They are greater differences than the originally planned 2 per cent (or 1.9 per cent in the convergence program) general government deficit, they do not underpin the justification of the early approval of the budget by the strengthening of predictability.

Based on the figures of the first quarter, GKI reduced its GDP forecast from 2.3 per cent to 2 per cent in 2016, whereas the government insists on its 2.5 per cent projection. This decelerating GDP growth rate **does not have any negative impact** on general government revenues. Since GKI reckons with higher wage growth than earlier (6 per cent rather than 4.5 per cent) and consumption growth (4 per cent rather than 3 per cent), revenues may be higher than predicted earlier.

Based on the favourable figures at the beginning of the year, **the government modified the 2016 budget** in June by distributing additionally about HUF500bn. According to the calculations of GKI, additional revenues of this size could have reckoned with as well. The announced additional expenditures are allocated among random interventions, demand stimulation and the preparation for the parliamentary elections in 2017. E.g., the major part of the amount of HUF100bn allocated for education is essential for the settlement of the debts of KLIK (the colossal government agency for maintenance and coordination in education). HUF50bn-HUF50bn each are envisaged for home building in order to promote construction and the Modern Cities Program. (The latter is at the personal disposal of the prime minister in part for funding propagandistic agreements with selected local governments.) Some HUF70bn is allocated for road reconstruction, HUF10bn-HUF10bn each for counter-terrorism, sports and for individual local governments. Reserves are raised by HUF30bn.

An interesting feature of the modification of the 2016 budget is that it contains in part changes that were announced several months ago (homebuilding, the settlement of the debts of KLIK), but wage increases in healthcare with significant budgetary implications were announced only after the submission of the modifications. The lack of coordination is indicated by the fact that certain planned items of the 2017 budget **were smaller** than the raised figures of the 2016 general government, which were corrected by internal reorganisation with

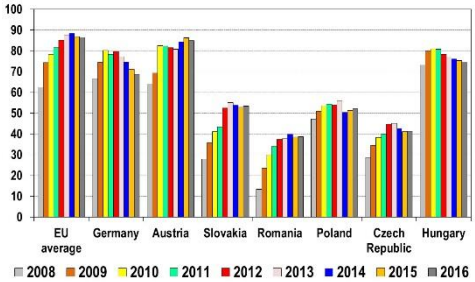
unknown content. **This kind of opaque budgetary planning based on improvisations is not unlawful, since according to the law approved last spring, new commitments can be made without parliamentary approval, by decrees at the expense of budgetary expenditures. Nevertheless, it is questionable from all other aspects.**

While the transparency and soundness of the general government deteriorate, the figures of the 2017 budget reveal that there is a **negative turn** in the efforts to date aiming at reducing the deficit continuously. The general government deficit planned for 2017 is 2.4 per cent of GDP, that is, **significantly higher (by 0.7 percentage points)** than the 1.7 per cent deficit expected in the 2015 convergence program and the 2016 budget. This change in policy will certainly **have an impact on expenditures in 2016**, which can finally be higher than the current (augmented) appropriations. In some areas extraordinary interventions might be necessary, due to, for example, the repeatedly renewing debts of hospitals. Despite the Commission's recommendations for a correction in the amount of about HUF100bn as the structural deficit is expected to exceed the medium-term deficit target in 2016, the government plans loosening dictated by the logic of the looming elections as at present there is no risk of any retaliation from the EU. Thus, GKI expects a **deficit of around 2.3 per cent** of GDP instead of the previously planned 2 per cent or later 1.9 per cent deficit.

Although the amendment of the 2016 budget did not affect the cash flow deficit (it remained HUF761.6bn), in the official EDP report reviewing the financial position of the general government, the official general government deficit (financing need) was HUF1,110.7bn. The **HUF300bn difference** can be explained by the fact that **the second deficit probably contains the difference between the advance payments from the general government and the postponed arrival of last year's EU transfers**. Although these amounts do not affect the deficit according to the European methodology (ESA), they need financing, thereby increasing the general government debt. Though it is difficult to judge the exactness of this HUF300bn, it seems to be realistic. However, this amount, together with the higher deficit expected by GKI and the lower GDP suggest that the **general government debt** will decrease only **symbolically**, by 0.3 percentage points (to 75 per cent) by the end of 2016 compared to the end of last year (while it will be higher almost all the other days of the year).

Figure 44

Government debt of EU member states in per cent of GDP, 2008-2016



Source: European Commission, GKI

10. Inflation, interest and exchange rates

The rate of inflation is likely to accelerate slightly, totalling 0.8 per cent in the average of 2016. The 0.9 per cent reference rate of the National Bank of Hungary will hardly change in the course of 2016, the exchange rate of the forint to the euro is projected to average HUF315. With Brexit, money market volatility is on the rise.

Table 11

Price index of various groups of goods, 2013-2016

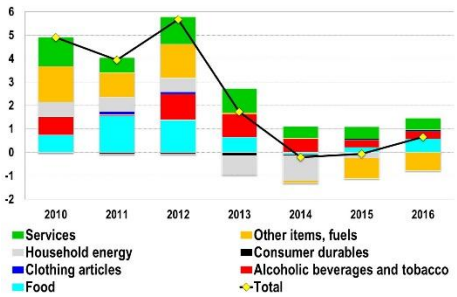
(previous year = 100)

	2013	2014	2015	2016
Food	102.8	99.6	100.9	102.3
Alcoholic beverages and tobacco	110.9	106.2	103	103
Clothing articles	99.6	99.3	100	101
Consumer durables	98.1	99.5	100.8	100.5
Household energy	91.5	88.3	97	100
Other items, fuels	100.5	99.5	95.5	96
Services	103.6	101.8	101.9	102
Total	**101.7**	**99.8**	**100**	**100.8**

Figure 45

Structure of inflation, 2010-2016

(Preceding year = 100)



Source: HCSO, GKI

In the first five months of 2016 **consumer prices increased by an average of 0.2 per cent**. The price level decreased by 0.2 per cent in May compared to the previous year, whereas it increased by 0.3 per cent compared to April. Until now, as a result of tax increases, the prices of consumer goods rose the most, by 2.6 per cent, followed by durable goods (partly reflecting the weakening of the forint) and services (the least exposed to competition), both by 1.4 per cent. The latest reduction of overheads targeted garbage collection and chimney-sweeping fees. Their weight in the consumer basket is insignificant, however, serious problems with these services can be expected if they become unprofitable. The price of food increased by nearly 1 per cent (pork prices declined due to the reduction in VAT), whereas prices of household energy and clothing essentially remained unchanged. However, prices of fuels and other goods dropped by 3.8 per cent. The inflation rate is significantly affected by global energy prices. **However, unlike in the EU, domestic prices of household energy were not affected by plummeting prices last year.** The reasons are the former overhead reductions and government price control. Changes in oil prices, however, immediately appear in the price of fuels. As a result of the significant increase in world oil prices in recent weeks, the average price of gasoline was 8 per cent higher in May than in March.

Despite the price decrease in May, **there is no deflationary pressure** as households' demand is expanding very rapidly, and core inflation and inflation expectations are positive. Wage increases have inflationary impact both from cost and demand side. Gross earnings rose by more than 5 per cent in the business sector in the first quarter, whereas they grew by nearly 8 per cent in the public sector, resulting in an almost 7.5 per cent rise in real earnings. **Inflation is expected to be an average of 0.8 per cent in 2016 and 1.5 per cent at the end of the year.**

The National Bank of Hungary **started another easing cycle** in March, and in three steps, by 15 basis point cuts, **reduced** the reference rate to 0.9 per cent, which will likely **remain unchanged at least until the end of the year**. The Monetary Council applied other unorthodox

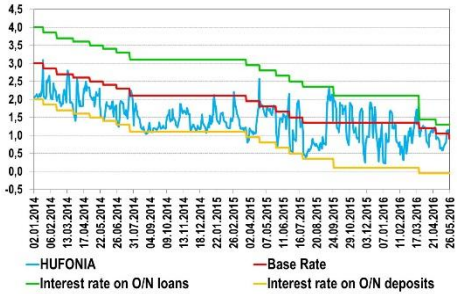
easing methods as well, since the difference between the upper limit of the interest rate corridor and the reference rate decreased significantly, whereas the lower limit became negative.

As a result, in 2016 the depreciation of the forint can be expected, with a **HUF315 average exchange rate of the forint to the euro**. **The National Bank of Hungary, though it has no official exchange rate objective, continues to strive for weakening the forint as this is its main source of profit.** (From an economic point of view, the foreign trade surplus makes the weakening of the forint meaningless.) In addition to funding its foundations, these profits may be used as reserves in the future as the previous programmes of the National Bank of Hungary had significant interest rate risks, which will lead to losses in a rate hike cycle. The Fed is expected to raise interest rates at least once in 2016, and this may weaken the forint. The launch of the European bond purchase programme provides a safety net against this, to some extent.

As a result of the low but accelerating inflation, **real interest rates are expected to decline** in 2016. Long-term Hungarian government securities have 250 basis points interest rate advantage above the average interest rate on corporate and household deposits (which, after the deduction of transaction costs, may be around zero or even negative).

Figure 46

Interest rate corridor, base rate and interbank rates in Hungary, 2014-2016 (in percentage)



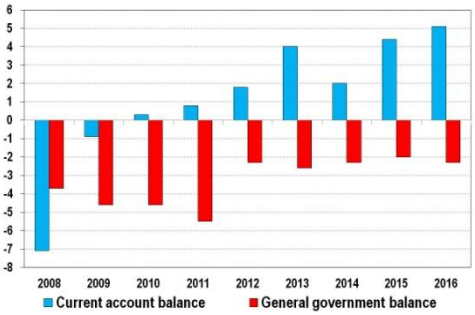
Source: NBH

11. External equilibria

Hungary's combined current and capital account has produced surpluses in almost every year since 2009; the surplus reached EUR9.5 billion in 2015. In 2016, this surplus will drop to EUR8 billion due to the reduction of EU funds in spite of sharply growing current account surplus. In the past seven years Hungary's FDI stock did not change, with the exception of the enforced recapitalization of the banking sector. This can be considered a hard critic of the domestic investment environment. FDI has been replaced by EU transfers. In 2015, net FDI figures reflected capital withdrawal of around EUR0.2 billion, and no turnaround can be expected in this trend. Other countries of the CEE region did not substitute but complemented FDI by EU funds.

Figure 47

The current account deficit and the general government balance in per cent of GDP, 2008-2016



Source: HCSO, NBH, GKI

The surplus of trade of **goods and services** is likely to increase from EUR9.3bn in 2015 to EUR10.7bn in 2016. The deficit of the inflow and outflow of **incomes** is projected to total EUR4.6bn in 2015 and EUR5bn in 2016. With the increasing surplus of trade in goods and services and slightly rising outflow of incomes, **the current account surplus** is anticipated to grow from EUR4.7bn in 2015 to EUR5.7bn in 2016.

With decreasing international interest rates, **interest payments** to foreign investors was down by 1.5 per cent of GDP between 2013 and 2015. Incomes **transferred to Hungary** by those employed abroad, too, mounted, but the negative balance of **incomes realized on investments** exceeded them. (Profits earned by foreigners in Hungary are higher than those realised on capital exports. With different magnitudes this is natural. The problem concerns repatriation, this reduces the capital stock in Hungary.) The net amount of **EU funds** meant for investments in real assets reached EUR4.7bn in 2015, at the end of the previous EU budget period, which was a historic peak. In 2016 when the current programming period ends and apart from the retained sums, only the accrual of EU funds of the 2014-2020 period can be reckoned with, their amount falls to about EUR2.3bn. Thus, the external financing capacity will decline to EUR7.2bn in 2016 from EUR8.7bn in 2015.

From a different point of view, **the low general government deficit, the high savings in the private sector** (partly transferred home in euro) **and the inflow of EU transfers can explain Hungary's outstanding external financing capacity in central and eastern European comparison.** (As far as high savings of the private sector are concerned, those of households are favourable, whereas those of the business sphere are unfavourable.)

In the previous EU budgetary period, Hungary was one of the first beneficiary countries in terms of obtained EU funds relative to GNI. In the past decade Hungary

received total transfers valued at some EUR30bn, corresponding to 4 per cent of annual GDP.

In 2015, the balance of foreign direct investments was **EUR0.2bn outflow.** The capital withdrawal by foreigners investing in Hungary and capital exports by Hungarians played the most important role in it. **Net FDI outflow is worrying from the point of view of investments as well**, and with the persistence of the unpredictable business environment, no turnaround is likely.

At the end of September 2015, **Hungary's net external debt** (excluding intercompany loans within foreign direct investments) totalled EUR26.6bn (corresponding to 24.7 per cent of GDP in the average of the last four quarters that was similar to the Polish figure), EUR7.4bn less than one year before. The lion's share of the decrease (EUR6.3bn) accounted for the private sphere, within this for the payback of the external debt of the banking sector, but the external debt of the general government fell as well. Thus, at the end of December 2015, the external debt was allocated equally between the state and the private sphere.

Within net debt, **short-term net debt** totalled EUR21bn at the end of December 2015, by EUR2.8bn less than at the end of the previous quarter. Changes in regulation, too, contributed to this, since in January 2016, the foreign exchange equilibrium indicator was introduced, and the foreign exchange adequacy indicator was tightened as well. These measures prompted banks to reduce their short-term external debts. 80 per cent of Hungary's net foreign debt is due in the short-term.

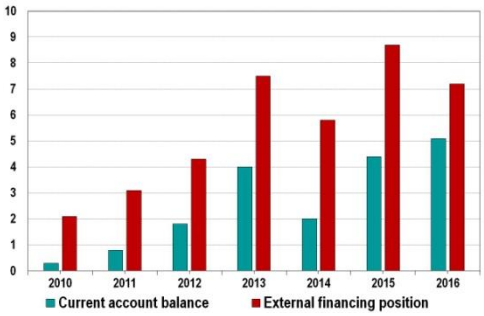
International reserves held by the NBH fell from EUR34.6bn at the end of 2014 to EUR26.4bn as of 30 April 2016. The cause of the decrease was the withdrawal of funds by banks for the conversion of households FX based debts to forints. (The National Bank of Hungary provided commercial banks with EUR8bn to convert FX loans to forint, and this step will reduce both international reserves and foreign debt.) The completion of this process will of course require many years, taking place in line with the scheduling of FX loans maturities. The reduction of international reserves was made possible primarily by the decrease of foreign debt.

Basically with the fall of short-term external debt and the increase of external financing capability, Hungary' **gross (re)financing need** declined from EUR22bn in 2014 to EUR13bn (to 12 per cent of GDP) in 2015.

In order to meet these needs in a relatively safe way and with favourable conditions, maintaining the confidence of

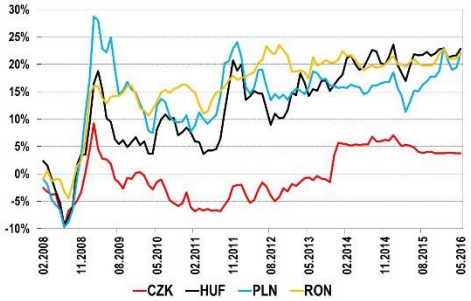
Figure 48

Current account balance and external financing need in per cent of GDP, 2010-2016



Source: NBH, GKI

Figure 49
Depreciation of regional currencies against the euro, 2008-2016
(2 January 2008 = 100)



Source: ECB, GKI

foreign financial investors is essential. This May, **Fitch Ratings** upgraded Hungary putting it to investment grade first from among the three big rating agencies. (It is true, however, that Hungary is in the lowest notch of investment grade, low even by CEE comparison.) Thereby, Hungary caught up with Namibia. Because of unpredictable economic policy, **S&P** does not intend to upgrade Hungary. Due to slower-than-expected GDP growth, budgetary loosening in 2017 and the scandals surrounding the National Bank of Hungary, the decision of **Moody's** is uncertain. The effects of the upgrade can unfold completely if at least two of the three rating agencies switch Hungary's government debt to investment grade. This is likely to have a minor impact on the rather low CDS swap points, but some institutions such as smaller pension funds and investment houses, too, would be allowed to buy Hungarian government securities whose internal regulations prohibited doing so until now. The improvement in Hungary's grading could exert a favourable impact on stock prices and on some specific investment decisions, and it could contribute to a slight drop of financing costs.

12. Risks of the forecasts

Based on the figures of the first quarter, GKI reduced its GDP growth forecast from 2.3 per cent to 2 per cent compared to March. Lower growth rate is much more probable than higher. The 0.8 per cent inflation forecast of GKI did not change, however, here, too, lower value is more probable than higher.

Regarding **the production of GDP**, agriculture may grow more rapidly than assumed earlier since not only the statistical base is very low, but until recently weather conditions were favourable as well. A more than 10 per cent growth rate projected by GKI is not probable. In April, industrial production has already recovered, with the consolidation of the motor industry in general and that of Audi in particular, the growth rate may be even higher than 2 per cent. According to **GKI**, the decline of **construction** is likely to slow down significantly. A more substantial deterioration of the situation is slightly more probable since this year no positive change is expected in the absorption of EU funds and home building. The 6 per cent growth in GDP production by trade and tourism is rather high, the probability of positive and negative corrections is similar.

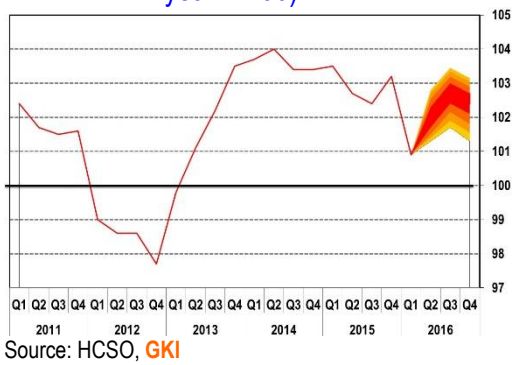
The government cannot exert influence on the temporary decline in the inflow of EU funds and its negative impact on **investments** this year. The possible increase of advance payments will have a minor impact since they could be embedded only in few projects. A profound turn in economic policy or a large investment project backed by state funds are required to raise **business investments** spectacularly. Even the outlines of a solution to these problems cannot be seen yet. The 4 per cent rate of increase in household **consumption** is a rather sharp acceleration compared to the 2.6 per cent rate of last year (it has been the highest growth rate since 13 years), but it is still the same as that of the first quarter. Although with the deceleration of inflation, the rate of increase of real incomes sets to slow down in the second half of 2016, it is still enough to maintain the propensity to consume. Therefore, the probability of a lower and higher rate of growth is the same. In the first quarter of 2016, the growth rate of imports exceeded that of exports by nearly 2 percentage points. With the acceleration of industrial production, this gap in growth rates is not likely to disappear. In other words, **the probability of the increase of the gap in favour of imports** is higher than vice versa.

After all, somewhat **slower than expected GDP growth is more probable** in 2016 than higher. **In structural terms**, the growth rate of imports exceeding that of exports is more probable than vice versa, whereas

Figure 50

GDP fan chart, 2011-2016

(Corresponding quarter of the previous year = 100)

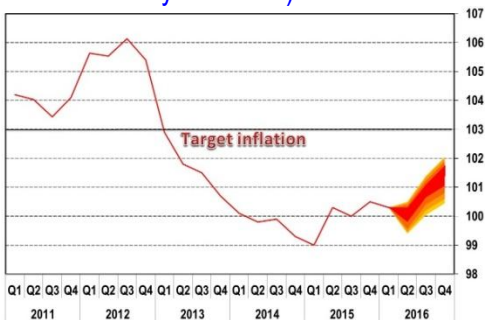


Source: HCSO, **GKI**

Figure 51

Inflation range chart, 2011-2016

(Corresponding quarter of the previous year = 100)



Source: HCSO, GKI

deviations are symmetrical in investments and consumption.

As far as **inflation** is concerned, higher than expected wage increases have inflationary impacts in terms of both demand and costs. In addition, the possible further increase of energy and commodity prices as well as the spectacular weakening of the forint to the euro, too, constitute essential risk factors. Measure taken to promote the construction of homes tend to precipitate in price increases on the side of both vendors and buyers. Excise tax rates, too, are likely to be raised this autumn. The forecast of GKI reckons with these factors. Since the combined effects of the identified risk factors is uncertain, **the probability of lower inflation rate** than that predicted by GKI is slightly higher than the other way round.

However, the **effects** of the management of **several political risks**, such as the direction of the post-Brexit development of the EU and the refugee crisis may be **much more significant than those of other usual economic risk factors**.

Statistical Annex

List of tables

Appendix 1

GDP by economic activity, 1996-2016 (preceding year = 100)

	GDP	Agriculture, hunting and forestry, fisheries	Industry	Construction	Retail and wholesale trade	Transport, storage	Information and communication
1996	100.0	104.9	104.4	93.0	98.3	93.7	118.2
1997	103.4	96.5	111.2	107.1	104.1	108.1	115.2
1998	104.2	104.6	107.3	108.1	102.3	98.5	113.3
1999	103.2	103.1	105.3	106.7	101.2	104.9	109.9
2000	104.2	90.0	102.7	110.2	110.9	102.2	106.7
2001	103.8	113.6	103.2	107.4	99.9	115.2	107.2
2002	104.5	83.9	105.8	112.7	109.5	101.4	114.8
2003	103.8	103.3	105.1	99.3	104.4	98.1	110.4
2004	104.9	150.2	105.3	101.6	102.9	106.0	103.0
2005	104.4	94.2	104.0	110.6	107.1	104.6	106.8
2006	103.8	93.5	106.2	96.1	109.4	104.7	105.5
2007	100.4	78.5	107.5	92.7	100.3	106.8	105.7
2008	100.8	155.6	95.7	90.0	99.7	94.1	101.8
2009	93.4	88.6	86.9	96.2	83.3	91.9	106.2
2010	100.7	77.9	108.1	90.3	98.6	102.6	101.1
2011	101.8	115.4	100.4	102.6	103.0	100.2	103.2
2012	98.3	79.0	97.8	93.7	99.4	101.1	101.0
2013	101.9	115.3	97.5	105.8	106.3	101.0	103.9
2014	103.7	113.9	106.7	112.3	104.3	102.4	101.4
2015	102.9	87.1	106.3	102.9	105.7	101.7	102.9
2016	102	110	102	85	106	102	103

Source: HCSO, 2016: GKI

Appendix 1 (continued)

GDP by economic activity, 1996-2016 (preceding year = 100)

	GDP	Financial activities, insurance	Real estate activities	Professional, scientific, technical and administrative services (9)	Public administration, defence, health, education	Arts, entertainment, leisure and other services
1996	100.0	87.4	103.5	113.6	100.1	91.0
1997	103.4	74.5	100.8	102.7	101.2	95.7
1998	104.2	99.6	93.5	103.0	106.5	98.0
1999	103.2	84.4	102.7	103.8	101.7	104.5
2000	104.2	111.1	100.7	108.0	103.7	105.8
2001	103.8	99.1	96.9	113.3	98.8	110.1
2002	104.5	106.2	97.9	108.5	102.2	107.0
2003	103.8	104.8	106.2	104.5	103.9	95.1
2004	104.9	102.7	99.6	99.8	101.9	98.7
2005	104.4	103.4	105.9	105.6	102.5	104.5
2006	103.8	98.5	107.1	106.4	100.6	99.9
2007	100.4	93.9	99.4	99.2	96.2	101.5
2008	100.8	99.3	100.5	103.0	100.5	102.9
2009	93.4	102.0	103.1	96.9	99.8	95.2
2010	100.7	95.9	98.3	101.9	101.2	101.8
2011	101.8	96.3	102.0	102.9	101.7	102.6
2012	98.3	97.2	98.2	100.7	101.6	97.3
2013	101.9	95.2	100.3	103.6	106.7	100.0
2014	103.7	97.1	99.6	105.8	97.8	104.8
2015	102.9	99.8	102.0	105.6	100.6	106.0
2016	102	101.5	102	105	101	102

Source: HCSO, 2016: GKI

Appendix 2

GDP by expenditure, 1989-2016 (preceding year = 100)

	GDP total	Domestic demand	Private consumption	Public consumption	Gross fixed capital formation	Exports	Imports
1989	100.6	100.0	99.8	58.8	100.9	98.5	96.4
1990	96.5	96.9	96.4	102.6	92.9	94.7	95.7
1991	88.1	90.9	94.4	97.3	89.6	86.1	93.9
1992	96.9	96.4	100.0	104.9	97.4	102.1	100.2
1993	99.4	109.9	101.9	127.5	102.0	89.9	120.2
1994	102.9	102.2	99.8	87.3	112.5	113.7	108.8
1995	101.5	96.9	92.9	95.9	95.7	113.4	99.3
1996	100.0	99.1	97.6	96.6	104.6	109.5	107.1
1997	103.4	103.8	100.9	103.0	108.7	122.9	124.1
1998	104.2	107.4	103.2	105.0	112.0	115.6	122.6
1999	103.2	104.1	105.8	101.7	108.0	111.9	113.3
2000	104.2	103.7	102.9	101.2	105.2	125.0	123.1
2001	103.8	101.9	104.2	104.7	102.7	108.8	105.8
2002	104.5	106.4	107.9	103.8	107.8	105.8	108.7
2003	103.8	105.7	107.6	106.3	101.3	106.3	109.5
2004	104.9	104.9	102.2	101.4	107.6	118.0	117.3
2005	104.4	101.5	103.1	102.4	103.6	112.9	107.8
2006	103.8	101.7	101.5	100.0	100.7	119.5	115.5
2007	100.4	99.0	99.3	94.8	104.2	116.1	113.9
2008	100.8	100.2	99.6	103.1	101.0	106.9	106.0
2009	93.4	90.8	94.4	103.2	91.7	88.6	85.3
2010	100.7	99.5	97.2	102.2	90.5	111.3	110.1
2011	101.8	99.8	100.7	100.0	98.7	106.6	104.5
2012	98.3	97.0	97.7	99.7	95.6	98.5	96.7
2013	101.9	101.2	100.6	103.0	107.3	105.9	105.9
2014	103.7	104.2	101.5	105.8	111.2	107.6	108.5
2015	102.9	100.7	102.6	100.6	101.9	108.4	107.8
2016	102	101.7	104	102	92	106	106

Source: HCSO, 2016: GKI

Appendix 3

Volume of gross output, 1989-2016 (preceding year = 100)

	Agriculture	Industry	Construction	Retail trade
1989	100.0	95.0	101.6	-
1990	98.2	90.7	86.2	-
1991	93.8	81.6	91.7	71.2
1992	79.9	90.3	101.5	96.3
1993	90.4	104.0	102.6	103.2
1994	103.0	109.6	112.1	-
1995	102.6	104.6	82.4	91.7
1996	106.3	103.4	99.9	95.1
1997	96.3	111.2	109.7	98.4
1998	97.8	112.5	113.1	112.3
1999	99.6	110.4	108.3	107.9
2000	93.6	118.1	104.7	102.0
2001	114.2	103.7	107.7	105.4
2002	92.4	103.2	117.5	108.8
2003	95.9	106.9	102.2	109.0
2004	122.0	107.8	106.8	105.8
2005	90.0	106.8	118.8	105.5
2006	95.1	109.9	99.3	104.1
2007	85.0	107.9	84.8	97.0
2008	128.0	100.0	94.6	98.1
2009	90.0	82.2	96.7	95.9
2010	85.0	110.6	88.1	97.7
2011	110.0	105.6	94.1	100.3
2012	90.8	98.2	91.7	98.1
2013	122.0	101.1	109.7	101.6
2014	112.0	107.7	113.4	105.2
2015	87.1	107.5	103.0	105.8
2016	110.0	103.5	85.0	105.0

Source: HCSO, 2016: GKI

Appendix 4

Indicators of disequilibria, 1991-2016 (in per cent of GDP)

	Foreign trade balance	Current account balance	External financing need	General government balance (ESA)
1991	-4.2	0.8	0.8	-2.1
1992	-1.3	0.8	0.8	-7.0
1993	-11.0	-9.0	-9.0	-5.6
1994	-11.1	-9.4	-9.4	-8.4
1995	-0.3	-3.4	-3.4	-8.7
1996	0.5	-3.8	-3.5	-4.4
1997	1.2	-4.1	-3.8	-5.6
1998	-1.8	-7.2	-6.7	-7.5
1999	-2.8	-7.8	-7.8	-5.1
2000	-3.9	-8.4	-7.8	-3.0
2001	-1.3	-5.8	-5.2	-4.1
2002	-1.8	-6.3	-6.0	-8.9
2003	-4.0	-8.0	-8.1	-7.2
2004	-3.4	-8.5	-8.4	-6.4
2005	-1.2	-7.0	-6.3	-7.9
2006	-1.0	-7.0	-6.2	-9.4
2007	0.5	-7.1	-6.4	-5.1
2008	0.4	-7.1	-6.1	-3.7
2009	4.3	-0.9	1.0	-4.6
2010	5.4	0.3	2.1	-4.6
2011	6.2	0.8	3.1	-5.5
2012	6.9	1.8	4.3	-2.3
2013	6.5	4.0	7.5	-2.4
2014	6.1	2.0	5.8	-2.5
2015	7.4	4.4	8.7	-2.0
2016	8.1	5.1	7.2	-2.3

Source: HCSO, MoF, NBH,. 2016: GKI

Appendix 5

Labour and earnings indicators, 1990-2016

	Gross average earning	Net average earning	Real earning	Rate of unemployment (annual average in per cent)
	(preceding year = 100)			
1990	128.6	121.7	94.3	-
1991	133.4	128.1	93.0	-
1992	124.3	120.7	98.6	9.9
1993	121.9	117.7	96.1	12.1
1994	122.6	125.3	107.2	10.9
1995	116.8	112.3	87.8	10.3
1996	120.4	116.9	95.0	10.0
1997	122.3	126.0	104.9	8.8
1998	118.3	118.4	103.6	7.8
1999	113.9	110.9	102.5	7.0
2000	113.5	111.4	101.5	6.4
2001	118.2	116.4	106.4	5.7
2002	118.3	119.6	113.6	5.8
2003	112.0	114.3	109.2	5.9
2004	106.2	105.7	98.9	6.1
2005	108.8	110.0	106.3	7.2
2006	108.1	107.6	103.5	7.5
2007	108.0	103.0	95.2	7.4
2008	107.5	106.8	100.7	7.8
2009	100.5	101.7	97.6	10.0
2010	101.3	106.9	101.9	11.2
2011	105.2	106.4	102.4	11.0
2012	104.6	102.0	96.5	11.0
2013	103.4	104.9	103.1	10.2
2014	103	103	103.2	7.7
2015	104.2	104.2	104.3	6.8
2016	106	107.5	106.7	5.8

Source: HCSO, 2016: GKI

Appendix 6

Financial indicators, 1989-2016

	Consumer price index (Annual average in per cent)	Official rate of the NBH (At year-end in per cent)	HUF / EUR (Annual average)	HUF / USD) (Annual average)
1989	117.0	-	65.1	59.1
1990	128.9	22.0	80.5	63.2
1991	135.0	22.0	92.7	74.8
1992	123.0	21.0	102.1	79.0
1993	122.5	22.0	107.5	92.0
1994	118.8	25.0	124.8	105.1
1995	128.2	28.0	162.7	125.7
1996	123.6	23.0	191.2	152.6
1997	118.3	20.5	210.9	186.8
1998	114.3	17.0	241.0	214.5
1999	110.0	14.5	252.8	237.3
2000	109.8	11.0	260.0	282.3
2001	109.2	9.8	256.7	286.5
2002	105.3	8.5	243.0	258.0
2003	104.7	12.5	253.5	224.4
2004	106.8	9.5	251.7	202.6
2005	103.6	6.0	248.0	199.7
2006	103.9	8.0	264.3	209.8
2007	108.0	7.5	251.3	183.4
2008	106.1	10.0	251.2	170.9
2009	104.2	6	280	201.4
2010	104.9	5.5	275.4	211.8
2011	103.9	7	279.2	200.9
2012	105.7	6	289.4	226.1
2013	101.7	3	296.9	223.3
2014	99.8	2.1	308.7	232.5
2015	99.9	1.35	309.9	279.3
2016	100.8	0.9	315	286

Source: HCSO, 2016: GKI

Appendix 7

World market prices, interest and exchange rates, 2000-2016

	2000	2002	2004	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Crude oil, Brent, USD/barrel	**28.3**	**25.0**	**38.0**	**65.4**	**72.7**	**97.5**	**62**	**79.6**	**111**	**112**	**109**	**100**	**52.4**	**45**
Crude oil, Brent, EUR/barrel	**30.8**	26.6	30.6	52.3	53.1	66.3	43.2	59.8	79.8	87.5	82.6	75.2	47.2	40.9
EUR/USD exchange rate	**0.92**	**0.94**	**1.24**	**1.25**	**1.37**	**1.47**	**1.39**	**1.32**	**1.39**	**1.28**	**1.32**	**1.33**	**1.11**	**1.1**
EU-28 inflation rate (per cent)	**2.4**	**2.5**	**2.3**	**2.3**	**2.4**	**3.7**	**1.0**	**2.1**	**3.1**	**2.6**	**1.5**	**0.5**	**0.0**	**0.3**
Commodity prices in USD (per cent)	**4.8**	**1.1**	**14.9**	**22.3**	**12.4**	**14.1**	**-18.0**	**26.2**	**18.5**	**-9.7**	**-1.4**	**-4.3**	**-17.3**	**-5.8**
• Food	2.5	1.9	12.4	10.3	12.6	21.6	-12.5	9.8	13.1	0.2	3.2	-3.7	-15.7	-4.7
• Agricultural raw materials	4.4	5.2	6.7	9.1	11.3	7.7	-17.0	31.1	32.5	-15.9	-4.7	3.8	-14.3	-2.9
• Metals and minerals	12.2	-4.3	32.2	53.4	12.9	9.5	-25.7	46.6	15.2	-15.8	-4.9	-11.1	-22.5	-10.3
3 month interest rate (annual average, per cent)														
USA	6.5	1.8	1.6	5.2	5.3	3.2	0.9	0.5	0.5	0.4	0.4	0.3	0.5	0.7
Japan	0.2	0.1	0.0	0.2	0.7	0.7	0.3	0.2	0.3	0.2	0.3	0.2	0.1	0.1
Eurozone	4.4	3.4	2.1	3.1	4.3	4.6	1.2	0.8	1.0	0.6	0.2	0.2	-0.02	-0.3

Source: OECD, IMF, European Commission, GKI

Appendix 8

GDP growth rates in selected countries and regions, 2000-2016

(percentage change over the previous year)

	2000	2002	2004	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
World gross product	**4.7**	**2.7**	**4.9**	**5.5**	**5.6**	**2.8**	**-0.5**	**5.5**	**4.1**	**3.5**	**3.2**	**3.3**	**3.0**	**3.1**
–Industrial countries	3.7	1.5	3.1	2.9	2.6	0.0	-3.7	2.7	1.7	1.0	1.1	1.8	2.0	2.0
USA	3.7	1.6	3.6	2.7	1.9	-0.4	-2.8	2.5	1.6	2.2	1.5	2.4	2.4	2.3
Japan	2.4	0.3	2.7	1.7	2.2	-1.0	-5.5	4.7	-0.5	1.7	1.4	0.0	0.5	0.8
EU-27	**3.8**	**1.2**	**2.5**	**3.3**	**3.2**	**0.3**	**-4.4**	**2.1**	**1.8**	**-0.5**	**0.2**	**1.4**	**2.0**	**1.8**
United Kingdom	4.0	2.1	3.3	2.6	3.5	-1.1	-4.3	1.5	2.0	1.2	2.2	2.9	2.3	1.8
Economic and Monetary Union	**3.8**	**0.9**	**2.2**	**3.3**	**3.0**	**0.4**	**-4.5**	**2.1**	**1.6**	**-0.9**	**-0.3**	**0.9**	**1.7**	**1.6**
Germany	3.2	0.0	1.1	3.7	3.3	1.1	-5.6	4.1	3.7	0.4	0.3	1.6	1.7	1.6
France	4.1	1.0	2.5	2.5	2.3	-0.1	-2.9	2.0	2.1	0.2	0.7	0.2	1.2	1.3
Italy	3.0	0.5	1.5	2.2	1.7	-1.2	-5.5	1.7	0.6	-2.8	-1.7	-0.3	0.8	1.1
Austria	3.4	0.9	2.3	3.7	3.7	1.4	-3.8	1.9	2.8	0.8	0.3	0.4	0.9	1.5
Spain	5.1	2.7	3.3	4.1	3.5	0.9	-3.6	0.0	-1.0	-2.6	-1.7	1.4	3.2	2.6
Netherlands	3.5	0.1	2.2	3.4	3.9	1.8	-3.3	1.4	1.7	-1.1	-0.5	1.0	2.0	1.7
Finland	5.0	1.6	3.7	4.4	5.3	0.3	-8.3	3.0	2.6	-1.4	-0.8	-0.7	0.5	0.7
–CIS	9.0	5.2	8.2	8.7	8.9	5.3	-6.5	5.0	4.8	3.4	2.1	0.9	-2.9	-1.1
Russia	10.0	4.7	7.1	8.2	8.5	5.2	-7.8	4.5	4.3	3.4	1.3	0.6	-3.7	-1.9
Ukraine	5.9	4.1	9.6	7.3	7.9	2.1	-15.1	4.0	5.0	3.5	3.0	-7.5	-9.0	2.0
–Asia	6.5	6.4	8.0	9.6	10.3	6.9	5.5	9.8	7.7	7.0	6.5	6.2	5.9	5.8
China	8.0	9.1	10.1	12.7	14.2	9.6	9.5	10.6	10.3	9.6	8.0	7.3	6.9	6.5
India	3.9	3.8	7.5	9.6	9.3	6.7	5.0	11.0	7.9	4.9	6.9	7.1	7.3	7.4
Republic of Korea	8.5	7.0	4.7	5.2	5.1	2.3	0.3	6.5	3.7	2.3	2.9	3.3	2.6	2.6
Latin America	4.3	0.2	6.0	5.6	5.7	4.3	-1.3	6.0	4.9	3.1	2.9	1.2	-0.1	-0.4
Middle East and North Africa	5.1	2.0	6.3	5.5	5.4	4.2	1.7	5.4	2.9	3.5	1.7	2.7	2.8	2.9
Sub-Saharan Africa	3.3	3.5	5.8	6.7	7.1	5.4	4.0	5.8	4.4	4.4	5.0	5.0	3.3	3.3
World trade	**28.3**	**4.1**	**10.9**	**9.2**	**9.5**	**4.8**	**-10.7**	**12.6**	**6.5**	**2.6**	**3.2**	**3.3**	**2.4**	**2.7**

Source: OECD, IMF, European Commission, GKI