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HUNGARY'S LAGGING BEHIND THE CEE REGION CONTINUES

The 2 per cent GDP growth in the third quarter of 2016 confirmed the correctness of the 2 per cent growth forecast of GKI for 2016. In recent weeks, the IMF reduced its forecast to 2 per cent and the EU to 2.1 per cent, which is significantly lower than expected growth rates in the region. The significant decline in investments in 2016 will be followed by a noticeable growth in 2017 mainly due to the restart of the inflow of EU transfers, while the increase of consumption, which is very rapid this year, will continue similarly. GKI expects GDP to grow by 2.7 per cent in 2017, which is almost identical with the projections of the IMF and the EU. At present, internal and external equilibria are very favourable; however, some manageable deterioration can be expected next year due to the start of government spending related to the forthcoming parliamentary elections. Inflation began to pick up, too.

In the third quarter of 2016 Hungary's GDP growth (1.4 per cent according to EU methodology) lagged behind most of its regional competitors (the Polish rate was 2.1 per cent, the Slovak 3.2 per cent and the Romanian 4.6 per cent) and the EU average (1.8 per cent) as well. The Hungarian economy will hardly be able to accelerate substantially in the fourth quarter of 2016 since the last quarter of 2015 was particularly favourable, and economic expectations have essentially been stagnant.

Factors increasing risks for 2017 include the possible rise of populist political forces throughout the world seeking to dampen globalization, leading to a slowdown in the expansion of world trade, which is unfavourable for the export-oriented Hungarian economy. In addition, the present trends in the world economy favourable for Hungary, such as very low interest rates and energy prices, are not expected to improve any further. However, investments will increase in 2017 due to the rise in EU transfers, strengthened by a revival in housing construction. Gross wages are expected to accelerate next year due to labour shortages and the forced increase of the minimum wage by 15 per cent. Taking into account the rise in inflation from 0.5 per cent to 1.5 per cent, real earnings and consumption are expected to grow in 2017 similarly to 2016 (around 7 per cent and 4-5 per cent, respectively). It is doubtful that some of the companies actually employing minimum wage earners will be able to tolerate a rise in labour costs. This may lead to the greying of the economy. The higher the wage increases are, the higher short term competitiveness concerns will be. The modest acceleration in industrial production will also be reflected in exports. However, the growth rate of imports will be much higher due to the increase in domestic demand as a result of expanding, and not shrinking, investments. In addition, the improvement in the terms of trade is expected to come to an end. This will reduce the already very high trade surplus. However, this loss will be more than offset by the inflow of EU transfers, thus the balance of the current and capital account will improve further in 2017.

At the end of October the general government balance reached an unprecedented surplus of nearly HUF60bn. The decrease in capital spending and interest expenses, the soaring corporate tax receipts as a result of tax credit for growth (mainly from GE), last year's postponed EU transfers, land sales revenues and the increase in social security contributions and income tax revenues have played a major role in the reduction of the deficit. However, an increase in government spending can be anticipated during the rest of the year, and especially for 2017. The general government deficit remains below 3 per cent of GDP in 2017, whereas the nearly 1 percentage point annual decline in the general government debt will be in line with EU requirements. Despite these positive facts, lack of legal certainty impedes the development of the Hungarian economy at a rate similar to its competitors in the CEE region.

FORECAST OF GKI FOR 2016-2017

	Description	2014	2015	01-09 2016	2016 forecast	2017 forecast
1.	GDP (%)	104.0	103.1	102.0	102	102.7
2.	Industrial production (%)	107.7	107.5	101.5	102	103.5
3.	Investments (%)	119.3	103.8	82.7**	90	105
4.	Construction services (%)	113.4	103.0	79.3	80	110
5.	Retail trade turnover (%)	105.2	105.8	104.9	105	105
6.	Exports (current prices in euro, %)	104.0	107.0	102.9	104	106
7.	Imports (current prices in euro, %)	104.7	104.6	101.2	103	108
8.	Foreign trade balance (EUR billion)	6.3	8.6	7.6	9	8
9.	Balance of the current and capital account (EUR billion)	6.1	8.7	3.6**	7.7	8.2
10.	Average exchange rate of euro (in HUF)	308.7	309.9	311.6***	312	315
11.	General government financing needs* (HUF billion)	-825.7	-1218.6	57.3***	700	750
12.	Index of average gross earnings	103.0	104.2	106.1	106	108
13.	Consumer price index	99.8	99.9	100.2***	100.5	101.5
14.	Consumer price index at the end of the period (corresponding month of the previous year=100)	99.3	100.9	101.0***	101	102
15.	Rate of unemployment (at the end of the period, %)	7.1	6.2	4.9****	5.1	5

* *Cash flow basis, without local governments*
** *First half of 2016*
*** *January–October 2016*
**** *July–September 2016*
Sources of actual data: CSO, NBH, NGM

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