

Monthly flash report for top executives (June, 2016)

The growth rate of the Hungarian economy slowed down more than expected in the first quarter of 2016. Although GDP grew by 0.9 per cent on an annual basis, it decreased by 0.8 per cent compared to the previous quarter. Only the GDP growth rate of Greece was slower than that of Hungary. **Three groups of factors** played important roles in the **slowdown**. The fall in EU transfers resulted in a decrease in investments. The poor investment climate caused by the “Hungarian model” in operation for six years had negative effects on growth. In addition, serious problems arise in certain market segments (e.g., Audi). The **sectoral picture** is mixed: output dropped in construction, it declined slightly in industry and the financial sector; however, the trade and tourism sector expanded significantly. The decline in construction may abate significantly during the rest of 2016, industrial growth already picked up, sectors providing households with goods and services may grow, and agricultural production has also good prospects. **GKI reduced its 2016 growth forecast from 2.3 per cent to 2 per cent, whereas it continues to expect a growth rate of 2.5 per cent in 2017.** These rates are lower than those of Hungary’s regional competitors.

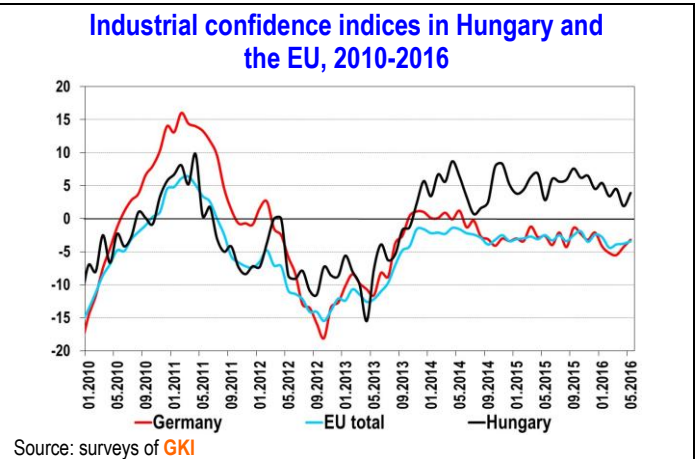
After three months of restrained growth, **industrial production** gave a sign of life in April: it increased by 5.3 per cent on an annual base, and by 5.4 per cent compared to the previous month. Overall, it increased by 1.5 per cent in the first four months of 2016. The sector’s confidence index increased slightly in May, returning almost to its level in March. A further recovery is likely during the rest of the year and next year.

Summary figures, 2015-2017

	2015	Q1 2016	2016	2017
GDP (previous year = 100)	102.9	100.9	102	102.5
Investments (previous year = 100)	101.9	92.2	92	105
Consumption (previous year = 100)	102.6	104	104	103.5
Current account balance (EUR billion)	4.8	1.6	5.7	5.2
Current account and capital account/GDP (per cent)	8.7	7.6	7.2	7.2

Source: HCSO, NBH. 2016-2017: GKI

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. May survey results show that expectations stagnated in industry and construction, whereas they improved in trade and services. Consumer expectations were also somewhat more optimistic.



Source: surveys of GKI

Construction output in March 2016 was a third less than a year ago, resulting in a fall of 27.6 per cent in the first quarter. The construction confidence index dropped significantly in May, reaching its lowest point in the past 32 months. Expectations of **home building companies** were significantly more favourable than the industry average. The expected launch of construction projects financed by EU transfers and the highly anticipated increase in home building can only be sufficient to mitigate the fall. Output will likely drop by 13 per cent in 2016.

Real economic trends, 2015-2017

(Volume, the same period of the previous year = 100)

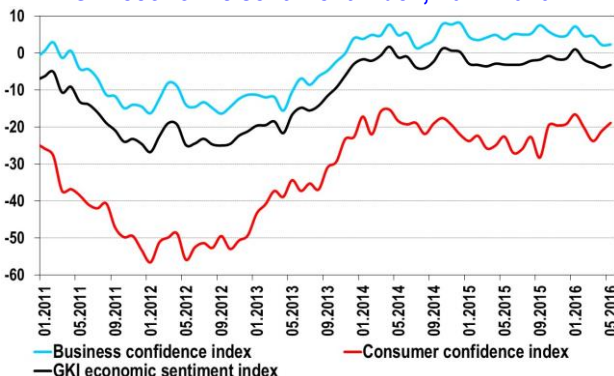
	2015	Jan-Apr 2016	2016	2017
Industrial production	107.5	101.5	103.5	105
Construction	103.0	72.4*	87	107
Exports	107.9	103.0*	106	107
Imports	107.0	106.2*	106	108
Retail sales	105.6	104.7	105	103

Source: HCSO, 2016-2017: GKI, */ January–March

Retail sales grew by 4.7 per cent both in April and in the first four months of 2016. The main driving force in the first four months of 2016 was the revival in the sales of non-food articles (by 8 per cent) and fuels (by 5 per cent). The **trade confidence index** rose in April and May, thereby reaching its level at the beginning of 2016.

The **service sector confidence index** has been declining for the fourth consecutive month, reaching its lowest point in the past 30 months in May. According to the data of the Hungarian Central Statistical Office, most business services sectors performed well in the first quarter of 2016. **Tourism performed exceptionally well**: in the first quarter the performance of commercial lodgings grew by 11 per cent and

GKI economic sentiment index, 2011-2016



Source: surveys of GKI

In Hungary, the decline of the **GKI economic sentiment index**, which started in January 2016, stopped in May, and it even slightly increased. The business confidence index remained unchanged compared to April. However, consumer expectations almost reached their peak value this year.

that of catering by 13 per cent. Significant growth can be expected in 2016 and 2017, too. The GDP production of info-communication, professional, scientific, technical and administrative services also grew at a rate above 3 per cent in the first quarter. Real estate transactions slowly but surely continued to increase by over 1 per cent. The **financial sector's GDP** decreased only minimally in the first quarter. The new uniformity decision of the Supreme Court about foreign currency loans is favourable to banks, and the bank tax will decrease as promised. Although the loan portfolio is still lower than a year ago, the performance of the sector will increase slightly both in 2016 and 2017.

The **unemployment rate** decreased to 5.8 per cent between February and April, which is 1.8 percentage points lower than one year earlier, in part due to the expansion of public workfare programs. The number of employees increased by 3.4 per cent in the first quarter of 2016 (by 2.8 per cent with the exclusion of those involved in public workfare schemes). Employment grew by 3.5 per cent in the private sector, and the growth was especially rapid in info-communications (5 per cent), and professional, scientific and technical activities (9%). **Employment intentions** in trade reached their peak of all times, and they also improved in services. However, they weakened in other sectors. The fear of unemployment of households strengthened slightly, too.

Labour market trends, 2015-2017

	2015	Jan-Mar, 2016	2016	2017
Rate of unemployment (end of year)	6.2	5.8*	5.9	5.7
Gross earning (competitive sector)**	103.9	105.4	105.5	105.5
Gross earning (public sphere)**	105.1	107.8	107.0	107
Real earning **	104.3	107.4	106.7	104

Source: HCSO, 2016-2017: **GKI**
*/ February–April, **/ The same period of the previous year = 100

Although in May 2016 **consumer prices** were 0.2 per cent lower than a year earlier, they rose by 0.3 per cent compared to the previous month. The inflation rate was 0.2 per cent in the first five months of 2016. The prices of consumer goods and consumer durables increased most, whereas fuel prices fell by almost 4 per cent. The inflation rate is expected to be 0.8 per cent in 2016 and around 2 per cent in 2017, though it might be slower.

Gross earnings grew by 6 per cent in the first quarter of 2016 (by 6.6 per cent with the exclusion of those involved in public workfare schemes), and by 5.4 per cent in the private sector. **Real earnings are expected to increase by 6.5-7 per cent in 2016** and by a slower rate of **4 per cent in 2017**, due to the phasing out of the impacts of the personal income tax rate reduction and accelerating inflation. Although real incomes may rise at a slower pace than this, **consumption** will increase considerably (by 4 per cent) in 2016 and by only slightly less (3.5 per cent) in 2017.

Owing to the fall in EU transfers, **investments** dropped by almost 10 per cent in the first quarter of 2016, and within that, construction investments fell by almost 20 per cent. Investments in environmental protection fell to one quarter of the level a year earlier, whereas those in transportation and storage halved and those in the health and social care system

decreased by 28 per cent. Although to a lesser extent, **business investments** (including manufacturing investments) **also declined**. The volume of investments is expected to decline by around 8 per cent in 2016 and to increase by 5 per cent in 2017. Investments remain very dependent on the availability of EU transfers. Business investments cannot be expected to recover mainly due to the unpredictable economic policy of the government (often changing its priorities and tools).

Interest rates and exchange rates, 2015-2017
(end of period)

	2015	May 2016	2016	2017
NBH reference rate	1.35	0.9	0.90	0.90
Fed reference rate	0.50	0.50	0.70	1
ECB reference rate	0.05	0.0	0.0	0.0
EUR/HUF exchange rate	309.9	312.4	315	320

Source: NBH, 2016-2017: **GKI**. */ Periodical average

The **Fed** continues to emphasize the principle of progressivity and the importance of caution. One or two further **rate hikes** can be expected during the rest of 2016, and the first one might be in the summer period. The **ECB** did not change its benchmark interest rate in April and May and the parameters of its asset purchase programme also remained unchanged. The **National Bank of Hungary** cut its **base rate** again in May, this time reducing it to 0.9 per cent, and at the same time declaring an end to the current easing cycle. In May, financing of the Hungarian government debt became somewhat more expensive as the **benchmark yield** of one-year government bonds rose slightly (to 1 per cent).

Financial indicators, 2015-2017

	2015	Jan-May 2016	2016	2017
Consumer price index	99.9	100.3	100.8	102
The reference rate of the central bank (per cent)*	0.93	1.00	1	2
Foreign trade balance (EUR billion)	8.1	3.4**	9	9.7
Government deficit (cash flow, without local governments, HUF billion)	1218.6	13.2	1100	800

Source: CSO, NBH, NGM, 2016-2017: **GKI**. */ End of period, **/ January–April 2016

Hungary's government debt was upgraded to investment grade by **Fitch**; however, it is well below the typical grades in the region. Although further upgradings are questionable due to the slower-than-expected growth, the more relaxed 2017 budget and the scandals surrounding the National Bank of Hungary, nonetheless, they may eventually be likely to happen.

The **general government deficit** in the first five months was very favourable; it has never been so low in the last one and half decades. However, tensions are foreshadowed by the fact that some appropriations (for example, in education) in the 2016 budget were set higher than in the proposed 2017 budget. The situation of healthcare and education will probably enforce further expenditures in addition to the already decided reallocations. Despite the favourable budgetary developments, the ratio of **government debt** to GDP at the end of the first quarter of 2016 increased by 1.6 percentage points compared to the end of 2015 as the artificially depressed reserves had to be replenished.