Forecast for 2016-2017

The Hungarian economy is essentially proceeding on a path indicated in September. Owing to the fall in EU transfers, GDP growth in Hungary slowed down to 2 per cent 2016. It is expected to accelerate to around 3 per cent in 2017 due to the rise in EU transfers and accelerating growth in consumption. As a result of the significant wage increases in 2017, growth in consumption will be 5 per cent, that is, 1 percentage point faster than previously expected. Inflation will also pick up in 2017, from 1.5 per cent to 2 per cent. However, the situation of the general government in 2016 is much more favourable than previously thought, in part due to one-time revenues. Although the government realised that GDP growth based on cheap labour was sputtering, economic competitiveness was deteriorating, and Hungary became excessively dependent on EU transfers, the government failed to revise the Hungarian model. Thus, we can only expect some temporary improvement rather than genuine changes, and the using up of EU transfers and the lagging behind the CEE region will continue.

Global economic growth in 2016 will be similar to last year's, and it will slightly accelerate in 2017 mainly due to the somewhat more dynamic growth of emerging countries, most specifically those producing crude oil and commodities (Russia, Brazil and the Middle East oil producers). However, there are a number of uncertainties not only for the US but the entire global economy including the future economic policy of Trump and the actual timing, method and consequences of Britain's departure from the EU. **The rise of populist political forces throughout the world seeking to dampen globalization leads to a slowdown in the previously expected expansion of world trade, which is unfavourable for the export-oriented Hungarian economy.** 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**.

After November, the **GKI economic sentiment index** rose again in December. Business expectations increased slightly, whereas consumer ones went up more strongly, reaching their ten-year peak. The **GKI** economic sentiment index has fluctuated in a relatively narrow band for three years, and now it is somewhere around the top of this band.

In 2016, as a result of barely rising price levels and the reduction in the personal income tax rate, the growth rate of **gross earnings** was about 2 percentage points higher than in 2015. 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 wage increases in the public sector and the effects of the mounting shortage of labour. As a result of similar factors, gross earnings are expected to rise by almost 3 percentage points in 2017, to 9 per cent, whereas **real earnings will increase again by around 7 per cent** due to the unchanged income tax rate and the accelerating inflation (from 0.4 per cent to 2 per cent). Unlike in previous years, **earnings have been rising faster in the public sector since 2015**. **The consumption of households is expected to go up by 4.5 per cent in 2016 and by 5 per cent in 2017. GKI surveys** show that businesses employing over 250 persons planned to lift wages by 11 per cent and SMEs by a rate between 6.5 and 8.2 per cent. This also highlights the fact that raising the minimum wage and the guaranteed minimum wage by 15 per cent and 25 per cent, respectively, **will not cause a problem for large (often foreign) companies. In contrast, small firms will suffer severe competitiveness problems** forcing them to layoffs and making their activities "grey".

Gross fixed capital formation expanded by 11 per cent in 2014 and by 2 per cent 2015. It **dropped by 10 per cent in 2016**, mainly due to the decline of EU transfers and it is expected to **rise by 5 per cent in 2017** due to the resumption of the EU investment cycle. The investment rate was 21.3 per cent in

2015, and it is expected to be 18.8 per cent in 2016 and 19.3 per cent in 2017, which is a low rate for a moderately developed country like Hungary

In the past decade, the growth rate of the Hungarian economy has been significantly lower than that of other countries in the CEE region, with the exception of 2013-2014, when the inflow of EU transfers reached their peak. The Hungarian economy became **consumption-oriented**, and the investment rate is not expected to exceed 20 per cent in 2017 (after its drop in 2016) in spite of the boosting effects of EU transfers. Industry ailing in 2016 is expected to accelerate slightly in 2017, construction will stop declining and will grow rapidly, and business services, especially trade, will increase relatively fast.

The number of **employees** is expected to grow by around 3 per cent in 2016 in all sectors of the national economy. This can be attributed to the still favourable dynamics of the business cycle, the dynamic expansion of employment abroad and a further increase of public employment. In 2017, which is the year before the parliamentary elections, the government is expected to promote the further increase of employment, although it projected the possibility of mass layoffs in the public sector in the framework of fighting against government bureaucracy and some reduction in public workfare schemes, too. Employment will grow by around 2 per cent, and the **unemployment rate** will be 5 per cent, after being 5.2 per cent in 2016. After taking into account the realistic value-creating ability of public workfare schemes, unemployment can be around 8 per cent in Hungary. **However, the shortage of highly qualified labour is increasing.**

The reduction in the corporate loan portfolio already stopped in 2016, whereas the decline in the retail loan portfolio, with the exception of real estate loans, will stop only in 2017. The quality of the loan portfolio is improving. The liquidity and the capital adequacy ratio of the banking system (20 per cent) are outstanding.

Internal and external equilibria are very favourable. The general government deficit has been below 3 per cent for 5 years. It is expected to remain below 2 per cent in 2016 and it will be around 2.5 per cent in 2017. Since 2009 the combined current and capital account has been recorded increasing surpluses year by year. The **drawback** of all this includes an anti-growth tax structure, the degradation of large distribution systems, lack of the transparency of the fiscal policy and the stopping of FDI inflow. Although the budgetary burdens of tax cuts will largely be offset by the forced corporate wage increases in 2017, the increased spending in many areas before the elections are expected to enhance the deficit. The nearly 1 percentage point annual decline in the general government debt will be in line with EU requirements. **The external financing capacity will essentially remain unchanged in 2015-2017 as the different changes in the foreign trade surplus and EU transfers will largely neutralize each other. The external financing capacity relative to GDP, however, will decline slightly.**

After several months of decreasing prices in 2016, the **inflation rate** was 0.6 per cent in September, 1 per cent in October, and 1.1 per cent in November, **reaching its three-year peak, which represents a clear trend reversal**. Prices have also been rising in the euro area in recent months, and the inflation rate was 0.6 per cent in November. In Hungary, the average rate of inflation will be 0.4 per cent in 2016 and around 2 per cent in 2017. Although the central bank **reference rate is expected to remain 0.9 per cent until the end of 2017**, monetary easing by unconventional methods will continue. **The exchange rate of the forint to the euro is expected to be HUF312 in the average of 2016, and around HUF315 in 2017.**

The forecast of GKI for 2016 and 2017

	2013	2014	2015	2016	2017 forecast	
	Fact			Estimate	September	December
GDP	102.1	104.0	103.1	**102**	102.7	**103**
• Agriculture (1)	114.7	117.0	94.9	**110**	100	**100**
• Industry (2)	97.5	105.9	108.2	**102**	103	**103**
• Construction (3)	106.1	110.5	101.5	**80**	108	**108**
• Trade (4)	107.0	104.1	104.6	**106**	105	**107**
• Transport and storage (5)	101.9	101.8	101.4	**103**	103	**103**
• Information, communications (6)	104.3	104.0	101.6	**104**	103	**103**
• Financial services (7)	95.0	97.0	100.2	**100**	102	**102**
• Real estate services (8)	100.8	100.0	102.0	**102**	102	**102**
• Professional, scientific, technical activities (9)	104.2	105.4	102.9	**105**	103	**103**
• Public administration, education, healthcare (10)	106.7	100.6	99.9	**101**	101	**101**
• Arts, entertainment (11)	101.9	107.0	98.9	**102**	102	**102**
• Core growth (2)+(3)+(4)+(5)+(6)+(7)+(8)+(9)	101.3	104.2	104.5	**102**	103.5	**103.7**
GDP domestic demand	102.3	104.6	101.4	**101.5**	103.2	**104.2**
• Private consumption	100.5	102.1	103.1	**104.5**	104	**105**
• Gross fixed capital formation (investments)	109.8	109.9	101.9	**90**	105	**105**
Foreign trade in goods						
• Exports	104.2	106.9	107.8	**106**	107	**107**
• Imports	105.0	108.8	106.3	**107**	109	**109**
Consumer price index (preceding year = 100)	101.7	99.8	99.9	**100.4**	101.5	**102**
Balance of current and capital account						
• EUR billion	7.5	6.1	8.7	**8.5**	8.2	**8.5**
• In per cent of GDP	7.4	5.8	7.9	**7.6**	7.2	**7.3**
Unemployment rate (annual average)	10.2	7.7	6.8	**5.2**	5.1	**5.1**
General government balance in per cent of GDP (ESA)	-2.6	-2.1	-1.6	**-1.9**	-2.5	**-2.5**

Source: HCSO, GKI