Forecast for 2017

(Summary – 29 March 2017)

The growth rate of the Hungarian economy slowed down considerably in 2016 compared to the previous two years, mainly due to the decline of EU transfers and the resulting fall in investments. GDP grew by 2 per cent, exactly at the rate projected by GKI, slower than anticipated by the government (2.8 per cent) or the National Bank of Hungary (2.5 per cent). According to data appropriate for international comparisons, the growth rate in 2016 (1.8 per cent) was the same as the EU average, only Estonia and Latvia had lower rates than Hungary in the CEE region. Especially Romania and Bulgaria grew significantly faster. Investments fell by 15 per cent in Hungary whereas they grew by almost to 2 per cent in the EU. However, households' consumption expanded by 4.2 per cent in Hungary, much faster than its around 2.7 per cent average growth in the EU. GDP growth was boosted by consumption alone. The 0.8 per cent growth rate of Hungary's industrial GDP lagged behind the EU average of close to 1.5 per cent. Everybody agrees that the growth rate of the Hungarian economy will accelerate in 2017, primarily due to the increase in EU transfers. The predicted rate varies between 3 and 4 per cent. Primarily due to the statistical effects of the performance of investments that had been much lower than previously expected, GKI raised its GDP forecasts for 2017 to 3.2 per cent from 3 per cent. It is halfway between the projections of the IMF (3 per cent) and the EU (3.5 per cent), and it is lower than the expectations of the Hungarian government (4.1 per cent). As far as production is concerned, it will be boosted by construction, which has already been able to work off a large proportion of its decrease last year, and trade, which was already expanding rapidly last year. Growth can be projected in all sectors, with the exception of agriculture, where a "natural decline" can be expected after last year's uptick. Inflation will accelerate. Although external and internal equilibria will deteriorate slightly, they remain favourable. No substantial improvement can be expected in the main factors determining long-term development (in terms of the functioning of institutions, maintaining specific regulations, neglecting market solutions, and starting real structural reforms). Although the government frequently emphasises the importance of competitiveness, it is no more than empty lip service.

Global economic growth 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), and some improvements in the US. However, the **world economic order** established after the Second World War and the **globalization process are facing great challenges**. The realisation of the isolationist and protectionist ideas of Donald Trump may rearrange the relations of the power centres of the world and may dampen the previously expected acceleration in the expansion of world trade. The future of the **EU** is significantly affected by the timing and method of **Brexit**, elections to be held in some important member states, as well as the Greek and Italian financial and economic situations. In addition, the **present trends in the world economy** favourable for Hungary, such as very low interest rates and energy prices, are slowly coming to an end.

The EU's **economic sentiment index** in February was slightly higher than at the end of 2016. The **GKI economic sentiment index** has fluctuated in a relatively narrow band for three years, and it was somewhere around the top of this band in March. The construction confidence index reached its nineteen-year peak and the consumer confidence index its eleven-year height.

Two conflicting ideas can be detected in Hungarian **economic policy**: preserving continuity (including external and internal equilibria based on EU transfers) and realizing the unsustainability of the current situation (GDP growth based on cheap labour was sputtering, economic competitiveness was deteriorating, and Hungary became excessively dependent on EU transfers). The government regarded the rise of **populist forces** in the world last year as evidence **justifying its policy of "freedom fight" against the EU**. However, this trend was broken by the Dutch elections and similar results can be expected after the French and German elections as well. 2017 will hardly be the "Year of Rebellion" in Europe. Voices of those wishing to **strengthen integration, at least within a narrow circle**, and to search **adaptive solutions** for tensions have become louder within the EU. This requires an improvement in the competitiveness of individuals (employees), individual countries and the EU as a whole. In the long run isolation and **exclusion from the decision-making circles of the EU** are **strategic mistakes** for the export-oriented Hungarian economy, notwithstanding the possible widening of the national room for manoeuvring.

The **consumption of households** increased by 4.5 per cent in 2016, and reached its level of ten years earlier. In 2017 the expansion of consumption is **accelerating for the fifth consecutive year**. Although the growth of real wages and income will slow down slightly in 2017, the growth rate of **consumption** may **accelerate** to around 5 per cent due to carry-over effects, the slow increase in net borrowing, and the strengthening of the propensity to buy. The pick-up in public sector wage increases, the raise of minimum wages, and the resulting general pressure to increase wages everywhere is obviously part of an **economic policy influenced by the forthcoming elections**. However, this is a **"cheap"** solution as far as the general government is concerned, since the impact of tax cuts might be offset by the tax burden imposed on wages. However, since there is no free lunch, the results will include deterioration in the competitiveness of businesses (especially small ones).

Gross fixed capital formation decreased by 15.5 per cent in 2016 due to the fall in EU transfers. In 2017, **as a result of the resumption of the EU investment cycle at least an 8 per cent growth is expected**. The investment rate was 21.7 per cent of GDP in 2014-2015, it dropped to 17.8 per cent in 2016, and it will rise to 18.5 per cent in 2017, which is a very low ratio in a country with medium level of economic development. Although in 2017 the government is expected to announce the calls for tenders of the new EU budget period started in 2014, its main goal remains spending money fast. Of the HUF3,950bn available for applicants in the 2014–2020 cycle only HUF1735bn have been spent until now. In addition, as major projects were handled first in order to gain **as much and as fast as possible**, a significant portion of disbursements are advance payments, thus no substantive activities have started in these areas yet.

After two favourable years, the growth rate of **industrial production** did not reach 1 per cent in 2016. Its performance in 2017 is primarily dependent on the automotive industry. A 3.5 per cent increase in production can be expected in 2017, in part due to the start of production of the Apollo tire factory. Following its almost 19 per cent decline in 2016, **construction** will grow rapidly in 2017, by up to 15 per cent, due to expanding EU transfers and an increase in residential construction (though it will still remain under its 2015 level). After 10 thousand new flats in 2016, the building of 14-16 thousand units can be expected in 2017. **Agricultural** GDP rose by nearly 17 per cent in 2016. In case of average weather conditions, around 5 per cent decrease can be expected in 2017 since agricultural techniques used make performance heavily dependent on weather conditions, and thus very volatile. Since 2010, the agricultural sector had double-digit growth in four years and double-digit decline (over 20 per cent) in two years, and the change was around 5 per cent only once. **GDP in services** will increase by about 3.3 per cent in 2017, faster than the average GDP growth or the rate of the previous year. Growth is expected mainly in business services, of which trade-tourism and telecom will grow most in 2017. The financial sector, being the only one that declined last year, is also expected to expand in 2017.

Exports of goods and services rose by almost the same rate as imports in 2016 (though exports of goods was somewhat lower than imports, whereas exports of services exceeded imports by 4 percentage points). The export surplus contributed to the 2 per cent GDP growth of 2016 by about 0.6 percentage points. The growth rate of foreign trade volume will accelerate slightly in 2017; that of exports slower (from 5.3 per cent to 6 per cent), and that of imports faster (from 6 per cent to 7.5 per cent). The **increase of the gap in favour of imports** can be explained by the fact that although domestic consumption is accelerating, no improvement can be expected in Hungary's export potential. The **surplus of foreign trade in goods** will decrease from HUF9.9bn to HUF9.3bn in 2017 due to an increase in domestic demand, whereas that of services may continue to rise slightly.

Employment is improving, unemployment is decreasing, and companies' intentions to employ are favourable. **There is labour shortage in many areas, and the fear of unemployment of households is at its lowest level in almost 20 years.** However, **statistics** show a much more **spectacular improvement** in trends due to the increase in **foreign employment** and **public workfare schemes**, as well as some **methodological** changes. Despite the acceleration of economic growth, in 2017 demand for labour may increase at a lower rate than in 2016, by 1.5-2 per cent. The employment generating capacity of the **private sector** is increasing, although its dynamics decelerates to some 3 per cent. However, employment may even drop in the **public sector** as a result of channelling those employed in public workfare schemes into the private sector and outsourcing some other employees. Whereas jobs are **scarce** for unskilled workers and those with low level labour culture force in the labour market, **labour shortage** characterizes more and more professions. In 2016 the unemployment rate decreased by 1.7 percentage points to 5.1 per cent, and the year-end rate was 4.5 per cent, the third best in the EU. If two thirds of those involved in public workfare schemes are considered unemployed, Hungary's unemployment rate would be **8.1 per cent**, not much better than the EU average of around 8.5 per cent. The trend of **forcing down unemployment statistics** aggressively is expected to continue in 2017. (Disabled people, who officially lost their ability to work by less than 50 per cent and practically cannot find jobs in the labour market, will be deleted from the labour records.) The official **unemployment rate** will be around 4.2 per cent in 2017.

The corporate loan portfolio already increased in 2016, whereas the retail loan portfolio still decreased. The **quality of bank loan portfolios** improved significantly largely due to the sale of non-performing loans. The release of provisions has greatly contributed to bringing **bank profits to their ten-year peak**. Retail loan portfolio is expected to increase in 2017, mainly due to the boom in housing loans. GDP production of the financial sector will increase by 2 per cent in 2017, after its 1 per cent decline last year.

The Hungarian general government deficit will be **below 3 per cent** of GDP in 2017 for the sixth consecutive year, with the government debt on a declining path. The **drawback** of all this includes an anti-growth tax structure, the degradation of large distribution systems, lack of the transparency of fiscal policy and the nationalization of the private pension fund assets. Improvement of the balance can be attributed mainly to EU transfers (saving some expenditures, and increasing tax revenues on excess activities), and more recently, to the tax credit for growth. Although further rise in spending, and thus in the deficit, can be expected in many areas before the elections, the **deficit will remain below 3 per cent** (around 2.5 per cent), the government debt relative to GDP will decline by 0.5–1 percentage points, to around 72.8 per cent.

Consumer prices rose by 0.4 per cent in 2016. They increased by 2.3 per cent in January 2017 and by 2.9 per cent in February, which was already within the inflation target range. In recent months, inflation has also increased in the EU due to the growth in world energy prices. In Hungary, this was exacerbated by the cost-side and demand-side inflationary impacts of the rapid rise in households' incomes. Even if average world energy prices will grow modestly in 2017, the **inflation rate** is likely to reach **at least 2.5 per cent**. The **base rate of the National Bank of Hungary is not expected to change** in 2017, thus the impact of the Fed's interest rate rises may cause a weakening of the forint, **raising last year's average exchange rate of the forint to the euro from HUF311.5 to HUF315**.

Hungary's **combined current and capital account** produced surpluses in almost every year between 2009 and 2015, and the surplus reached EUR8.7 billion in 2015. Despite the outstanding improvement in the foreign trade balance in 2016, it probably decreased to around EUR7.5bn due to the contraction of the inflow of EU transfers. In 2017, however, despite some decline in the foreign trade surplus, it **may increase to EUR8bn** as a result of the restart of EU transfers, which means **stagnation if calculated as a percentage of GDP** (6.7 per cent). Net inflows of **FDI** received a boost in 2016, and this trend may continue, though at lower rates, in 2017, too.

Although statistics are expected to be favourable in 2017 and 2018, there are still no signs of any preparation for the post-2020 period following the phasing out of EU transfers.

The forecast of GKI for 2017

	2014	2015	2016	2017 forecast		
	fact			September	December	**March**
GDP	104.0	103.1	102	102.7	103	**103.2**
• Agriculture (1)	117.0	94.9	116.8	100	100	**95**
• Industry (2)	105.9	108.2	100.8	103	103	**103**
• Construction (3)	110.5	101.5	82.1	108	108	**112**
• Trade (4)	104.1	104.6	106	105	107	**107**
• Transport and storage (5)	101.8	101.4	102.5	103	103	**103**
• Information, communications (6)	104.0	101.6	103.7	103	103	**104**
• Financial services (7)	97.0	100.2	98.9	102	102	**102**
• Real estate services (8)	100.0	102.0	101.2	102	102	**103**
• Professional, scientific, technical activities (9)	105.4	102.9	106.3	103	103	**104**
• Public administration, education, healthcare (10)	100.6	99.9	101.3	101	101	**101**
• Arts, entertainment (11)	107.0	98.9	101.4	102	102	**102**
• Core growth (2)+(3)+(4)+(5)+(6)+(7)+(8)+(9)	104.2	104.5	101.5	103.5	103.7	**104.2**
GDP domestic demand	104.6	101.4	101.5	103.2	104.2	**104.2**
• Private consumption	102.1	103.1	104.2	104	105	**105**
• Gross fixed capital formation (investments)	109.9	101.9	84.5	105	105	**108**
Foreign trade turnover						
• Exports	106.9	107.8	105.8	107	107	**106**
• Imports	108.8	106.3	105.7	109	109	**107.5**
Consumer price index (preceding year = 100)	99.8	99.9	100.4	101.5	102	**102.5**
Balance of current and capital account						
• EUR billion	6.1	8.7	7.5*	8.2	8.5	**8**
• In per cent of GDP	5.8	7.9	6.7*	7.2	7.3	**6.7**
Unemployment rate (annual average)	7.7	6.8	5.1	5.1	5.1	**4.2**
General government balance in per cent of GDP (ESA)	-2.1	-1.6	-1.9	-2.5	-2.5	**-2.5**

* GKI estimate
Source: HCSO, GKI