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TRENDS ARE FAVOURABLE IN THE SHORT TERM

Trends in the Hungarian economy of the first half of the year have continued in the past few months, and no substantial changes can be expected until mid-2018. Owing to the surge of EU transfers and their budgetary advance payments as well as the pre-election demand boost, the economic growth rate reached 3.8 per cent, which is above the EU average but it is among the lowest in the CEE region. Although GDP growth is driven by investments, consumption is also rising fast. Although external and internal equilibria deteriorate slightly, and inflation accelerates, this is not a problem for the time being. The trends are favourable in the short term; however, long-term solutions are still missing.

The fastest growing sector in the Hungarian economy will be construction both in 2017 and 2018. It increased by 28 per cent in the first eight months of this year and it is expected to grow by 25 per cent in 2017, as a result of the upswing at the end of last year, and by 10 per cent in 2018. Monthly fluctuations in industrial production remain significant. Although the expected yearly growth rate of over 5 per cent is much faster than last year's near-stagnation, it is noticeably below its levels in 2014 and 2015. The main reason for this is the termination of the driving force of the automotive industry. The performance of foreign trade fluctuates. In the first eight months of 2017 the growth rate of imports in euro terms exceeded that of exports by more than 3 percentage points. As a result, the export surplus decreased by more than EUR1bn; however, it is still quite impressive, totalling EUR5.6bn. Terms of trade are deteriorating by nearly 1 per cent. The foreign trade surplus continues to drop in 2018 (from EUR8.5bn to EUR7.7bn). The growth rate of retail sales will be over 4 per cent in 2017 and it will remain slightly below 4 per cent next year. Consumption growth is expected to be about 3.5 per cent in 2017 and between 3 and 3.5 per cent in 2018.

Consumer prices increased by 2.4 per cent in the average of the first nine months of 2017. Among internal factors, the rapid growth of wages, affecting both costs and purchasing power, has inflationary impacts in principle; however, presently this is hardly noticeable. The relatively stronger forint constrains the inflationary effects of external price increases. Inflation is boosted by increased taxes on consumer goods, and it is curbed by the reduction of certain products' VAT rates, though market effects partly offset the latter. The consumer price index is expected to be 2.5 per cent in 2017 and around 3 per cent in 2018.

Gross earnings will rise by 13 per cent in 2017 and by around 7 per cent next year. The earnings of employees in the public sector are expected to expand faster. The number of those involved in workfare programs will decrease.

In the first three quarters of 2017, the general government deficit in cash flow terms exceeded the annual target by some 6 per cent, which is a consequence of the advance payments related to EU transfers. Since the latter does not affect the accrual-based general government deficit (calculated by the European methodology), GKI forecasts a general government deficit only slightly higher than the projected one, between 2.5 and 3 per cent of GDP in 2017. Deficit is expected to be in this range next year as well. The high cash flow deficit, as it needs to be funded, endangers the 0.8 percentage points reduction of the debt-to-GDP ratio expected by the EU. If, in accordance with Eurostat's opinion, Eximbank and the foundations of the National Bank of Hungary are classified within the general government, it may further hamper the improvement.

THE FORECAST OF GKI FOR 2017-2018

Description	2015	2016	2017	2017	2018
			01-08	forecast	
1 GDP (%)	103.4	102.2	103.7**	103.8	103.8
2 Industrial production (%)	107.5	100.9	105.1	105.5	105.5
3 Investments (%)	107.1	85.1	125.4**	120	109
4 Construction services (%)	103.0	81.2	127.9	125	110
5 Retail trade turnover (%)	105.8	104.7	104.0	104.5	103.5
6 Exports (current prices in euro, %)	107.0	103.4	109.3	110	109
7 Imports (current prices in euro, %)	104.6	102.3	112.5	113	110.5
8 Foreign trade balance (EUR billion)	8.6	9.7	5.6	8.5	7.7
9 Balance of the current and capital account (EUR billion)	8.9	7.0	4.2**	7.5	8.3
10 Average exchange rate of euro (in HUF)	309.9	311.5	308.5***	308	308
11 General government deficit* (HUF billion)	1218.6	848.3	1236***	1300	1400
12 Index of average gross earnings	104.2	106.1	112.7	113	107
13 Consumer price index	99.9	100.4	102.4***	102.5	103
14 Consumer price index at the end of the period (corresponding month of the previous year=100)	100.9	101.8	102.5***	102.5	103
15 Rate of unemployment (at the end of the period, %)	6.2	4.4	4.1****	4.3	4.3

* Cash flow basis, without local governments

** First half of 2017

*** January-September 2017

**** July-September 2017

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