28 JANUARY 2019

## 2018 WAS PROBABLY THE BEST YEAR OF THE DECADE FOR HUNGARY

**GKI estimates that Hungary's GDP expanded by 4.6 per cent in 2018 and this rate was remarkably high in the EU. The growth cycle is likely to have reached its peak, and the growth rate is expected to be around 3.4 per cent in 2019. Expansion continues to be driven primarily by domestic demand. However, owing to the high statistical base, the boosting effects of EU transfers will be significantly weaker in 2019. The growth rate of the EU will also slow down in the near future, and the forecasts are becoming more pessimistic. At the end of 2018, inflationary and budgetary trends in Hungary were favourable, thanks to the drop in world energy prices and the inflow of EU transfers.**

Growth in Hungary was driven by domestic demand in 2018 (having increased by about 6 per cent on an annual basis). Consumption was up by 5 per cent and gross fixed capital formation by 15 per cent. Imports rose faster (by 5.5 per cent) than exports (by 4 per cent). The Hungarian growth rate (similarly to the Latvian one) was ranked second-third behind Poland in the EU. Last year's GDP growth of around 4.6 per cent was much faster than expected by any, and GKI's 3.8 per cent forecast in the autumn of 2017 was among the best (market consensus was 3.4 per cent). Although EU transfers will continue to grow in 2019, they will only generate an investment growth of around 5 per cent. The growth rate of gross earnings is slowly but steadily decreasing, in accordance with inflationary trends. As a result, real earnings slowed down to around 8 per cent in the private sector and around 6.5 per cent in the public sector in 2018 (without those employed in public workfare schemes) from a rate above 10 per cent in 2017. The rate can be expected around 5-5.5 per cent in 2019. This is also a very high rate; real earnings have been rising faster than GDP for five years, pointing to the need to improve competitiveness.

Inflation was 3.8 per cent in October 2018, and it fell to 2.7 per cent in December, mainly due to a 12 per cent drop in fuel prices over two months. However, it was the third highest rate in the EU. In addition, the so-called tax-filtered core inflation rate, which was particularly carefully monitored by the National Bank of Hungary, continued to rise, reaching the 3 per cent inflation target in December. For this reason, the National Bank has already indicated that the bank is prepared to tighten its monetary policy. Subsequently, the forint strengthened by 1.5 per cent. Although fuel prices started to rise again in January, the chances of a somewhat lower year-on-year rise in prices and a slightly stronger forint than previously thought have increased.

In December, the Hungarian general government showed a surplus of nearly HUF400bn instead of the huge deficits in previous years (the deficit was almost HUF200bn in December 2017). This was primarily due to the inflow of EU transfers as about half of the annual amount accrued in the last month. In addition, the hasty spending in December was much lower than in recent years, probably as a result of the EU's call to reduce deficit and in order to reduce public debt. Thus, the annual cash-flow deficit was much less than previously assumed and it exceeded the projected value only by HUF75bn. In addition, a significant part of the deficit, some HUF450bn, was due to the advance payments related to EU transfers. As the latter is not part of the general government deficit according to the EU methodology, last year's deficit was below the planned 2.4 per cent of GDP, close to 2 per cent. However, this is still one of the highest in the EU. The government debt relative to GDP declined from around 73.3 per cent in 2017 to 71 per cent in 2018, taking into account also the strong forint at the end of the year.

## THE FORECAST OF GKI FOR 2019

| | Description | 2016 | 2017 | 01-11, 2018 | 2018 estimate | 2019 forecast |
|---|---|---|---|---|---|---|
| 1 | GDP (%) | 102.3 | 104.1 | 104.8** | **104.6** | **103.4** |
| 2 | Industrial production (%) | 100.9 | 104.8 | 103.5 | **103.5** | **103.0** |
| 3 | Investments (%) | 88.3 | 118.2 | 117.5** | **115** | **105** |
| 4 | Construction services (%) | 81.2 | 129.6 | 122.9 | **122** | **105** |
| 5 | Retail trade turnover (%) | 104.7 | 104.9 | 106.3 | **106.5** | **104** |
| 6 | Exports (current prices in euro, %) | 103.4 | 108.2 | 104.5 | **104.5** | **104** |
| 7 | Imports (current prices in euro, %) | 102.3 | 111.1 | 107.0 | **107** | **106** |
| 8 | Foreign trade balance (EUR billion) | 9.7 | 8.1 | 5.7 | **6.3** | **5** |
| 9 | Balance of the current and capital account (EUR billion) | 7.0 | 5.1 | 3.6** | **7** | **6.5** |
| 10 | Average exchange rate of euro (in HUF) | 311.5 | 309.2 | 318.9*** | **318.9*** ** | **322** |
| 11 | General government deficit* (HUF billion) | 848.3 | 1974 | 1445.1*** | **1445.1*** ** | **1000** |
| 12 | Index of average gross earnings | 106.1 | 112.9 | 111.5 | **111.5** | **109** |
| 13 | Consumer price index | 100.4 | 102.4 | 102.8*** | **102.8*** ** | **103.5** |
| 14 | Consumer price index at the end of the period (corresponding month of the previous year=100) | 101.8 | 102.1 | 102.7*** | **102.7*** ** | **103.5** |
| 15 | Rate of unemployment (at the end of the period, %) | 4.4 | 3.8 | 3.6**** | **3.7** | **3.6** |

** Cash flow basis, without local governments*
*** First three quarters of 2018*
**** Actual figure, year*
***** September-November 2018*


**GKI ECONOMIC RESEARCH CO.**

1092 Budapest, Ráday u. 42-44.

Phone: +36 1 318 1284

E-mail: gki@gki.hu

*For more information: Andras Vertes, Laszlo Akar, Gabor Karsai*