MINISTRY
FOR NATIONAL ECONOMY

Various data indicate ongoing economic expansion in Hungary

Hungary's GDP grew year-on-year by 2.6 percent in the second quarter of 2016. The main drivers of the expansion were the market services, industrial and agricultural sectors. The performance of the construction sector has, nonetheless, continued to drag down economic growth.

Growth has picked up following subdued data in the first quarter

Data published by the Hungarian Central Statistical Office (KSH) show that a weaker reading in the first quarter had been caused by some one-off factors, as almost every sector posted growth in the period April-June. As a whole, the economy expanded by 1.7 percent in the first half of the year. Favourable data were naturally also attributable to a lower basis in H1 2015.

The second estimate of Eurostat reveals that the compound GDP of the European Union was up by 0.4 percent quarter-on-quarter, and by 1.8 percent year-on-year. There were, however, huge differences between the data of countries. Quarterly growth in Hungary has picked up, in comparison to the previous quarter. Following negative growth of 0.8 percent in the first quarter, the country posted growth of 1.1 percent in the second quarter, and thus Hungary has advanced from the position of a tail-ender to second best in the EU. Only Romania was ahead of us, with a growth rate of 1.5 percent. Although the year-on-year performance was less satisfactory, major improvement is being expected for the second half of the year.

In the second quarter, the structure of economic growth was balanced, as practically every sector has contributed to the expansion. Output in the industrial sector – especially at motor vehicle and electric goods manufacturers – has accelerated. Preliminary agricultural data show that the sector's performance has improved compared to last year, as yields on both harvested and still un-harvested crops appear higher. Thanks to wage hikes, the market services sector has also managed to expand. The fact that the volume of retail sales gained some 6 percent signals the demand-boosting effect of real wage growth.

As another positive factor, exports were also higher, thanks partly to higher-than-expected economic growth in Germany. In Q2 2016, according to data adjusted for seasonal and calendar effects and the estimate of Destatis, Germany's GDP was up by 0.4 percent quarter-on-quarter. Year-on-year growth, on the basis of unadjusted, raw data, was 3.1 percent.

The construction sector in Hungary has suffered much more from the drying-up of EU funds than it has gained from the lacklustre growth of the housing construction market. Following a massive output slump in previous quarters, the volume of output declined only slightly in the second quarter. As the sector is of relatively minor weight, this indicator does not much influence quarterly GDP data, but it may erase as much as 0.7 percent of the full-year figure. The performance of the construction sector is traditionally more sensitive to the increase or decrease of EU funds than that of any other sector.

National Bank of Hungary also predicts higher growth

The National Bank of Hungary (MNB) is also expecting economic growth to accelerate, following a temporary downturn at the beginning of the year. Steadily improving wage trends are seen to boost consumption recovery and thus lead to the dynamic increase of household consumption. Improving labour market conditions are lifting expectations of long-term income growth, therefore the household sector's rebalancing-driven spending constraints are predicted to give way to a pick-up in consumption. According to our calculations, the investment rate will be steadily above 20 percent in coming years. Although the volume of state investment projects – parallel to the steep decline of EU funds inflows – dropped at the beginning of the year, the commitment of the Government is anticipated to drive investment higher in the second half of the year. Private sector investment is seen to be underpinned by the MNB's Funding for Growth Scheme and EU funds which become available from the second half of the year. EU funding has continued to be a key determinant of Hungary's GDP growth. These resources in emerging EU countries may boost competitiveness, but they may just as well turn an economy too dependent on grants, reducing corporate risk-taking and investment efficiency. The Hungarian Government has decided to spend the majority of EU funds on economic development. This priority as well as objectives identified in the Partnership Agreement and operative programmes ensure that Hungary will properly utilize these resources, gaining the possible advantages but not creating potential risks.

In the opinion of the MNB, the investment activity of households will be boosted, after the second half of the year, by expectations of rising incomes, the removal of forex loan risks and the new housing programme. Wages in real terms have been rising steadily, and this factor – together with the declining volume of loans – is pointing to further household consumption growth. Higher domestic demand is fuelling import demand; therefore net exports will only modestly contribute to the expansion of the economy. The MNB also predicts that the economy's external financial capacity will remain high in coming years, which will help reduce net external debt and, consequently, the vulnerability of the Hungarian economy to external shocks. In recent months, several international analyses highlighted the significant improvement of Hungary's vulnerability indicators.

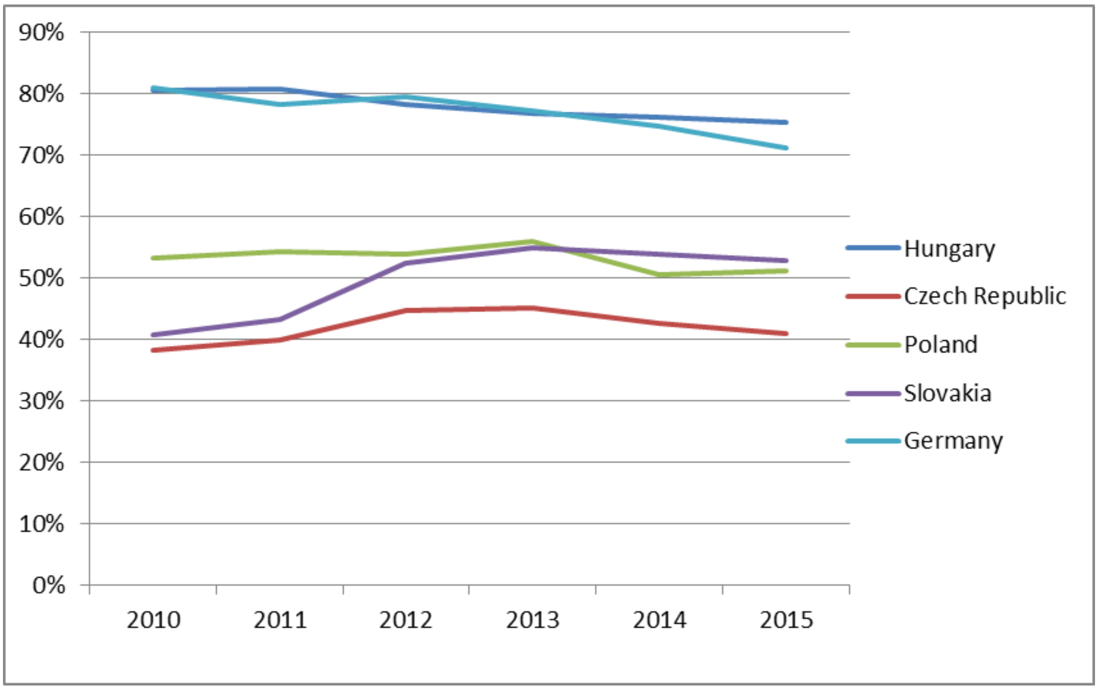
Making growth prognoses also requires the analysis of market confidence and business sentiment in the observed country. The latest report of the Quarterly Business Climate Survey by the Institute for Economic and Enterprise Research, an economic think-tank operated by the Hungarian Chamber of Commerce and Industry, shows a slight fall in business sentiment compared to the previous quarter. The indicator edged down from 33 points to 30 points, and thus the upward trend in place since October has been broken. On the other hand, it is still a high figure.

Falling debt and excellent fiscal trends

The consolidated general government gross debt at nominal (face) value, the so-called Maastricht debt, fell in the period April-June by HUF 248bn to HUF 25 900bn. This constitutes 75.5 percent of GDP, down from 77.2 percent quarter-on-quarter and 75.3 percent at the end of last year, according to the preliminary MNB report on general government financial accounts. In light of current processes, the ESA deficit is expected to be some 1.6-1.8 percent of GDP this year. The reduction of net debt by HUF 306bn has also helped cut debt, whereas forint depreciation has added HUF 58bn to it.

The debt rates of Hungary and other European countries are shown at the chart below. It clearly demonstrates that thanks to prudent fiscal policy that has reduced interest payments on debt, the relative debt ratio has changed favourably in recent years. Low interest rates in Europe have helped improve financing conditions, and countries such as Hungary that used to have a very high debt level gain even more through lower interest payments than low-debt countries.

Government debt-to-GDP ratio, in certain EU member states



Source: Eurostat

In terms of fiscal balance, the positive trend observed in recent months has continued unabated. At the end of July 2016, the budget posted one of the lowest deficit figures of all time, at HUF 464.8bn. The balance of the central government budget is stable, and it confirms that Hungarian reforms are working.

In the initial seven months of the year, the central sub sector had a deficit of HUF 585.8bnm, while Social Security Funds and Extra-Budgetary State Funds posted surpluses of HUF 52.2bn and HUF 68.5bn, respectively. In the corresponding period of 2015, the deficit of the central sub sector of the state budget was almost double this figure, HUF 894.1bn. In the month of July, the deficit of the central sub sector was HUF 62.7bn, down significantly from HUF 70.8 in the same period of 2015.