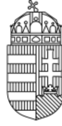


MINISTRY
FOR NATIONAL ECONOMY

OECD Economic Survey of Hungary recognizes the performance of the economy in recent years

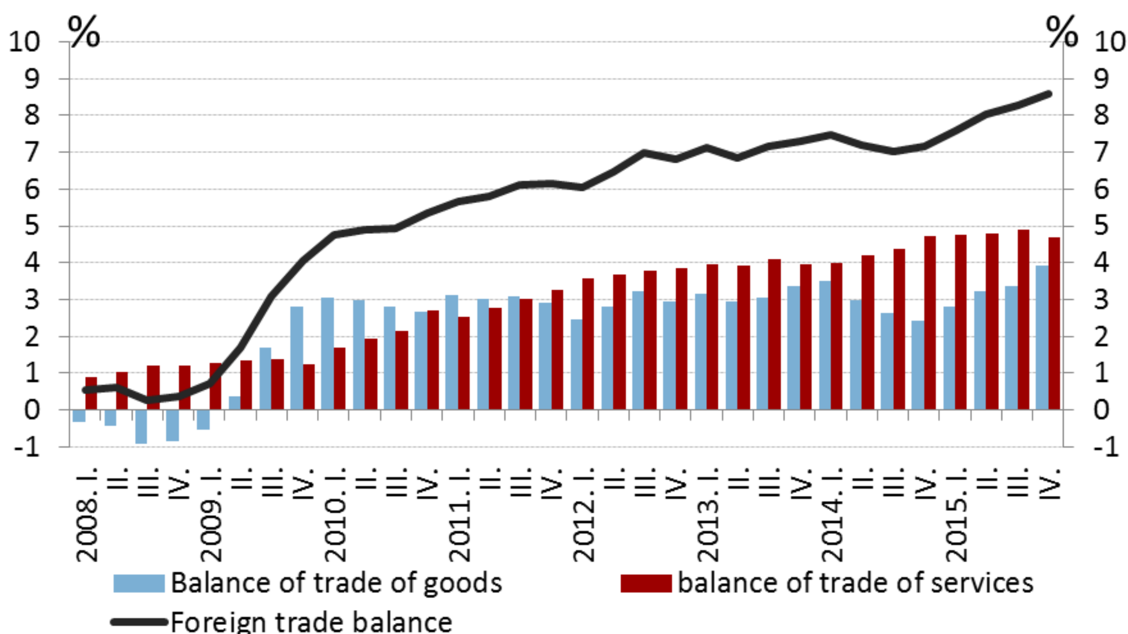
The Economic Survey of Hungary published last week by the OECD acknowledges the performance of the Hungarian economy in recent years. The study points out that favourable current account data and the significant amount of EU funds have been instrumental for positive growth data. Incoming EU funds and FDI have also spurred investment rate growth. The survey also highlights the fact that Hungary's financial vulnerability has been reduced. The OECD believes that further structural reforms are also necessary in order to maintain economic growth momentum in the medium term, to assist corporate investment and tailor labour skills to market requirements. Measures aiming to boost long-term competitiveness also feature prominently among the objectives of the Hungarian Government. Several pro-competitiveness measures have already been recently introduced. Low interest rates, supportive and prudent fiscal policy and changes in the tax regime are also fuelling investment growth. At the press conference where the survey was first presented Minister for National Economy Mihály Varga stressed that the Government agreed with the majority of OECD recommendations and these were in line with the Government's long-term economic policy goals.

Positive foreign trade data

According to the Hungarian Central Statistical Office (KSH), the Hungarian foreign trade sector accumulated **a surplus of EUR 966 million in March 2016**. In Euro terms, the value of exports and imports rose by 3.4 percent and 3.3 percent, respectively, compared to the high base in the corresponding period of the previous year. The trade surplus was down by EUR 44 million year-on-year. In the initial three months of the year, exports and imports in Euro terms grew by 1.6 percent and 2.3 percent, respectively.

In an analysis of current account data in the month of March 2016, the National Bank of Hungary (MNB) points out that net export growth has been the result of the steady increase in the trade surplus of goods and the constantly high surpluses of the trade of services. The below chart demonstrates changes in foreign trade balance and components.

Foreign trade balance and components (as percentage of GDP, Q/Q)



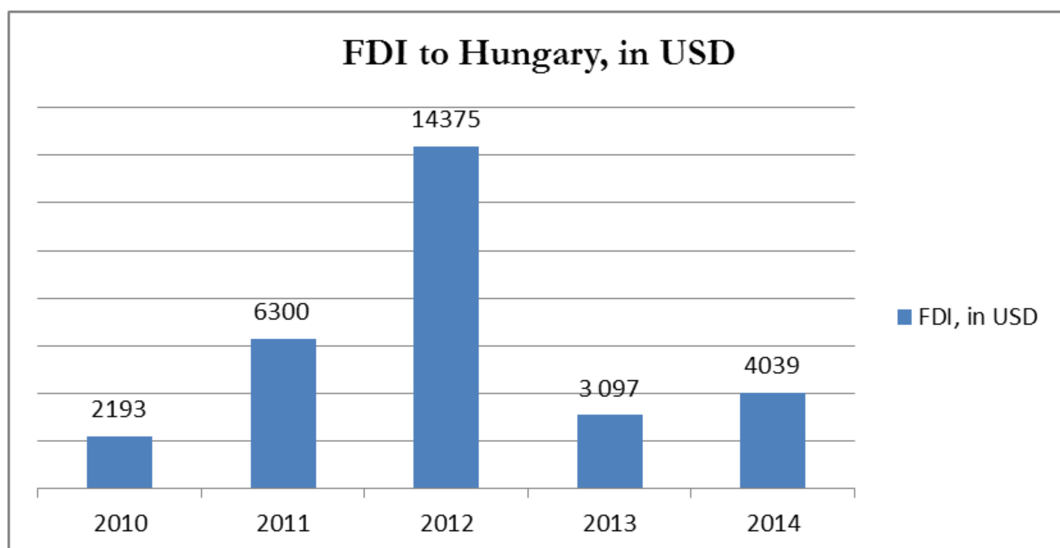
Source: National Bank of Hungary (MNB)

The Hungarian economy has been open and export-focused. One of the leading sectors is the **car industry**, which has seen sizable investment in recent years. Multinational companies have registered massive export volumes and that has been a positive factor behind Hungary's favourable current account data. The MNB report also underlines that Hungary achieved export growth in 2015 despite weakening general external demand, and it is assumed to be the consequence of higher motor vehicle industry output thanks to the capacity expansion of past years.

Improving investment rate

As it is also emphasised by the OECD survey, **Hungary's investment rate has picked up after reaching a low point in 2012**. Retrenchment in bank lending caused by deteriorating conditions at crisis-hit businesses has reduced the investment rate. Recently, the inflow of FDI and EU funds has once again boosted the investment rate. FDI has been a key determinant in the development of the Hungarian economy ever since the regime change.

These investments have injected much-needed capital into a cash-strapped economy and provided high technology and know-how. It is very important to examine the effect of multinational companies on host countries. This effect can be evaluated from various aspects. One angle may be how a newcomer multinational company shapes competition in the host country and thus impacts domestic enterprises. One of the key questions is to what extent do multinational companies add to the competitiveness and productivity of domestic enterprises. A recent study conducted in this field in Hungary shows that this effect has rather been positive in Hungary. As the OECD survey also finds, closer integration requires the promotion of investment in knowledge-based industries, but the international integration of the economy and the distribution of skills must also be improved. The below chart shows volumes of FDI to Hungary in recent years. The year 2012 was an extraordinary one in terms of FDI inflow; this higher volume was attributable to the post-crisis recapitalization of banks.



Source: UNCTAD

Valuation of Hungary's exposure to external risks has improved

Thanks to the prudent fiscal policy of recent years and a new fiscal financing policy, the government debt-to-GDP ratio has fallen and the debt composition has improved. By 2015, the share of forex debt has been reduced to 33 percent and the average maturity has been extended.

The OECD survey underlines that Hungary's economic imbalances and its vulnerability have been reduced. The country' external debt has fallen and forex loans have been phased out.

As a result, Hungary's CDS premia have neared the pre-crisis level, which was mainly the consequence of the forint conversion of forex mortgages. The **MNB's Financial Stability Report**, published in November 2015, reveals that several country-specific factors have been behind the drop in CDS premia, which helped offset the effects of a deteriorating international environment. The expected upgrade of Hungary's credit rating may result in the further decline of CDS premia, which in turn would cut the country's interest expenditures. The volume of external debt that matured in 2015 was already down by 30 percent compared to the amount of EUR 30bn one year before.

The improvement in financial exposure was the result, on the one hand, of the falling government debt ratio and its more favourable composition. In recent years, the share of forex debt has fallen, and this helped mitigate fiscal risks and bolstered the country's financial exposure.

Other factors have also played a part in improving vulnerabilities. Analysts of **Capital Economics** find that Hungary scored 2.3 points out of the maximum 10 points in the **CERI** (Capital Economics Risk Indicator), which gauges countries' economic weaknesses, and this places Hungary in a prominent position within the Central and Eastern European region. Hungary was given 1 point in the categories of trade balance, private sector lending and forint real exchange rates. The country received only 2 points in the external debt sub index, while it scored 4 points for changes stock prices.

OECD recommendations for Hungary

One of the OECD's recommendations calls attention to the **importance of combating VAT fraud,** and the organization also proposes amendments to the tax regime with a larger emphasis on less distortive consumption-related taxes. In past years, the Hungarian Government did just that and consumption-type taxes have gained larger weight. Among anti VAT-fraud measures, the **introduction of reverse-charge VAT in the agricultural sector** or the **Electronic Trade and Transport Control System (EKÁER)** must be noted.

The survey recommends the improvement of the stability, transparency and homogeneity of regulatory policies. The study also remarks that impediments and disincentives of certain sectors must be removed in order to achieve a more efficient application of modern competitiveness

policies. The support of life-long learning and programmes paving the way for jobseekers to the primary labour market are also among the survey's proposals.