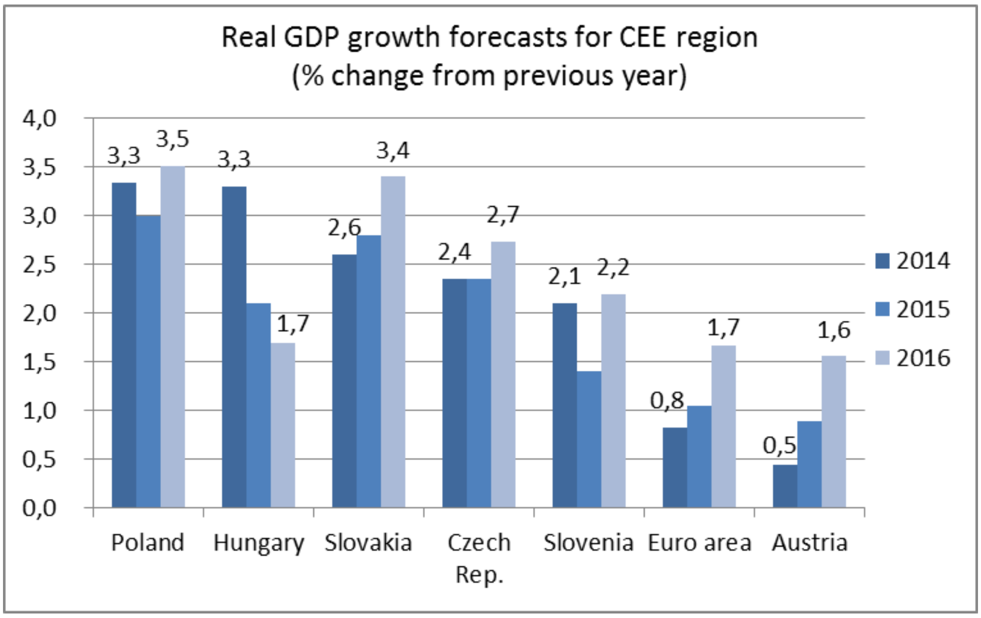
MINISTRY
FOR NATIONAL ECONOMY

European Commission draws hasty conclusions about Hungary

The European Commission published last week an in-depth analysis on Hungarian macroeconomic imbalances and a Country Report which provides the basis of country-specific recommendations scheduled to be published in May. On the one hand, the study acknowledges the results recently achieved within the country's economy and it calls attention to future pitfalls on the other.

The analysis of the European Commission has partly affirmed data published in a prior report: among these, it reiterated that GDP growth in 2014 is expected to be outstanding, reaching 3.3 percent. As far as the next two years are concerned, the report predicts muted growth for the Hungarian economy. While the rate of expansion is seen at 2.5 percent for 2015, Brussels estimates that the economy will grow by only 2 percent in 2016. The below chart shows that in **Central and Eastern Europe economic growth in Poland and Hungary was the same, 3.3 percent in 2014.** Although the OECD forecasts that the rate of expansion may slow to 1.7 percent in 2016, it will still be on par with the average expansion rate of the Euro-zone.



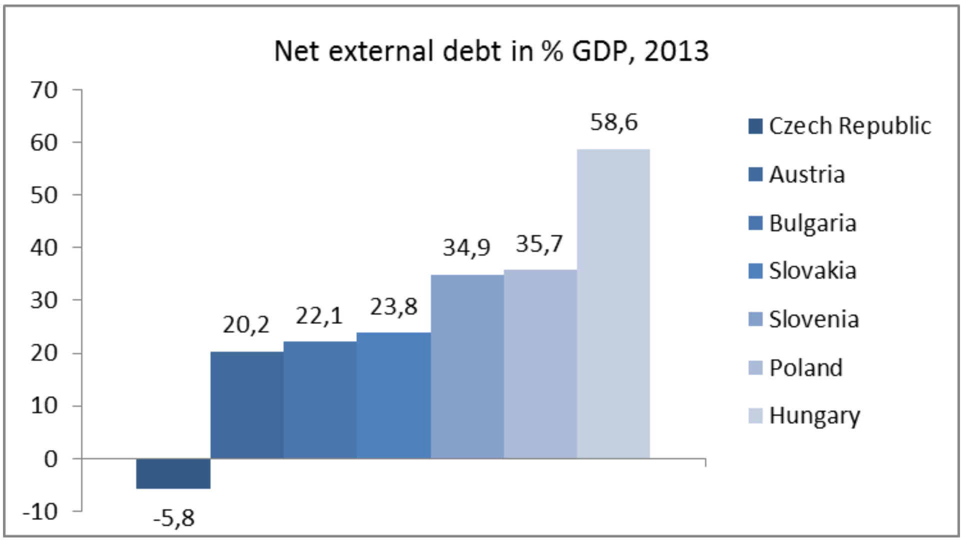
Source: OECD

On 4 March 2015, Minister for National Economy Mihály Varga stated that **in the coming years Central Europe is set to become the heart and engine of European economic**

growth. This assumption is confirmed by the fact that the average growth of EU member states exceeds that of the Euro-zone. According to the estimate of the OECD, in 2016 the best performer of the region is expected to be Poland, a country with its own currency. **The Minister for National Economy also stressed that in 2015 economic growth is set to remain sustainable and stable in Hungary.** Recent economic data, which show that this region has become the bloc with the fastest growing economy within the EU, have confirmed this expectation**. As bank lending is set to revive and the clearly defined economic policy objectives of the Government as well as EU funding will continue to boost the economy, the upward trend is expected to stay in place.**

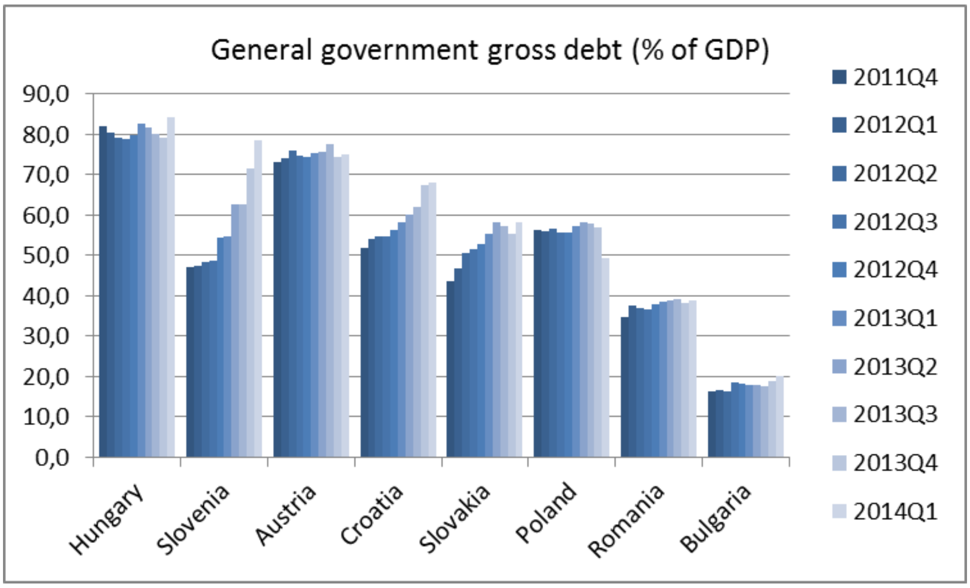
In their predictions, the majority of experts argue that lower EU funding will slow down economic expansion. Until February 2015, certain tenders with EU funding of the 2014-2020 fiscal period have already been announced – among these the final two legs of the Economic Development Operative Programme that is to be concluded this year -- while **the adoption of strategic operative programmes by the European Commission has facilitated the announcement of larger tenders**. The most important of these, the competitiveness-oriented Economic Development and Innovation Operative Programme was endorsed in February and **thus the door has been opened to make avaialable a massive number of tenders for small- and medium-sized enterprises**. Along with the very last grants from the previous period, new tenders will also be announced soon and this will help enterprises to schedule investment and plan timetables. This means that thanks to the positive effect of the inflow of new EU funds the momentum behind economic growth is set to remain in 2015, as the final instalments of 2007-2013 funds can be disbursed for participants until the end of 2015.

In addition to the risk of diminishing EU resources, the report of the European Commission identified the amount of the country's external debt as another major pitfall. In light of Eurostat data, in 2013 Hungary's external debt-to-GDP ratio was the highest in the region. **In 2011-2012, this indicator showed 69 percent, while in 2013 it could be reduced to 58.6 percent.** This figure indicates that private sector debt has been shrinking and the inflow of EU funding has had a positive effect. Indeed, despite the favourable trend, the level of Hungary's debt remains the highest within the region.



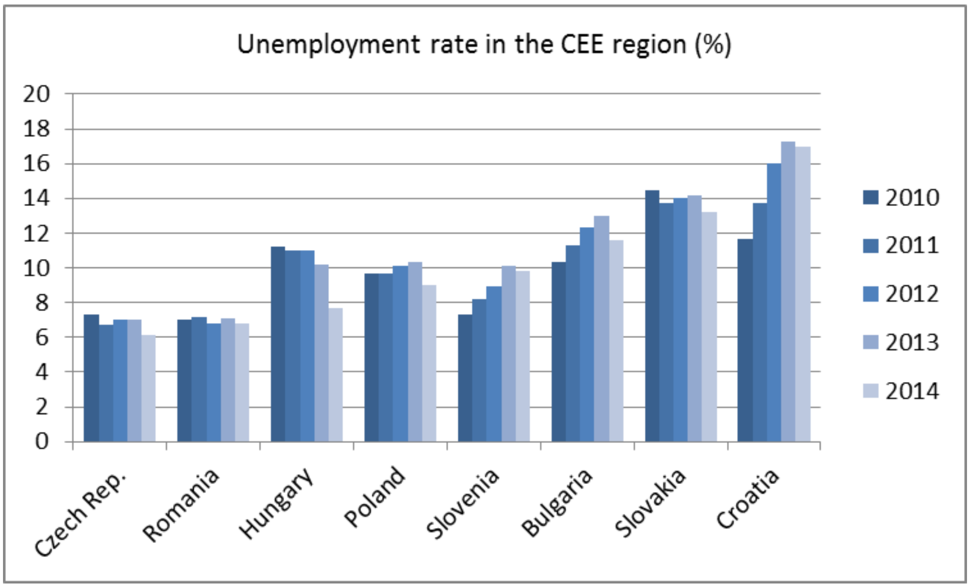
Source: Eurostat

According to the study of the Commission, the high debt level increases Hungary's vulnerability, in spite of the improvement the paper is predicting. The structure of debt makes indebtedness especially risky and unforeseeable economic turbulences may aggravate the problem. **The Government of Hungary, however, has been committed to reducing the level of debt,** but exchange rate fluctuations have thus far allowed only partial results. Unforeseeable exchange rates have posed the largest risks for households. Relief schemes for forex borrowers, such as the forint conversion of forex loan facilities, have significantly eased the burden of a large number of families and thus secured stable growth and improved the living conditions of Hungarian citizens.



Source: Eurostat

Thanks to Government measures, unemployment has fallen substantially in Hungary. As the below chart shows, in 2014 -- within the observed Central and Eastern European countries -- the third lowest unemployment rate was registered in Hungary. **The largest drop in unemployment was also seen in the country: it fell from above 11 percent in 2010 to 7.7 percent in 2014,** constituting an improvement of 3.5 percentage points over the past four years. In the same period, the unemployment rate only improved by 1.2 percentage points in the Czech Republic and by 0.2 percentage points in Romania.



Source: Eurostat

Lower unemployment has been mainly the result of the Job Protection Action Plan and the public work scheme, which is also mentioned by the Commission's Country Report. In the opinion of the Commission, the scheme is not efficient enough as the programme, it alleges, is just a covert form of paying social benefits. But the real aim of the scheme is to pave the way for former long-time unemployed people back to the labour market. Without the active intervention of the state this process would be impossible in the most underprivileged regions, especially given the fact that the Government of Hungary is facilitating investment projects that help hire people with freshly gained work experience. To this end, in 2013 the Government set up free entrepreneurial zones in the most deprived regions which are entitled to "apply for extra funding". **This measure is expected to further reduce the level of long-time unemployment in Hungary.**