MINISTRY
FOR NATIONAL ECONOMY

Hungarian economic growth from a European perspective

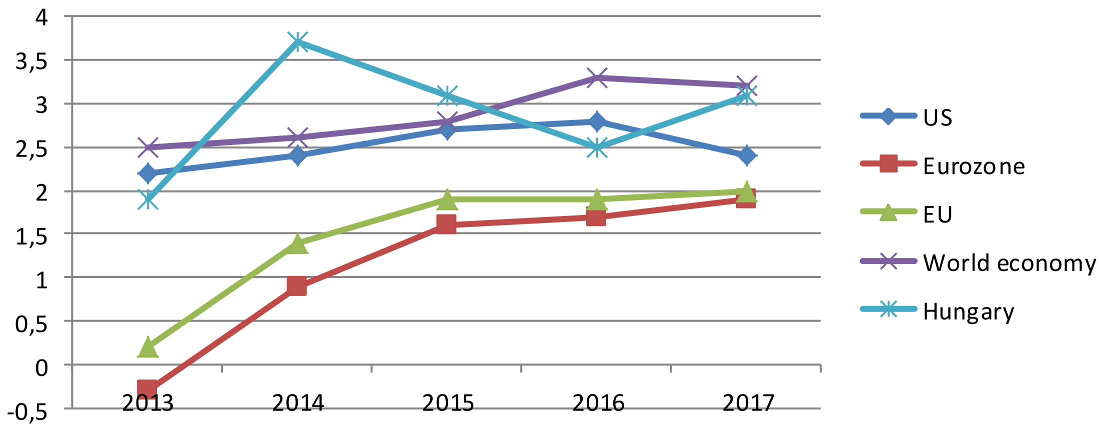
Improving vulnerability, domestic consumption and investment indicators are all pointing to further GDP growth and diminishing vulnerability in 2016.

The European Union has struggled to rebound after the onset of the financial crisis in 2008 which caused the EU's economy to shrink by some 5 percent. Although responses to the crisis by both member states and the EU had varied greatly, since 2013 **countries seem to have managed to recover from the most devastating crisis in almost eighty years** – albeit more slowly than some global peers, first and foremost the United States. According to the latest study of the European Commission titled *European Economic Forecast*, published on 4 February 2016, GDP growth in the 18-member Euro-zone and the EU 28 is predicted to be 1.7 percent and 1.9 percent, respectively, in 2016. For the year 2017, projections are even more upbeat, with 1.9 percent and 2.0 percent, respectively, and these figures fit well into the economic upturn prevalent since 2013.

It is of course encouraging that expansion is being expected, but **the picture is far from being rosy with meagre average quarter-on-quarter growth of 0.3 percent.** The global economic environment has been unique from various aspects. There are several special positive factors. For example, the current crude oil price of USD 39 per barrel, which – although it falls short of being a historic low as the price slumped to below USD 20 per barrel during Russia's default in 1998 – it has more than halved since the peak of more than USD 110 in May 2014. This development has fuelled domestic consumption, a major growth factor in the EU, through generating extra earnings within the economy. As far as the Euro-zone is concerned, **the monetary loosening of the European Central Bank pursued since 2015** has also stimulated consumption and, coupled with the protracted Greek crisis, the ECB's monetary easing has also **had a formidable impact on the Euro's exchange rate**. This latter outcome has been in line with the ECB's aim to push the inflation rate up to the 2013 level of 2 percent. Benefits of a devalued Euro (or forint) are evident: cheaper and thus more competitive export prices, higher import prices and the subsequent rise of aggregate demand which boosts inflation. In March 2015, the value of the common currency of the 19 member states comprising the Euro-zone hit a 12-year low against the US dollar, and as Mario Draghi has stated the stimulus package was to remain in place at least until September 2016. Nonetheless, the institution has hitherto failed to meet its inflation target of 2 percent, as the January figure, 0.5 percent, is far below the desired level. Contrary to the United States: the Federal Reserve predicts in its prognosis of 16 March 2016 that the inflation rate is to reach 1.2 percent this year and 1.9 percent in 2017, while the economy is seen to post weak growth of 2 percent, which figure is roughly in line with the forecasts of the OECD and the American Bureau of Economic Analysis but fall short of the 3.6 percent estimate predicted one year ago.

This factor, along with the interest rate hike by the US in December, a slowing Chinese economy and decelerating emerging markets may cause the entire global economy to switch to a lower gear: **the IMF predicts that after the 3.1 percent increase in 2015, world economic growth may marginally rise and hit 3.4 percent in 2016 and 3.6 percent in 2017**. This will leave its mark on the European Union as the largest single economic bloc of the world, especially with regard to trade. Exports to China alone accounted for some 15 percent of the total volume of EU exports, while trade with China generates 2.5 percent of Germany's GDP. **It has to be noted, however, that persistently low oil prices may mitigate unforeseeable global economic risks.**

Real GDP growth (%)



Source: Eurostat/World Bank

The Hungarian economy

Both Hungarian and international organizations as well as economic research institutions agree that Hungary's economic expansion is set to continue this year. The OECD, the World Bank and the IMF expect GDP growth of 2.4 percent, 2.5 percent and 3 percent, respectively, for 2016. The most pessimistic prediction by the European Commission is 2.1 percent increase this year, but sluggish growth is believed to be temporary and set to return to the figure of 2015, 2.5 percent, in 2017. Although these estimates are below the 3.7 percent peak reached in 2014, they still place Hungry among the best performers in Europe and exceed the EU averages of 1.9 percent and 2 percent, respectively, for the two observed years. The economic revival has been mainly driven by higher domestic demand, that is, by consumption and investment growth. Household consumption growth is expected to be 2.3 percent by the European Commission and 3 percent by the OECD, roughly in line with the MNB's prediction if 3.5 percent. This upturn is partly attributed to the reduction of the personal income tax rate from 16 percent to 15 percent, which generates HUF 120bn *more* of disposable income at households. **On the other hand, the inflation rate is another factor that gives us reason for hope: it is expected by the European Commission to be 1.7 percent and 2 percent, but the MNB's revised, current estimate is 0.3 percent which signals that wages in real terms can be reasonably expected to rise further.** In order to achieve its inflation target, the National Bank of Hungary further eased monetary conditions by cutting the benchmark rate, lowering and narrowing the interest rate corridor and even adopting a negative overnight deposit rate in March 2016.

Predictions of major Hungarian macro-economic indicators 2016			
	Real GDP	Unemployment	Inflation
European Commission	2.1%	6%	1.7%
OECD	2.4%	6.3%	3%
World Bank	2.5%	7.8%	0.2%*
IMF	3%	6%	2.3%
National Bank of Hungary	2.8%	5.7%	2.4%
Ministry for National Economy	2.5%	6.1%	2.5%

Source: National Bank of Hungary, Ministry for National Economy, OECD, Eurostat, World Bank, IMF

Among investment stimulus measures, the acceleration of the utilizing EU funds in the largest possible amounts must be underlined. Thanks to fiscal instruments designed for this end, the Government may approve the transfer of HUF 2048bn of funds this year. The anticipated rebound of corporate lending in 2016, the MNB's economic stimulus package and stock market development strategy as well as the Government's housing programme may partially replace EU funding as the key driver of investment growth. **The new housing programme is seen to add 0.4 percent this year to Hungary's GDP growth.**

Labour market data are similarly promising. While the EU's unemployment rate is estimated at 9 percent for this year and some 8.7 percent next year, the Hungarian indicator is expected to be about 6 percent and 5.2 percent, respectively. These figures are the consequence of several factors. The employment situation is being improved -- besides economic growth -- by targeted Government measures, such as the lowering of the retirement age, welfare reform and the channelling of formerly inactive people back to the labour market. Reducing welfare benefits had been a cornerstone of the Government's social policy, and a key instrument of these efforts has been the public work scheme. This has been a major social policy tool, as it provides a workplace as the first stepping stone for re-integration, then several others to help the highest possible number of aspirants to make it to the primary labour market and become active contribution payers. The ultimate success of this scheme hinges on its capability of assisting this transition.

It is also worth comparing Hungary's performance with that of the member states of the European Union. Estimates on Hungarian GDP growth for 2016 and 2017 are above the 1.9 percent and 2 percent respective estimates for the EU, but below those of some Western and Southern European countries, such as Ireland and Spain, which are staging a comeback, as well as Sweden, Luxembourg and Malta. Comparison with regional peers, however, casts a slightly darker shadow on the picture. Slovakia tops the ranking in terms of real GDP growth rates, with 3.2 percent and 3.4 percent prognosticated for 2016 and 2017, respectively, followed by the Czech Republic (2.3 percent and 2.7 percent) right ahead of third-ranked Hungary.

As far as employment is concerned, Hungarian statistics are promising, as the unemployment rate has fallen from 11 percent in the period 2010-2012 to 6.1 percent by March, below the pre-crisis level, while the activity rate has improved from 63 percent in 2015 to 69 percent. In the region, only the Czech Republic has even better unemployment data, with 4.8 percent for this year and 4.7 percent for next year.

As a whole, Hungary has been among the top performers in light of European statistics but in comparison to regional peers further efforts are required to help the country take over the leading position in the CEE region also with regard to economic growth.