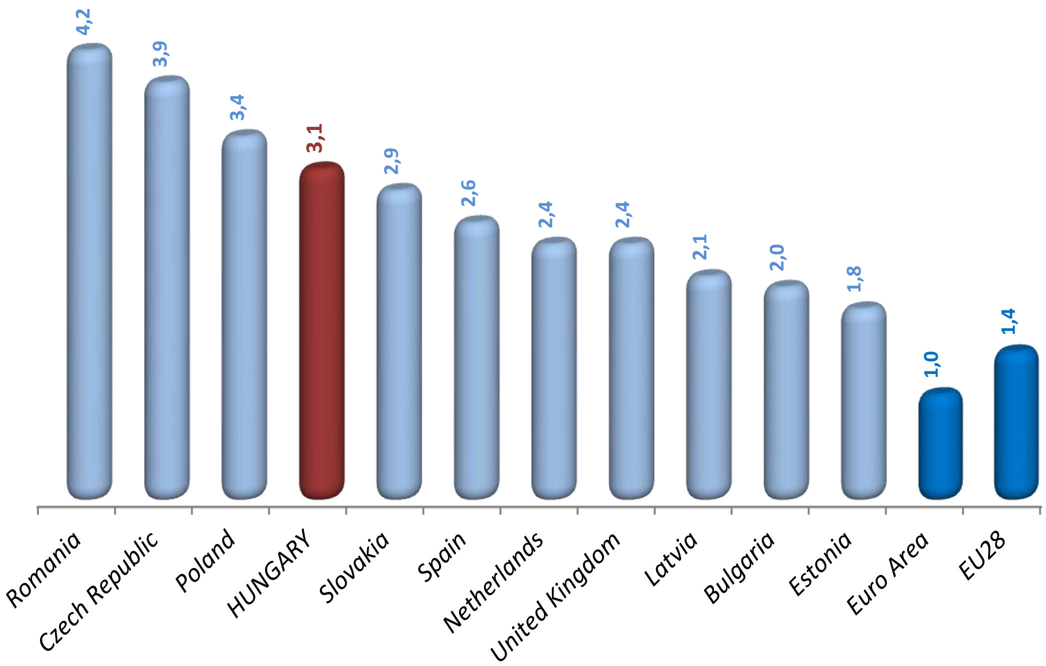
MINISTRY
FOR NATIONAL ECONOMY

Hungary's GDP growth among EU top five in Q1 2015

According to seasonally adjusted GDP data published in the latest Eurostat flash report, in Q1 2015 gross domestic product grew by 0.4 percent in the Euro-zone and the EU28, while it was up by 0.6 percent quarter-on-quarter in Hungary. In the fourth quarter of 2014, this indicator showed 0.3 percent growth in the common currency bloc and 0.4 percent growth in the entire EU. In comparison to the corresponding period of the previous year, in light of seasonally adjusted quarter-on-quarter data GDP was 1.0 percent and 1.4 percent higher in the Euro-zone and the EU28, respectively, following increases of 0.9 percent and 1.3 percent, respectively, in the previous quarter. Hungary's GDP was up by 3.1 percent in the observed period.

Hungary's economy posted the European Union's second largest growth rate in 2014, and the country also performed very well at the beginning of 2015. Hungary's expansive fiscal and monetary policies have been facilitating growth and the latest data also show that the economy remains on an ascending growth path: in March 2015, industrial output growth accelerated, while in April 2015 several confidence indices showed improvement thus signalling future expansion.

Highest GDP growth rates within the EU, Q1 2015 (y/y)



Source: Eurostat

In order to facilitate further consumption growth and revive bank lending, as part of the 2016 Budget Bill **the Government has adopted a tax reduction package valued at some EUR 750 million** in April 2015, which includes lower personal income tax and bank tax rates as well as lower bureaucracy-related costs. In addition, the Government of Hungary – aiming to bolster fiscal balance – reduced general government deficit estimates up to the year 2018 on the basis of more robust growth.

Contributing factors behind Hungary's GDP growth in Q1 2015

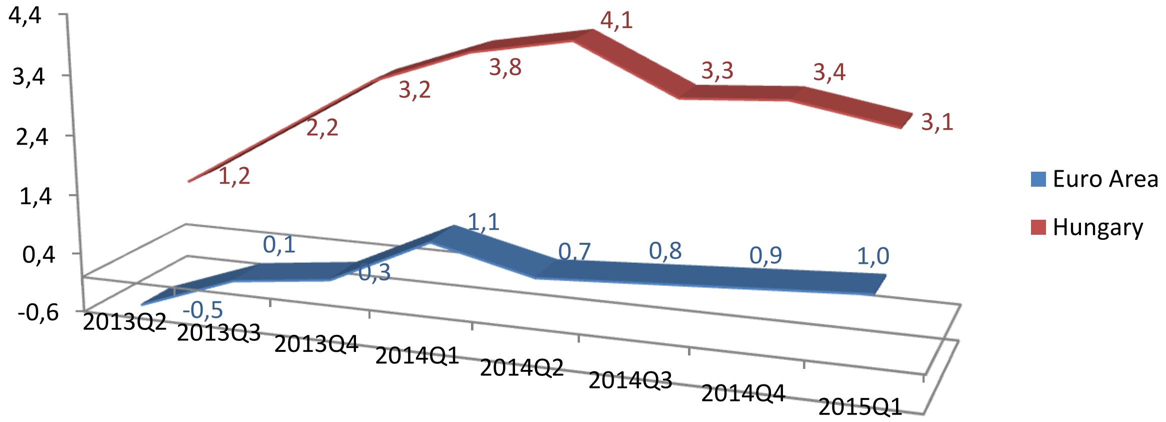
In light of preliminary data (as final GDP data are scheduled to be published in some weeks' time), the main driver of marked GDP growth is believed to be the increase in industrial output, whereas the agricultural sector – following outstanding production data recorded last year – could not substantially contribute to expansion. Analysts expect that the services sector (the share of which averages 63 percent within total GDP) did not act as a growth engine either, due to the fact that household consumption may have been lower than it had been originally expected or as it could be expected on the basis of wage growth, and due to the excellent performance of investment-related services sub sectors last year. Accordingly, statistics may show a decline in this field.

As Pál Pozsonyi, Head of Department at the Hungarian Central Statistical Office (KSH) said when he was presenting these data, within the industrial sector the vehicle manufacturing, electronic consumer goods manufacturing and food sub sectors had been the key determinants behind GDP growth. In the construction sector, the volume of output was higher regarding civil engineering, road construction, railway reconstruction and public utility development, while the transport and services sectors – excluding financial services – also performed well in the first quarter of 2015.

The fact that expansion did not generate more debt and both external and internal balances could be maintained shows a sound and balanced output structure. In Q1 2015, foreign trade surplus increased by more than EUR 500 million compared to the outstandingly high level of last year. As a result, **the country's external financing capacity is expected to exceed 9 percent of GDP in 2015**. Besides the positive external balance indicator, the internal balance is also set to improve, as general government deficit is seen at 2.4 percent of GDP this year, down from last year's 2.6 percent.

Except for a short period of moderate slow-down, the Hungarian economy has been in the EU's economic performance top league for two years, and this momentum appears to remain in place for the entire year 2015 (as the below chart shows). Analyst consensus sees growth of about 2.5 percent in 2016, even as EU transfers for 2007-2013 are expected to dry up. Major risk factors include the Ukraine-Russia conflict due to the significant exposure of Hungarian agricultural sector exports to the markets of Russia and the Commonwealth of Independent States, which was one of the impacts that caused a slight quarter-on-quarter output drop. Employment has also been improving for the eighth consecutive quarter, and the past quarters joined the year 2013 as the periods of private sector job growth: in the first quarter of 2015, the number of private sector jobs was up by 80 thousand quarter-on-quarter. In the initial three months of the year, Hungary's foreign trade posted a record high surplus of EUR 2.5bn, and the EUR 930 million surplus recorded in the month of March was the second highest figure – following a peak in September last year – ever registered in Hungarian economic history.

GDP growth rates of the past eight quarters, within the Euro-zone and Hungary (y/y)



Source: Eurostat

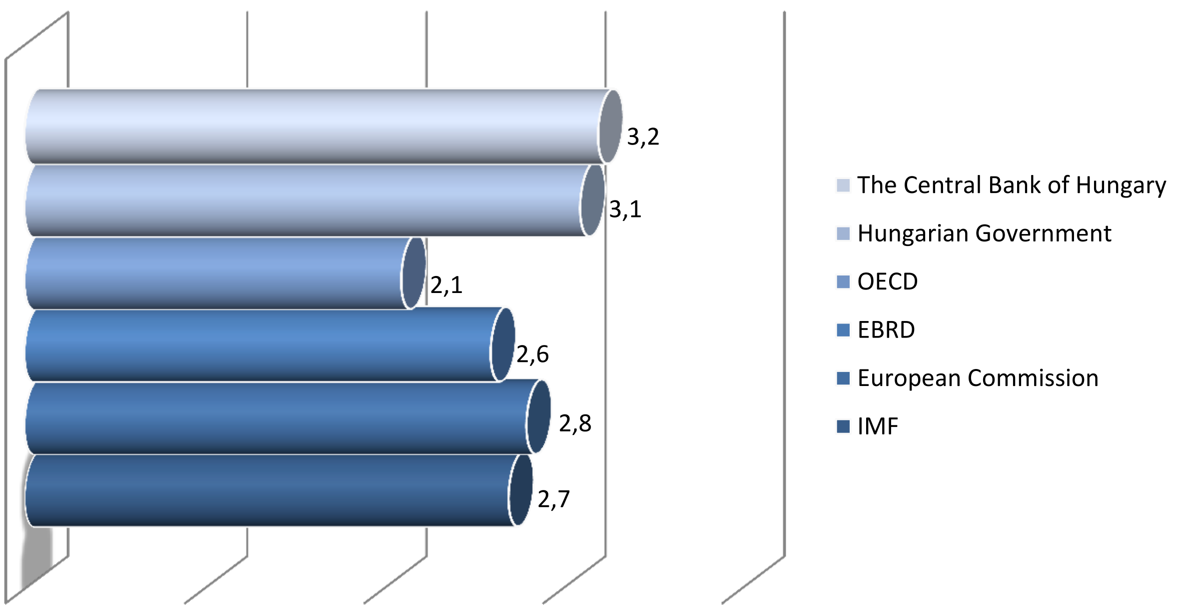
<u>2015 GDP growth estimates and growth components</u>

In 2015, the volume of household consumption is expected to keep growing, thanks mainly to the extra income stemming from the lower amount of loan instalments payable by former forex borrowers. Industrial output growth will be even higher than the current pace of expansion, as certain elements of Mercedes and Audi development projects will add more to this year's industrial output growth. The Funding for Growth Scheme of the National Bank of Hungary (NBH) will be continued in 2015, and it is also planned to be enhanced with two more programmes. Through the Funding for Growth Plus (NHP+) model the NBH assumes 50% of SME credit risk from retail banks in case of enterprises with low credit score. Under the second growth-stimulating model enterprises are entitled to take out loans with a maximum interest rate of 2.5 percent for the financing of the construction of residential property. This programme is expected to have a favourable impact on the construction and the real estate sectors. Export volume growth is predicted to slow somewhat in 2015 – following the excellent year of 2014 – but this indicator is still expected to show expansion. Parallel to domestic consumption growth, the volume of imports is also seen to edge higher, but without substantially reducing recent current account surplus levels.

Analysts of the London-based investment unit of Morgan Stanley Group, however, stated in their forecast on the outlook of CEE economies that **they would not rule out economic growth of 3.5 percent in Hungary for this year**. For next year, the study prognosticates slower expansion for the Hungarian economy, with 2.5 percent GDP growth, but Morgan Stanley has significantly upgraded the forecasts, as the previous estimates predicted 2.9 percent growth in 2015 and 2.3 percent in 2016.

According to the **London-based analysts of JP Morgan**, the potentially higher demand for the updated version of the National Bank of Hungary's Funding for Growth Scheme and the Government pledges for the financial sector pose positive risks for the second quarter growth estimate of analysts, while rising oil prices may act as a negative factor. Analysts of JP Morgan **revised their estimate of Hungarian economic growth for the year 2015 from 2.8 percent to 3.2 percent.**

Official Hungarian GDP growth estimates for the year 2015



Source: OECD, EBRD, EC, IMF, National Bank of Hungary, Hungarian Government