MINISTRY
FOR NATIONAL ECONOMY

Outline of Hungarian macro-economic trends prognosticated for 2016

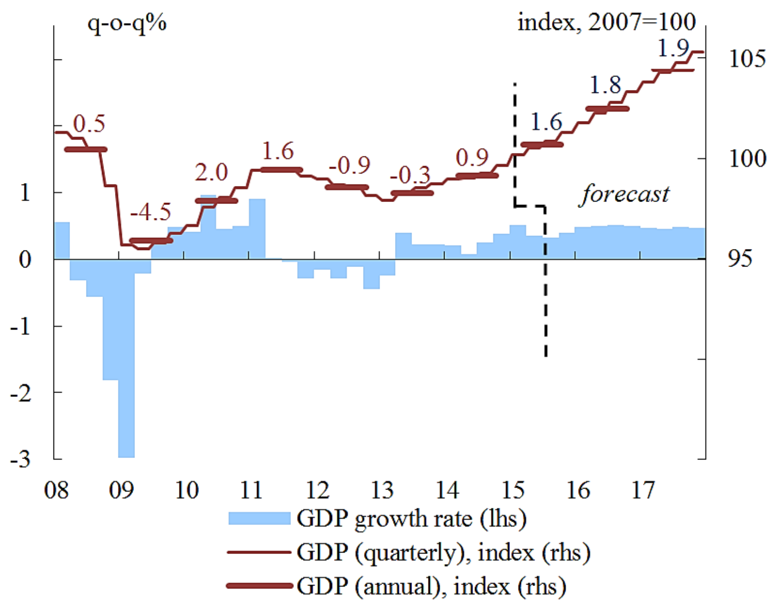
Due mainly to favourable economic environment in Europe as well as a prudent fiscal policy, the growth prospect of the Hungarian economy has been stable. Although growth of the real economy is decelerating and it is expected to be around 2.4 percent, but it is still 0.5 percent above the EU average. Real economic processes display data that characterize post-crisis cyclical adjustments; it is expected that 2016 will produce statistics that signal a firm base for economic expansion. The rate of inflation is seen to shift from the current 0 percent, a result of subdued oil prices, to about 1.6 percent core inflation in 2016. Maintaining the international positions of export-focused sectors will be crucial. Budgetary positions are stable, safe from structural shocks and thus the rating of Hungary's sovereign debt is expected to be raised to investment grade which may secure deficit targets and, concurrently, to generate extra funding within the budget thanks as a the medium-term result of more optimal financing. Following the clean-up of loan portfolios in the banking system, lending has still failed to pick up. Currently, the major tasks for Hungarian economic policy are to lay down the foundation for future sustainable growth through implementing a development policy that focuses on a knowledge- and innovation-based economy capable of attracting international investment.

Macro-economic data from 2014-2015, expert prognoses and real-economic expectations all indicate that the pro-growth European economic environment that has also been fuelling the Hungarian economy is to continue to prevail. According to the 2015 growth estimates of the European Commission for the EU28 published in Q4 2015, the rate of expansion is seen at 1.6 percent in 2015 and 1.8-1.9 percent in 2016 and 2017. The Commission's report has already factored in the effect of the management of the migration crisis in government expenditures. This component will be positive for GDP growth in the short term, but it may lead to economic and social repercussions in the medium- and long term creating social-economic sustainability and security contingencies. In the near future, the partial restoration of the Schengen borders and the subsequent rise in the costs of the transport of goods and products will obviously adversely affect the EU's interior market. Europe's leading economies have skilfully profited from the Euro's depreciation on global markets and achieved good export figures thanks to dynamically rising consumption in the USA and demand on the Chinese market. Consumption has also increased within the EU and a strikingly high unemployment rate could also be reduced to below

10 percent. The EC predicts with some optimism that the employment rate will rise by some 1 percent in the medium term. Excluding occasional fluctuations, record low average inflation rates of 0-0.3 percent have underpinned income and household consumption growth. The EC and international estimates (e.g. by OECD) forecast a rise of inflation to 1.4-1.6 percent in the medium-term within the economies of Euro-zone countries, while in 2016 the indicator may show 1 percent growth.

Aggregate statistical data of general government debt show that Euro-zone countries have met Maastricht criteria and fiscal expenditures have been kept prudently in check. Monetary easing by the European Central Bank (ECB) has calmed financial markets and eased financing conditions of European countries' general government debt. However, the global market of capital investments is still characterized by uncertainty and short-term strategies.

Real GDP growth in the Euro-zone



Figures above horizontal bars are annual growth rates.

Source: European Commission (EC)

The EU's economic expansion, however, is overshadowed by looming risks. The diverse economic processes at member states disguised by favourable aggregate indicators constitute exceptional risk factors. Greek debt management and real economic reforms that might be effective also in the medium term have hitherto produced no tangible results whereas negative news may speedily destabilize the Euro on global markets. Among large economies, that of France has posted only meagre growth, and forecasts and expectations concerning the real economy are not upbeat, either.

Real economy

According to the latest EC report, following unexpectedly good aggregate indicators in 2014, the Hungarian economy managed to produce GDP growth of 3 percent also in 2015. Forecasts predict GDP growth to stabilize at 2.2-2.4 percent in 2016 and 2.5 percent in 2017 after the dynamic increases of former years. When compared to other members of the Visegrad Four, Hungary seems to have joined economies on an upward growth path. In the medium term, the Hungarian economy is expected to produce GDP above the 2008 level and a growth trend exceeding the EU average by 0.5 percent. As of 2015, domestic consumption is seen to be one of the main drivers and beneficiaries of the near-3 percent consumption growth. This trend has been bolstered by an inflation rate of some 0 percent, resulting from low oil prices on world markets. The expansion of nominal capital transfers is expected to lead to higher inflation, to 1.6-1.9 percent in 2016. In 2015, the volumes of both exports and imports rose; in 2016, export and import growth is seen slightly lower, at around 6 percent and 6.1 percent, respectively. In contrast to the anticipated, more than 7 percent growth of trade surplus in 2015, the year 2016 may bring a figure of 6.5-6.7 percent. The export of products made in Hungary may be curbed by weakening global trade in 2016.

European Economic Forecast Autumn 2015				
Forecasts for Hungary	**2014**	**2015**	**2016**	**2017**
GDP growth (%, yoy)	3.7	2.9	2.2	2.5
Inflation (%, yoy)	0.0	0.1	1.9	2.5
Unemployment (%)	7.7	7.1	6.7	6.2
Public budget balance (% of GDP)	-2.5	-2.3	-2.1	-2.0
Gross public debt (% of GDP)	76.2	75.8	74.5	72.6
Current account balance (% of GDP)	2.2	4.3	5.5	6.1

Source: EC Country Report – Hungary 2015

Employment and incomes

Data presage a continuing positive unemployment trend in 2016; the indicator may be below 7 percent, around 6.7 percent in 2016. The Government's public work scheme has undoubtedly played a major role in the decrease achieved thus far, but the statistical impact of this factor is set to significantly diminish in 2016 at a structural level, as job growth is seen to be driven by rising domestic consumption. Over the past two years, wages in real terms have been on the rise, but this trend is expected to continue less markedly in 2016. Changes in economic growth and inflation will be key determinants from this aspect.

Monetary policy and financial system

In the short term, the Fed's monetary tightening may prompt the National Bank of Hungary (MNB) not to go on with cutting the base rate, as the current rate – in light of expected medium-term rating upgrades – appears to be appropriate. The prognosticated rise of inflation, on the other hand, increases the likelihood of interest rate increases in the medium term. Relatively cheap funding may accelerate lending in the real economy. The post-crisis adjustment process is coming to an end within the Hungarian banking sector: international financial institutions are concluding the clean-up of loan portfolios, the state had acquired ownership in several financial institutions and thus became a key stakeholder in the sector and the MNB continues the Funding for Growth Scheme. The banking sector did not reach a breakthrough in 2015; neither the demand nor the supply side saw growth in terms of lending. In 2016, the disbursement and utilization of EU funds may trigger a positive U-turn on the market. Corporate lending already shows signs of an upturn, and as far as the economies of the EU are concerned, investment and purchasing manager indices show that international markets are upbeat. The MNB's purchase of the Budapest Stock Exchange and a large-scale reform aimed at boosting the market capitalization of Hungarian companies and increasing the number of listed enterprises have caused a major change on the domestic stock market.

State budget and fiscal sub sectors

Real economic processes have favourably influenced fiscal policy. Government expenditures in 2015 did not exceed the level of the previous year. As one of the major achievements of Hungarian fiscal policy, Hungary exited the excessive deficit procedure at the end of 2013. In all probability, the Government's fiscal policy has managed to meet each headline figure laid down in the Convergence Programme. General government budget deficit is expected to be 2.1 percent in 2016 and 2.0 percent in 2017. Depending on the disbursement and commitment of EU funding, the planning of Government expenditures requires constant monitoring. The general government budget deficit target of 2.3-2.4 percent of GDP appears to be attainable in 2015, as sufficient funding has been earmarked for the allocation of EU resources. The level of gross state debt has been placed on a stable ascending path; the general government debt-to-GDP ratio is expected to be 75.8 percent in 2015 and 75.4 percent in 2016, as a result of a 1.5 percent improvement. Nominal inflationary processes may add to the fall of the debt ratio. As a result of steadfast domestic fiscal policy and stabilizing growth trends in Europe, analysts are anticipating that domestic securities of sovereign debt will be reinstated to investment grade status in 2016 by at least one credit rating agency (Fitch) or preferably even two (the second being Moody's). This step would significantly ease the financing of state debt and steady medium-term deficit targets. In 2016, the personal income tax rate is set to fall by 1 percent, to 15 percent, corporate tax rate will be uniformly 10 percent and the rate of bank tax will also be cut. Analysts predict that the pension system will remain stable in the next five years, without causing any financing alarm within the budget. Over the past two years, the value of pension benefits could be preserved, and in the future pensions are expected rise in nominal terms, in line with inflation.

Economic and development policy 2016

One of the actual challenges that economic policy is currently facing -- also in accordance with EU objectives and the funding guidelines of the 2014-2020 programming period -- lies in re-establishing investment and economic growth upon the foundations of a knowledge- and innovation-based economy. In order to ignite growth, the country's net investment position must be strengthened. Realistically, this cannot stem any more from investment projects creating assembly-line production capacities, but increasingly from knowledge-based activities and services capable of producing high added value that may serve as drivers of innovation. Boosting the production capacities of the SME sector is vital for laying the foundation for a well-functioning economy and long-term social well-being. In addition, among other major challenges one can mention the development of the infrastructure of large social services providers and wage reform for human resources at budgetary institutions.