17. HUNGARY

Private consumption to drive growth

Hungary's real GDP growth is expected to decrease in 2016 before rebounding in 2017 and 2018. Unemployment is set to decrease further, falling to 4.1% by 2018 in a tightening labour market. Inflation is projected to pick up gradually. The fiscal deficit is set to widen to 2.3% of GDP in 2017.

Domestic demand relies on household consumption

In the first half of 2016, real GDP growth declined to 1.9% after expanding by 3.1% in 2015. This moderation is mainly due to a temporary lull in EU-funded investment, which is important for Hungary. Investment contracted by 16.5% in in the first half of the year, following 3.8% growth in 2015. Despite this contraction, domestic demand growth remained positive, as private consumption grew by a robust 4.3% supported by accelerating wage growth and growing employment. Trade flows remained strong as imports and exports grew by 7% and 6.9% respectively in H1-2016

Economic growth is forecast at 2.1% in 2016. The negative developments regarding investments in the first half of 2016 highly affect the yearly growth prospects. Investment is expected to pick up in the second part of the year as EU fund absorption is set to rebound after some quarters of strong decline. Household consumption is forecast to continue growing, driven by improved consumer confidence, an upturn in bank lending to households and continuing positive labour market trends. As a result, private consumption remains the main contributor to economic growth. On the production side, dynamic growth of market services and a favourable year for agriculture are expected to boost growth.

Real GDP is forecast to expand by 2.6% in 2017 and 2.8% in 2018 with domestic consumption remaining the main growth driver. Household consumption is forecast to grow by 4.0% in 2017 and by 3.6% in 2018, amid accelerating wage growth. Consumer confidence is at a post-crisis high, and further positive developments in lending to households and second-round effects from the improved housing market are expected. However, employment growth, which boosted household income growth and private consumption until now, is expected to slow down over the forecast horizon as the economy reaches full employment.

Investment is forecast to recover progressively in 2017 and 2018. This is mainly due to an increased absorption of EU funds, improving domestic demand prospects, increasing household' investment and several large investments planned in the automotive sector. The low interest rate environment and a recovery in corporate bank lending, in particular to SMEs, are also expected to boost investment.

Net exports contributed positively to growth until 2016 but are forecast to start having an adverse effect as of 2017, when the pick-up in domestic demand boosts imports. Hungary's relative trade performance is set to deteriorate slowly in line with increasing unit labour costs, which should start putting pressure on price competitiveness.

Unemployment continues to fall while inflation picks up

The unemployment rate fell to 4.9% in September 2016 but is projected to decrease only marginally further over the forecast horizon. This is due to the fact that the labour market is starting to get tight, with skill mismatches overall and difficulties to match both skilled and unskilled workers with growing vacancies. Consequently, there is significant pressure on wage growth, leading to a sizeable expansion in real incomes. Nominal gross wages are forecast to grow by more than 5% per year over the forecast horizon. As labour shortages have already started to limit production, mainly in industry, construction and services, wage pressures are expected to become more prominent.

Consumer prices remained broadly stable in 2015. HICP inflation is expected to accelerate moderately to 0.4% in 2016. Elevating oil prices and low inflationary expectations imply that inflation will only gradually pick up and get close to the central bank's 3% target at the end of the forecast horizon.

The headline deficit is projected to rebound from an historic low

In 2016, the general government deficit is projected to decrease further to 1.5% of GDP. The fiscal balance benefits from a tax-rich recovery and a steady decline in interest outlays and social payments. In addition, sizeable temporary gains arise from state land sales and a windfall in corporate income tax which is expected to be paid during 2016 and 2017. The increased budgetary leeway is forecast to be largely absorbed by tax cuts and spending increases even though it is assumed that the planned public investments will not be fully implemented this year.

Based on the already adopted budget, the deficit is forecast to increase to 2.3% of GDP in 2017. This reflects the phase out of one-off revenues from land sales, expenditure increasing measures and rising domestic co-financing needs as EU-funded projects get underway. The forecast also incorporates additional tax reductions, most notably selective VAT cuts, which are largely offset by increases in excise duties and the conservatively estimated impact of further steps to enhance tax collection.

Based on a no-policy-change assumption, the deficit is forecast to stay at 2.3 % of GDP in 2018. The deficit-increasing effect of phasing out corporate income tax revenue windfalls is expected to be partly offset by projected savings in interest and social transfer expenditure. It is also assumed that the stability reserve (some 0.2% of GDP) will not be spent.

Regarding budgetary risks, delays in the implementation of the large scale investment projects budgeted may result in considerably lower-than-projected deficit outcome, particularly this year and next. Furthermore, the fiscal effects of the new housing scheme and measures to combat tax avoidance are subject to significant uncertainty.

The structural balance is estimated to deteriorate significantly, from -1.8% of GDP in 2015 to -2.6% in 2016 and then further to around -3% by 2018. This mirrors a widening positive output gap and the one-off effect linked to land sales in 2016. The debt-to-GDP ratio is projected to decline steadily, by nearly 1½ pps. this year to somewhat above 73% and then to around 72% by the end of 2018. The speed of debt reduction is assumed to be negatively affected by the expected lags in the cash payment of EU funds, while the relatively high rate of nominal GDP growth has the opposite effect.

Table II.17.1:

Main features of country forecast - HUNGARY

		2015		Annual percentage change						
	bn HUF	Curr. prices	% GDP	97-12	2013	2014	2015	2016	2017	2018
GDP		33999.0	100.0	2.2	2.1	4.0	3.1	**2.1**	**2.6**	**2.8**
Private Consumption		16775.0	49.3	2.0	0.3	2.5	3.4	**4.9**	**4.0**	**3.6**
Public Consumption		6811.7	20.0	1.1	4.1	4.5	1.0	**2.0**	**1.0**	**2.0**
Gross fixed capital formation		7366.9	21.7	2.4	9.8	9.9	1.9	**-8.2**	**5.9**	**3.0**
of which: equipment		3077.7	9.1	4.7	2.6	20.5	2.2	**-9.0**	**4.2**	**3.0**
Exports (goods and services)		30846.2	90.7	10.5	4.2	9.8	7.7	**6.7**	**5.1**	**6.4**
Imports (goods and services)		27816.7	81.8	9.8	4.5	10.9	6.1	**6.2**	**6.6**	**7.2**
GNI (GDP deflator)		32404.2	95.3	2.2	3.6	2.4	2.6	**2.6**	**2.9**	**3.9**
Contribution to GDP growth:	Domestic demand			2.0	2.9	4.3	2.3	**1.0**	**3.4**	**2.8**
	Inventories			-0.2	-0.8	0.0	-1.0	**0.0**	**0.0**	**0.0**
	Net exports			0.5	0.0	-0.2	1.8	**1.0**	**-0.8**	**-0.1**
Employment				-0.1	1.1	4.8	2.6	**2.7**	**0.6**	**0.8**
Unemployment rate (a)				8.0	10.2	7.7	6.8	**5.1**	**4.7**	**4.1**
Compensation of employees / head				8.4	1.6	1.3	1.6	**4.4**	**5.4**	**5.0**
Unit labour costs whole economy				6.0	0.6	2.1	1.1	**5.1**	**3.3**	**3.0**
Real unit labour cost				-0.7	-2.3	-1.2	-0.6	**2.6**	**0.7**	**0.2**
Saving rate of households (b)				10.2	9.8	10.9	9.6	**8.6**	**6.5**	**6.4**
GDP deflator				6.8	2.9	3.4	1.7	**2.4**	**2.6**	**2.8**
Harmonised index of consumer prices				7.3	1.7	0.0	0.1	**0.4**	**2.3**	**2.7**
Terms of trade goods				-0.6	0.8	1.0	0.8	**0.4**	**0.0**	**0.2**
Trade balance (goods) (c)				-2.9	3.3	2.3	4.0	**4.7**	**3.7**	**3.4**
Current-account balance (c)				-5.3	3.8	2.0	3.1	**4.1**	**3.1**	**4.1**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-4.5	7.4	5.8	7.8	**6.9**	**6.1**	**7.7**
General government balance (c)				-5.6	-2.6	-2.1	-1.6	**-1.5**	**-2.3**	**-2.3**
Cyclically-adjusted budget balance (d)				-	-1.3	-1.9	-1.9	**-1.9**	**-2.9**	**-3.1**
Structural budget balance (d)				-	-1.4	-2.2	-1.8	**-2.6**	**-2.9**	**-3.1**
General government gross debt (c)				64.9	76.6	75.7	74.7	**73.4**	**72.5**	**71.8**

(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.