

16. HUNGARY

Painful adjustments ahead

The starting economic recovery...

Growth fell to 1.1% in 2007 compared with a historical average of 4.2% between 2001 and 2006. The fiscal austerity measures from mid-2006 certainly played a role in the slowdown. Nevertheless, the private sector showed some resilience as consumption expenditure grew by a moderate 0.7% in 2007 despite the close to 5% decrease in real wages (as measured on cash-flow basis). Gross fixed capital formation also increased at a modest rate, while net exports continued their surge, providing the momentum for the economy. These trends continued in the first half of 2008. However, preliminary data for end summer 2008 and current soft indicators suggest that external shocks, such as the financial crisis, may have interrupted the recovery of the economy.

...was obliterated by the financial crisis

Hungarian financial markets came under severe stress from early October 2008, as there was a freeze on the government bond market, a sharp fall in the stock market and a strong depreciation of the forint exchange rate. These events were provoked by the substantially increased risk aversion vis-à-vis emerging markets, and in particular with respect to Hungary due to its vulnerabilities (e.g. large external debt).⁽⁹⁾

The financial crisis will have the largest impact on the Hungarian real economy through two channels. First, foreign demand and thus export performance will have to abate due to the slowdown in the EU and the rest of the world. Second, widespread credit rationing will seriously affect households'

ability to borrow. Consumption expenditure is thus foreseen to decline in 2009 by more than 1%, assuming a temporary halt in foreign currency lending to households. The evolving credit crunch would also hinder the reacceleration of investment activities, albeit some stimulus is still expected from the already announced foreign direct investments and an increasing inflow of EU funds. Export performance is likely to slow down to below 8% in 2008 and to below 2% in 2009.

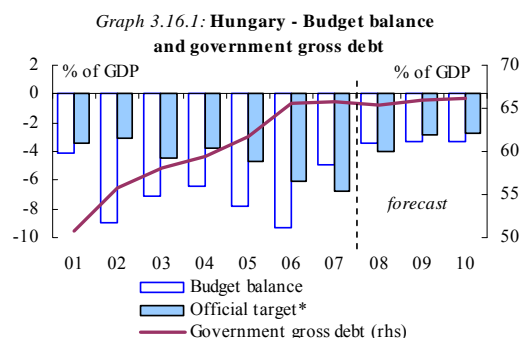
Based on monetary conditions prevailing in mid-October, GDP growth is anticipated to decline to 0.7% in 2009 before resuming its recovery by reaching 1.8% in 2009. At the same time, given falling consumption and the adjusted fiscal plans, the current account deficit is foreseen to decrease to around 5% of GDP in 2009. However, should the financial turmoil turn out to be more serious, or should the authorities adopt additional austerity measures as currently discussed, the slowdown will be more pronounced and the recovery will be even more protracted.

Inflationary pressures subside

After reaching 8% in 2007, inflation is expected to decline in the coming years, supported by both the significant fall in oil and food prices and tighter monetary conditions, as well as the widening negative output gap. However, wages are expected to remain more persistent than inflation, providing a moderate rise in real wages. Since mid-2006, firms' profitability has been suffering from persistently high wages and increases in labour taxes. This together with changes in retirement regulations has led to a decline in employment in the first half of 2008. The radical slowdown in economic activity is likely to take its toll on employment as well, which is now expected to decrease by around 1% both in 2008 and in 2009.

Public finances

After the very high budgetary outturn recorded in 2006 (a deficit of 9.3% of GDP), the deficit was reduced significantly to 5% of GDP in 2007 as a result of the fiscal consolidation programme. In 2008, due mainly to further expenditure restraints and the elimination of deficit increasing one-off operations, the deficit is expected to decrease to 3.4% of GDP (well below the official target of 4%



*Note: Deficit targets were compiled from official documents as defined in the preceding year in successive Pre-Accession Economic Programmes, Convergence Programmes and budget bills.

of GDP). This improved outcome is chiefly explained by higher-than-expected revenues by 0.4% of GDP compared to the budgeted figures thanks to the combined impact of higher-than-expected wage dynamics and further economic whitening. The changes in the expenditure side are expected to move in both directions (e.g. indexed social transfers are up, investment expenditures are down), and finally would lead to another 0.2% of GDP deficit reduction. In 2009, the general government deficit is expected to decline moderately to 3.3% of GDP in 2008 (against the 2.9% of GDP target set in the revised draft budget). Based on the usual no-policy-change assumption, the deficit is envisaged to remain at this level in 2010.

The forecast is based on the measures contained in the revised draft budget (submitted to Parliament on 18 October); therefore it could not incorporate any additional expenditure cuts as currently discussed. On the revenues side, given the full withdrawal of the measures of the Government's multi-year tax package, the forecast is based on an unchanged tax code. The foreseen meagre growth would especially take its toll in the form of a slowdown in the growth of indirect taxes. On the expenditure side, the forecast assumes that the

planned savings in social transfers and government consumption will only partly be achieved after 2008, since it may be difficult to continue to contain spending, particularly for operational expenditures and the public wage bill in 2010. The forecast does not incorporate any budgetary loosening linked to the forthcoming election scheduled for 2010. This assumption, however, is subject to considerable risks as evidenced by past experience; although historical trends cannot be extrapolated, since various structural changes have taken place since mid-2006. It also does not consider any receipt or capital transfer in relation to the ongoing privatisation of the State-owned railway company's (MÁV) cargo division.

After the stabilisation of the debt-to-GDP ratio in 2007 at 65¾%, a gradual decrease is expected for 2008 to below 65½%, chiefly as a result of the anticipated shift to a primary surplus of around ½% of GDP. However, the debt ratio is projected to increase again in both 2009 and 2010.

(^o) On 29 October, it was announced that the EU was ready to provide a medium-term assistance of €6.5 billion to Hungary in conjunction with IMF assistance of €12.5 billion and World Bank assistance of €1 billion.

Table 3.16.1:

Main features of country forecast - HUNGARY

	2007			Annual percentage change					
	bn HUF	Curr. prices	% GDP	92-04	2005	2006	2007	2008	2009
GDP at previous year prices	25419.2	100.0	3.0	4.0	4.1	1.1	1.7	0.7	1.8
Private consumption	13645.4	53.7	-	3.4	1.7	0.6	1.0	-1.2	1.4
Public consumption	5369.7	21.1	1.1	2.4	4.3	-7.4	-0.8	2.1	2.7
Gross fixed capital formation	5343.7	21.0	5.7	8.5	-6.2	1.5	1.5	2.7	4.6
of which : equipment	2268.9	8.9	-	-	-	-	1.6	3.8	6.4
Exports (goods and services)	20400.9	80.3	12.6	11.3	18.6	15.9	7.7	1.3	6.8
Imports (goods and services)	20017.1	78.7	13.4	7.0	14.8	13.1	7.7	0.8	7.6
GNI at previous year prices (GDP deflator)	23564.2	92.7	-	3.5	3.5	-0.1	1.7	1.3	1.7
Contribution to GDP growth :									
Domestic demand			3.0	4.3	0.5	-1.0	0.7	0.3	2.3
Stockbuilding			0.5	-2.9	1.4	0.1	0.8	0.0	0.0
Foreign balance			-0.5	2.5	2.3	2.1	0.2	0.4	-0.5
Employment			-	0.4	0.9	-0.1	-1.2	-0.8	0.2
Unemployment rate (a)			8.1	7.2	7.5	7.4	8.1	8.6	8.5
Compensation of employees/f.t.e.			-	7.1	4.5	6.2	8.9	7.1	5.9
Unit labour costs whole economy			-	3.4	1.3	4.9	5.9	5.6	4.3
Real unit labour costs			-	1.1	-2.5	-0.8	0.6	1.6	1.1
Savings rate of households (b)			-	-	-	-	-	-	-
GDP deflator			14.0	2.2	3.9	5.7	5.3	3.9	3.2
Harmonised index of consumer prices			-	3.5	4.0	7.9	6.3	3.9	2.9
Terms of trade of goods			-	-2.7	-1.9	0.5	0.0	0.3	0.2
Trade balance (c)			-4.7	-2.5	-2.3	0.2	0.3	0.7	0.2
Current account balance (c)			-	-7.5	-7.5	-6.4	-6.3	-5.1	-5.5
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			-	-6.7	-6.9	-5.3	-5.1	-3.7	-3.8
General government balance (c)			-	-7.8	-9.3	-5.0	-3.4	-3.3	-3.3
Cyclically-adjusted budget balance (c)			-	-8.3	-10.5	-5.7	-3.9	-3.4	-3.3
Structural budget balance (c)			-	-8.7	-10.1	-4.8	-4.0	-3.4	-3.3
General government gross debt (c)			-	61.7	65.6	65.8	65.4	66.0	66.2

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.