24. HUNGARY

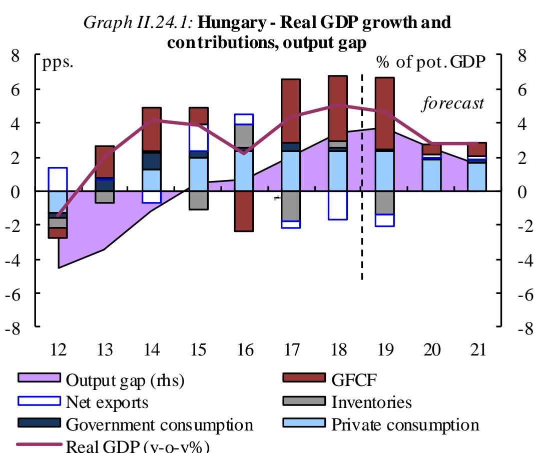
Strong growth set to moderate

Hungary's economy has proved resilient to the global slowdown so far thanks to temporary domestic drivers. Growth, however, is set to slow as domestic support fades and the weakness in key export markets is expected to persist. The moderation in growth should ease the pressure on costs and prices and bring the deterioration in the external balance to halt. The headline and structural budget balances are both forecast to improve.

Domestic tailwinds support growth in 2019

Real GDP growth remained stable at 5.1% in the first half of 2019, similar to the growth rate in 2018. So far, Hungary has managed to withstand the global slowdown thanks to a domestic construction boom and a revival of the automotive industry. Investment activity was supported by rising public expenditure in the run-up to local elections, the recovery of the real estate sector, and high capacity utilisation in manufacturing. Household consumption continued to benefit from rising employment and real wages. The automotive industry and exports received a boost from the launch of new models in major factories. Still, the trade balance decreased due to buoyant import demand.

Graph II.24.1: **Hungary - Real GDP growth and contributions, output gap**



A slowdown is expected in the coming years

The support to growth from construction and the automotive industry are set to fade towards the end of 2019, and GDP growth is projected to drop from 4.6% in 2019 to 2.8% in both 2020 and 2021. Short-term indicators already anticipate this slowdown. The growth of construction output had moderated from double digits to 5.9% by August, while order books have been contracting throughout the year. Manufacturing has also lost momentum in recent months.

Household consumption is projected to slow gradually. The labour market may become less tight as lower GDP growth limits labour demand and constrains further real income gains. Rising government support to families and for home buying contribute to higher household investment. At the same time, the attractive yields of retail government bonds will keep the saving rate high.

The investment rate is set to decrease from a record high level. Public investment is projected to moderate in 2020 after Hungary's absorption of EU funds peaked in 2019. In contrast, private investment is forecast to rise further as real estate projects already in the pipeline are completed. Several big-ticket projects in manufacturing are expected to be finalised in the forecast years.

Exports are set to grow more slowly in 2020, in line with subdued growth in trading partners. However, new manufacturing capacities may raise the market share of Hungarian exporters, especially in 2021. The depreciation of the currency has so far limited the impact of strong wage growth on cost competitiveness. Import growth is forecast to slow because of weaker domestic demand. As a result, the current account deficit is set to decrease in the coming years. The continuing inflow of EU funds should keep the external financing position positive.

External risks to the forecast remain on the downside. Upside domestic risks stem from the continuing tightness of the labour market, which could sustain faster wage and consumption growth.

Cost pressure eases gradually

Inflation passed its peak in summer 2019, thanks to moderating fuel prices and favourable base effects. Decreasing commodity prices should help HICP inflation revert from 3.4% in 2019 to 3.1% in 2020 and 3.0% in 2021. Core inflation is expected to remain higher than HICP with still strong, albeit easing consumption and wage growth.

General government deficit set to shrink

The deficit is forecast to decrease to 1.8% of GDP in 2019. Tax revenues remain buoyant, on the back of favourable macroeconomic developments. The increase is, however, below nominal GDP growth, partly due to a 2 pps. cut in employers' social security contributions. The absorption of EU funds is also expected to increase compared to 2018, reaching its peak over the current Multiannual Financial Framework. The only factor contributing to the deficit's reduction is the moderate increase of total current expenditure compared to GDP, taking also into account the full use of free reserves in the budget. Interest expenditure is expected to remain stable as a share of GDP, due to the high premium offered by new retail bonds launched in June 2019. The deficit-reducing contribution of current spending is only partly offset by an increase in capital expenditure resulting from the implementation of the programme to develop villages, the take-up of the pre-natal loan under the 'demography programme' and higher-than-foreseen national co-payments to EU funded projects.

In 2020, the deficit is forecast to decrease further to 1% of GDP. Revenues from EU funds are assumed to decline by 0.5% of GDP. Tax revenues are expected to continue increasing but at a lower rate compared to 2019, following the measures included in the Economy Protection Action Plan, in particular the further cut of employers' social security contributions by 2 pps. Except for interest spending, current expenditure growth is expected to remain moderate, thus contributing to the deficit reduction. The drop in public investment (by 1% of GDP), following also a lower absorption of EU funds, is only partly compensated by higher capital transfers due to the increasing take-up of the 'demography programme'. These projections assume almost the full use of the substantially high level of free reserves (1% of GDP) foreseen in the budget. In 2021, the deficit is estimated to decrease marginally, to 0.8% of GDP, under a no-policy-change scenario. Budgetary risks stem from higher expenditure related to public investments and the measures in the 'demography programme', whose take-up was higher than expected in 2019.

The structural deficit peaked in 2018 at 3.8% of GDP and is estimated to improve by almost 2 ½ pps., reaching 1 ½% of GDP, over the forecast horizon, as the positive output gap closes. The debt-to-GDP ratio is expected to remain on a downward path, falling from 70.2% in 2018 to 64.4% in 2021.

Table II.24.1:

Main features of country forecast - HUNGARY

	2018			Annual percentage change						
	bn HUF	Curr. prices	% GDP	00-15	2016	2017	2018	2019	2020	2021
GDP		42661.8	100.0	2.2	2.2	4.3	5.1	**4.6**	**2.8**	**2.8**
Private Consumption		20776.4	48.7	1.5	4.9	4.7	4.8	**4.9**	**3.8**	**3.4**
Public Consumption		8404.5	19.7	2.0	0.7	2.4	0.9	**0.3**	**0.6**	**0.8**
Gross fixed capital formation		10739.3	25.2	2.3	-10.6	18.7	17.1	**17.0**	**2.1**	**2.6**
of which: equipment		4163.3	9.8	3.0	2.5	16.1	10.2	**18.0**	**3.6**	**4.3**
Exports (goods and services)		36236.5	84.9	8.7	3.8	6.9	4.3	**5.1**	**4.0**	**4.6**
Imports (goods and services)		34370.5	80.6	7.5	3.4	8.2	6.8	**6.2**	**4.0**	**4.5**
GNI (GDP deflator)		40952.1	96.0	2.3	4.3	2.8	5.1	**4.8**	**2.9**	**2.9**
Contribution to GDP growth:	Domestic demand			1.8	0.2	6.5	6.4	**6.7**	**2.6**	**2.6**
	Inventories			-0.4	1.4	-1.8	0.4	**-1.4**	**0.0**	**0.0**
	Net exports			0.8	0.6	-0.5	-1.7	**-0.6**	**0.2**	**0.2**
Employment				0.3	3.7	1.9	2.4	**1.9**	**0.2**	**0.0**
Unemployment rate (a)				8.0	5.1	4.2	3.7	**3.4**	**3.4**	**3.4**
Compensation of employees / head				6.2	2.4	7.0	6.2	**7.8**	**6.5**	**6.4**
Unit labour costs whole economy				4.3	4.0	4.5	3.4	**5.0**	**3.8**	**3.5**
Real unit labour cost				-0.5	3.0	0.8	-1.0	**0.8**	**0.1**	**0.5**
Saving rate of households (b)				10.6	11.9	11.4	11.6	**12.3**	**12.2**	**12.1**
GDP deflator				4.8	1.0	3.7	4.5	**4.2**	**3.7**	**3.0**
Harmonised index of consumer prices				4.8	0.4	2.4	2.9	**3.4**	**3.1**	**3.0**
Terms of trade goods				-0.5	1.5	-0.3	-1.0	**-0.1**	**0.3**	**0.0**
Trade balance (goods) (c)				-1.0	3.4	1.5	-1.3	**-1.9**	**-1.5**	**-1.3**
Current-account balance (c)				-4.0	4.7	2.3	-0.3	**-1.2**	**-0.8**	**-0.7**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-2.4	4.6	3.1	2.1	**0.6**	**1.2**	**1.2**
General government balance (c)				-4.9	-1.8	-2.4	-2.3	**-1.8**	**-1.0**	**-0.8**
Cyclically-adjusted budget balance (d)				-4.6	-2.1	-3.3	-3.8	**-3.5**	**-2.1**	**-1.5**
Structural budget balance (d)				-	-2.0	-3.7	-3.8	**-3.3**	**-2.1**	**-1.5**
General government gross debt (c)				68.2	75.5	72.9	70.2	**68.2**	**66.7**	**64.4**

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