HUNGARY

Economic activity slowed temporarily in 2016, but has since rebounded, fuelled by public investment as the disbursement of EU structural funds resumed. Business investment should expand on the back of inward FDI and emerging capacity constraints. Continued robust private consumption will rely on further employment gains and higher real wages, driven by unemployment at record-low levels. Declining external cost competitiveness will limit gains in export markets.

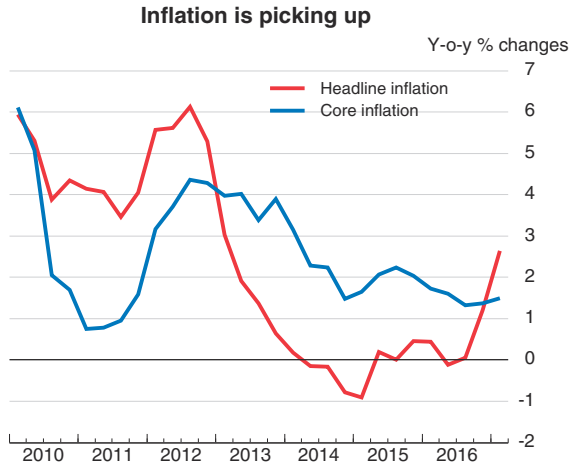
The fiscal stance will remain expansionary, as taxes are lowered and growth-supporting measures are implemented. The disappearance of economic slack and large statutory minimum wage increases have boosted wage gains, and consumer price inflation is projected to surpass the central bank's 3% inflation target in early 2018, requiring monetary tightening.

Hungary is benefitting from globalisation through inward FDI in selected sectors and regions. A more market-friendly regulatory and competition policy stance would promote competitive firms that participate in global value chains. Domestic firms could benefit more from such external market opportunities by a faster shifting of public support from public works schemes to relevant training and skills development, enabling other sectors and regions to participate in such opportunities.

Growth relies on private consumption

In 2016, private consumption became the main growth driver, as real incomes rose, and it is set to continue its robust expansion. Investment declined, as spending on public infrastructure contracted, but should rebound thanks to faster disbursement of EU structural funds. This was only partially offset by rising business investment, where the effects of favourable credit conditions and strong business sentiment outstripped the drag from rising unit labour costs. Rising industrial production and export orders should secure

Hungary



1. Three-month moving average.
2. Percentage of firms in the industrial sector pointing to labour shortages as a factor limiting production.

Source: OECD Main Economic Indicators database; Eurostat; and OECD Economic Outlook 101 database.

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Hungary: **Demand, output and prices**

	2013	2014	2015	2016	2017	2018
	Current prices HUF billion	Percentage changes, volume (2005 prices)				
GDP at market prices	30 450.9	3.9	3.1	1.9	3.8	3.4
Private consumption	15 718.2	2.5	3.4	5.0	5.0	5.0
Government consumption	5 948.5	4.5	1.0	0.1	1.0	1.1
Gross fixed capital formation	6 308.2	9.9	1.9	-15.5	8.3	7.2
Final domestic demand	27 974.9	4.6	2.5	-1.0	4.7	4.6
Stockbuilding[1]	366.2	0.1	-1.0	2.2	-0.2	0.0
Total domestic demand	28 341.1	4.6	1.4	1.5	4.5	4.5
Exports of goods and services	25 909.4	9.8	7.7	5.8	4.8	5.4
Imports of goods and services	23 799.7	10.9	6.1	5.7	5.8	6.8
Net exports[1]	2 109.8	-0.2	1.8	0.6	-0.3	-0.7
Memorandum items						
GDP deflator	_	3.2	1.7	0.7	1.7	3.7
Consumer price index	_	-0.2	-0.1	0.4	3.0	3.0
Private consumption deflator	_	1.0	-0.3	0.2	2.2	3.0
Unemployment rate	_	7.7	6.8	5.1	4.2	3.9
General government financial balance[2]	_	-2.1	-1.5	-1.8	-2.6	-2.7
General government gross debt[2]	_	97.9	96.4	96.8	96.0	94.3
General government debt, Maastricht definition[2]	_	75.0	74.2	73.8	72.9	71.2
Current account balance[2]	_	2.1	3.3	4.9	3.6	2.1

1. Contributions to changes in real GDP, actual amount in the first column.
2. As a percentage of GDP.
Source: OECD Economic Outlook 101 database.

StatLink http://dx.doi.org/10.1787/888933505866

further increases in business investment in 2017. New housing subsidies have boosted building permits and housing investment. Export growth slowed, as market share gains decelerated amidst tighter market conditions that forced exporters to cut prices.

Strong private-sector job creation has contributed to a fall in the unemployment rate to 4.5%, despite a reduction in the extensive use of public works schemes. Private-sector wages have accelerated, and this pick-up will continue as a six-year wage agreement stipulates minimum wage increases of 15-25% in 2017 and another increase of 8-12% in 2018; employers are being partly compensated by lower corporate taxes and social security contributions to safeguard external competitiveness. Consumer price inflation rose to nearly 3% in early 2017, reflecting only in part temporary effects of higher energy prices and indirect taxes.

The expansionary policy stance is fuelling inflationary tensions

Fiscal policy is projected to be expansionary in 2017 as corporate income taxes, social security contributions and the VAT rate on selected goods have been cut, while public spending and housing subsidies have been increased. As a result, the budget deficit is projected to widen by three-quarters of a percentage point of GDP, to 2.6% of GDP. The resulting boost to demand is adding to labour market tensions and cost pressures. The central bank has signalled that its supportive stance remained appropriate for achieving its inflation target of 3%. However, with real wage gains already outpacing productivity

growth, profits and external cost competitiveness are being weakened, reducing the attractiveness of Hungary as a FDI destination and the globalisation process.

Activity is projected to accelerate on the back of stronger domestic demand

Economic activity will continue to be driven by domestic demand. Public infrastructure spending will recover with faster disbursements of EU structural funds, and business investment will benefit from easy credit conditions and production bottlenecks, while housing subsidies are boosting construction activity. Robust private consumption growth should continue, as real incomes are augmented by real wage gains and lower taxes. Strong export growth will moderate as competitiveness is eroded by cost increases. A sharp recovery in imports will narrow the large current account surplus. Pressure on resources could push inflation to 3.4% by end-2018.

A faster scaling back of public works programmes would expand the labour resources available to the private sector, easing labour market tensions and inflation pressures. Similarly, greater-than-expected productivity increases from public infrastructure and business investment could preserve Hungary's FDI attractiveness. Renewed financial turbulence that hurt European growth would reduce exports, as would higher wage growth.