HUNGARY

Economic growth is projected to remain strong but to slow somewhat in 2019 as capacity constraints bite. Real wage gains and employment increases will support private consumption, while investment will be stimulated by private firms and the disbursement of EU structural funds. Exports will benefit from robust external demand and new capacity expansion, although gains in market share will slow. Wage increases resulting from tighter labour market conditions will raise inflation, which is projected to exceed the central bank's 3% target in early 2019.

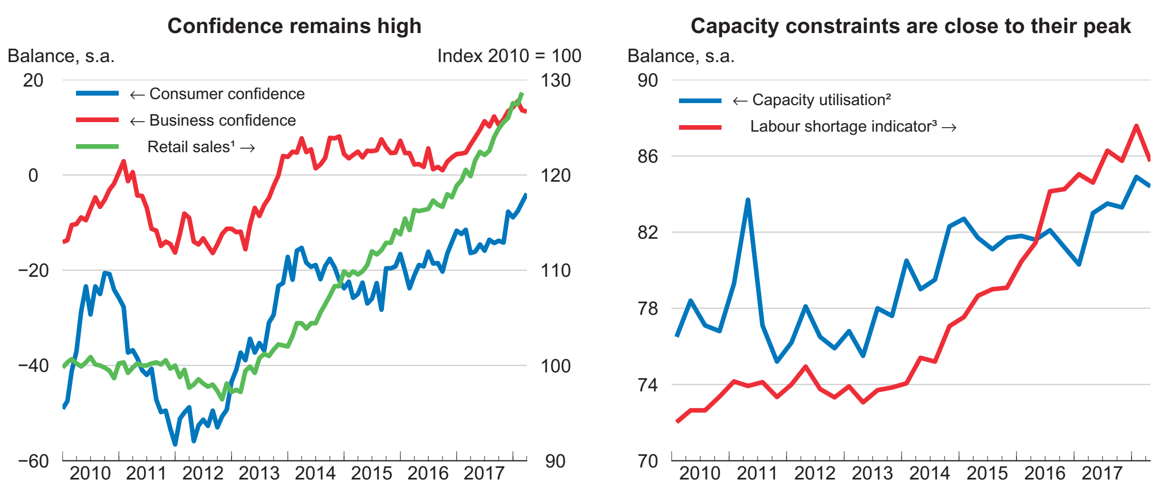
Fiscal and monetary policies are expansionary. In 2018, there have been tax reductions alongside widespread spending increases. Statutory minimum wages have also been raised sharply, with further increases scheduled. Prudent policies are needed to prevent overheating. Furthermore, with strong economic growth, a faster reduction of the budget deficit would allow the government to finance higher future age-related spending.

Domestic demand is the main economic driver

Robust domestic demand is driving growth. Private consumption is being supported by large increases in minimum wages, fast rising employment and buoyant consumer confidence, which has reached its highest level since 2002. Investment growth is continuing on the back of EU structural funds, a pick-up in residential construction and the need to expand capacity. Such expansions and strong external demand are boosting exports.

Unemployment has fallen sharply as employment has continued to increase. The tightening of the labour market and continued large minimum wage increases led to annualised wage growth of 13% in early 2018. Headline inflation has risen slightly, to 2.3%, but this reflects price increases for food, tobacco and alcohol, rather than underlying wage pressures.

Hungary



1. In volume.
2. Data refer to the manufacturing sector.
3. Percentage of firms in the industrial sector pointing to labour shortage as a factor limiting production.

Source: OECD Main Economic Indicators database; Thomson Reuters; and Eurostat.

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Hungary: **Demand, output and prices**

	2014	2015	2016	2017	2018	2019
	Current prices HUF billion	Percentage changes, volume (2005 prices)				
GDP at market prices	32 591.7	3.4	2.2	4.0	4.4	3.6
Private consumption	16 406.2	3.6	4.3	4.7	5.9	4.9
Government consumption	6 504.5	1.1	0.8	0.3	2.5	0.9
Gross fixed capital formation	7 223.4	1.9	-10.6	16.8	13.5	10.7
Final domestic demand	30 134.2	2.7	-0.1	6.3	6.9	5.5
Stockbuilding[1]	376.6	-1.3	1.5	-0.3	-1.8	0.0
Total domestic demand	30 510.8	1.3	1.6	5.9	4.9	5.5
Exports of goods and services	28 568.1	8.5	3.4	7.1	6.3	5.9
Imports of goods and services	26 487.1	6.4	2.9	9.7	7.2	8.2
Net exports[1]	2 081.0	2.2	0.7	-1.4	-0.3	-1.5
Memorandum items						
GDP deflator	_	1.9	1.0	3.7	3.1	3.8
Consumer price index	_	-0.1	0.4	2.3	2.6	3.4
Core inflation index[2]	_	2.0	1.5	1.8	2.0	3.3
Unemployment rate (% of labour force)	_	6.8	5.1	4.2	3.6	3.4
Household saving ratio, net (% of disposable income)	_	6.3	7.1	7.7	7.2	6.1
General government financial balance (% of GDP)	_	-1.9	-1.7	-2.0	-2.6	-2.1
General government gross debt (% of GDP)	_	97.6	97.5	91.8	90.4	88.0
General government debt, Maastricht definition (% of GDP)	_	76.7	76.0	73.6	72.2	69.8
Current account balance (% of GDP)	_	3.5	6.0	2.9	2.5	0.8

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 103 database.

StatLink http://dx.doi.org/10.1787/888933731073

A tighter policy stance is needed

The overall macroeconomic policy stance and higher statutory minimum wages are adding considerable stimulus, despite clear signs of labour-market overheating. The central bank is maintaining its policy rates close to zero and expanding liquidity to lower longer-term rates. It has signalled its intention to maintain the current monetary stance for some time. Fiscal policy is also expansionary, with cuts in business taxes and VAT on selected items, combined with growth-supporting measures, including spending on education, social services and law enforcement, and subsidies for house purchases. Despite rapid economic growth, only a marginal decline in the general government deficit is projected in 2019 compared with 2017. Both macroeconomic policy levers should become more restrictive, but this is unlikely to happen until 2019 at the earliest. To sustain low inflation expectations interest rates will need to be increased.

The strong upswing represents a window of opportunity to reduce the large number of participants in public works schemes, which, if combined with effective training measures, could make additional resources available for the primary labour market. In addition, deregulation and a variety of competitiveness-enhancing measures would contribute to an improved business environment and could bolster productivity growth, facilitating Hungary's integration into global supply chains.

Labour shortages may hold back further expansion

Economic activity is projected to accelerate in 2018 before moderating in 2019 as labour supply tightens. Demand will increasingly be met through imports. Nonetheless, the positive output gap will widen, and inflation will rise, absent a tightening of macroeconomic policies. Private consumption will drive growth, as real incomes surge and household savings fall. Business investment will stay strong in response to increasing capacity pressures, and housing construction will continue to expand. Exports will be supported by strong external demand and new industrial capacity, but rising costs will slow gains in export market shares. Downside risks are centred on a faster-than-expected pick-up in wages, further eroding cost competitiveness and unhinging inflation expectations. On the other hand, faster-than-expected productivity gains from capital spending would bolster the economy's capability to absorb rapid wage gains. Hungary also remains vulnerable to any shock to demand for vehicles in its main export market, Germany.