HUNGARY

Growth should pick up in 2017 as new infrastructure projects are launched in the context of the new cycle of EU structural funding, before moderating in 2018. Private consumption should remain the main growth driver, given projected employment gains, in part supported by still large public works schemes, and faster wage growth. Increasing unit labour costs and weak markets will cut export growth.

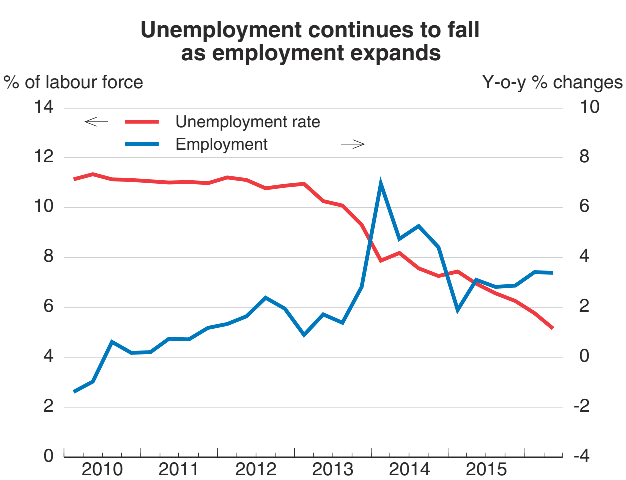
The fiscal stance is becoming expansionary, reflecting lower personal income taxes and other measures to support the economy. However, economic slack is disappearing, pushing up wage growth and consumer price inflation, which is projected to reach the official 3% target by end-2018.

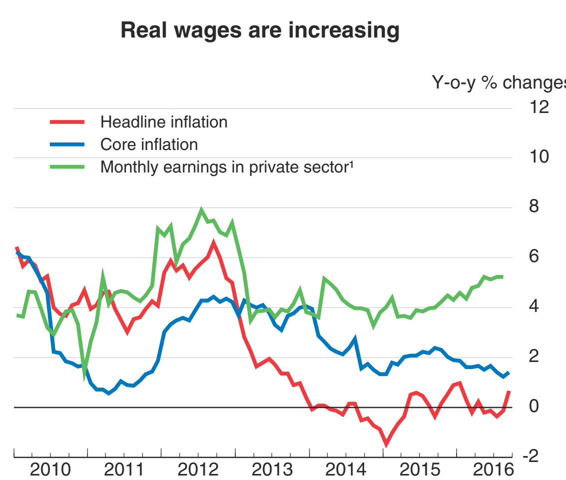
Debt service costs have fallen by 1 percentage point of GDP since 2013, creating some fiscal space. However, using that space could prove pro-cyclical unless growth disappoints, and public debt is still high. Fiscal policy could focus more on enhancing the economy's growth potential by re-prioritising public spending. In particular, scaling back public works schemes as the labour market continues to strengthen, and bolstering public infrastructure investment (beyond what is financed by EU structural funds), particularly in transport, would boost productivity.

Growth is still driven by private consumption

The slower growth in 2016 was driven by a sharp reduction in public investment in infrastructure arising from the slower disbursement of EU structural funds at the beginning of the new funding cycle. More favourable credit conditions and higher lending activity are supporting business investment, especially in manufacturing, despite profits being squeezed by higher unit labour costs that resulted from declining productivity. Exporters have been sustained so far only because firms have cut prices, but this cannot continue indefinitely. Private consumption, on the other hand, sustained its brisk pace on the back of rising real incomes.

Hungary





1. Three-month moving average.

Source: OECD Main Economic Indicators database; and OECD Economic Outlook 100 database.

StatLink http://dx.doi.org/10.1787/888933437666

Hungary: **Demand, output and prices**

	2013	2014	2015	2016	2017	2018
	Current prices HUF billion	Percentage changes, volume (2005 prices)				
GDP at market prices	30 127.3	4.0	3.1	1.7	2.5	2.2
Private consumption	15 718.2	2.5	3.4	5.0	3.8	3.7
Government consumption	5 948.5	4.5	1.0	2.7	1.4	1.0
Gross fixed capital formation	6 308.2	9.9	1.9	-16.0	5.9	6.3
Final domestic demand	27 974.9	4.6	2.5	-0.5	3.7	3.6
Stockbuilding[1]	42.6	0.0	-1.0	1.8	-0.3	0.0
Total domestic demand	28 017.6	4.6	1.4	1.6	3.3	3.7
Exports of goods and services	25 909.4	9.8	7.7	8.1	4.8	4.3
Imports of goods and services	23 799.7	10.9	6.1	8.2	5.9	6.1
Net exports[1]	2 109.8	-0.2	1.8	0.7	-0.4	-1.1
Memorandum items						
GDP deflator	_	3.4	1.7	0.2	2.2	2.9
Consumer price index	_	-0.2	-0.1	0.1	1.4	2.5
Private consumption deflator	_	1.0	-0.3	-0.1	1.3	2.5
Unemployment rate	_	7.7	6.8	5.1	4.5	4.4
General government financial balance[2]	_	-2.1	-1.6	-1.6	-2.0	-2.0
General government gross debt[2]	_	98.7	97.0	97.5	96.4	95.2
General government debt, Maastricht definition[2]	_	75.7	74.7	75.1	74.1	72.8
Current account balance[2]	_	2.1	3.4	6.8	6.7	5.7

1. Contributions to changes in real GDP, actual amount in the first column.
2. As a percentage of GDP.
Source: OECD Economic Outlook 100 database.

StatLink http://dx.doi.org/10.1787/888933439066

The private sector remains the main source of job creation, while the high level of enrolment in public work schemes is slowly coming down. Together with slower growth of the labour force, this has reduced the unemployment rate by almost 2 percentage points over the past year, to around 5%. Accordingly, wage compensation in the private sector has accelerated, reaching more than 5%. Headline inflation hovered around zero until late 2016, when the impact of previous declines in energy prices came to an end and higher indirect taxes pushed it to 1%. Excluding the effects of food and energy prices, core inflation has also dropped to about 1½ per cent.

Fiscal and monetary policy stances are supportive

The fiscal stance is set to be expansionary in 2017, as public wages, investment and housing subsidies increase. This expansion could add to economic tensions at a time when slack has disappeared. Monetary easing has continued, as the base and overnight lending rates were lowered to 0.90% and 1.05%, respectively, with the overnight deposit rate unchanged at -0.05%. Further reductions in the base rate are not expected, as the central bank has signalled that these rates are in line with the 3% inflation target. Market rates have been stable, with long-term rates around 3.2%.

A domestic demand-led recovery is projected to accelerate

Activity is projected to increase as faster disbursements from EU structural funds boost public infrastructure investment. Business investment should strengthen on the back of easier credit conditions, particularly for SMEs. Housing investment should also pick up along with higher subsidies and a recovery in housing loans. Private consumption should continue to expand robustly as real incomes continue to increase, supported by lower personal income tax and VAT on selected goods. However, export growth is projected to fall as competiveness will continue to be eroded by higher wage costs and slow productivity growth. Weak exports will contribute to a narrowing of the large current account surplus. Inflation is expected to reach 3% towards the end of 2018 as the positive output gap continues to increase.

Hungary depends heavily on exports to Europe, which would suffer if turbulence arose in financial markets or because of Brexit. If the public infrastructure investments have unexpectedly strong productivity effects, growth would benefit. Exporters may have more room to compress their margins, which would temper the slowdown in exports. If fiscal policy is loosened in 2018, growth could be higher, but labour market tensions would intensify.