Focus

The economic growth in Hungary in Q1 2015

The first three months of the year saw the continuation of growth convergence between developed and developing countries. EU growth was propelled by the Central and Eastern European region, with a significant contribution by Hungary’s GDP figure. The main driving force behind the Hungarian economy’s year-on-year growth was export, consumption further intensified, while GDP growth was held back by gross capital formation. On the production side, surpassing the service sector, industry made the highest contribution to economic growth between January and March.

The global economy continued to expand moderately in Q1 2015, but the performance of regions and countries was uneven. Although the world economy is still propelled by emerging countries, the growth rate of these countries has been decreasing since 2010. They lost further momentum in the first months of 2015, while the growth of developed economies was more dynamic in the period after 2012 than in the previous years, which trend continued in Q1 2015. The developing world’s share of global GDP keeps rising, albeit at a slower pace than in the past years (2005: 47.1%, 2010: 53.5%, 2015: 57.3%). According to the International Monetary Fund’s (IMF) April forecast, the gap between the growth rates of developed and developing countries will narrow further this year (Chart 1).

Economic growth remained steady in the US in Q1 2015, with GDP increasing by 3.0% as compared to the first three months of 2014. This was mainly due to intensified consumption, improved labour market and housing market conditions, as well as low energy prices. However, annualised on a quarterly basis, the output of the US economy decreased (-0.7%) as a result of the particularly cold winter and the appreciation of the dollar.

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Eurozone growth remained relatively slow by international standards, but it slowly picked up in late 2014 thanks to the expansion of external and internal demand coupled with low energy prices and inflation. In the first three months of 2015, the growth rate was 1.0% y/y and 0.4% as compared to Q4 2014. The performance of Germany – an economic centre of particular relevance to the Hungarian economy – was similar to that of the Eurozone, with a growth rate of 1.0% y/y in Q1 2015, while GDP rose by 0.7% in France and 0.1% in Italy. In the latter country, this marked the end of a period of recession which lasted thirteen quarters, while GDP has been falling over two or three consecutive quarters in other Eurozone Member states, namely Greece and Finland, respectively.

The Japanese economy has recovered gradually since the second half of 2014, expanding at a rate of 2.4% on a quarterly basis in the first three months of 2015 due to cheap energy sources, the weak Japanese yen and the loose monetary policy. However, as compared to Q1 2014, a decline of 1.4% occurred, mainly as a result of a VAT hike last April which had a moderating effect on consumption.

In Asian developing countries, and particularly in China, economic growth is slowing down. Nevertheless, this region still represents the growth centre of the global economy, and produced 29.5% of world GDP in 2014. In the last nine months, China showed decelerating GDP growth on a quarterly basis (Q3 2014: 1.9%; Q4 2014: 1.5%; Q1 2015: 1.3%), while the Chinese economy grew by a mere 7.0% as compared to the same period of 2014 (Chart 2).

In the EU, Central and Eastern European countries were the best performing member states in Q1 2015, with output growing at rates above 3% y/y in the four Visegrád countries and Romania alike. GDP rose at the highest rate in the Czech Republic and Romania (equally 4.2%) and by 3.5% in Poland, 3.3% in Hungary and 3.1% in Slovakia. The keys to expansion included improving external and internal demand, as well as rising consumption expenditure. Regarding the structure of GDP in the Czech Republic, Poland, Hungary and Romania, the first country recorded the highest rate of gross fixed capital formation for Q1 2015 in the region. Poland stood out in terms of final consumption expenditure thanks to its relatively wide internal market. In Hungary, net exports had a relatively high share in GDP production, which was due among other things to the quite weak performance of the Hungarian currency in Q1. Romania had a prominent import surplus between January and March (Chart 3).

According to seasonally and calendar adjusted, balanced data, the Hungarian economy expanded by 0.8% on a quarterly basis and 3.3% y/y between January and March (on the basis of unadjusted raw data, the growth rate was 3.5%). The adjusted data are equal to the rate achieved in the period one quarter before, suggesting that the relatively dynamic growth continued (Chart 4).
Thanks to the dynamic GDP growth, the growth rate of the Hungarian economy was higher than that of the Eurozone for the ninth consecutive quarter. However, the gap is gradually narrowing as the Eurozone is picking up and the Hungarian economy is slowing down: the difference between the annual rates melted from 3.0 percentage points in Q2 2014 to 2.3 percentage points in Q1 this year. Thus, while the Eurozone’s recovery is stimulating the Hungarian economy through the strengthening external demand, convergence with the Eurozone is slowing down as a result of the diminishing difference in growth (Chart 5).

With the Hungarian economy being on a growth path since early 2013, Hungary’s GDP reached its pre-crisis level (of Q2 2008) in the first three months of this year, but the economic weights of the factors contributing to growth have changed significantly. Exports now exceed their volume of April-June 2008 by 23.4%, but household consumption and gross fixed capital formation are still behind their level before the outbreak of the crisis (-7.3% and -12.7%), and overall internal consumption is also 10.5% lower than its level of March-June 2008 (Chart 6).

On the production side, agricultural output was 11.6% lower than one year before. Industry and construction expanded by 7.7 and 9.2% (y/y), respectively, with the latter recording growth for the eighth quarter in a row, though the amount of new orders suggests that the performance of construction may decline for the remainder of the year. Within industry, considerable growth was achieved in the manufacturing sector, and more specifically in the automotive industry and the connecting branches. The service sector grew at a rate of 2.3%, involving a 1.3% drop in the gross value added of financial, insurance activities, which have been in decline over a long period, and thus the financial intermediary system (which attempts to compensate falling revenues by cutting costs) indirectly impedes the performance of other sectors. Growth was set back by 0.3 percentage points by agriculture, while industry, construction and the service sector contributed to GDP growth by 1.8, 0.2 and 1.3 percentage points, respectively, suggesting that industry is increasingly becoming the engine of Hungarian economic growth on the production side (Chart 7).

On the expenditure side, the actual consumption of households expanded by 2.6% thanks to low fuel prices, increasing employment and rising real wages, and exports and imports grew by 10.3 and 7.8%, respectively, while gross capital formation shrank by 2.9%, involving a 6.7% drop in gross fixed capital formation due to the high base before the elections and the corporate sector’s reduced mood for investment. Thus net exports and final consumption contributed to the GDP growth of 3.5% by 3.0 and 1.1 percentage points, respectively, while gross capital formation pushed it down by 0.5 percentage points. Internal consumption only expanded by 0.6% (y/y) and made a contribution of 0.6 percentage points to GDP growth in Q1 2015, indicating partly the openness and vulnerability of the economy and partly the isolation of the export sector from other segments of the economy (Chart 8).
Foreign trade, current account

Net exports were the driver of economic growth regarding expenditure approach in Q1 2015

- Between January and March, Hungarian exports and imports expanded by 10.3% and 7.8% (y/y), respectively, while net exports made an overall contribution of 3.0 percentage points to economic growth, which has been unprecedented for the past five years (Chart 1). The trade balance of goods showed a record surplus in Q1 (HUF 767.5 billion), mainly resulting from a surplus of HUF 946.3 billion recorded in the product group of machinery and transport equipment. In this major product group, the increase in export exceeded import growth by 2.9 percentage points. By contrast, imports were more dynamic than exports in the case of manufactured goods and food, beverages and tobacco products due to intensified consumption (Charts 2-3). However, exports may lose momentum in the months ahead, because export orders declined significantly on a monthly basis in May, while they increased in Germany and the EU (Chart 4).

- Q1 2015 was closed with a surplus on the current account. The amount of the surplus, which increased on a monthly basis, was attributable to a positive and improving trade balance of goods and services. On the financial account, the deteriorating balance of general government (HUF -130.3 billion) could be offset by the improving balances of the central bank (HUF +202.2 billion) and other sectors (corporates, households) (HUF +120.5 billion) in March (Charts 5-6).
Investments

Investments may be close to stagnation for the remainder of the year

- The volume of investments decreased by 4.5% (y/y) between January and March, following an expansion of 1.9% in Q4 last year, while gross fixed capital formation (y/y) fell at a rate of 6.7% in Q1 this year, after growing by 1.9% between October and December 2014 (Chart 1). Gross fixed capital formation as a percentage of GDP dipped to a record low level in the region, hitting a two-year low in the first three months of the year (14.7%) (Charts 1-2).

- Private sector investments and public investments were lower by 0.7% and 10.0%, respectively, than a year before, with the high base of early 2014 also playing a key role in the decline (Chart 3).

- Investments fell at a rate above 10% in the info-communication sector and education, and the electricity sector was the only one of the important sectors where investments expanded on an annual basis (Chart 4).

- The level of industrial capacity utilisation, which exceeds 80%, and the expected development of orders may give an impulse to developments in the quarters to come, but the high base, the temporary scarcity of Community funds and the reduced investment appetite (MFB Periscope February 2015) are expected to keep the dynamics of developments close to stagnation this year (Charts 5-6).
Industry and construction

The industrial outlook is promising, while construction may lose momentum in the months to come

- The gross value added of industry and construction increased by 7.7% and 9.2% (y/y), respectively, in Q1 2015, and thus the contribution of these two sectors to GDP growth reached 1.8 and 0.2 percentage points, respectively. The performance of the construction sector has an upward impact on growth for the eighth quarter in a row, while industry’s contribution to growth is considered the highest over the last four years (Chart 1). In April 2015, industrial production grew by 6.3% on an annual basis but contracted by 0.1% as compared to March (Chart 2).

- The automotive industry remained the driver of the manufacturing industry (+16.9%). In the rubber and plastic manufacturing also expanded at a rate above 10% (Chart 3). The slowdown in new domestic orders and the worsening German business expectations are expected to hold back the momentum of industrial production in the months to come, while the manufacturing industry may continue to expand at a rate between 5 and 10% in the same period (Charts 4-5).

- Although construction output grew at a rate of 12.7% in March and then 10.8% y/y in April (building construction and other constructions grew by 4.3% and 16.3%, respectively), the amount of new orders and the total amount of orders was 10.6% lower, respectively, than one year before, casting a shadow on the outlook for the months ahead (Chart 6).

The performance of the construction sector has an upward impact on growth for the eighth quarter in a row, while industry’s contribution to growth reached 1.8 and 0.2 percentage points, respectively. The automotive industry remained the driver of the manufacturing industry (+16.9%). In the rubber and plastic manufacturing also expanded at a rate above 10% (Chart 3). The slowdown in new domestic orders and the worsening German business expectations are expected to hold back the momentum of industrial production in the months to come, while the manufacturing industry may continue to expand at a rate between 5 and 10% in the same period (Charts 4-5).

Although construction output grew at a rate of 12.7% in March and then 10.8% y/y in April (building construction and other constructions grew by 4.3% and 16.3%, respectively), the amount of new orders and the total amount of orders was 10.6% and 38.4% lower, respectively, than one year before, casting a shadow on the outlook for the months ahead (Chart 6).
Consumption became one of the drivers of economic growth

- Hungarian households’ consumption expenditure increased by 2.6% (y/y) in Q1 this year, and the overall contribution of actual consumption to economic growth was 1.7 percentage points between January and March 2015 (Chart 1).
- Retail trade expanded by 0.1% on a monthly basis and 5.3% on an annual basis in March, and then year-on-year growth accelerated to 5.3% in April (Chart 2). The sales of food products only grew by 1.6% y/y in April, which is partly explained by the restriction of stores’ Sunday opening hours (which may also be the reason behind the decline in consumer confidence early this year and its slow recovery), while the 9.7% growth in fuel sales was stimulated by low oil prices (Charts 3-4).
- Following bank settlement and the conversion of foreign currency loans to Hungarian forints, loan repayments still exceed new borrowings in the household sector, as the value of the former was HUF 62.0 billion higher than that of the latter in April. As employment increases, the burden caused by the repayment of foreign currency loans eases, and real wages rise, households’ disposable income may grow, which may in turn stimulate consumption in the months to come (Charts 5-6).
Labour market

Employment growth is gradually reaching its upper limits

- The unemployment rate reached 7.8% in Q1 2015, which is 0.5 percentage points lower than in the period one year before. The activity and employment rates stood at 59.2% and 54.5%, respectively, representing an increase of 1.2% and 1.3% in a similar comparison, mainly attributable to economic growth: the number of public works employees dropped by 5.4 thousand, while that of non-public works employees increased by 84.4 thousand. At the same time, the number of fixed-term employment contracts, which are relatively sensitive to economic development, stopped to grow in Q1 as a result of the gradual slowdown of economic growth (Charts 1-2). The May decline in employment plans and the deceleration of the term employment contracts, which are relatively sensitive to economic development, stopped to grow in Q1 as a result of the economic slowdown.

- The number of employees rose by 3.2% in the private sector, but fell by 4.8% in the public sector in March 2015 (y/y). As a result of the wage compensation provided to tens of thousands of employees in the public sector, wages rose at a higher rate than in the private sector (+6.7%) than in the private sector (+3.2%) (Charts 5-6).

Chart 1: Activity rate, employment rate and unemployment rate in Hungary (population aged 15-74)

Chart 2: Economic growth and number of employees with fixed-term contract

Chart 3: Employment expectations and number of employees in the manufacturing sector

Chart 4: Registered new supported and not supported vacancies

Chart 5: Changes in number of employed persons (March 2015, same period of the previous year = 100%)

Chart 6: Changes in gross wages* (March 2015, same period of the previous year = 100%)

Sources: HCSO, MFB
Inflation

Consumer prices increased both on an annual and monthly basis after a period of ten months

- In line with the trend following last year’s price drop, the price of Brent crude fell by 2.0% in May following the price fluctuations caused by the adjustment in supply and demand and as a result of the strengthening of the dollar against the euro. The price per barrel stood at USD 63.6 at the end of the month (Chart 1).
- In April in Hungary, agricultural and industrial producers’ prices fell by 8.0% (y/y) and 1.7% (y/y), respectively, with the latter involving a 3.6% drop in domestic sales prices and a still lower decrease of 0.6% in export sales prices (Chart 2). In May, consumer prices rose by 0.5% (y/y), while the average rate of increase in the price of consumer goods hit a two-year high at 0.7%. As an indication of the gradually strengthening price pressure, the 12-month core inflation rate reached 1.3% (+0.1 percentage point as compared to the data for April) (Charts 3-4). Low fuel prices have a weakening downward impact on the price index due to the base effect, and the consumer price index was reduced by a mere 0.6 percentage points by the decline in fuel prices in May, while food and fuel prices increased at the highest rate on a monthly basis (Charts 5-6).

Inflation indicators:
- Sticky price inflation
- Core inflation excluding indirect taxes
- Demand sensitive inflation

Chart 1: USD/EUR exchange rate and the world crude oil price

Chart 2: Producer price index of industry and agriculture, export price index and import price index in Hungary (y/y)

Chart 3: Core inflation, monthly and yearly changes of consumer price index in Hungary

Chart 4: Underlying inflation indicators (y/y)

Chart 5: CPI by the main groups of goods and services

Chart 6: Changes of consumer prices by the main groups of products and services (May 2015, m/m)

Other goods, including motor fuels
- Food
- Clothing and footwear
- Alcoholic beverages, tobacco
- Services
- Consumer durable goods
- Fuel and power

TOTAL

Sources: HCSO, MFB
Banking sector

The situation and prospects of the financial intermediary system are better than one year before

- In Q1 2015, the pre-tax and after-tax profits of credit institutions reached HUF 75.1 billion and HUF 62.8 billion, respectively, representing substantially the same result as that of the period one year before. Banks attempted to compensate for their falling interest margins and non-interest earnings by cutting operating costs further (Chart 1). Between December 2014 and March 2015, the volume of assets (-1.4%) and gross lending to non-financial corporations (-5.7%) reduced after an increase last year, while gross total lending (-4.7%) and lending to households (-7.6%) continued to shrink, with the latter being largely the result of settlement and the conversion of foreign currency loans to Hungarian forints. With the phasing out of lending in foreign currency to households, the banking sector is becoming less dependent on direct foreign funding (Charts 2-3).

- Deleveraging continued in Q1 (the loan-to-deposit ratio dropped by 2.4 percentage points to 96.1% within three months), portfolio quality improved (the proportion of non-performing loans melted by 3.1 percentage points to 10.1%, representing a three-and-a-half-year low), while the stability of the banking system also strengthened (the capital adequacy ratio increased from 17.2% to 18.3%) (Charts 4-6).
Corporate funding

Despite falling interest rates on loans, the amount of corporate loans declined further in April

- The total amount of corporate loans in Hungary fell by HUF 34.9 billion to a new nine-year low of HUF 6354.1 billion in April 2015, with the decline mainly resulting from the contraction of the forint loan segment by 34.6 billion. Based on maturities, the total amount of 1–5-year loans increased (HUF +19.3 billion) following a significant contraction in March, while that of loans with both shorter and longer maturities decreased (HUF - 40.6 billion and HUF -13.5 billion). Based on transactions, the total amount of forint and foreign currency loans dropped by HUF 9.5 and 16.1 billion, respectively (Charts 1-3).
- In the SME segment, with the leadership of medium-sized companies, both the total and the average amount of investment loans increased in Q1, bringing a turn in the one-year long downward trend (Chart 4).
- In the segment of 1–5-year loans, the increase in interest rates experienced in March proved to be temporary, and the average interest rate melted from 4.50% to 4.28% within one month, while the interest rate on loans with longer maturities fell by 21 basis points (based on revised data) to a new record low of 3.96%, which is getting ever closer to the pricing of loans in the Czech Republic (Charts 5-6).

** annualised interest rates weighted by month-end values
* annualised interest rates over 5 year maturity, weighted by month-end values, in national currency
Exchange rates

The Hungarian currency’s weakening in May was primarily due to country specific factors

- In May, the European common currency depreciated at a rate of 2.2% against the US dollar as a result of the European Central Bank’s continued commitment to asset purchases and the still unresolved and increasingly worrying Greek debt situation (Chart 1).
- Although the global investment climate remained relatively favourable and supported emerging currencies, the Hungarian currency lost 2.0% in value compared to the euro and depreciated at a rate of 4.3 and 3.4% against the US dollar and the Swiss franc, respectively (month-end exchange rates: 308.9 HUF/EUR, 281.6 HUF/USD and 298.7 HUF/CHF (Charts 2-3).
- Among Central and Eastern European currencies, the Romanian leu depreciated by 0.5%, the Polish zloty moved closely together with the Hungarian forint and weakened by 2.6%, while the Czech koruna, considered a safe haven currency in the region, appreciated by 0.1% against the euro (Chart 4).
- The Hungarian forint was weakened by the diminishing yield on Hungarian government bonds and the strengthening expectations regarding further interest rate cuts by the central bank (Charts 5-6).
General government and its financing

This year’s budget figures are developing as planned

- On the basis of preliminary data, between January and May 2015 the central budget deficit amounted to HUF 588.5 billion, reaching 71.2% of this year’s target, while the amount of the deficit produced in the first five months of 2014 (HUF -817.3 billion) was close to the deficit foreseen for the entire year (reaching 97.6% of the target). The detailed figures of the first four months indicate that the balance being more favourable than last year’s resulted from, to a lesser extent, an increase in revenues (HUF +91.7 billion) and, for the most part, the reduction of expenditure (HUF -296.2 billion). The former was driven by an increase in the revenues from the taxes levied on consumption (HUF +81.1 billion), while the reduction of expenditure was mainly due to the fact that the state spent HUF 219.9 less on supporting general government subsystems between January and April 2014 (Charts 1-2, Table 1).

- In May, secondary market yields on discount treasury bonds fell by 11-23 basis points in line with the central bank’s interest rate cuts, while 5 and 10-year reference yields fell by 8 and 4 basis points to 2.80 and 3.40, respectively. Compared to the Visegrád Countries and Romania, the 10-year yield only fell in Hungary, also as a result of the Fitch’s decision on changing the Hungarian sovereign debt outlook from stable to positive in May, which raises the prospect of upgrading. The stock of Hungarian government bonds held by foreigners shrank by HUF 310.6 billion, while the average residual maturity of the portfolio increased by 0.1 year (Charts 3-4).

### Table 1: The revenues of the central government and the social security funds by main groups

<table>
<thead>
<tr>
<th>HUF billion</th>
<th>2014</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>total income (estimation)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>January - April</td>
<td>% of yearly revenues</td>
<td>yearly revenue target</td>
</tr>
<tr>
<td>CENTRAL GOVERNMENT</td>
<td>11 800.9</td>
<td>3 171.4</td>
</tr>
<tr>
<td>Taxes imposed on corporations</td>
<td>1 305.1</td>
<td>401.0</td>
</tr>
<tr>
<td>Corporate income tax</td>
<td>394.8</td>
<td>117.6</td>
</tr>
<tr>
<td>Taxes imposed on SMEs</td>
<td>151.7</td>
<td>41.2</td>
</tr>
<tr>
<td>Special taxes on banks and branches</td>
<td>205.9</td>
<td>61.3</td>
</tr>
<tr>
<td>Taxes imposed on consumption</td>
<td>4 335.9</td>
<td>1 221.0</td>
</tr>
<tr>
<td>Value added tax</td>
<td>3 035.6</td>
<td>812.2</td>
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<tr>
<td>Excise tax</td>
<td>918.0</td>
<td>255.3</td>
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<td>Financial transaction tax</td>
<td>277.9</td>
<td>99.0</td>
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<tr>
<td>Taxes imposed on households</td>
<td>1 753.8</td>
<td>588.6</td>
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<tr>
<td>Personal income tax</td>
<td>1 589.1</td>
<td>531.1</td>
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<tr>
<td>Pension Fund</td>
<td>3 124.5</td>
<td>1 022.8</td>
</tr>
<tr>
<td>Health Care Fund</td>
<td>1 907.1</td>
<td>648.3</td>
</tr>
</tbody>
</table>

Sources: Ministry for National Economy, HCSO, MFB