Euler Hermes Economic Research

Country Report

Hungary

Investment supports growth, but foreign exchange reserves continue to fall

General Information

GDP	USD121.7bn (World ranking 56, World Bank 2015)
Population	9.8mn (World ranking 88, World Bank 2015)
Form of state	Parliamentary Republic
Head of government	Viktor ORBAN (Prime Minister)
Next elections	2018, legislative

Strengths

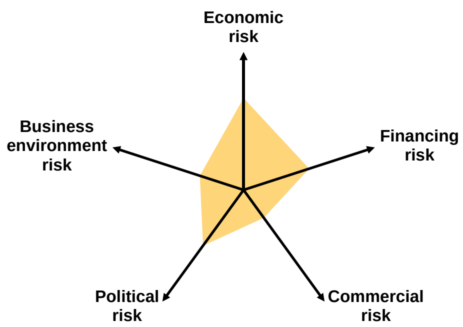
- Generally stable parliamentary democracy
- EU membership
- Strong specialization in automobile industry
- Current account surpluses since 2010

Weaknesses

- Deteriorated investment climate, as a consequence of unconventional economic policy measures since 2010
- At times, difficult relations with the IMF and the EU
- High public debt and large total external debt burden
- Exchange rate vulnerability
- Continued decline of FX reserves – import cover now below three months
- Vulnerable banking sector

Country Rating

B2



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

Exports		Rank		Imports
Germany	25%	1	26%	Germany
Romania	6%	2	8%	China
United States	5%	3	6%	Poland
Slovakia	5%	4	5%	Czech Republic
Italy	4%	5	5%	Slovakia

By product (% of total)

Exports		Rank		Imports
Cars And Cycles	12%	1	8%	Electrical Apparatus
Engines	11%	2	8%	Engines
Electrical Apparatus	9%	3	6%	Vehicles Components
Vehicles Components	5%	4	6%	Telecommunications Equipment
Pharmaceuticals	5%	5	6%	Miscellaneous Hardware

Source: Chelem (2015)

Economic Overview

Growth has regained momentum

Real GDP growth decelerated to +2% in 2016 from +3.1% in 2015, mainly a result of reduced EU fund absorption which caused a sharp drop in fixed investment by -15.5%. However, investment is expected to rebound sharply in 2017 as EU co-financed investment activity will rise again under the 2014-2020 programming period.

Indeed, in H1 2017 real GDP rose by +3.7% y/y, driven by a +24.8% y/y surge in investment. Private consumption increased by +3% y/y in H1 while public spending contracted by -3.9% y/y. Exports expanded by +6.5%, outpaced by imports at +7.6%, so that net exports deducted -0.3pp from H1 growth. Inventories subtracted -1.8pp from H1 growth. The dynamics of both investment and exports moderated from Q1 to Q2 and we expect this to continue in H2 while the growth pattern should broadly continue otherwise, resulting in full-year growth of +3.3% in 2017, followed by +3% in 2018.

Solid fundamentals, except for reserves

Deflation pressures have eventually waned since Q4 2016. Headline inflation rose to 2.8% y/y in February 2017, due to energy price increases and in part also to base effects, but has eased to around 2% thereafter. We expect if to level off at this rate until the end of the year. Monetary policy, which is officially based on inflation targeting (3% ± 1pp since 2007), should remain loose for now. A gradual tightening of the key policy interest rate from currently 0.9% is expected in 2018.

Following the considerable downtrend and high volatility in 2010-2014, the HUF/EUR exchange rate has steadied since early 2015, reflecting improved economic fundamentals. Going forward, we expect the exchange rate to remain somewhat volatile but fairly stable in trend.

Public finances have improved. The annual fiscal deficit has been less than -3% of GDP since 2012 (-1.8% in 2016) and should remain so in 2017-2018. Public debt has gradually improved from the peak of 81% of GDP in 2011 to 74% in 2016, however, a still high ratio that requires continued monitoring.

The current account has been in surplus since 2010. This has helped reduce total external debt from 154% of GDP in 2009 to 92% in 2016 which, however, is still among the highest in the region.

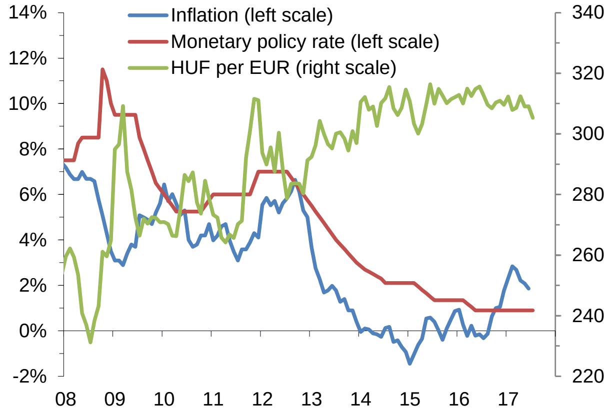
A cause of concern is the sharp drop in FX reserves from EUR38bn in early 2015 to EUR23bn in June 2017 and the corresponding fall in import cover from 5.0 to 2.7 months (now below the benchmark “comfort” level of 3 months). The main reasons for this have been redemptions of central bank swap contracts related to the phasing out of household FX loans and redemptions of FX-denominated government bonds. Close monitoring is warranted.

Figure 1: Key economic forecasts

	2015	2016	2017f	2018f
GDP growth (% change)	3.1	2.0	3.3	3.0
Inflation (%, annual avg.)	-0.1	0.4	2.1	2.2
Fiscal balance (% of GDP)	-1.6	-1.8	-2.5	-2.5
Public debt (% of GDP)	74.7	74.1	73.5	73.0
Current account (% of GDP)	3.4	5.4	3.5	2.5
External debt (% of GDP)	105.4	91.5	90.0	89.0

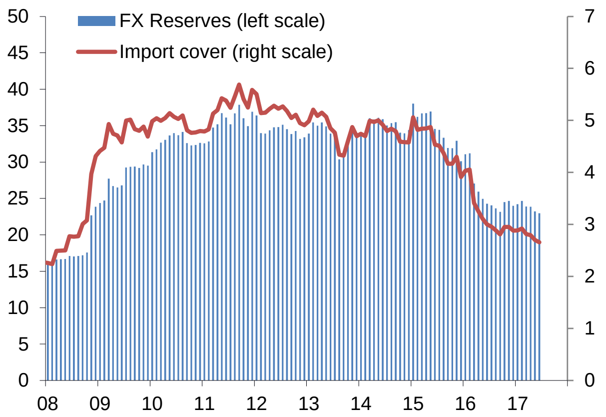
Sources: National sources, IHS, Euler Hermes

Figure 2: Monetary policy interest rate, inflation rate (y/y) and exchange rate



Sources: National sources, IHS, Euler Hermes

Figure 3: Foreign exchange reserves (EUR bn) and import cover (months)



Sources: Central Bank of Hungary, Euler Hermes

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