

## Losing momentum due to slowdown in EU fund absorption

### General Information



|                           |  |
|---------------------------|--|
| <b>GDP</b>                | USD137.1bn (World ranking 58, World Bank 2014) |
| <b>Population</b>         | 9.9mn (World ranking 88, World Bank 2014)      |
| <b>Form of state</b>      | Parliamentary Republic                         |
| <b>Head of government</b> | Viktor ORBAN (Prime Minister)                  |
| <b>Next elections</b>     | 2017, presidential                             |



### Strengths

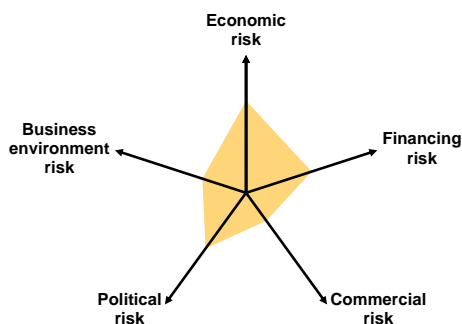
- Generally stable parliamentary democracy
- EU membership
- Strong specialisation in automobile industry
- Current account surpluses since 2010

### Weaknesses

- Deteriorating 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 volatility
- Vulnerable banking sector

### Country Rating

**B2**



Source: Euler Hermes

### Trade Structure

By destination/origin (% of total)

| Exports       | Rank  | Imports     |
|---------------|-------|-------------|
| Germany       | 26% 1 | 25% Germany |
| Romania       | 6% 2  | 7% China    |
| Slovakia      | 5% 3  | 7% Russia   |
| United States | 4% 4  | 6% Slovakia |
| Austria       | 4% 5  | 6% Poland   |

By product (% of total)

| Exports                      | Rank  | Imports                         |
|------------------------------|-------|---------------------------------|
| Engines                      | 10% 1 | 7% Electrical Apparatus         |
| Cars And Cycles              | 9% 2  | 7% Engines                      |
| Electrical Apparatus         | 9% 3  | 6% Telecommunications Equipment |
| Pharmaceuticals              | 5% 4  | 5% Miscellaneous Hardware       |
| Telecommunications Equipment | 5% 5  | 5% Vehicles Components          |

Source: Chelem (2014)



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### Slowdown continues in 2016

Real GDP growth decelerated to +2.9% in 2015 from +3.7% in 2014, mainly a result of reduced EU fund absorption. The latter caused fixed investment growth to drop to just +1.9% (+11.7% in 2014) while inventories subtracted some -0.3pps from overall 2015 GDP growth. Private consumption increased by a solid +2.6% (+1.5% in 2014) while government consumption was up by just +0.6% (+5.8% in 2014). Exports expanded by +8.4% in 2015 (+7.6% in 2014) outpacing imports at +7.8% (+8.5% in 2014) so that net exports added a considerable +1.2pps to 2015 growth (-0.1pps in 2014).

In Q1 2016, real GDP growth dropped to +0.9% y/y, due to a sharp drop in investment as well as exports losing momentum, while private and public consumption rose robustly. Euler Hermes forecasts full-year GDP growth to slow down further to about +2% in both 2016 and 2017, due to less dynamic investment and export activity.

### Mixed macroeconomic fundamentals

Monetary policy is officially based on inflation targeting (3% ± 1pp since 2007). Since August 2012 the key policy interest rate has been reduced in 32 steps from 7% to 0.9% in May 2016, initially in order to support economic growth and then to fight deflation pressures. The latter has returned in early 2016 and one or two more rate cuts are possible this year. EH expects inflation to gradually pick up in H2 2016, reaching 1% or so by year-end.

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, Euler Hermes expects the exchange rate to remain somewhat volatile but fairly stable in trend.

Public finances have improved but need continued monitoring. The fiscal deficit has fallen to -2% of GDP in 2015 and should remain around that rate in 2016-2017. Public debt has gradually improved from the peak of 81% of GDP in 2011 but will remain relatively high at about 75% in 2016-2017.

The current account has been in surplus since 2010. This has helped reduce total external debt from 154% of GDP in 2009 to 110% in 2015 which, however, is still among the highest in the region.

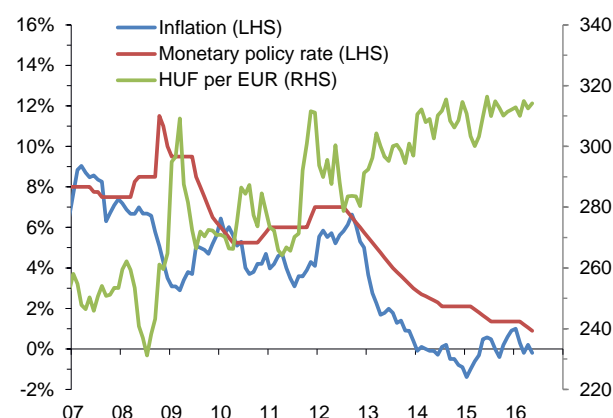
A cause of concern is the sharp drop in FX reserves from EUR38bn in early 2015 to EUR25bn in May 2016 and the corresponding fall in import cover from 5.0 to 3.1 months (now just above the 3-month threshold considered adequate). The main reasons for this have been redemptions of central bank swap contracts related to the phasing out of household FX loans and redemptions of FX-denominated government bonds. Close monitoring is warranted.

### Key economic forecasts

|                            | 2014  | 2015  | 2016f | 2017f |
|----------------------------|-------|-------|-------|-------|
| GDP growth (% change)      | 3.7   | 2.9   | 2.0   | 2.2   |
| Inflation (% end-year)     | -0.9  | 0.9   | 1.0   | 1.5   |
| Fiscal balance (% of GDP)  | -2.3  | -2.0  | -2.2  | -2.1  |
| Public debt (% of GDP)     | 76.2  | 75.3  | 74.9  | 74.5  |
| Current account (% of GDP) | 2.0   | 4.2   | 3.5   | 3.0   |
| External debt (% of GDP)   | 104.8 | 109.7 | 112.5 | 115.0 |

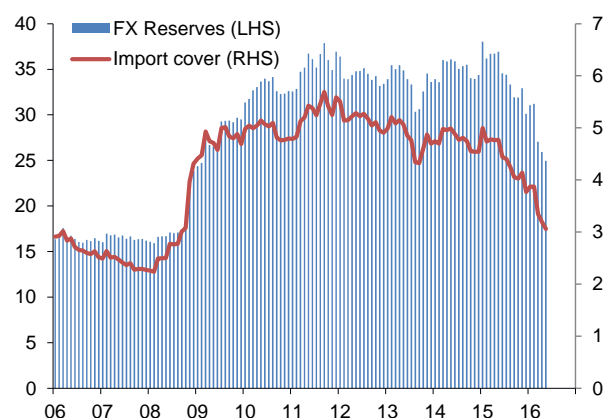
Sources: National sources, IHS, Euler Hermes

### Monetary policy interest rate, inflation rate (y/y) and exchange rate



Sources: National sources, IHS, Euler Hermes

### Foreign exchange reserves (EUR bn) and import cover (months)



Sources: Central Bank of Hungary, Euler Hermes

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