Monthly flash report for top executives

(September 2019)

The **Hungarian economy** grew by 4.9 per cent in the second quarter of 2019, faster than expected. This was the highest growth rate in the EU. However, the **slowdown**, if only to a very small extent, has begun (the growth rate was still 5.3 per cent in the first quarter). According to the data of the first half of 2019, the Hungarian economy is **driven by investments and consumer demand**. Domestic demand grew by 5.5 per cent, faster than GDP (by 5.1 per cent). The gap between imports and exports continued to widen in the second quarter, and the slightly increasing surplus of services could not offset the significantly deteriorating merchandise trade balance. **GKI**'s current forecast of the annual growth rate of about 4.3 per cent is in line with the recent expectations of the government and the National Bank of Hungary. A slightly higher rise is more likely than a smaller one. The deterioration of the external economic environment, the decelerating investment stimulating effects of EU transfers due to statistical base effects, and the worsening trends in domestic business expectations all play a role in the **anticipated slowdown starting in the second half of the year**. GDP growth rate is likely to be **2.7 per cent** in 2020.

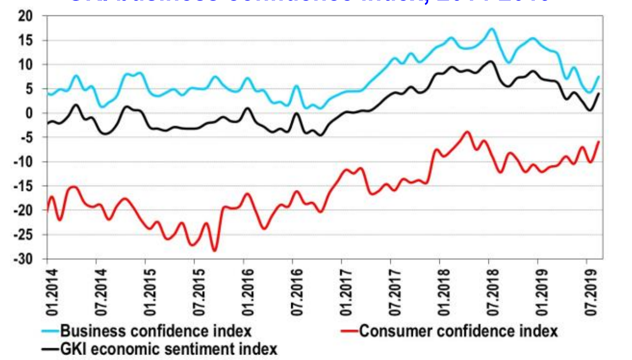
Summary figures, 2018-2020

	2018	Q1–Q2, 2019	2019	2020
GDP (previous year = 100)	104.9	105.1	104.3	102.7
Gross fixed capital formation (preceding year = 100)	116.5	119.1	113	102
Consumption (previous year = 100)	104.6	104.5	104.5	103.5
Current account balance (EUR billion)	0.6	0.3*	-1	-2
Current account and capital account/GDP (per cent)	2.3	3.4*	1.4	1.0

Source: HCSO, NBH. */ First quarter of 2019 2019-2020: GKI

Political **uncertainty** in the EU will persist in the near future. Although the distribution of posts in EU institutions is slowly coming to an end, the cooperation between factions and governments and the adoption of the next seven-year budget will be a source of great debates. The way, date and even the occurrence of **Brexit**, as well as the future of the United Kingdom, remain uncertain.

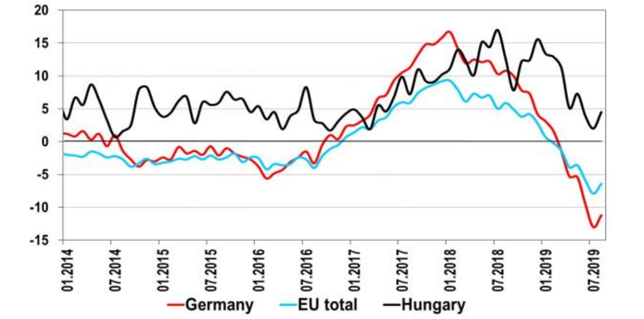
GKI business confidence index, 2014-2019



Source: surveys of GKI

For over a year and a half, the European economic outlook has continuously been worsening. The **EU's economic sentiment index** declined further in August within the statistical margin of error, reaching again its **three-year low**. On a monthly basis, the industrial and services confidence indices rose slightly, whereas the construction one remained unchanged and the trade one fell significantly. After July, consumer expectations continued to improve in August as well, returning to the level seen in the first half of 2019. Following its sharp fall in July, the **German business confidence index** adjusted somewhat positively in August. However, it still exhibits a pessimistic outlook.

Industrial confidence indices in Hungary and the EU, 2014-2019



Source: EU, surveys of GKI

The **GKI economic sentiment index** rose in August compared to its low of almost two and a half years in July. Improvement was registered not only in business expectations but also in the consumer confidence index, which had been fluctuating in recent months, and now reached its peak for more than a year. Households assessed their financial situation and especially savings capacity for the future much better than a month ago. The latter was more favourable last time in August 2002. Households considered the possibility of purchasing high-value durables more likely as well.

Trends in the real economy, 2018-2020

(Volume, the same period of the previous year = 100)

	2018	01–07, 2019	2019	2020
Industrial production	103.6	106.3	105	104
Construction	122.3	135.1*	121	102
Exports of goods	104.2	103.1*	103	102
Imports of goods	106.3	105.1*	105	103.5
Retail sales	106.0	105.8	105	104

Source: HCSO, 2019-2020: GKI. */ January–July 2019

Industrial production picked up strongly in July, growing by 12 per cent on an annual basis. The sector's performance in the first seven months of 2019 increased spectacularly by 6.3 per cent. After its two-month decline, the **manufacturing confidence index** rose in August. Due to the expected slowdown in the second half of the year, **GKI** expects a growth rate of around 5 per cent in 2019 and 4 per cent in 2020.

Construction output grew by 20 per cent in June (the smallest monthly increase this year), bringing the aggregate growth rate to 35 per cent in the first half of the year.

However, the volume of the sector's **stock of contracts** was 11 per cent lower at the end of May than a year earlier. This is not surprising; however, it is quite unfavourable for the 2020 outlook. The construction confidence index declined sharply in August, dropping to a 21-month low. However, it still reflects strong optimism. The growth rate of production is expected to jump by slightly more than 20 per cent this year; however, it may fall close to 2 per cent in 2020.

The second half of the year started off very well in **retail trade**, and its volume went up by 6.4 per cent on a year-on-year basis, adjusted for calendar effects. Thus, the growth rate was 5.8 per cent in the first seven months of 2019 (non-food retailing increased by 8.6 per cent and fuel sales by 7.5 per cent). At the same time, the trade confidence index dropped significantly to its three-year low in July and August. **GKI** expects retail sales to grow by at least 5 per cent in 2019 and by around 4 per cent next year. In **foreign trade of goods**, the volume of imports increased by nearly 2 percentage points faster than that of exports in the first six months. The **terms of trade** deteriorated by 0.4 per cent. Exports increased by 0.4 percentage points in the **external trade of services**, reaching an EUR0.2bn increase in trade surplus against a EUR1bn deterioration in the foreign trade balance.

Within **services**, the GDP growth rates of trade, commercial lodgings and catering, info-communication and professional, scientific, technical and administrative services were outstanding (6-7 per cent). The contribution of financial services, transport-telecommunications, real estate, and arts and leisure services to GDP increased by 3-4 per cent. The **confidence index** of services rose markedly in August.

Labour market trends, 2018-2020

	2018	Q1-Q2, 2019	2019	2020
Unemployment rate (average)	3.7	3.4*	3.5	3.4
Gross earnings**	111.3	110.6	110	108
Real earning **	108.3	106.9	106.5	104.5

Source: HCSO, 2018-2020: GKI */ May–July 2019,
**/ The same period of the previous year = 100

The **number of employees** was up by 0.8 per cent on an annual basis in the first half of 2019. Outstanding growth rates of employment were recorded in construction (9.2 per cent), tourism (6.4 per cent) and professional, scientific and administrative services (6.8 per cent). The **unemployment rate** declined to 3.4 per cent between May and July 2019, representing a 0.2 percentage point contraction on an annual basis. **Employment intentions** remained essentially unchanged in August; they strengthened mostly in services and weakened in construction. The fear of unemployment of households was fluctuating at a low level, it eased in August, reaching an unprecedented low point. The number of employees may increase by slightly more than 0.5 per cent this year, and by less than 0.5 per cent next year. **Real wages** rose by nearly 7 per cent in the first half of 2019, and household consumption by 4.5 per cent. In the second half of the year, the growth rate of wages may typically slow down slightly. Conditions for the payment of the pension premium will also be met this year. In the autumn, about 0.8 per cent retroactive increase in pensions can also be expected due to faster inflation than projected by the government. The purchasing power of pensioners and those involved in public work schemes is pushed up by overhead vouchers and extra wages. **GKI** expects real wages to grow by 6.5 per cent in 2019 and by 4.5 per cent in 2020, and **consumption** to **grow** by 4.5 per cent and 3.5 per cent, respectively.

In the second quarter, the **volume of gross fixed capital formation** mounted by 16.4 per cent and that of **gross domestic investments** by 18.8 per cent. Thus, in the first half of the year, these two categories increased by 19.1 per cent and 19.3 per cent respectively. The growth rates of commercial lodgings and catering (62 per cent), financial services (47 per cent) and arts, entertainment and leisure services (40 per cent) were the most outstanding sectors in the first half of 2019. However, the growth rates of investments in manufacturing industry (by almost 30 per cent) and in construction (by 26 per cent) were also noteworthy. **GKI** expects investment growth of 13 per cent this year and 2 per cent next year.

Interest rates, 2018-2020
(per cent, at the end of the period)

	2018	07, 2019	2019	2020
NBH reference rate	0.90	0.90	0.90	0.90
Fed reference rate	2.50	2.25	2.25	2.0
ECB reference rate	0.0	0.0	0.0	0.0
Benchmark yield of one-year government bonds	0.39	0.03	0.3	0.3

Source: NBH, 2019-2020: GKI

In August neither the **Fed** nor the **ECB** changed its benchmark interest rate. Another interest rate cut by the Fed in the US is possible this year; however, neither economic performance nor inflation data would justify it. At its September meeting, the Governing Council of the ECB may decide to adopt a monetary stimulus package, following a slowdown in economic growth and low inflation. International developments allow the **National Bank of Hungary** to maintain its ultra-loose monetary policy and therefore no change in the base rate can be expected until the end of 2020.

Financial indicators, 2018-2020

	2018	01-08, 2019	2019	2020
Consumer price index	102.8	103.4*	103.5	103.3
EUR/HUF exchange rate	318.9	322	324	333
Foreign trade balance (EUR billion)	5.5	3.4*	3.7	2.2
General government balance (cash flow, without local governments, HUF billion)	-1445	-352.7*	-1000	-500

Source: HCSO, NBH, MoF, 2019-2020: GKI. */January–July 2019

The **budgetary situation** is favourable in 2019 and the targeted deficit of 1.8 per cent of GDP can therefore be met. **GKI** expects a deficit of around 1.3 per cent of GDP next year, which is lower than this year but higher than the planned 1 per cent figure. The **government debt relative to GDP** may fall to close to 69 per cent by the end of 2019 and to 67 per cent in 2020.