

FLASH REPORT

6 June 2018

Domestic demand grew faster than a quarter ago but further acceleration seems unlikely

- Hungary's GDP grew by 4.4% YoY in Q1 2018 (in non-adjusted terms); a comparable pace was measured a quarter ago. (The seasonally and calendar adjusted figure is 4.7%, due to fewer working days than in 2017). Non-farm GDP grew by 4.5% in Q1 (previous: 5.0%), while non-farm private sector's GDP grew by 5.6% in Q1 (previous: 6.7%). The annualized QoQ figure is 6.4% for Q1, down from 8.2%, 7.9% and 7.4% over 2017Q2-Q4, respectively (all figures are SWDA). So recently we experience some deceleration in GDP growth.
- The expenditure side shows strong domestic demand. The annualized growth of households' consumption expenditure accelerated to 5.6% from 5.4% a quarter earlier, our seasonally adjusted figures indicate. In 2018 so far all consumer indicators (such as consumer confidence, retail turnover, car sales, tourism nights or loan businesses) paint favourable picture. However, we foresee gross wage dynamic to slow down next year as the cuts in employers' social security contribution may discontinue. As the CPI is very likely to accelerate (due to fuel prices and strong domestic demand), real wage dynamic is expected to slow down considerably from the current about 10% YoY rate. This will drive down the consumption growth rate, even though households are expected to smooth out the deterioration by taking out loans. Anyway, the expansion of household consumption will remain faster than the overall GDP growth.
- Gross fixed capital formation growth accelerated to 17.1% YoY and posted 25.9% annualized quarterly gain. This is not far from the 30.4% pace in Q1 2017, which was boosted by the sharp re-start of EU-fund absorption. The data exceeds our medium-term forecast by a large margin. Both public and private investment activity performed well while building as well as machinery investment volumes climbed higher. However, looking at the sectorial breakdown, we see that construction, real estate related and government driven sectors show fast expansion. The first two has limited room to go due to the lack of free capacities while the second may slow down after the parliamentary election, held at the beginning of April. We think there is upside risk to our 7.4% YoY forecast for 2018, but it may mean downward risk for 2019 due to the higher base.
- Regarding net exports, both exports and imports annual dynamics dropped sharply compared to 2017Q4 (to 3.5% and 3.8%, respectively, YoY), mainly due to base effects. In QoQ terms, imports showed much faster growth than exports in Q1. It is in line with our big picture that, given the capacity constraints, the strong domestic demand will more and more result in the deterioration of Hungary's external position. Net exports' contribution to GDP growth was zero in 2018Q1 and its average has been only 0.1pp since the current recovery started in 2013. Taking into account the surprising deterioration of the eurozone business confidence and of the GDP growth rate in 2018Q1, along with the threat of global trade war, net exports' growth contribution may decline further.
- The 2018Q1 GDP outturn was lower than our forecast (4.7%). Agriculture, industry and construction have somewhat lagged behind our prediction, but market as well as public services' growth contribution overshot our expectations. Regarding market services, the YoY growth rate accelerated to 6.9% from 5.9% a quarter ago and hence approaches its all-time high of 7.1% YoY, hit in Q1 2002. The current pace is the joint second highest ever. On the other hand, some deceleration has occurred over the past two quarters in QoQ terms. We assess re-acceleration as unlikely.
- Agricultural value added declined by 0.6% in year-over-year comparison. This surprised us as our forecast was 4.5% YoY growth. The KSH statistical office regularly revises its agriculture figures in its Q2 publications – if there will not be an upward revision this time, then our assumption of growing agricultural value added this year is likely to prove to be wrong.
- In all, our big picture has not changed: the economy is in the mature phase of the business cycle, when domestic demand is particularly strong and growth is widespread among the

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economic sectors. 2018Q1 brought further acceleration in household consumption expenditure and also in market services; investment activity was also very robust. However, in quarter/quarter comparison we see some deceleration and there are signs of further slowing to come. The labour shortage and capacity constraints increasingly lead to the deterioration of Hungary's external position. This process began already last year when the C/A and trade balance declined by 2.4% and 1.5% of GDP, respectively. Besides, the lack of free capacities drives consumer prices upward, sooner or later (prices of e.g. intermediate goods, hotel rooms, and real estate rents show accelerating pace, although they barely appear in the consumer price index). Our factor-model-based prediction suggests that economic growth rate may have reached its peak in recent quarters.

- Taking into account the expected deceleration owing to the domestic factors, the drivers of the good investment performance in Q1, agriculture's surprisingly low growth contribution, as well as the threats surrounding Hungary's external environment, we assess the risks to our 4.0% GDP growth forecast for 2018 to be balanced. In 2019 GDP expansion is likely to slow down.

Main macro forecasts

Key economic indicators					OTP		Focus Economics 2018.05.		EC Winter 2018	
	2014	2015	2016	2017	2018F	2019F	2018F	2019F	2018F	2019F
Nominal GDP (at current prices, bn HUF)	32 400	33 999	35 005	37 520	39 988	42 579	40 555	42 974		
Real GDP change	4,2%	3,4%	2,2%	4,0%	4,0%	3,2%	3,7%	3,1%	3,7%	3,1%
Household final consumption	2,1%	3,1%	4,2%	4,1%	4,0%	3,9%	4,3%	3,6%		
Household consumption expenditure	2,5%	3,4%	4,9%	4,7%	4,6%	4,6%				
Collective consumption	9,2%	0,6%	0,1%	-0,4%	1,1%	1,1%	1,9%	1,4%		
Gross fixed capital formation	9,9%	1,9%	-15,5%	16,8%	7,4%	0,3%	10,0%	4,9%		
Exports	9,8%	7,7%	5,8%	7,1%	6,4%	6,0%				
Imports	10,9%	6,1%	5,7%	9,7%	6,3%	6,3%				
General government balance (ESA'10 based, HUF bn)	-847	-654	-600	-756	-991	-1012				
in percent of GDP	-2,6%	-1,9%	-1,7%	-2,0%	-2,4%	-2,3%	-2,4%	-2,3%		
General government debt (in percent of GDP)	75,6%	75,5%	74,8%	73,2%	71,5%	69,9%	71,0%	69,6%		
Current account (EUR bn)*	1,6	3,9	6,8	3,6	2,1	1,3	2,9	2,7		
in percent of GDP	1,5%	3,5%	6,1%	2,9%	1,6%	1,0%	2,2%	2,0%		
Gross nominal wages**	3,6%	4,3%	6,5%	11,9%	8,1%	6,8%				
Gross real wages	3,8%	4,4%	6,1%	9,3%	5,7%	4,1%				
Gross disposable income***	4,2%	4,4%	2,7%	7,3%	5,9%	4,9%				
Gross real disposable income	4,4%	4,4%	2,3%	4,8%	3,5%	2,2%				
Employment (annual change)	5,3%	2,7%	3,4%	1,7%	0,6%	0,3%				
Employment domestic concept w/o public workers	3,3%	1,5%	3,3%	3,0%	1,3%	0,9%				
Unemployment rate (annual average)	7,7%	6,8%	5,1%	4,2%	3,9%	3,9%	3,8%	3,7%		
Inflation (annual average)	-0,2%	-0,1%	0,4%	2,4%	2,3%	2,6%	2,5%	2,9%	2,8%	2,9%
Base rate (end of year)	2,10%	1,35%	0,90%	0,90%	0,90%	1,05%	0,90%	1,14%		
1Y Treasury Bill (average)	2,28%	1,17%	0,77%	0,09%	0,01%	0,58%				
Real interest rate (average, ex post)	2,5%	1,2%	0,4%	-2,3%	-2,2%	-2,0%				
EUR/HUF exchange rate (average)	308,6	309,9	311,5	309,3	313,7	316,3	311,0	309,0		
EUR/HUF exchange rate (end of year)	314,9	313,1	311,0	310,1	315,0	317,5	310,0	308,0		

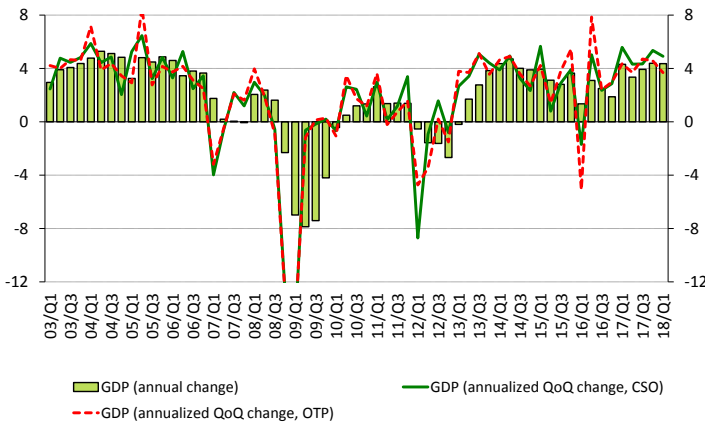
Sources: CSO, MNB, OTP Bank

*: Official data of balance of payments (excluding net errors and omissions)

** : Total wages including accrual based salaries in governmental sector. In the case of private sector wages we calculated with whitening effect filtered wages and we adjusted the changeable

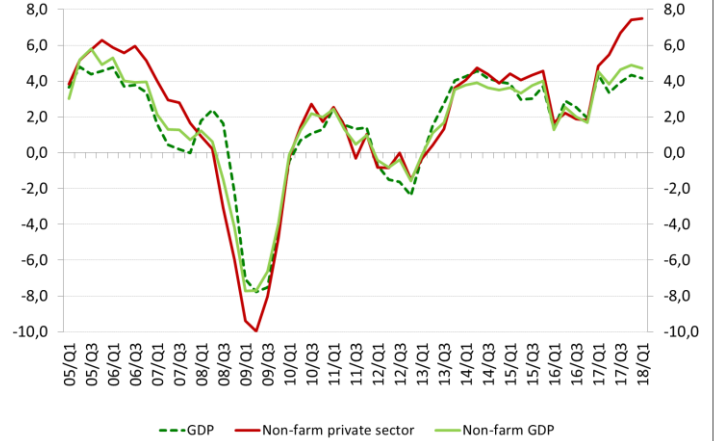
***: Calculation based on financial accounts data

Chart 1: Summary chart of GDP growth
(annual and annualized QoQ growth rate, %)



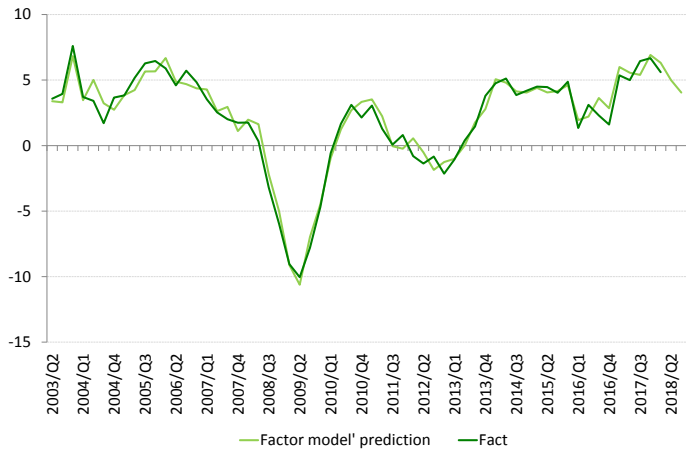
Sources: KSH, OTP Research

Chart 2: Different indicators of economic activity
(annual changes, %)



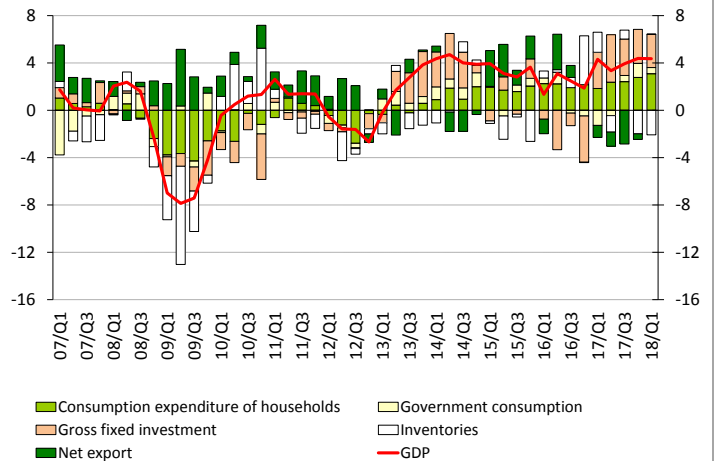
Sources: KSH, OTP Research

Chart 3: Non-farm private sector's GDP and our short-term prediction
(quarterly data, YoY, %)



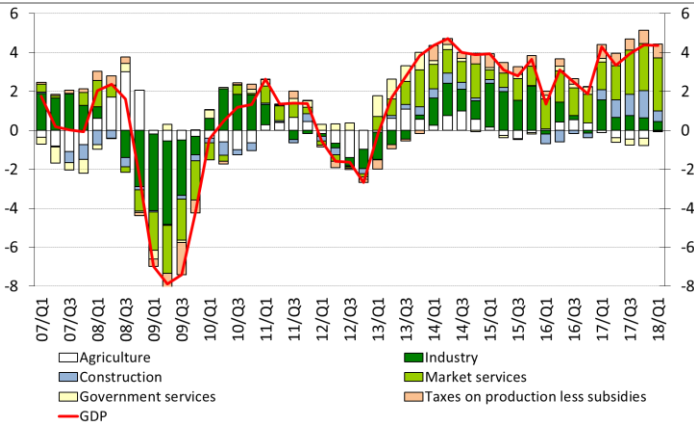
Sources: KSH, OTP Research

Chart 4: Decomposition of GDP growth by expenditure-side items
(quarterly data, %)



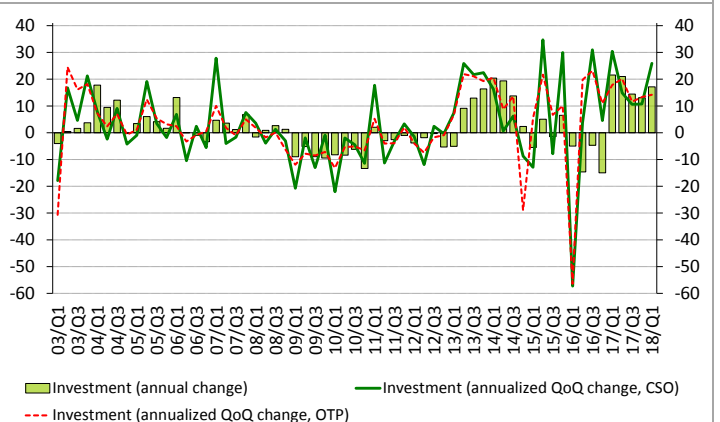
Sources: KSH, OTP Research

Chart 5: Decomposition of GDP growth by production-side items
(quarterly data, %)



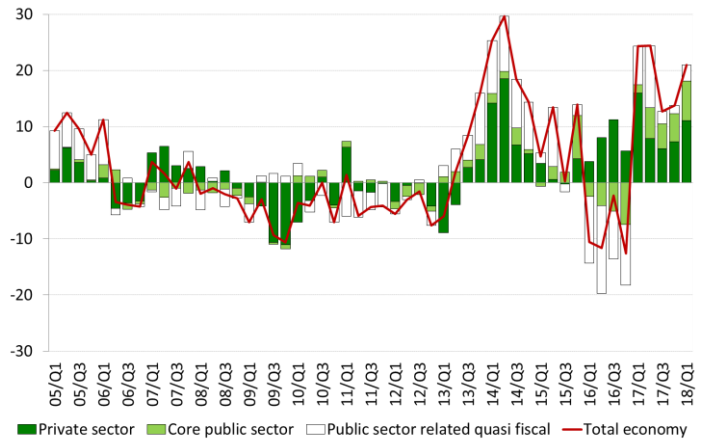
Sources: KSH, OTP Research

Chart 6: Summary chart of investment growth
(annual and annualized QoQ growth rate, %)



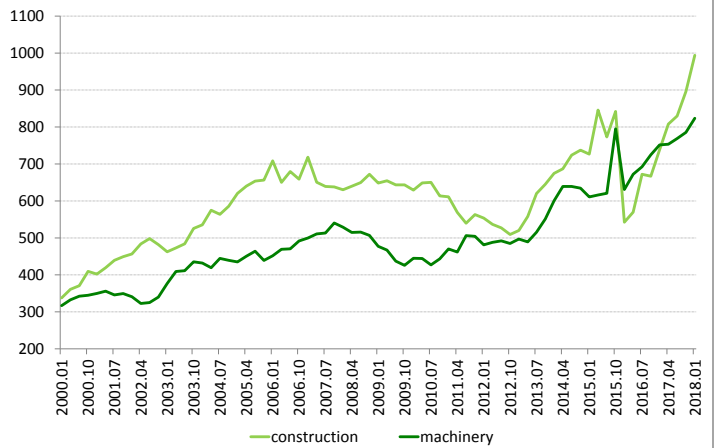
Sources: KSH, OTP Research

Chart 7: Investment activity by sectors
(decomposition of annual change, %)



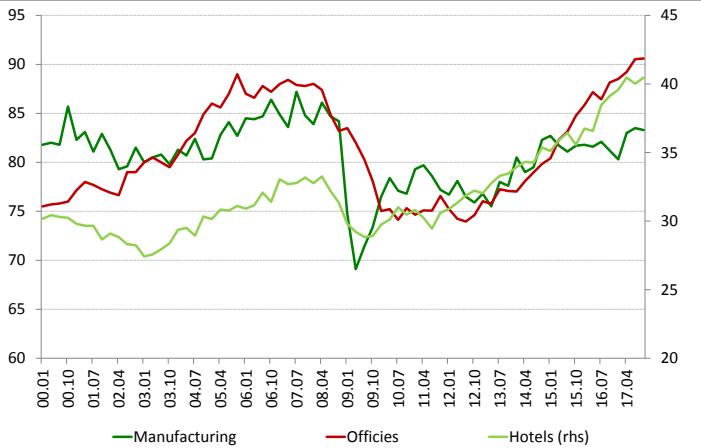
Sources: KSH, OTP Research

Chart 8: Investment by type
(at year 2000 constant prices)



Sources: KSH, OTP Research

Chart 9: Capacity utilization in some sectors
(%)



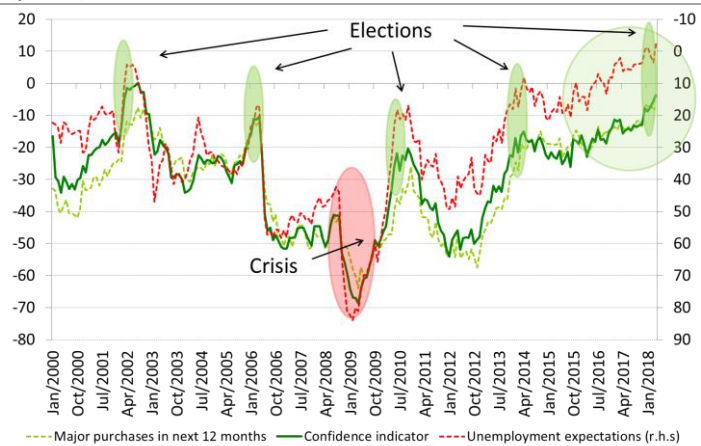
Sources: KSH, OTP Research

Chart 10: Unemployment rate
(LFS, monthly, %)



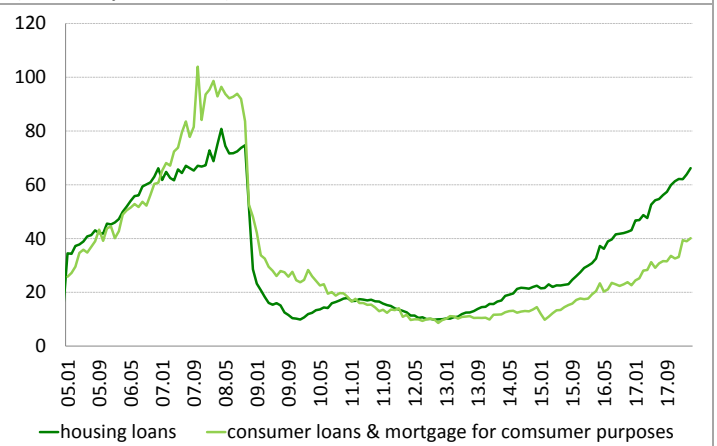
Sources: KSH, OTP Research

Chart 11: Consumer confidence indicator
(point)



Sources: KSH, OTP Research

Chart 12: New business of household loans
(monthly, HUF bn)



Sources: NBH, KSH, OTP Research

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