

# FLASH REPORT

6 December 2018

## Approaching the cyclical peak; GDP growth may reach 4.7% in 2018 and 4% in 2019

- Hungary's GDP grew by 4.9% YoY in Q3 2018 (in non-adjusted terms). This figure is 0.1 ppt higher than the preliminary estimate and marks the strongest YoY growth figure since Q4 2005. To recall: the preliminary data brought a significant positive surprise for us and the market, as both had expected 4.2% GDP growth for Q3. According to the KSH statistical office, the seasonally adjusted QoQ figure was 1.3%, which is higher than the previous quarter's 1.1% figure. Nevertheless, our in-house adjustment shows some deceleration on QoQ basis, from 1.3% in Q2 to 1.2% in Q3.
- Non-farm GDP grew by 4.9% YoY (Q2: 5.1%), and its QoQ growth rate decelerated from 1.35% to 1.25%. Non-farm private sector's GDP grew by 5.9% (Q2: 6.3%).
- Technical note: the new publication contains many data revisions. Both the 2017 and 2018 H1 GDP growth rates were revised up by 0.1 percentage point. In 2017, GDP grew by 4.1% instead of 4.0%, and the economic growth was 4.7% in 2018H1 instead of 4.6%. These revisions strongly affected the structure of GDP. Market services GDP was revised up significantly, while constructions' GDP was revised down considerably. This shift led to a noticeable change in industries' weight in total GDP. However, our forecasts for sub-items (industry, construction, market services) were very close to the published data, the forecast for the total non-farm private sector (aggregation of abovementioned items) undershot the released figure by 0.6 ppts only. And two-thirds of the difference came from weight shifts.
- Due to the data revisions and the higher-than-expected growth in Q3, we raise our GDP growth forecast for 2018, from 4.4% to 4.7%. For now, we left our 2019 GDP growth forecast unchanged.
- Nevertheless, the incoming data did not change our general big picture: the Hungarian economy is definitely in the mature phase of the business cycle, when domestic demand is the main driver of growth. The domestic capacity bottlenecks and the strong demand resulted in declining growth contribution of net exports. We still think that GDP growth may have reached its peak in the middle of 2018; we expect gradual deceleration, and economic growth may be around 4% in next year. Currently the Hungarian economy remained resilient to the slowdown in Europe (particularly to the QoQ decline in Germany) on account of the strong domestic demand. In our view, this phenomenon can be long-lasting, but there is a risk – if monetary and fiscal policies remain very supportive, the strong domestic demand will consume the current favourable external balance position.
- On the expenditure side, it was fixed capital formation that caused surprise again. It increased by 20% in Q3, and by 17.4% in 3Q. This implies that fixed capital formation can grow by 16%+ in 2018 as a whole, while our current forecast had assumed 14%. So this difference explains our GDP growth revision from the expenditure side. In the case of the consumption expenditure of the households, exports, and imports, there is only few tenths of ppts difference between the 3Q figure and our whole-year forecast. Exports' and imports' difference counterbalance each other while the slightly higher consumption expenditure is offset by the somewhat lower-than-expected growth in public consumption.
- Investment activity was the biggest 'individual' contributor to GDP growth, as its growth contribution was 4.9 ppts in Q3 and 3.7 ppts in 3Q. It was boosted not only by the EU fund-related government projects but also by the private sector. Capacity constraints and labour shortage are forcing businesses to make investments. Non-financial corporations' loan demand is also very strong, in line with the investment activity; the 12M rolling loan flow reached 2.5% of GDP and it is definitely on the rise.
- The large contribution of investment to GDP growth makes the risk assessment for 2019 more difficult, as this item could be highly volatile. Nonetheless, fiscal policy has enough

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### Fixed Income Desk

**András Sovány**

+36 1 288 7561

SoványA@otpbank.hu

**Benedek Károly Szűts**

+36 1 288 7560

SzutsB@otpbank.hu

### FX Desk

**András Marton**

+36 1 288 7523

MartonA@otpbank.hu

**József Horváth**

+36 1 288 7514

Horvath.Jozsef@otpbank.hu

### Money Market Desk

**Gábor Fazekas**

+36 1 288 7536

FazekasGa@otpbank.hu

**Gábor Heidrich**

+36 1 288 7534

HeidrichG@otpbank.hu

**Judit Szombath**

+36 1 288 7533

SzombathJ@otpbank.hu

### FX Option Desk

**Gábor Réthy**

+36 1 288 7524

RethyG@otpbank.hu

**Máté Kelemen**

+36 1 288 7525

KelemenMat@otpbank.hu

### Analyst

**Győző Eppich**

+36 1 374 7274

eppichgyo@otpbank.hu

room for manoeuvre as a baseline, we are confident that the planned public investment projects will realize; we even see upside risks. On the other hand, the current deterioration of the business cycle in the EU poses downside risks to exports' growth and to the fixed capital formation in the manufacturing sector (roughly the 30% of the total capital formation is realized in manufacturing). Households' consumption growth may remain strong despite the expectedly decelerating real income growth, because the current net financing capacity of the household sector is very high, so households have enough buffers to smooth their consumption.

### Main macro forecasts

Key economic indicators						OTP			Focus Economics 2018.11.	
	2013	2014	2015	2016	2017	2018F	2019F	2020F	2018F	2019F
Nominal GDP (at current prices, bn HUF)	30 213	32 550	34 278	35 378	38 132	<b>41 571</b>	<b>44 781</b>	<b>47 426</b>	<b>41 068</b>	<b>43 689</b>
Real GDP change	2.2%	4.5%	3.8%	2.6%	4.1%	<b>4.7%</b>	<b>4.0%</b>	<b>2.4%</b>	<b>4.2%</b>	<b>3.2%</b>
Household final consumption	0.5%	2.4%	3.4%	3.8%	4.1%	<b>4.8%</b>	<b>3.9%</b>	<b>2.8%</b>	<b>5.0%</b>	<b>3.7%</b>
Household consumption expenditure	0.2%	2.8%	3.6%	4.2%	4.7%	<b>5.5%</b>	<b>4.5%</b>	<b>3.3%</b>		
Collective consumption	6.5%	9.8%	0.2%	0.6%	-0.4%	<b>0.6%</b>	<b>1.7%</b>	<b>1.2%</b>	<b>1.5%</b>	<b>1.1%</b>
Gross fixed capital formation	9.8%	12.3%	1.9%	-10.6%	16.8%	<b>16.6%</b>	<b>9.8%</b>	<b>1.2%</b>	<b>12.5%</b>	<b>5.9%</b>
Exports	4.2%	9.1%	8.5%	3.4%	7.1%	<b>5.1%</b>	<b>7.0%</b>	<b>5.9%</b>		
Imports	4.5%	11.0%	6.4%	2.9%	9.7%	<b>6.5%</b>	<b>8.1%</b>	<b>4.4%</b>		
General government balance (ESA'10 based, HUF bn)	-791	-847	-654	-589	-746	<b>-1007</b>	<b>-787</b>	<b>-614</b>		
in percent of GDP	-2.6%	-2.6%	-1.9%	-1.7%	-2.0%	<b>-2.4%</b>	<b>-1.8%</b>	<b>-1.3%</b>	<b>-2.4%</b>	<b>-2.2%</b>
General government debt (in percent of GDP)	76.0%	75.2%	74.8%	73.9%	73.6%	<b>73.2%</b>	<b>70.6%</b>	<b>66.4%</b>	<b>72.0%</b>	<b>70.6%</b>
Current account (EUR bn)*	3.9	1.6	3.1	7.1	4.0	<b>2.0</b>	<b>1.0</b>	<b>2.5</b>	<b>2.6</b>	<b>2.2</b>
in percent of GDP	3.8%	1.5%	2.8%	6.3%	3.2%	<b>1.5%</b>	<b>0.7%</b>	<b>1.7%</b>	<b>2.0%</b>	<b>1.6%</b>
Gross nominal wages**	3.8%	3.6%	4.3%	6.5%	12.7%	<b>12.0%</b>	<b>7.6%</b>	<b>6.1%</b>		
Gross real wages	2.0%	3.8%	4.4%	6.1%	9.9%	<b>8.8%</b>	<b>4.8%</b>	<b>2.9%</b>		
Gross disposable income***	2.7%	4.6%	4.9%	2.5%	7.2%	<b>9.3%</b>	<b>6.7%</b>	<b>5.7%</b>		
Gross real disposable income	0.9%	4.8%	5.0%	2.1%	4.6%	<b>6.2%</b>	<b>3.9%</b>	<b>2.6%</b>		
Employment (annual change)	1.7%	5.3%	2.7%	3.4%	1.6%	<b>1.2%</b>	<b>0.2%</b>	<b>0.0%</b>		
Employment domestic concept w/o public workers	0.5%	3.3%	1.7%	3.1%	3.1%	<b>2.1%</b>	<b>0.7%</b>	<b>0.1%</b>		
Unemployment rate (annual average)	10.2%	7.7%	6.8%	5.1%	4.2%	<b>3.5%</b>	<b>3.0%</b>	<b>3.0%</b>	<b>3.7%</b>	<b>3.6%</b>
Inflation (annual average)	1.7%	-0.2%	-0.1%	0.4%	2.5%	<b>2.9%</b>	<b>2.7%</b>	<b>3.1%</b>	<b>2.9%</b>	<b>3.2%</b>
Base rate (end of year)	3.00%	2.10%	1.35%	0.41%	0.03%	<b>0.22%</b>	<b>1.07%</b>	<b>1.70%</b>	<b>0.90%</b>	<b>1.20%</b>
1Y Treasury Bill (average)	4.11%	2.28%	1.17%	0.77%	0.09%	<b>0.31%</b>	<b>0.69%</b>	<b>1.53%</b>		
Real interest rate (average, ex post)	2.3%	2.5%	1.2%	0.4%	-2.4%	<b>-2.5%</b>	<b>-2.0%</b>	<b>-1.5%</b>		
EUR/HUF exchange rate (average)	297.0	308.6	309.9	311.5	309.3	<b>319.3</b>	<b>325.0</b>	<b>325.8</b>	<b>319.0</b>	<b>322.0</b>
EUR/HUF exchange rate (end of year)	296.9	314.9	313.1	311.0	310.1	<b>325.0</b>	<b>325.0</b>	<b>326.6</b>	<b>322.0</b>	<b>321.0</b>

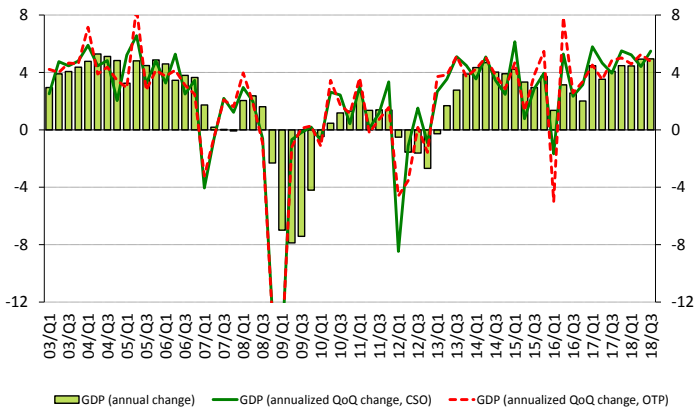
Sources: CSO, MNB, OTP Bank

\*: 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 seasonality of the bonus payments.

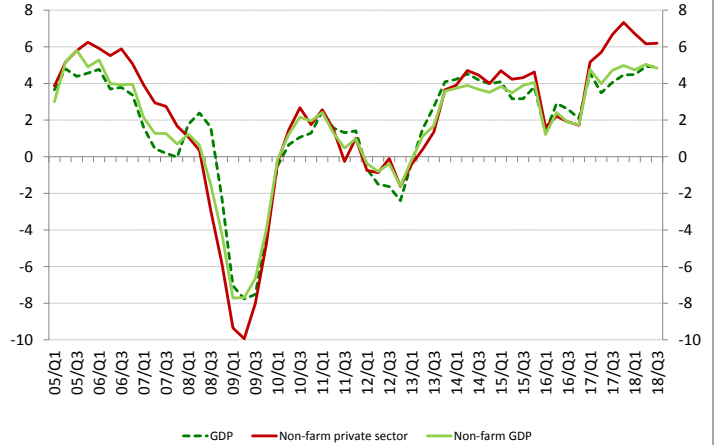
\*\*\*: Calculation based on financial accounts data

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



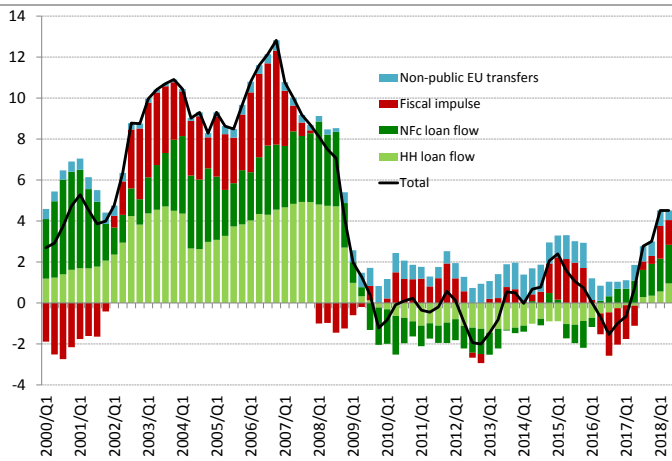
Sources: KSH, OTP Research

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



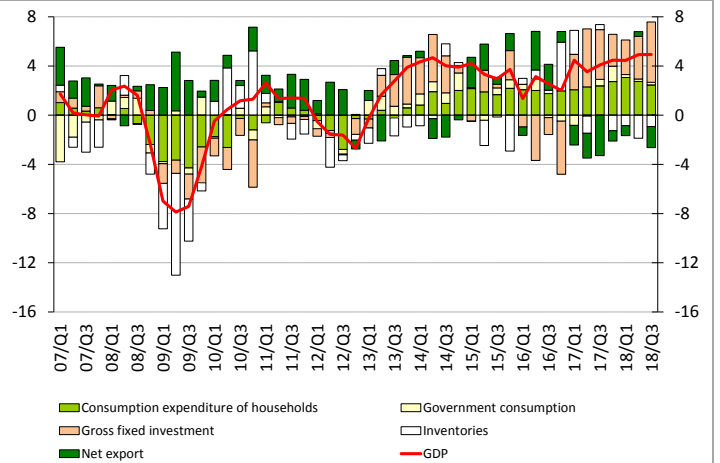
Sources: KSH, OTP Research

**Chart 3: 'Finance resources' of the economy (% of GDP)**



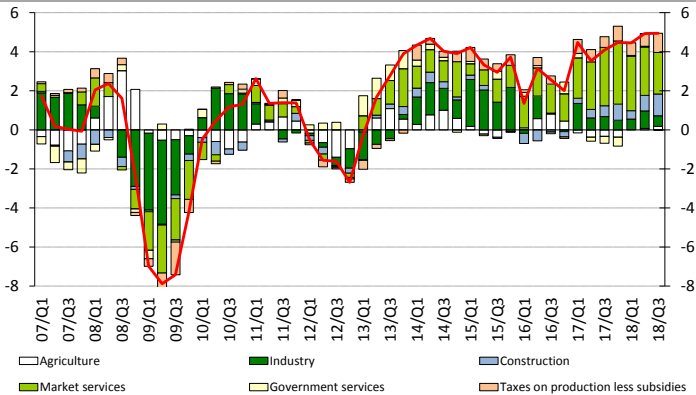
Sources: MNB, OTP Research

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



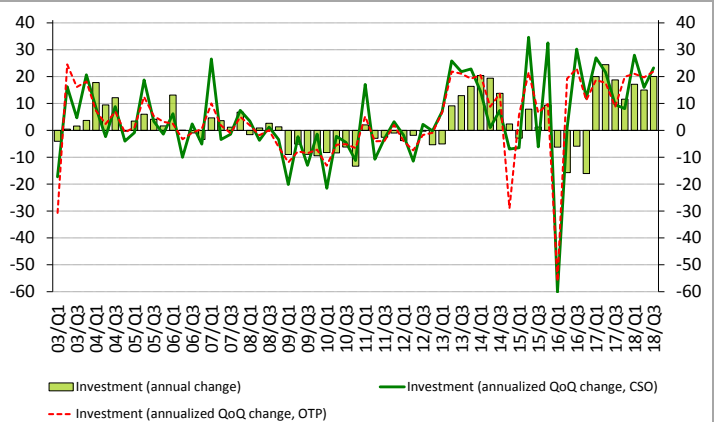
Sources: KSH, OTP Research

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



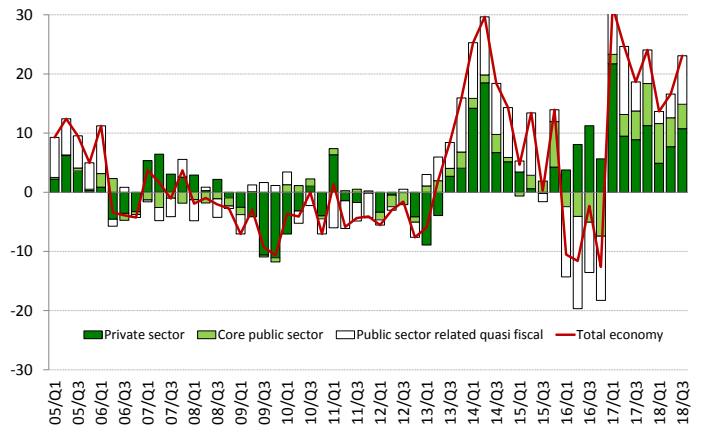
Sources: KSH, OTP Research

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



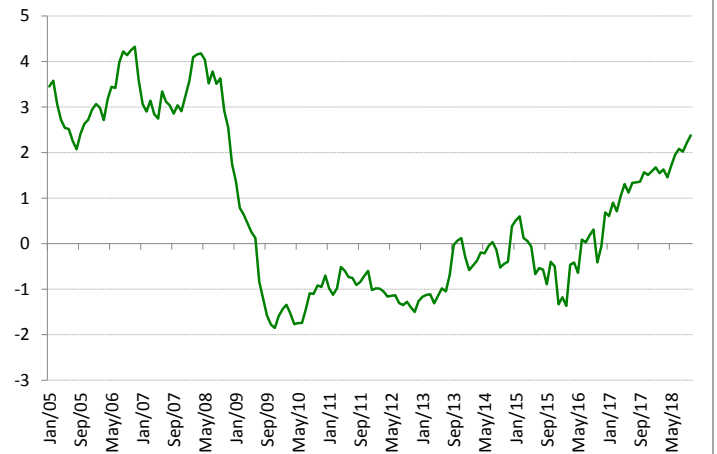
Sources: KSH, OTP Research

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



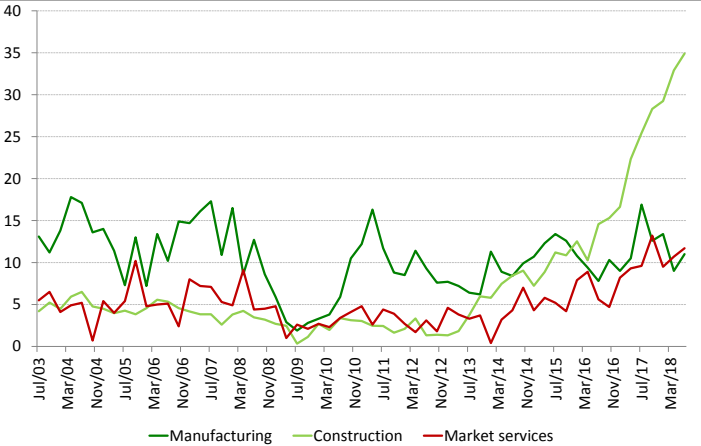
Sources: KSH, OTP Research

**Chart 8: Loan flow to NFC sector**  
(12M rolling, % of GDP)



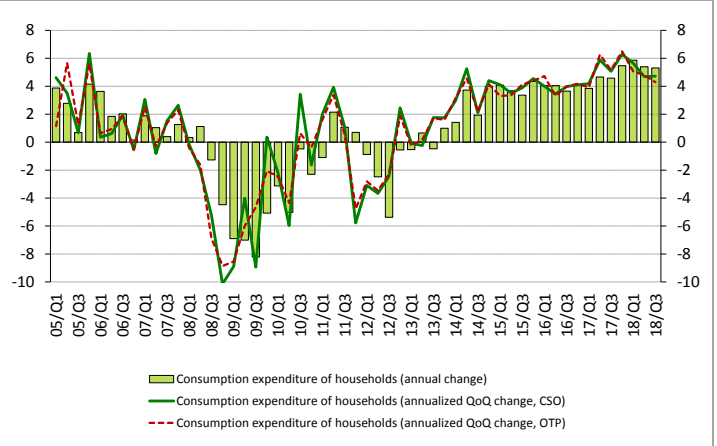
Sources: MNB, OTP Research

**Chart 9: Equipment shortage as the main production limiting factor (%)**



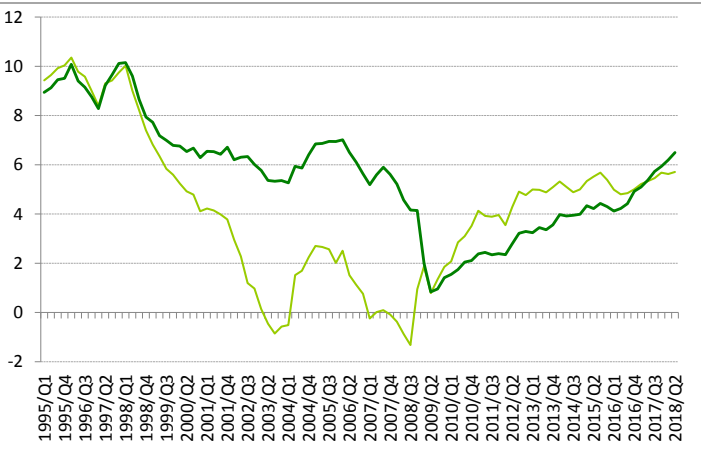
Sources: Eurostat, OTP Research

**Chart 10: Summary chart of consumption growth**  
(annual and annualized QoQ growth rate, %)



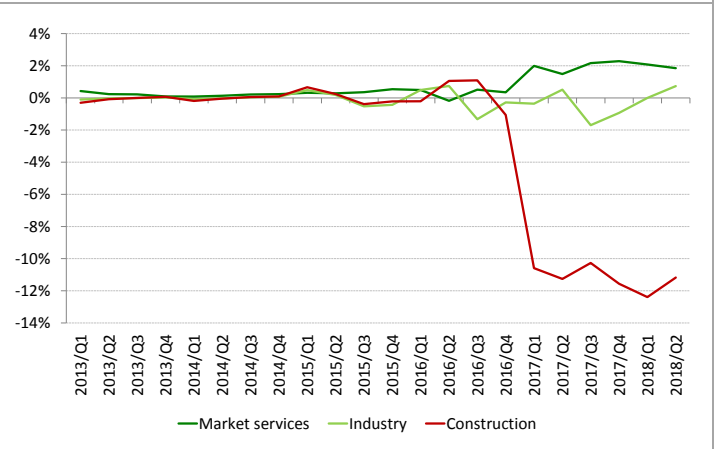
Sources: KSH, OTP Research

**Chart 11: Financial asset acquisition and net financing capacity of households (% of GDP)**



Sources: MNB, OTP Research

**Chart 12: Technical note: Difference between the current and previously published GDP data (%)**



Sources: KSH, OTP Research

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