

# MONTHLY BUSINESS REPORT

13 May 2016

## *2016 Q1 GDP surprised sharply on the downside with 0.9% YoY growth, the main driver could have been the ending of the EU-fund-related investments*

- The Hungarian economy lost steam in Q1 as GDP growth decelerated to 0.9 % YoY from 3.2% in Q4, while the SWDA figure weakened to 0.5% from 2.6%. Our short-term forecast in NSA terms was 1.8% YoY, Bloomberg consensus was 2.4% and local news portal portfolio.hu's poll was 2.0%. GDP contracted by -0.8% in quarterly comparison, the lowest reading since 2012Q1. The HCSO said that market services contributed positively to growth, while industry posted a minor, and construction a major fall.
- In regional comparison the Hungarian economy suffered the most noticeable deceleration. In Poland, Slovakia, and Bulgaria GDP grew by around 3.0% YoY, down from about 4.0% a quarter ago, while Romania's GDP accelerated to 4.3% YoY. The underperformance is strongly related to the role of EU funding: as the forced absorption in 2015Q4 boosted the economy, the stop of funding flow (Hungary's current account statistics signifies that the flow decreased to fifth of the amount seen a quarter ago) may have been a strong drag in 2016Q1. It is mirrored in the construction production data, which posted -26.2% annual fall in Q1. Furthermore, industry also performed weak. Our calculation for Q1 GDP, made before the publication of March industrial and construction data, showed that industrial value added grew by just a very modest 1.4% YoY, besides construction value added may have fallen by 20.2%, YoY. We seem to have overestimated both items' contribution to growth. We think as the one-offs in Q1 (fall in construction production, poor performance of industry, lack of EU funding) fade, GDP growth will accelerate. However, the recent data poses significant downward risk to our recently updated, 2.1% forecast, lowered from 2.5%.
- Indeed, apart from those related to household consumption, short-term business cycle indicators suggest deteriorating environment recently. It is clearly mirrored by our non-farm private GDP tracker (see next page). Industrial production heads downward and new orders stock also seems to be declining recently. Construction production fell sharply in January 2016 and dropped by 5% in March again. However, it is now somewhat below the historically consistent level of orders stock so it may pick up. In March civil engineering orders jumped higher. Besides, as the number of building permits takes off, residential construction is expected to grow, although historical evidences suggest that the lag could last two, maybe three, quarters. But construction value added will increase, in the second half of 2016 the latest.
- Export growth decelerated in 2016Q1 while import accelerated. Despite the increase in volume, trade balance surplus hit historical high, probably owing to the reduced import energy bill and improving terms of trade. However, as the growth rate of imports exceeds that of exports and energy prices have started to climb, the balance will narrow over time. The pace of this narrowing depends on what will happen with exports: although the assessment of order-book levels has deteriorated to three-year low, production expectations over the next three months are not so discouraging.
- Turning to the household sector, although retail sales posted its weakest yearly gain in 2016 Q1 since 2014 Q3, abolishing the ban on Sunday shopping may provide a boost in Q2. Passenger car sales accelerated recently, domestic holidays show strengthening demand after some break at the turn of 2015 and 2016. Household consumption is supported by strong, about 5-6% income growth and accelerating new business of loans.
- According to our recently updated medium-term forecast, which contains 2.1% GDP growth for 2016 and 3.0% for the year after, household consumption will remain the main engine of economic expansion, in line with the recent structural shift of GDP expansion. The growth of household consumption reached 3.5% in Q4 2015, the highest figure since 2005 Q4 and we expect that consumption can grow at a very similar pace in 2016 as a whole (3.6%). The VAT reduction and renewed fall in oil prices at the beginning of this year keep inflation at very low level (0.6% in 2016), and was coupled with accelerating nominal wage growth and

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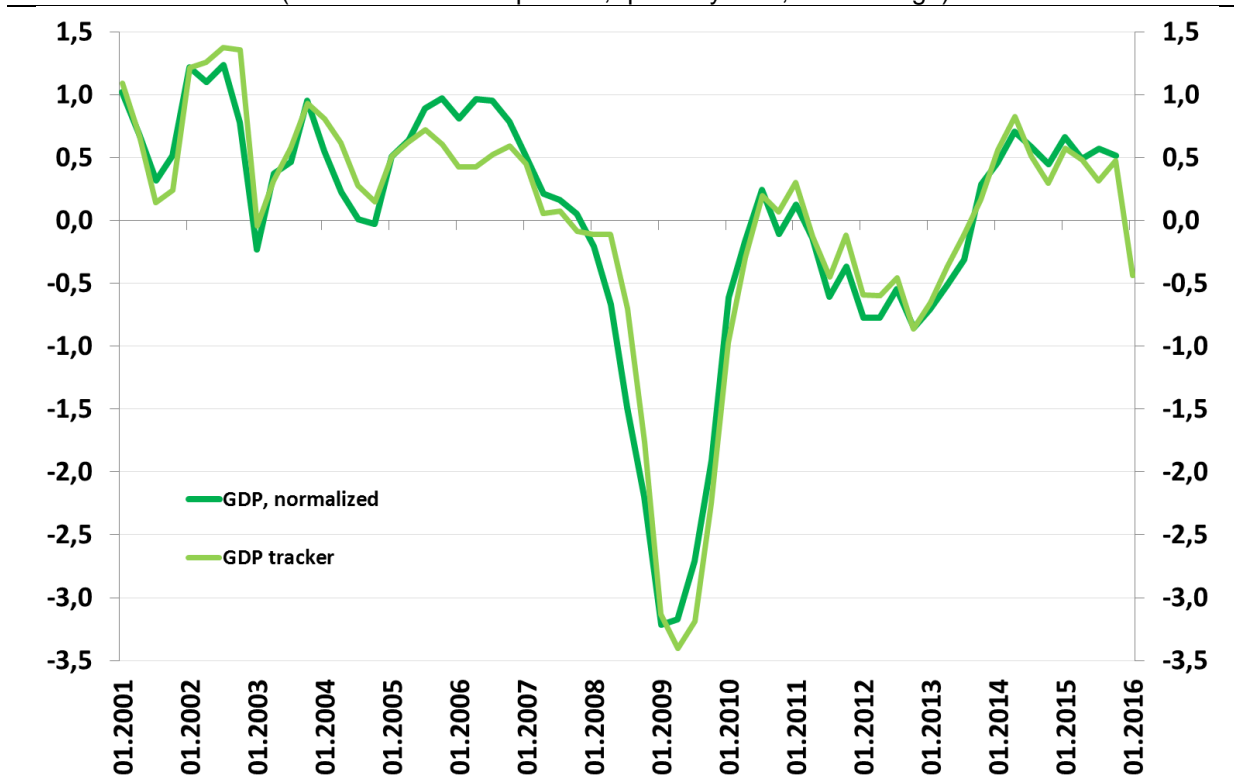
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the PIT reduction. These factors maintain the strong real disposable income growth rate in 2016 as well. From 2017, ahead of the 2018 parliamentary election, we anticipate on-going fiscal loosening (we expect 6-ppt PIT reduction [to reach single-digit PIT rate, as communicated by the government several times] in the second half of 2017), which will result in 4.8% gain in household consumption expenditure in 2017. The government has the room to support GDP growth, and we assume it will use it in the form of revenue reduction from households and propelling investments. In a no-policy-change scenario, we estimate GDP growth to be around 2.5%, which will be accelerated by government measures to 3.0% in 2017.

- Households' investments can also revive in 2016, which will add to the bottoming out of private investment rate. Our model-based forecast suggests that the number of completed dwellings may reach 10,750 units this year and it can accelerate further to around 19,000 in 2017. Nevertheless, the expected 19,000 units in 2017 means that with the number of population aged 25-34 (the most active cohort on real estate market) the normalized completed dwelling number can be very close to its historical highs. Public investments will also revive in 2017, thanks to emerging self-funded investments. Under the moderate levels of funding cost, corporate investment is also likely to get impetus.
- We think the economy has entered a matured phase of recovery where GDP growth is broad-based and will shortly be supported by strengthening lending activity, after years of creditless recovery. We estimate that the negative output gap is closed and the positive output gap will widen further on the forecast horizon. This means the spare capacity in the economy is very limited now, which will constrain the effect of fiscal loosening: in 2017 and beyond it will boost imports rather than GDP.
- As a consequence of the rising import demand and the reversing terms of trade effect, the C/A surplus can decline significantly from 4.6% of GDP in 2016 to 2.7% of GDP in 2017.

**Business cycle forecasting indicator for non-farm private GDP\***  
(normalized for comparison, quarterly data, YoY change)



Sources: HCSO, OTP Research  
\*as the figures are normalized, they cannot be used for numerical assessment

**Summary table of main macroeconomic indicators**

| Key economic indicators                           | 2012   | 2013   | 2014   | 2015          | OTP           |               | Focus Economics |              | EC Spring 2016 |               |
|---|--------|--------|--------|---------------|---------------|---------------|-----------------|--------------|----------------|---------------|
|   |        |        |        |               | 2016F         | 2017F         | 2016F           | 2017F        | 2016F          | 2017F         |
| Nominal GDP (at current prices, bn HUF)           | 28 628 | 30 065 | 32 180 | <b>34 200</b> | <b>35 344</b> | <b>37 633</b> |                 |              | <b>33 086</b>  | <b>34 727</b> |
| Real GDP change                                   | -1,7%  | 1,9%   | 3,7%   | <b>2,9%</b>   | <b>2,1%</b>   | <b>3,0%</b>   | <b>2,4%</b>     | <b>2,6%</b>  | <b>2,5%</b>    | <b>2,8%</b>   |
| Household final consumption                       | -2,3%  | 0,6%   | 1,5%   | <b>2,4%</b>   | <b>3,0%</b>   | <b>3,9%</b>   | <b>2,8%</b>     | <b>2,6%</b>  | <b>3,2%</b>    | <b>3,0%</b>   |
| Household consumption expenditure                 | -2,3%  | 0,2%   | 1,8%   | <b>2,8%</b>   | <b>3,6%</b>   | <b>4,8%</b>   |                 |              |                |               |
| Collective consumption                            | -0,3%  | 3,0%   | 5,8%   | <b>2,2%</b>   | <b>0,7%</b>   | <b>0,4%</b>   |                 |              |                |               |
| Gross fixed capital formation                     | -4,4%  | 7,3%   | 11,2%  | <b>3,0%</b>   | <b>-2,1%</b>  | <b>9,9%</b>   | <b>-0,9%</b>    | <b>3,4%</b>  | <b>-1,7%</b>   | <b>4,0%</b>   |
| Exports   | -1,8%  | 6,4%   | 7,6%   | <b>8,7%</b>   | <b>5,2%</b>   | <b>5,9%</b>   |                 |              | <b>6,2%</b>    | <b>6,4%</b>   |
| Imports   | -3,5%  | 6,3%   | 8,5%   | <b>8,6%</b>   | <b>6,5%</b>   | <b>8,7%</b>   |                 |              | <b>6,0%</b>    | <b>6,6%</b>   |
| General government balance (ESA'10 based, HUF bn) | -662   | -783   | -739   | <b>-680</b>   | <b>-641</b>   | <b>-886</b>   |                 |              |                |               |
| in percent of GDP                                 | -2,3%  | -2,6%  | -2,3%  | <b>-2,0%</b>  | <b>-1,8%</b>  | <b>-2,4%</b>  | <b>-2,1%</b>    | <b>-2,1%</b> | <b>-2,9%</b>   | <b>-2,5%</b>  |
| General government debt (in percent of GDP)       | 78,3%  | 76,8%  | 76,2%  | <b>75,3%</b>  | <b>74,7%</b>  | <b>73,5%</b>  | <b>74,3%</b>    | <b>72,6%</b> | <b>74,3%</b>   | <b>73,0%</b>  |
| Current account (EUR bn)*                         | 1,7    | 4,0    | 2,1    | <b>4,8</b>    | <b>5,1</b>    | <b>3,2</b>    | <b>4,7</b>      | <b>4,6</b>   |                |               |
| in percent of GDP                                 | 1,8%   | 4,0%   | 2,0%   | <b>4,4%</b>   | <b>4,6%</b>   | <b>2,7%</b>   | <b>4,3%</b>     | <b>4,0%</b>  | <b>5,0%</b>    | <b>4,5%</b>   |
| Gross nominal wages**                             | 5,7%   | 3,6%   | 3,5%   | <b>4,4%</b>   | <b>5,4%</b>   | <b>5,2%</b>   |                 |              |                |               |
| Gross real wages                                  | 0,0%   | 1,8%   | 3,7%   | <b>4,6%</b>   | <b>4,8%</b>   | <b>2,7%</b>   |                 |              |                |               |
| Gross disposable income***                        | 2,0%   | 3,1%   | 5,1%   | <b>4,7%</b>   | <b>5,4%</b>   | <b>6,9%</b>   |                 |              |                |               |
| Gross real disposable income                      | -3,5%  | 1,3%   | 5,3%   | <b>4,8%</b>   | <b>4,8%</b>   | <b>4,4%</b>   |                 |              |                |               |
| Employment (annual change)                        | 1,8%   | 1,7%   | 5,3%   | <b>2,7%</b>   | <b>2,3%</b>   | <b>1,6%</b>   |                 |              | <b>0,9%</b>    | <b>0,1%</b>   |
| Employment domestic concept w/o public workers    | -0,2%  | 0,5%   | 3,3%   | <b>1,5%</b>   | <b>2,3%</b>   | <b>1,8%</b>   |                 |              |                |               |
| Unemployment rate (annual average)                | 11,0%  | 10,2%  | 7,7%   | <b>6,8%</b>   | <b>5,4%</b>   | <b>4,4%</b>   | <b>6,4%</b>     | <b>6,1%</b>  | <b>6,4%</b>    | <b>6,1%</b>   |
| Inflation (annual average)                        | 5,7%   | 1,7%   | -0,2%  | <b>-0,2%</b>  | <b>0,6%</b>   | <b>2,4%</b>   | <b>0,5%</b>     | <b>2,1%</b>  | <b>0,4%</b>    | <b>2,3%</b>   |
| Base rate (end of year)                           | 5,75%  | 3,00%  | 2,10%  | <b>1,35%</b>  | <b>0,75%</b>  | <b>0,75%</b>  | <b>0,79%</b>    | <b>0,95%</b> |                |               |
| 1Y Treasury Bill (average)                        | 7,0%   | 4,11%  | 2,28%  | <b>1,17%</b>  | <b>0,87%</b>  | <b>0,70%</b>  |                 |              |                |               |
| Real interest rate (average, ex post)             | 1,3%   | 2,3%   | 2,5%   | <b>1,3%</b>   | <b>0,3%</b>   | <b>-1,7%</b>  |                 |              |                |               |
| EUR/HUF exchange rate (average)                   | 289,3  | 297,0  | 308,6  | <b>309,9</b>  | <b>314,5</b>  | <b>317,4</b>  | <b>314,0</b>    | <b>314,0</b> |                |               |
| EUR/HUF exchange rate (end of year)               | 291,3  | 296,9  | 314,9  | <b>313,1</b>  | <b>316,6</b>  | <b>318,2</b>  | <b>314,0</b>    | <b>314,0</b> |                |               |

Sources: CSO, NBH, OTP Bank

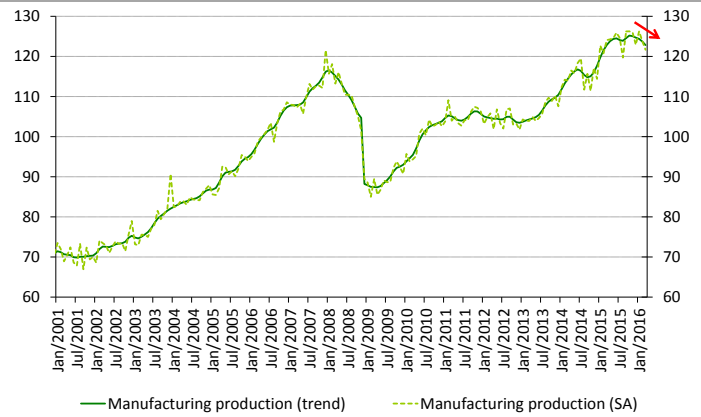
\*: Official data of balance of payments (excluding net errors and omissions)

\*\* : 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

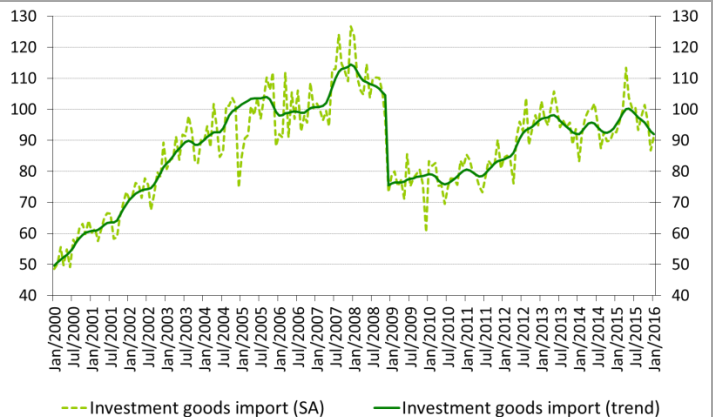
**Indicators of domestic demand – Investments**

**Chart 1: Manufacturing production**  
(SA, 2010 = 100)



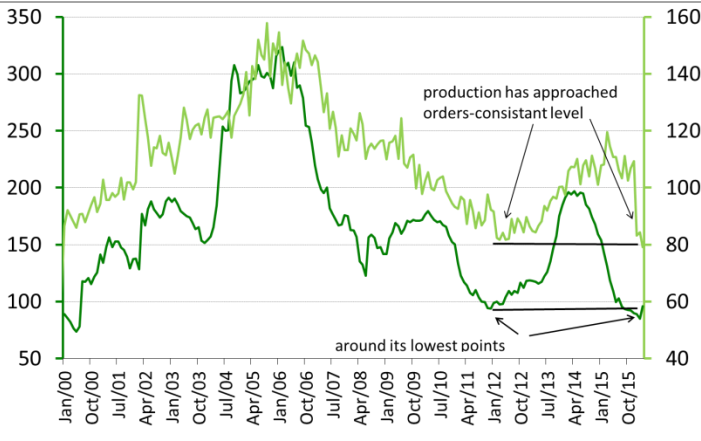
Sources: HCSO, OTP Research

**Chart 2: Import of investment goods**  
(SA, 2005 = 100)



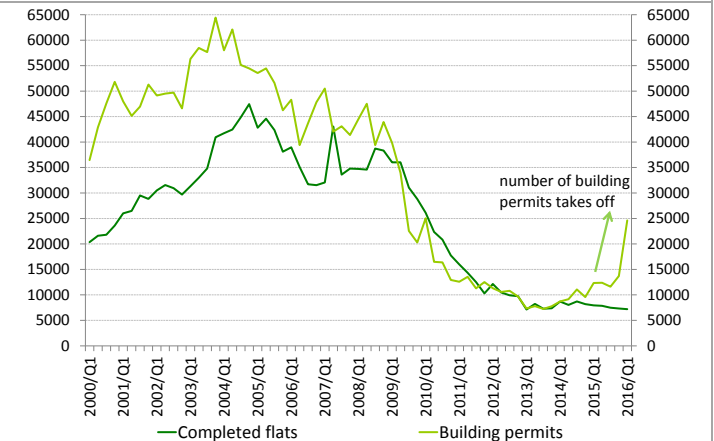
Sources: HCSO, OTP Research

**Chart 3: Orders stock and production of construction**  
(SA, 2000 = 100, 2010 = 100)



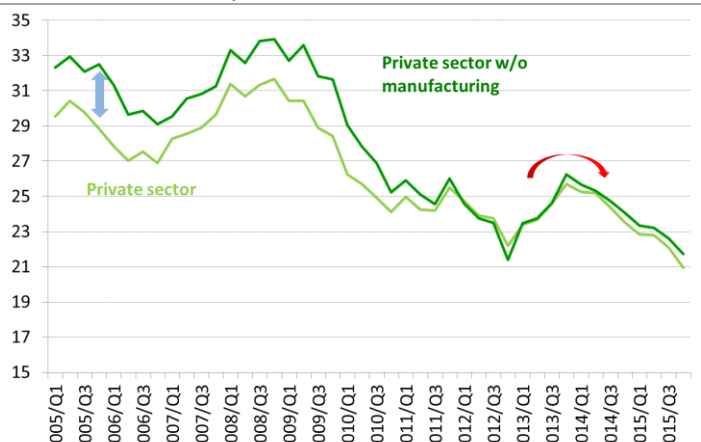
Sources: HCSO, OTP Research

**Chart 4: Number of building permits and completed flats**  
(SA, annualized quarterly)



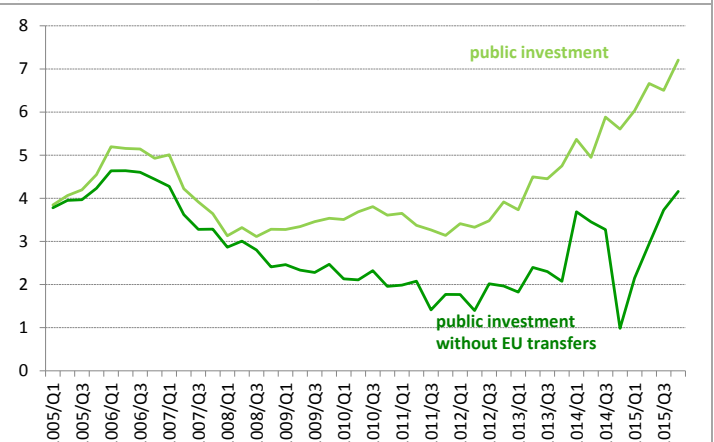
Sources: HCSO, OTP Research

**Chart 5: Investment rate in the private sector**  
(SWDA, as % of respective GDP)



Sources: HCSO, OTP Research

**Chart 6: Investment rate in the public sector**  
(SWDA, as % of total GDP)

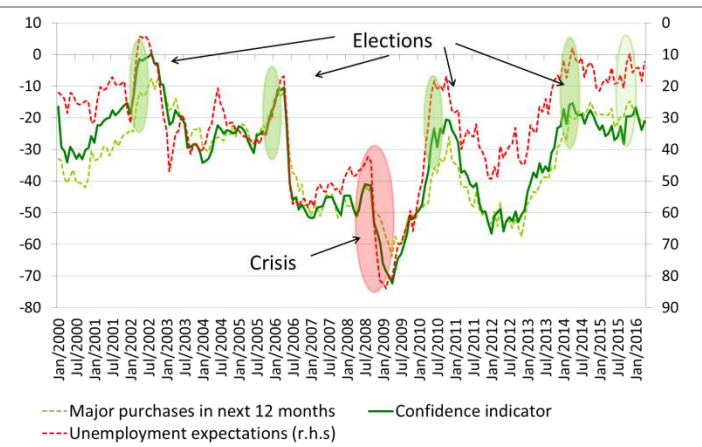


Sources: HCSO, OTP Research



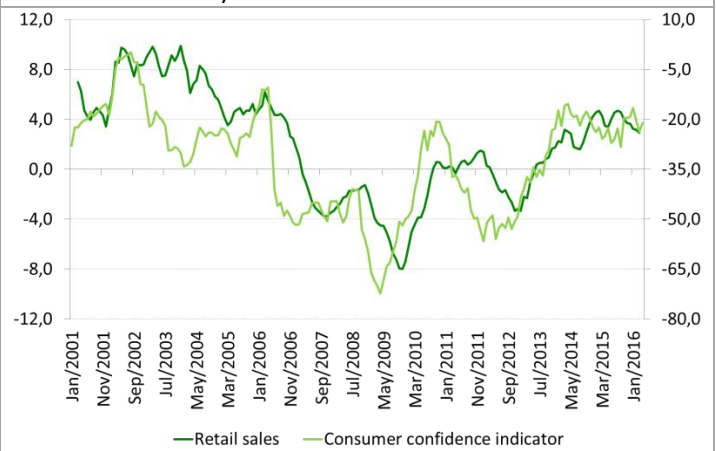
**Indicators of domestic demand – Consumption**

**Chart 1: Consumer confidence**  
(monthly data, balance index)



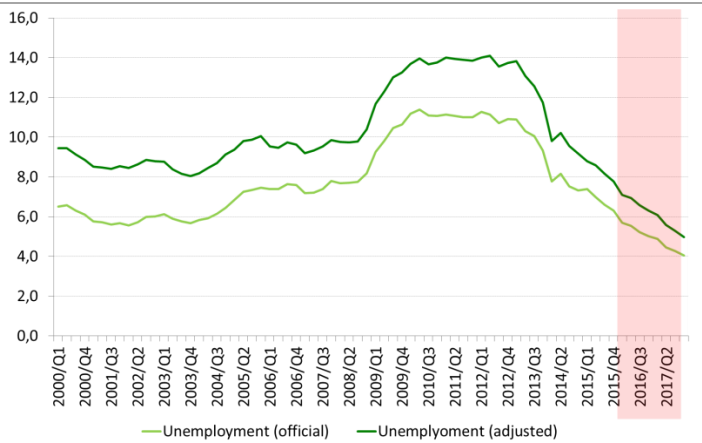
Sources: Eurostat, OTP Research

**Chart 2: Consumer confidence and retail trade**  
(monthly data, SA, 3M MA of annual changes, % and balance indicator)



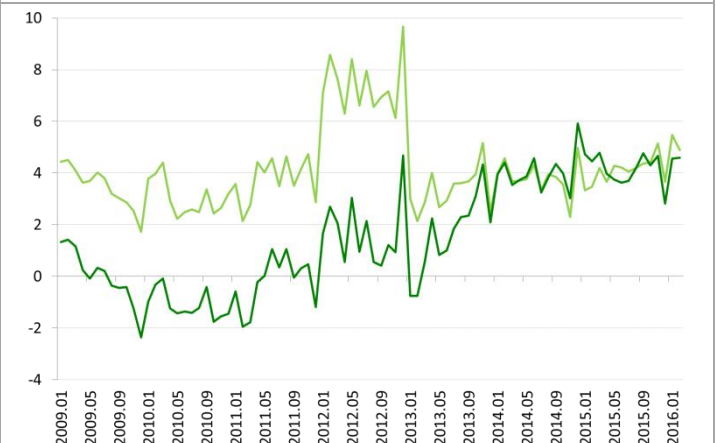
Sources: Eurostat, HCSO, OTP Research

**Chart 3: Unemployment**  
(SA, %)



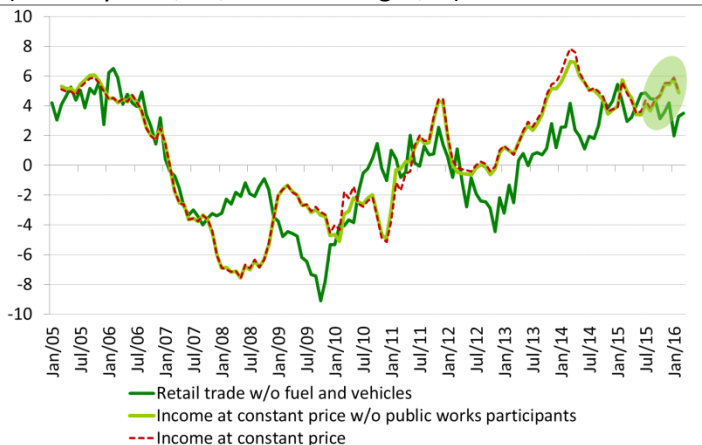
Sources: HCSO, OTP Research  
adjusted unemployment includes people who are willing to work but think no work is available

**Chart 4: Nominal and real wage growth in the economy**  
(monthly data, SA, annual changes, %)



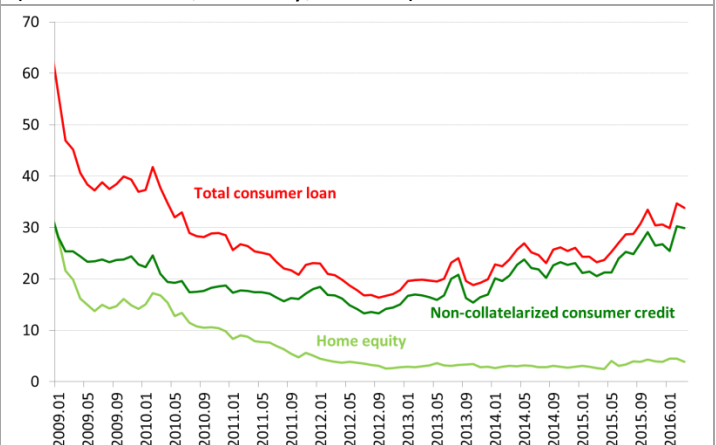
Sources: HCSO, OTP Research

**Chart 5: Income in real terms\***  
(monthly data, SA, annual changes, %)



Sources: HCSO, MoF, OTP Research  
\*: compensation of employees plus social transfers in cash

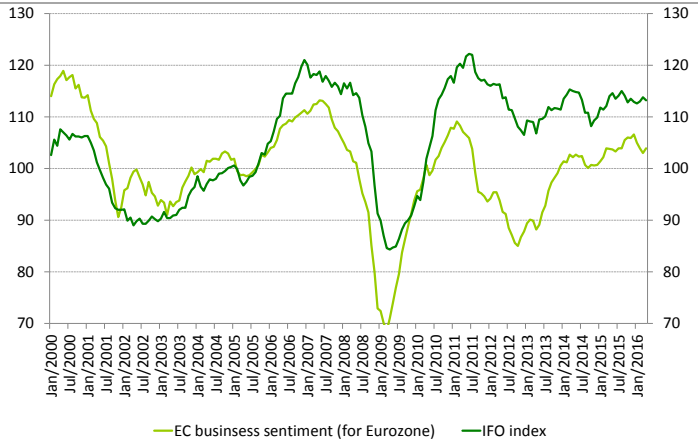
**Chart 6: New business of consumer loans to households**  
(new contracts, monthly, HUF bn)



Source: MNB, OTP Research

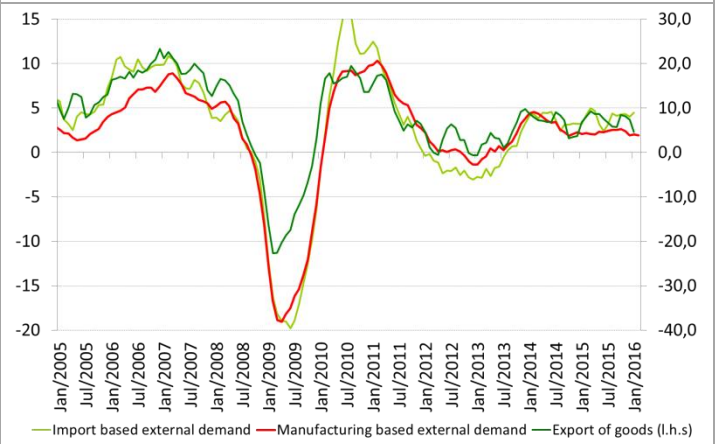
**Indicators of external demand**

**Chart 1: IFO\* and EC sentiment indicators**  
(monthly data, balance indicator)



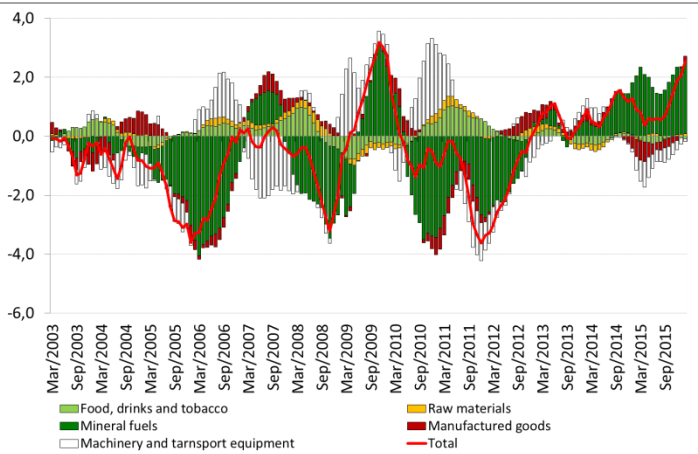
Sources: Reuters, Eurostat, OTP Research  
\*: current situation sub-index

**Chart 2: External demand**  
(annual changes, %)



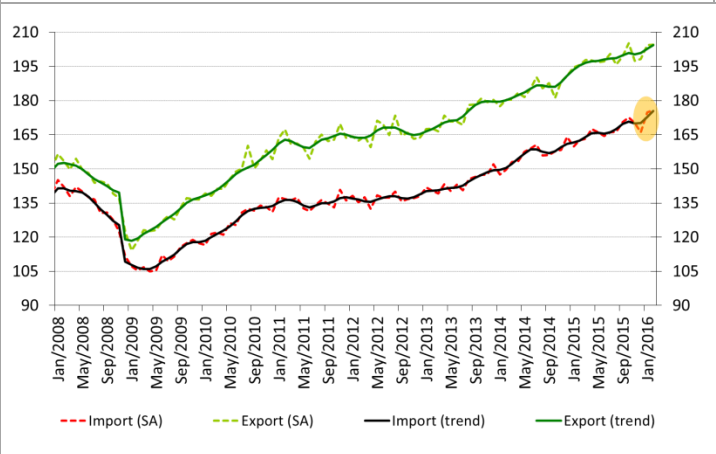
Sources: HCSO, Eurostat, OTP Research

**Chart 3: Decomposition of terms of trade**  
(3M avg. of YoY change, %)



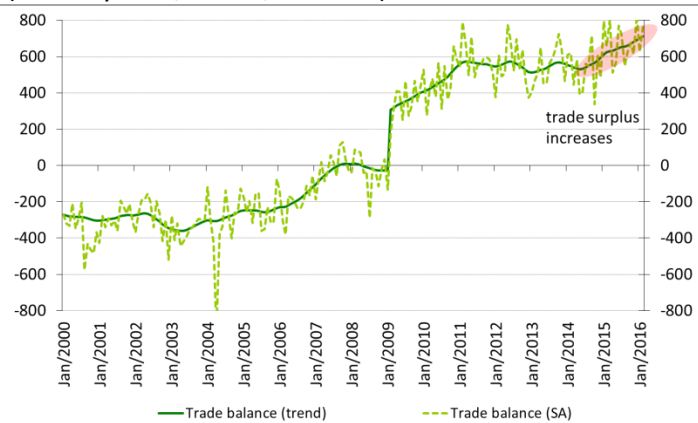
Sources: HCSO, OTP Research

**Chart 4: Exports and imports**  
(monthly data, SWDA, 2010=100)



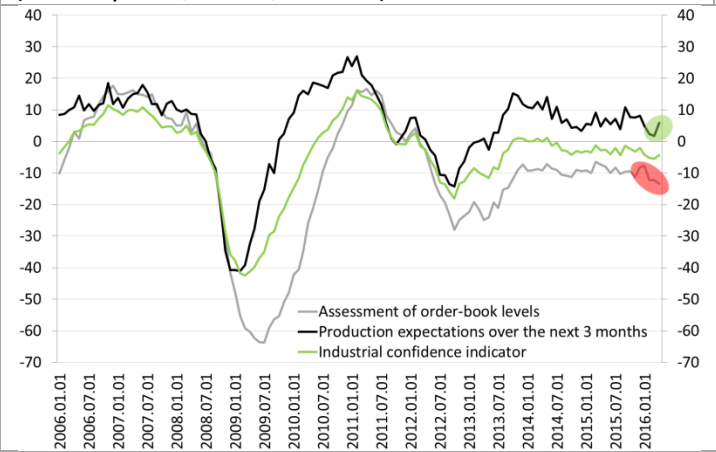
Sources: HCSO, OTP Research

**Chart 5: Trade balance**  
(monthly data, SWDA, EUR mln)



Sources: HCSO, OTP Research

**Chart 6: Business confidence in industry**  
(monthly data, SWDA, balance)



Sources: Eurostat, OTP Research

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