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Hungary: Private consumption rising – but challenges remain for corporates

Hungary is performing well, considering the context of struggling economies globally. It is continuing to benefit from a moderately growing economy and will show a gain of 2.2% this year. This positive performance is being driven by private consumption, in turn strengthened by falling unemployment, higher disposable incomes, the public welfare programme and the resolution of problems surrounding foreign-currency mortgage loans.

Private consumption, a major contributor to GDP

The Hungarian economy has been recording solid growth rates since its recession in 2012. EU funding has been an important contributor to this expansion, but by no means the only factor. The perspectives for the Hungarian economy and most of the country's main trading partners have been improving. Although the growth of 2.2% forecast for this year by Coface will be slower than the 2.9% achieved in 2015, this will mainly be due to the slower absorption of EU funds - which should speed up as from next year. Ongoing improvements in the labour market and fiscal measures (such as cuts in personal taxes and VAT rates) are supporting private consumption as the main driving force behind the economy. Households have seen a growth in demand for labour, from both the public and private sectors. They have also benefitted from the conversion of their foreign currency mortgage loans into domestic currency. The dynamic labour market and improved consumer sentiment are leading to higher consumer spending. Household consumption will thus continue to be the main driver behind the Hungarian economy over the next few quarters.

"Although Hungary will record a slower pace of growth this year, it is nevertheless forecast to reach a reasonable level, at 2.2%. While private consumption remains robust, economic activity has suffered from the adverse business environment, which is continuing to hamper the private sector's contribution to growth," explained Grzegorz Siewicz, Regional Economist for Central Europe at Coface.

Companies deleveraging despite stimulus measures

The country's excessive public budget and debt levels have led the government to introduce measures aimed at increasing revenues. Businesses have been suffering from various taxes and quasi-taxes, which have included additional financial burdens for the country's banks, energy and telecommunication companies and biggest retailers. Despite improvements to the budget situation and stronger growth, additional taxes have been implemented. The possibility of further changes to the country's regulatory and legislative frameworks has caused uncertainty, making companies reluctant to invest and expand their businesses. The Hungarian Central Bank has implemented stimulus measures, including the substantial



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lowering of interest rates, as well as the Funding for Growth Scheme, which provides low interest rate loans to SMEs. Nevertheless, the entire corporate sector has continued deleveraging. Additional measures to support further borrowing by SMEs could help to strengthen the country's economic activity. The business sentiment among larger companies indicates that there could be improvements - if no further tax burdens are introduced.

Faced with a slower pace of expansion this year, Hungary's government and central bank have decided to focus on other pillars of growth besides support through EU funding (a component which significantly contributed to the economy during previous periods). Business sentiment will take some time to recover, following the challenges that corporates have been experiencing. Nevertheless, companies are becoming more confident about the economic outlook and the central bank is continuing to introduce measures to discourage corporates from deleveraging and to help boost the economy.

Automotive sector, main component of the Hungarian economy

The challenges in the corporate sector were particularly felt by foreign-owned entities. This did not apply, however, to the automotive sector, which benefitted from Hungary's preferential business climate. The automotive sector is a significant contributor to Hungary's economic activity, creating nearly 4.5% of the country's added value and over 10% of total output. The industry's relatively positive outlook is benefitting from the demand for Western Europe – the destination for most of its production – as well as from its continued cost competitiveness, in comparison to other Eurozone plants which are often weakened by overcapacities. Although the sector could suffer from the effects of the Volkswagen scandal, due to the Group's strong FDI in Hungary, it appears that this risk has been mitigated over recent months.

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