Everything you need to know about Hungary, from A to Z, part two

What's really going on right now with Hungary's economy? Here's the second part of our A to Z look at the country by Peter Virovacz, ING's Senior Economist in Budapest... who apologises for having to cheat just a touch when he got to 'x'. Part one is here

Introducing part two

Here we go with the second part of our 'All you need to know about Hungary from A-Z'. If you haven't done so already, it probably makes sense to check out part one here to understand why I took on this challenge. Even the lower letters of the alphabet (mostly) held little fear...

N is for Natural rate of unemployment

The unemployment rate has decreased by only 0.3ppt since January 2018, showing a decelerating pace of improvement. It seems that the Hungarian labour market is now close to its natural rate of unemployment based on the current economic policy environment. A further significant drop in the unemployment rate is only possible if the government decides on new measures to fight against structural and geographical unemployment.

Record setting June in the labour market

O is for Output gap

When an economy performs above its potential level, capacity utilisation and labour market tightness are pretty much at their peak. Hungary perfectly fits this description. According to the IMF, the OECD, the European Commission and now the NBH, the Hungarian output gap is now firmly positive, standing between 0.5-2.5%, based on different calculations. It can be elevated further if Foreign Direct Investment continues to flow.

German carmakers still in love with Hungary

P is for Population

Hungary faces a long-term challenge: the issue of a declining and ageing population. The total fertility rate increased to 1.53 in 2016. Despite an increasing rate for 5 years now, we are still far from the 2.1 threshold meaning a reproduction rate which keeps the population rate unchanged. The demographic issue will be on the current government's agenda for the coming years.

Q is for Question marks

The government sees gross debt decreasing to 73.2% of GDP in 2018 in its latest convergence programme. That would only be a shallow decrease compared to 2017 and it could be derailed if the EU doesn't transfer the money on projects pre-financed from the budget using extra bond issuance. It's a hard job for the Government Debt Management Agency which has to raise that funding as it needs to take care that the debt to GDP ratio doesn't blow up with all that extra debt issuance.

R is for Retail bonds

ÁKK, the debt agent, increased retail bond yields (up to two years maturity) by 50bp from 30 July to attract more demand. By doing this, ÁKK tries to raise money from households, which can counterbalance the upward pressure on bond yields caused by the extra issuance of liquidity t-bills and HGBs due to the glaring financing need of the government due to the pre-financing.

S is for Sovereign debt rating

S&P and Fitch will review the Hungarian sovereign debt on 17 and 31 August, respectively. In the light of the recent turmoil in the markets (HUF weakness, steeper curve, bad looking deficit) it is likely the agencies will leave those Hungarian ratings unchanged despite the current positive outlook. When it comes to the rest of 2018, Moody's will have one more chance to award Hungary with a positive outlook too.

Fitch affirms Hungary's rating

T is for Tender

The main question for 4Q18 is what the NBH will do with FX swaps tenders when EU money starts to flow. In our view, the recent restructuring of the FX swaps stock (putting more emphasis on short-term swaps) is a sign the central bank might let some short-term FX swaps mature without them rolling over. When it comes to the MIRS (Monetary Policy Interest Rate Swaps), these end in 2018 but the mortgage bond buying programme could still be with us in 2019.

U is for Underground economy

The fight against the underground economy started with the introduction of online cash registers in 2013, and that's been spreading into more sectors. Targeted VAT cuts also helped in the fight, as did minimum wage increases. Overall, the volume of the shadow economy could have dropped to 15-20% from 22-25% in the early 2010s according to differing calculations.

V is for Variable rate mortgage

The proportion of variable rate mortgages is still significant, although they are becoming less popular mainly because of the NBH's consumer-friendly housing loans and new payment-to-income ratio rules. The NBH is trying to raise awareness on interest rate risks, which can help in its job to normalise monetary policy without sacrificing too much growth in the short run.

W is for World Economic Forum

Hungary registered a slight improvement in the World Economic Forum's Global Competitiveness Ranking last year, reading 60th place. It was mainly on the back of the favourable macroeconomic environment. However, the big picture's not quite so rosy as Hungary was also in 60th place back in 2012! Can Hungary improve further this year? Watch out for the new ranking due in September.

The Global Competitiveness Report 2017-2018

Y is for Yearning

The NBH yearns for a bit more stability after the huge sell-off earlier in the summer which endangered its monetary policy setup for a short while. With the recently found (albeit fragile) stability, the NBH can breathe a sigh of relief sticking to its loose monetary stance without jeopardising its main goal, price stability.

X is for 'X' in external factors

Despite headline CPI jumping above the 3% target for the first time since 2013, it was mainly due to external factors. The contribution of the fuel price increase alone was 0.4ppt. Core inflation has remained at 2.4 to 2.5% YoY for months now. We look to CPI easing somewhat by year-end on base effects and then accelerating back above 3% in 2019. Core CPI will only reach 3% by mid-2019.

Inflation jumps above target

Z is for zeal

The Fidesz-KDNP party alliance and Prime Minister Viktor Orbán won by a two-thirds majority for the third time in a row in 2018. Considering his latest speeches, it seems obvious that he's setting his eyes on a much bigger prize. With European Parliament elections approaching, Viktor Orbán's zeal and enthusiasm for becoming a major European leader has become increasingly clear. Although we see this as a bit of a longshot, eventually all the pieces could well fall into place for this to happen.

One week later

All smoke, no fire

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