German carmakers still in love with Hungary

BMW has just announced it is building a manufacturing plant in Debrecen, Hungary, following the lead of Audi and Mercedes, which have also built factories in the country

As per our latest Directional Economics EMEA (Ready, aim, invest), multinational companies are still looking to invest in central and eastern Europe and the latest announcement from BMW is further proof of this. The German carmaker said it's ready to invest €1 billion to build a new plant producing both traditional and electric cars.

The details

According to BMW, it will be manufacturing traditional and electric cars on a 400-hectare area near Debrecen (eastern Hungary) with the most cutting-edge technology used in the automotive sector. The top capacity of the new plant is said to be 150,000 cars, which means that it would increase domestic output by nearly 32%. In 2017, Hungary's motor vehicle production reached 472,000 (2.8% of all passenger cars manufactured in the EU).

Péter Szijjártó, Minister of Foreign Affairs and Trade, announced that the new investment by BMW will create over 1,000 jobs at the start. The company said that Hungary was chosen primarily because of the very good infrastructure, the suitable logistics connections, the proximity to an established supplier network and a qualified labour force. We have previously cited all of these local strengths and positioning factors in our assessment of what Hungary could offer to potential FDI investors (see: Directional Economics EMEA – Ready, aim, invest).

What are our main concerns

The Hungarian car manufacturing sector employs roughly 110,000 people, so from that point of view, 1,000 jobs doesn't look like much. However, BMW will need to hire these workers in the next 18 months, if the plant is indeed up and running by 2020. In our view, this will be the biggest challenge for the carmaker, besides finding workers to build the plant.

First of all, Hungary is facing a tight labour market the likes of which have never been seen before and a labour shortage where roughly 80% of manufacturers are complaining about a lack of labour. BMW, however, seems quite confident in its own attractiveness as an employer and mentioned the qualified personnel in the local area as a key advantage. It is important to note here, that the unemployment rate is higher in the eastern part of the country than the average, so this is an opportunity. Still, the skill level hardly matches what would fit BMW, in our opinion. The other issue here is the booming construction industry, where capacity constraints have led to significant delays in construction time.

When it comes to Hungary, our main concern is the economy's increasing dependence on a cycle-sensitive industry. Roughly one-third of Hungarian exports comes from car manufacturers, and this could be even higher with the recently started electric motor production by Audi and the new BMW investment. Moreover, as the domestic value added is still low in Hungarian industry (around 50%), we can only hope that this project will help to increase the added value (and not just the output) of car manufacturers.

What we can be happy about

Primarily, this is a favourable development that will help smooth Hungary's growth path. The investment could help to offset a decline in development financing from the European Union. Construction is due to start in the second half of next year and this could help counterbalance the fading support of EU projects in 2019. While one project won't be enough to keep the investment-to-GDP ratio around recent levels (21.5% in 2017 as a whole) after Hungary runs out of EU money, it could, at least, help to deliver a soft landing.

The plant will also boost Hungary's export capacity in the long run because it's clear that BMW isn't placing a factory here to serve local needs. Moreover, it will have a positive effect on the trade balance and current account balance, helping to keep them in surplus, which is an important element and goal of economic policy.

If it's true that BMW plans a state-of-the-art project with high levels of digitalisation, flexibility and productivity, the plant could help to boost the country's technological progress and improve Hungary's potential growth. Through capital accumulation, it could also elevate the potential output of Hungary.

Another significant factor is BMW's decision to build the plant in the eastern part of the country. This could serve as a catalyst to bring other international companies with new investments to this less developed region. It could help to improve infrastructure and also boost the local labour market, in turn increasing competition for labour and enhancing salaries. Due to the lack of skilled labour, in our view, BMW will need to spend a lot of money on education, which will also prove to be a positive development. It's possible that BMW will follow the lead of its peers (Audi and Mercedes) in financing local educational institutions to help them fill recent and future vacancies.

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