Wage growth in Hungary is not all it seems

The big rise in Hungarian wage growth is partly an illusion

The puzzle

The most intriguing macro phenomenon in Hungary right now is the strengthening labour market. Month by month, Hungary is reaching new records in activity, employment and unemployment rates. And that tightening labour market is supplemented by a net real wage growth not seen since 2002.

10% Hungarian net real wage growth

First half, 2017

A statistical blip?

With that ten percent wage growth figure, we've got the unemployment rate at 4.1%, which has never been so low. How is that translating into economic activity? Well, for a superficial observer, the 3.7% YoY GDP growth is more or less in sync with the strong labour market. However, if we dig into the details, it raises some question. Despite the rarely seen dynamic wage growth, the rate of household consumption came in at only 3.5% year-on-year in 1Q17, the lowest rate since early 2015. So what we have here? A never seen tight labour market, combined with a strong economic activity, which lacks both strong household consumption and significant inflation. So what's going on?

The most plausible explanation is this 15-year high wage growth exists just on paper, a statistical phenomenon.

The increased wage bill on the national level has a lot to do with the increase of minimum wages for both skilled and unskilled labour, 25% and 15% salary increase, respectively. In Hungary, we are well aware that in many cases this wage only exists on paper, and doesn't reflect reality. The number of employed people is around 4.4 million in Hungary. The latest research suggests 15% of those employed, some 600-thousand people, are working in the shadow economy. Just to make it clear, this crowd equals the joint population of the three biggest cities in Hungary (except Budapest). Half of those who work in the underground economy are hidden from the authorities, paying zero tax on labour. Another half earns minimum wage on paper but gets complementary payments in cash without paying taxes. As the majority of the wage increase on the national level affects these employees, this is the place where the “statistical wage growth” pops up. So what is happening? Legal income grows, the illegal part decreases and at the end of the day, the employee’s disposable income is unchanged. The worker does not become richer.

The missing link

Another explanation for the missing link between wage growth and consumption is that we have a lot of workplaces where the performance-related share of the wage is decisive. Those people are now earning a higher base salary (minimum wage), but the moving part of the payroll was decreased by the employer, thus with the same effort, you earn the same as a year ago. Moreover, as Hungary is an ageing society, we have roughly 2 million pensioners and the number has been increasing. Pensioners got a 1.6% pension increase in 2017. CPI inflation was at 2.3% YoY in the first half of the year. So, the real value of pensions has fallen and as pensioners have the highest propensity to consume, it could be another answer to the conundrum.

The Statistical Office recently released the latest consumption data and it seems that it started to accelerate. It is not really convincing,; it is not jumping off the chart, but at least it shows some promise, that eventually the wage growth will spill over into the real economy.

One quarter of promising data is not necessarily enough to convince us the wage growth is genuine

As we pointed out previously, the shadow economy is still a significant problem for Hungary, thus the challenge now for the government to tackle the underground economy related to the labour market. To achieve this goal, the government is decreasing the payroll tax further in 2018. Whether this will be enough to level the playing field between the honest companies and those which are 'playing' dirty remains to be seen. What we know that Hungarian workers are now aware of their strong bargaining power, so sooner or later the wage growth should reflect the REAL processes.

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