



Hungary in 2013-14

Stagflation for Longer



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CORPORATE & INVESTMENT BANKING

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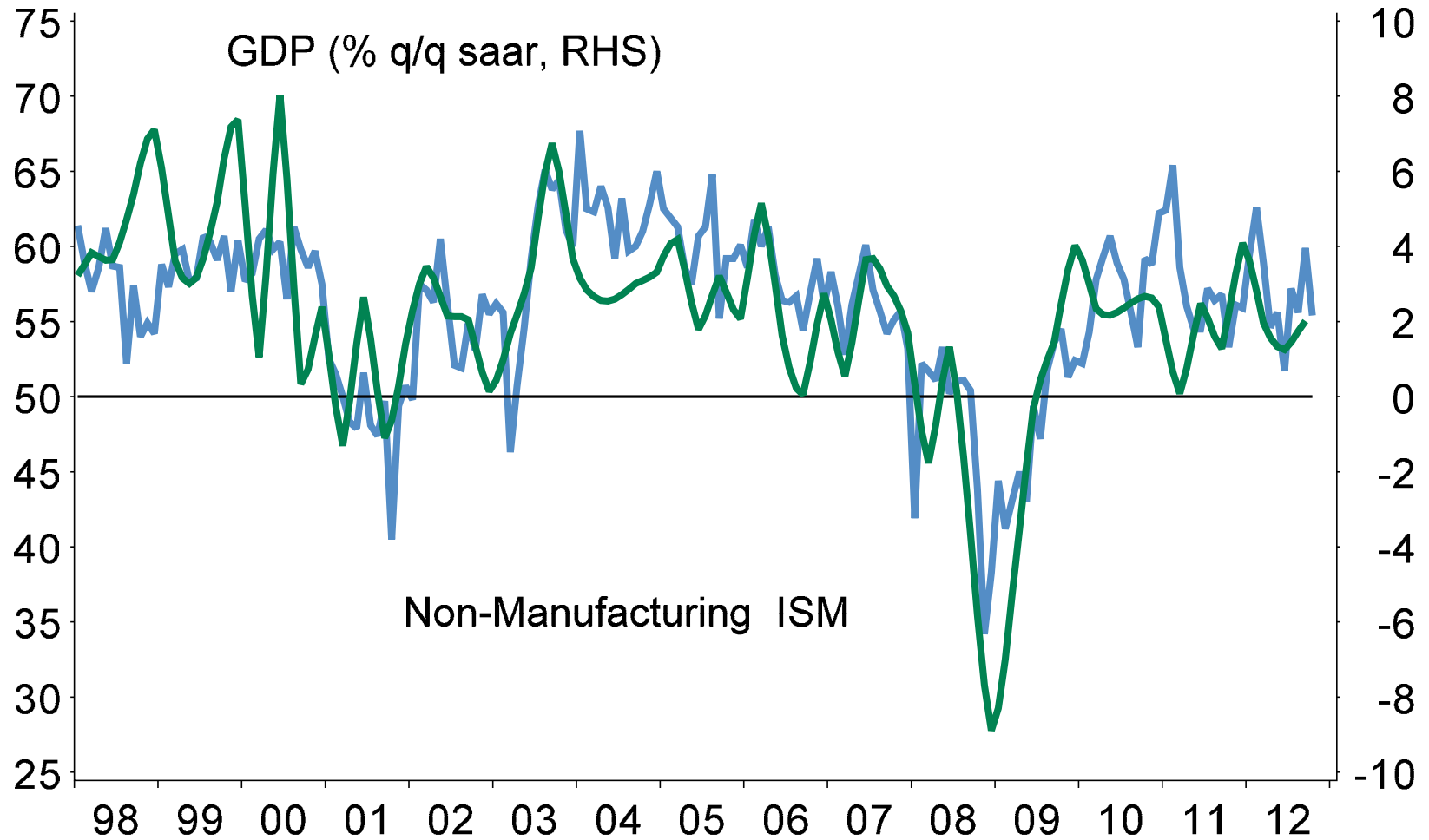
Michal Dybala
Chief Economist Central and Eastern Europe

Global backdrop: Recovery in Q2 2013, but multiple risks linger

- We expect the global economy to be bottoming out in late 2012
- The global recovery will be fuelled by a rebound in China, after the leadership transition is complete, and stronger US growth by Q2 2013
- Note, US financial and monetary conditions are extremely accommodative, more recently this is also reflected by easing of lending conditions for the private sector (both corporates and households)
- Eventually Europe will follow suit, thanks to Germany benefiting from accelerating global trade activity
- However, there are multiple risks, especially to the downside:
 - Eurozone crisis could deepen (Greece, Italian elections, Spanish fiscal, and generally social discontent about further austerity)
 - US fiscal cliff (we expect a compromise but a temporary going over the cliff must not be entirely ruled out)
 - Potential growth has fallen across the globe, due to disinvestments and slowing productivity growth



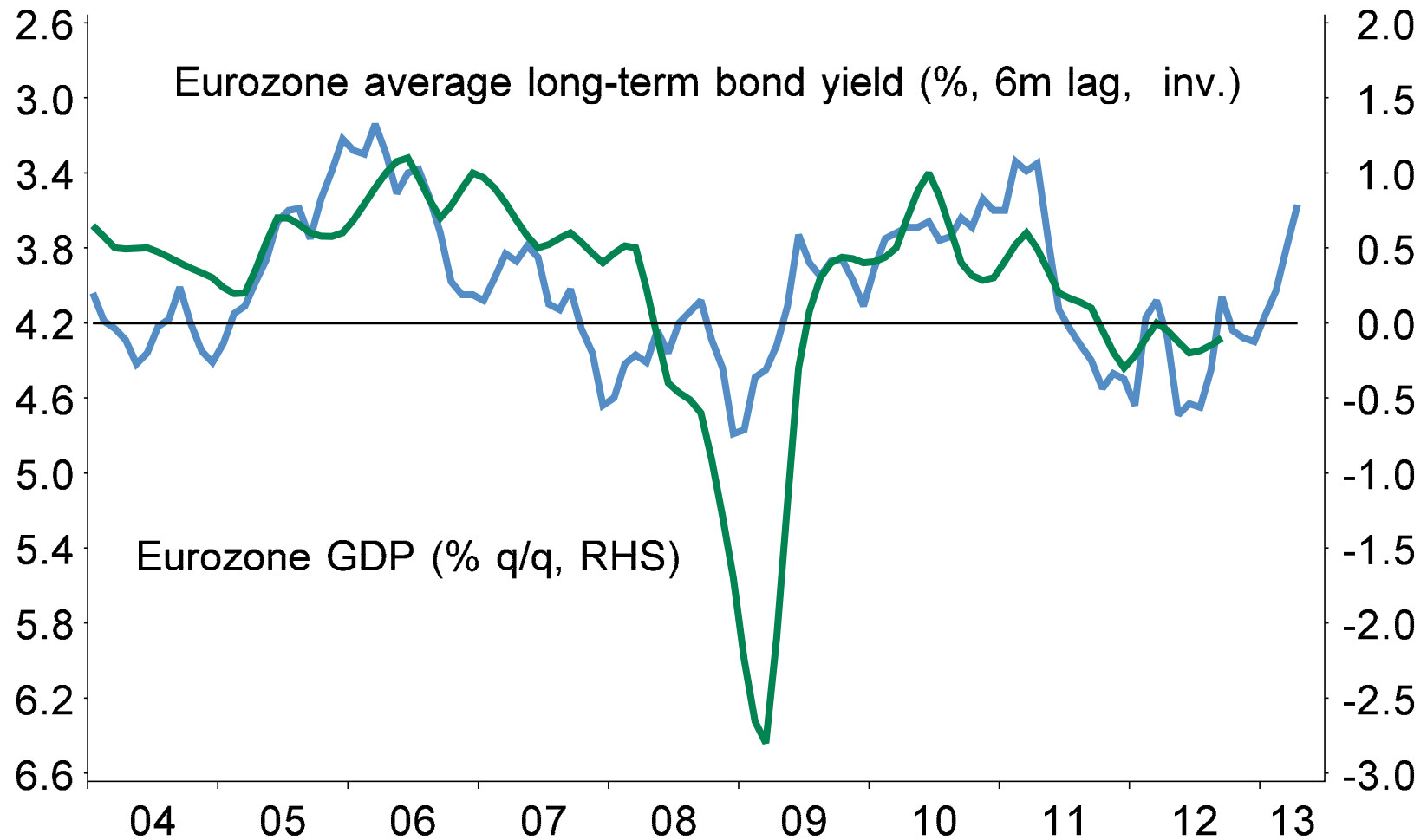
US not doing badly



Source: Reuters Ecowin Pro, BNP Paribas



Lower funding costs to support eurozone recovery by mid-next year



Source: Reuters Ecowin Pro, BNP Paribas

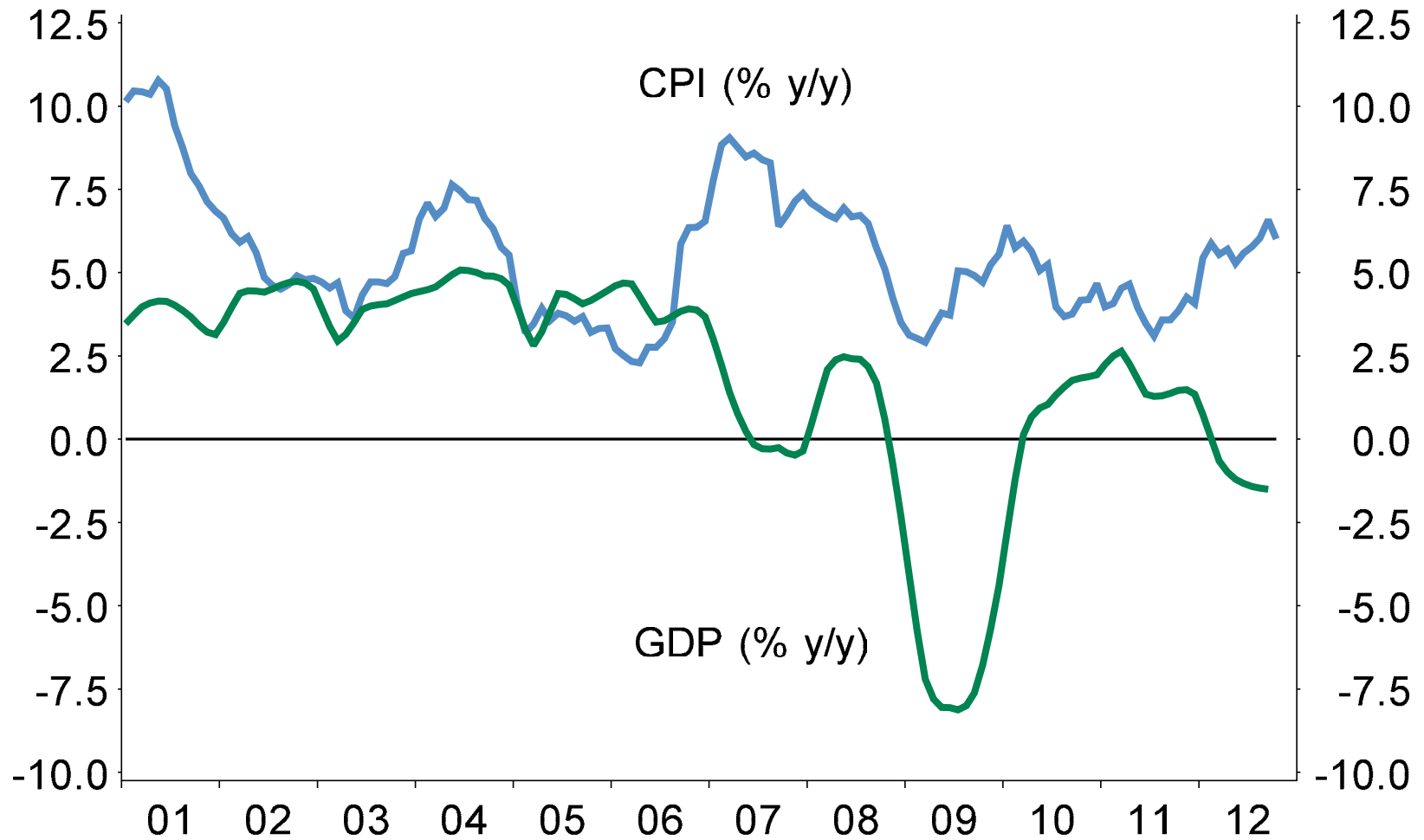


Main developments ahead

- Deal with IMF/EU on financial aid is unlikely anytime soon;
- The risk for further rating downgrades as well as depressed confidence make Hungary very vulnerable to any pick-up in risk aversion;
- Meanwhile the economy remains in recession, driven by falling consumption;
- External surpluses to continue rising on weak domestic demand;
- Signs of investment recovery are countered by weak business sentiment;
- Government pledged further discretionary tightening measures in 2013, with the bulk of action being on the revenue side;
- This reduces the outlook for investment, potential and actual growth;
- Inflation in 2012 was boosted by VAT the hike and a volatile currency; CPI will remain high also next year owing to new tax increases;
- Monetary easing has started and more rate cuts will be delivered; reshuffle of the NBH Board in 2013 may increase the risk of excessive monetary easing – with no benefit for the economy, but further adding to inflation worries.



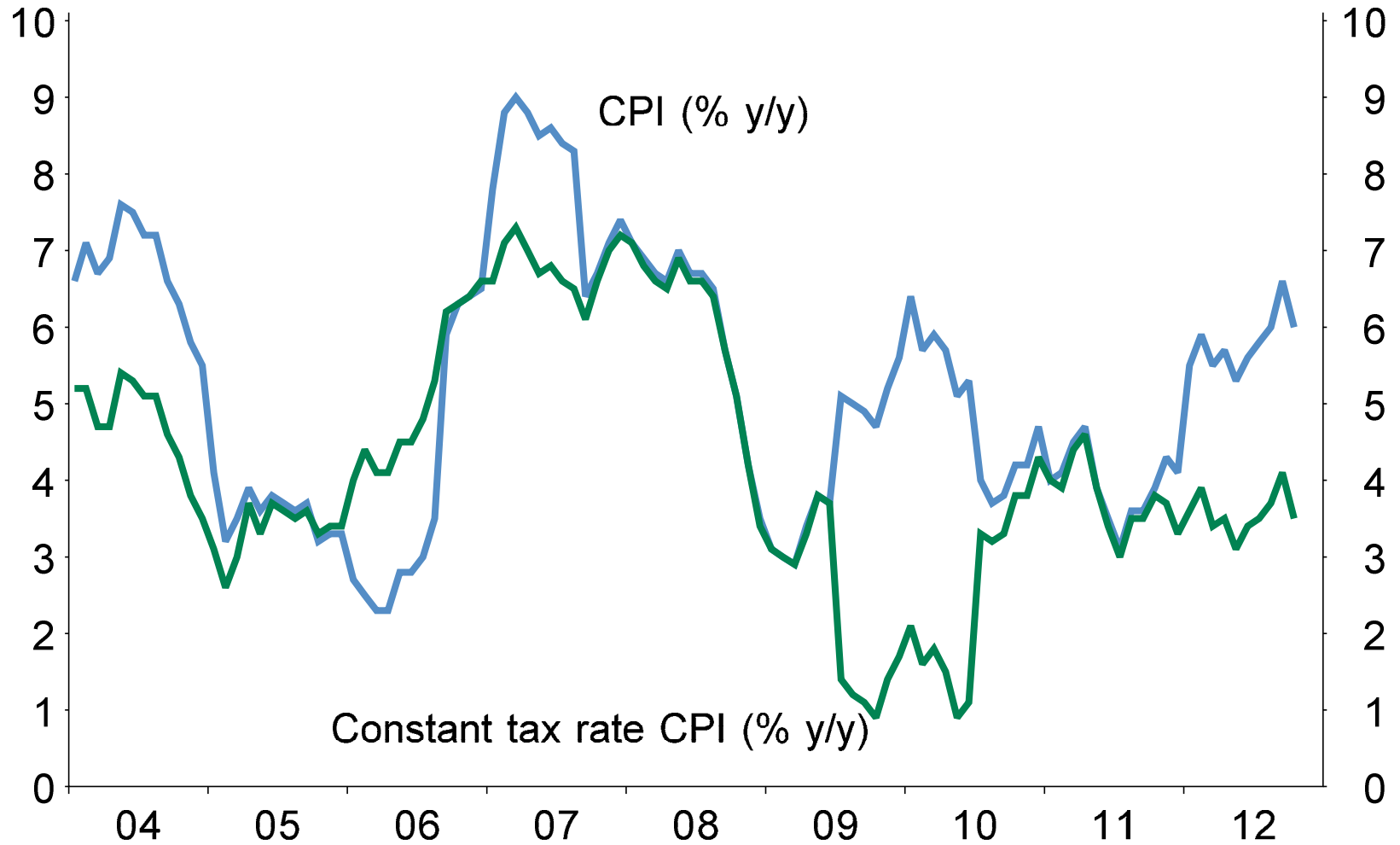
Stagflation



Source: Reuters Ecowin Pro, BNP Paribas



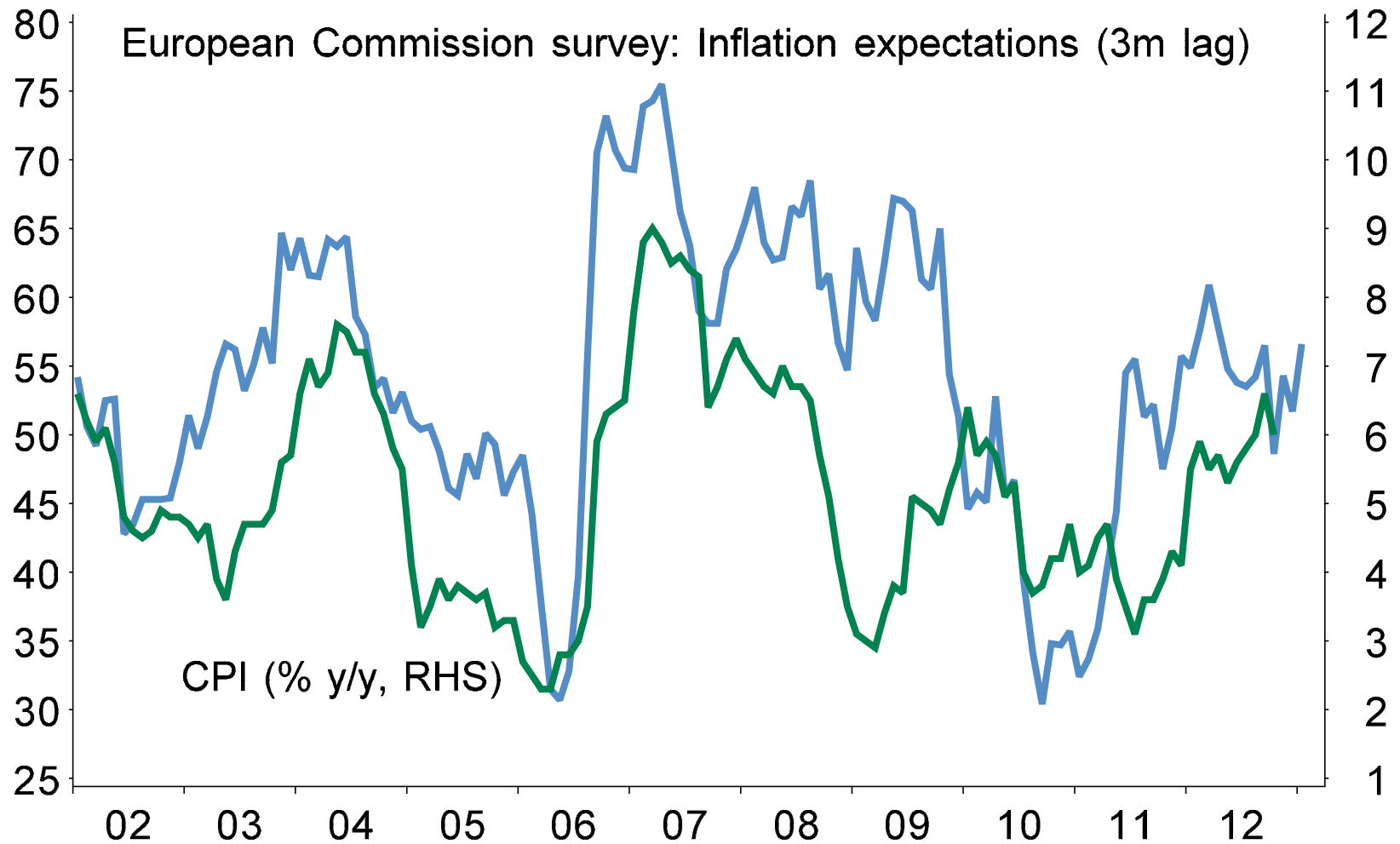
Taxes boosting inflation...



Source: Reuters Ecowin Pro, BNP Paribas



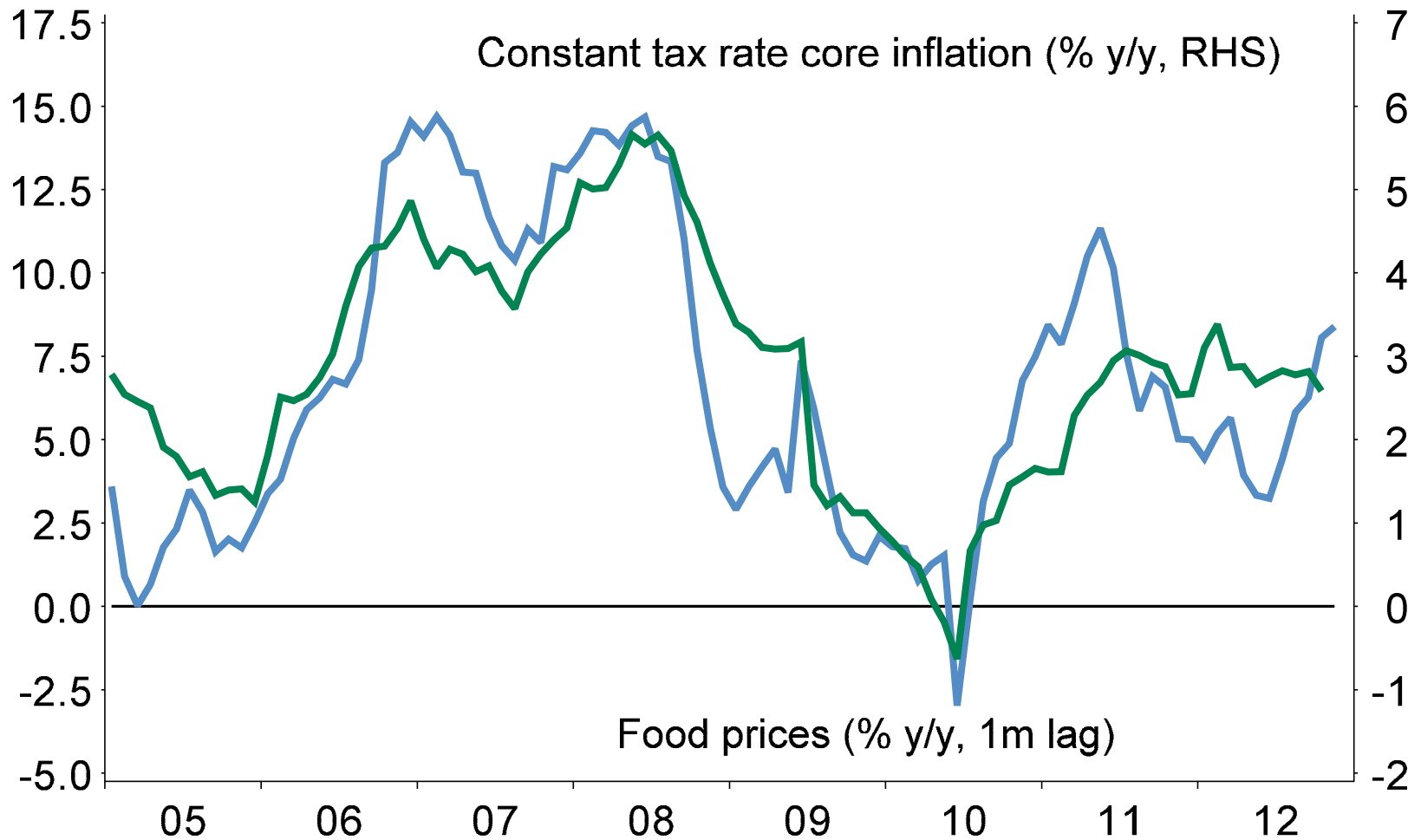
...and inflation expectations continue inching up



Source: Reuters Ecowin Pro, BNP Paribas



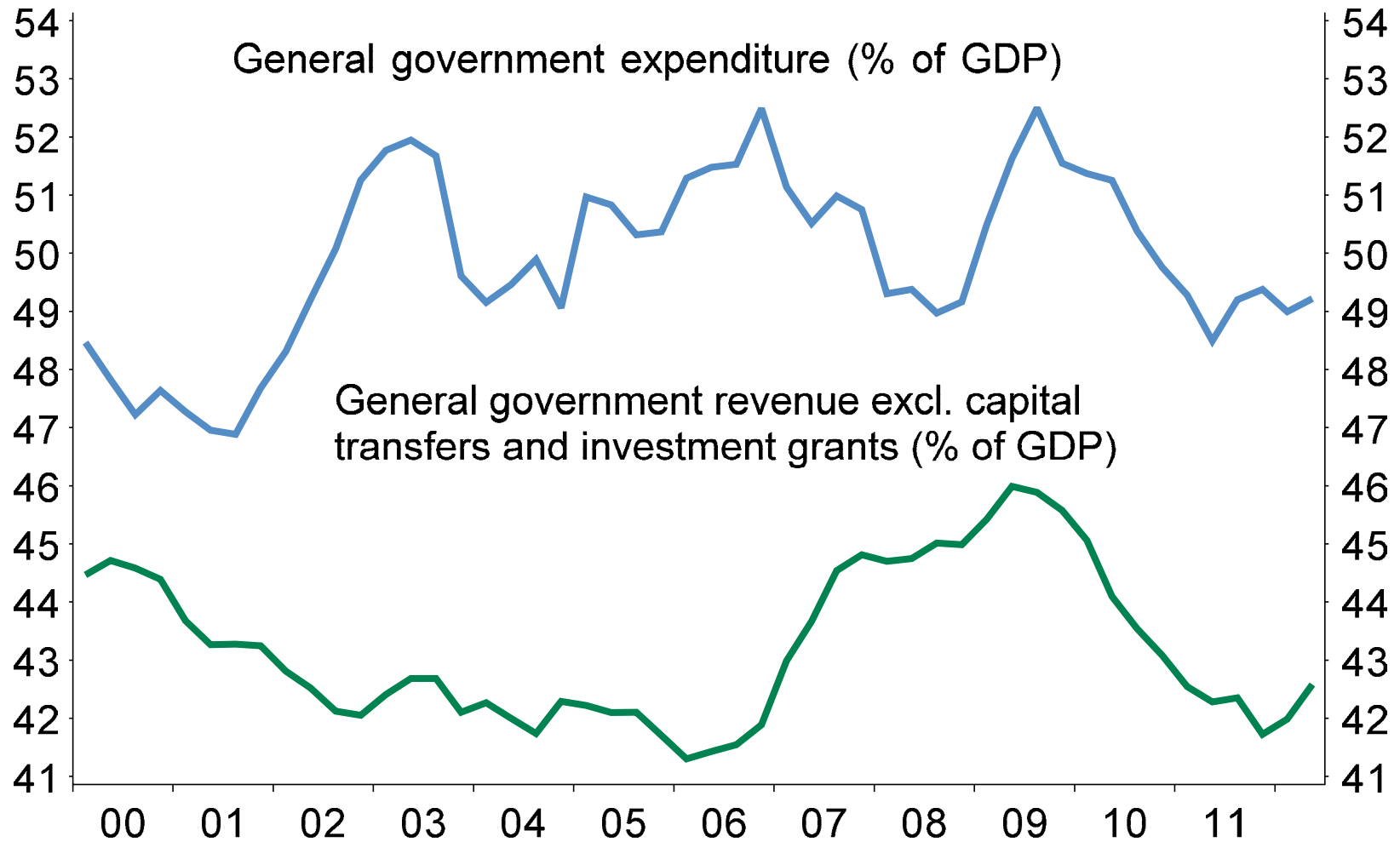
Higher food inflation is upside risk to underlying prices' growth



Source: Reuters Ecowin Pro, BNP Paribas



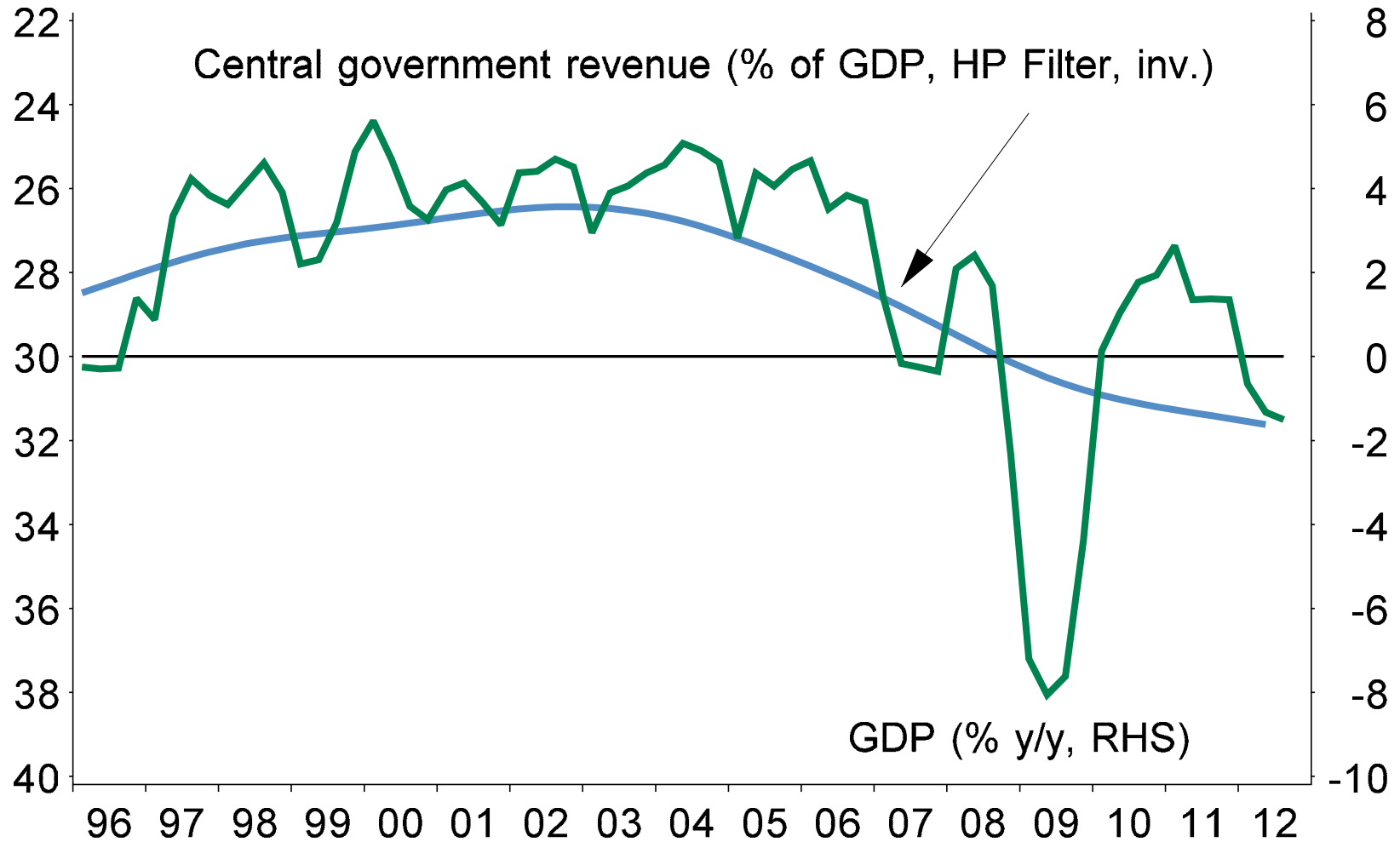
High share of fiscal redistribution requires a high level of taxes



Source: Reuters Ecowin Pro, BNP Paribas



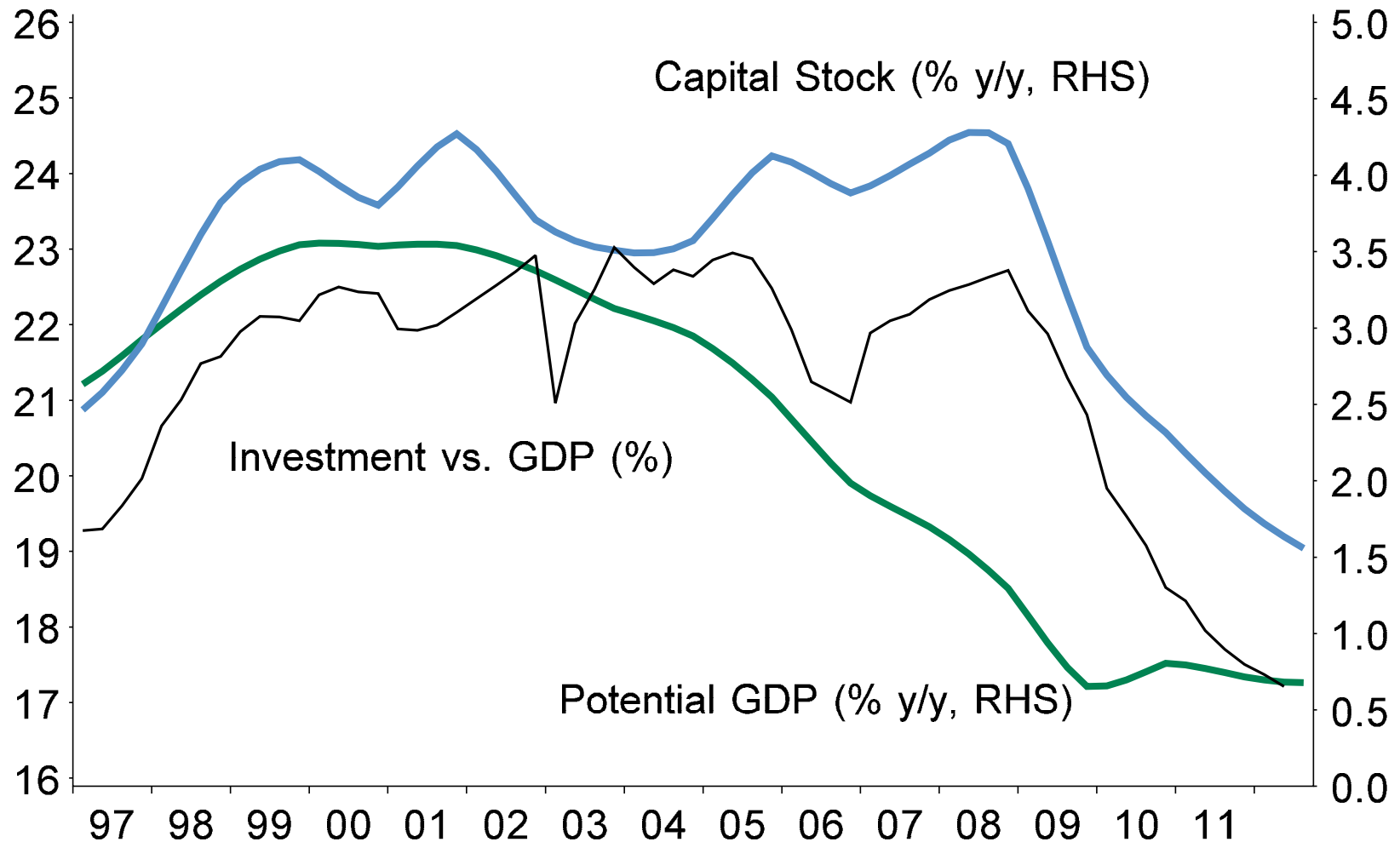
High taxes kill the economy



Source: Reuters Ecowin Pro, BNP Paribas



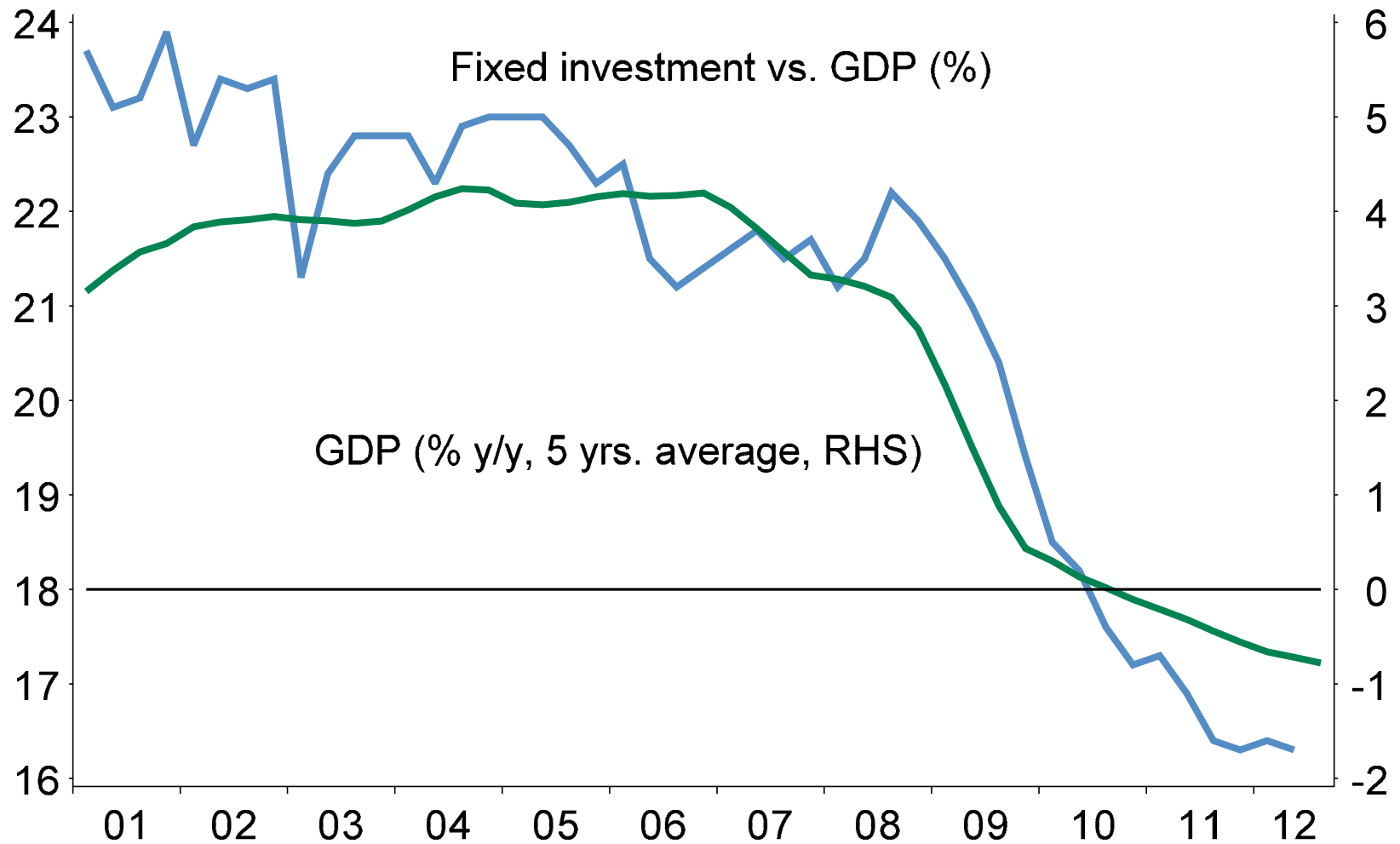
Erosion of Capital Stock (OECD estimate) points to low potential growth



Source: Reuters Ecowin Pro, BNP Paribas



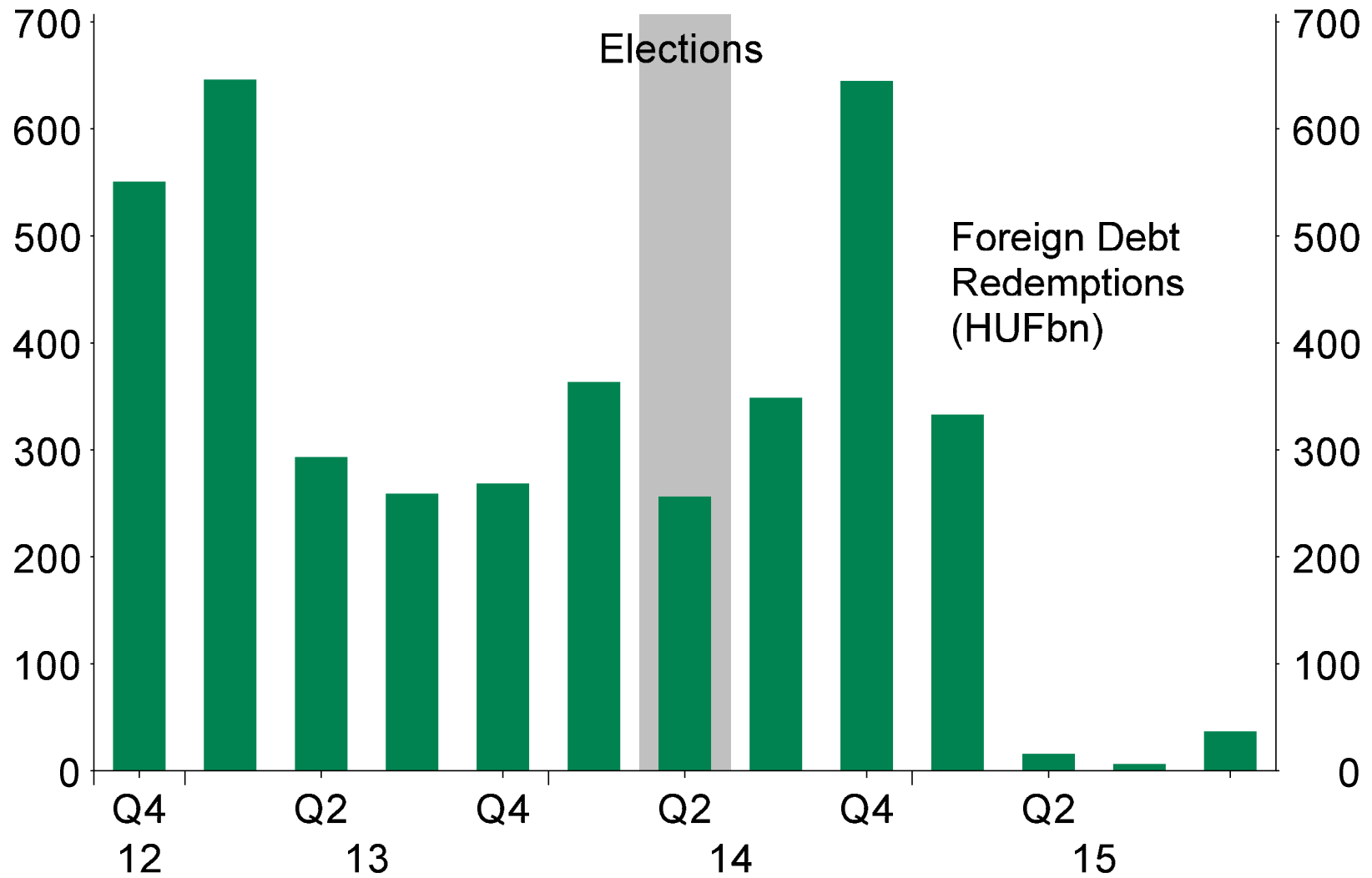
Risk is that potential growth is negative!



Source: Reuters Ecowin Pro, BNP Paribas



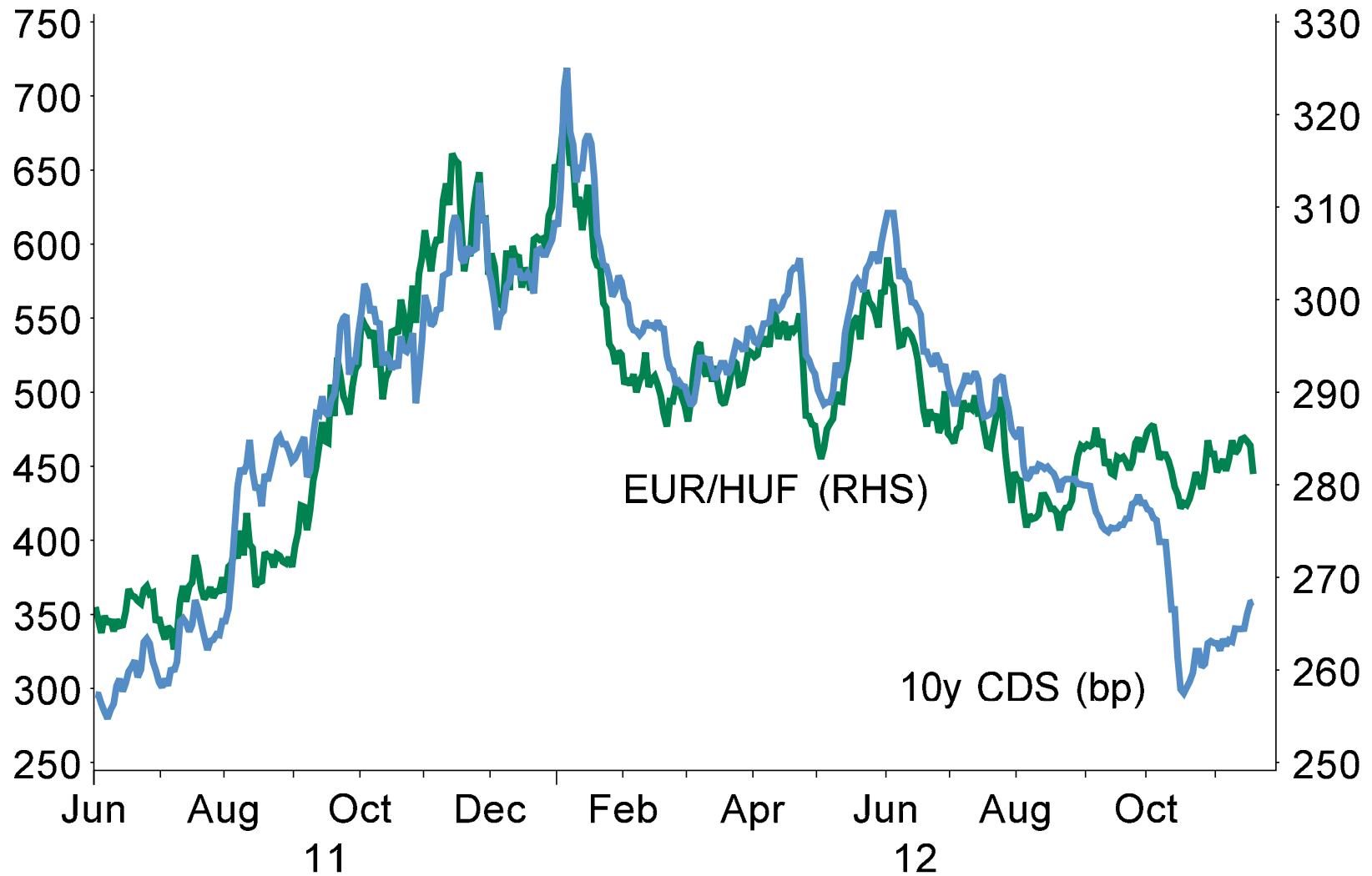
Government in no rush to sign the IMF/EU Deal...



Source: AKK, Reuters Ecowin Pro, BNP Paribas



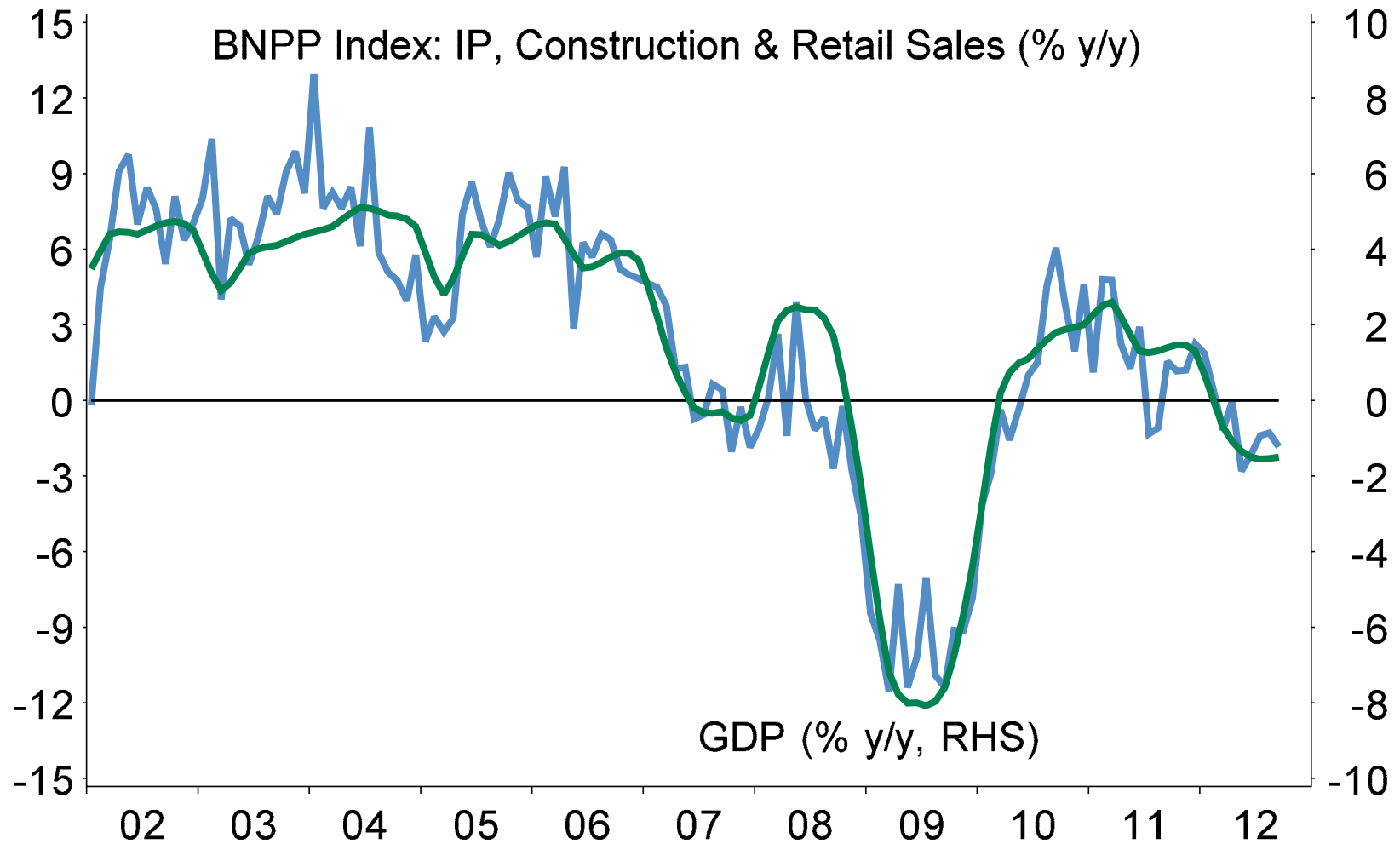
...as long as the risk premium is low



Source: Reuters Ecowin Pro, BNP Paribas



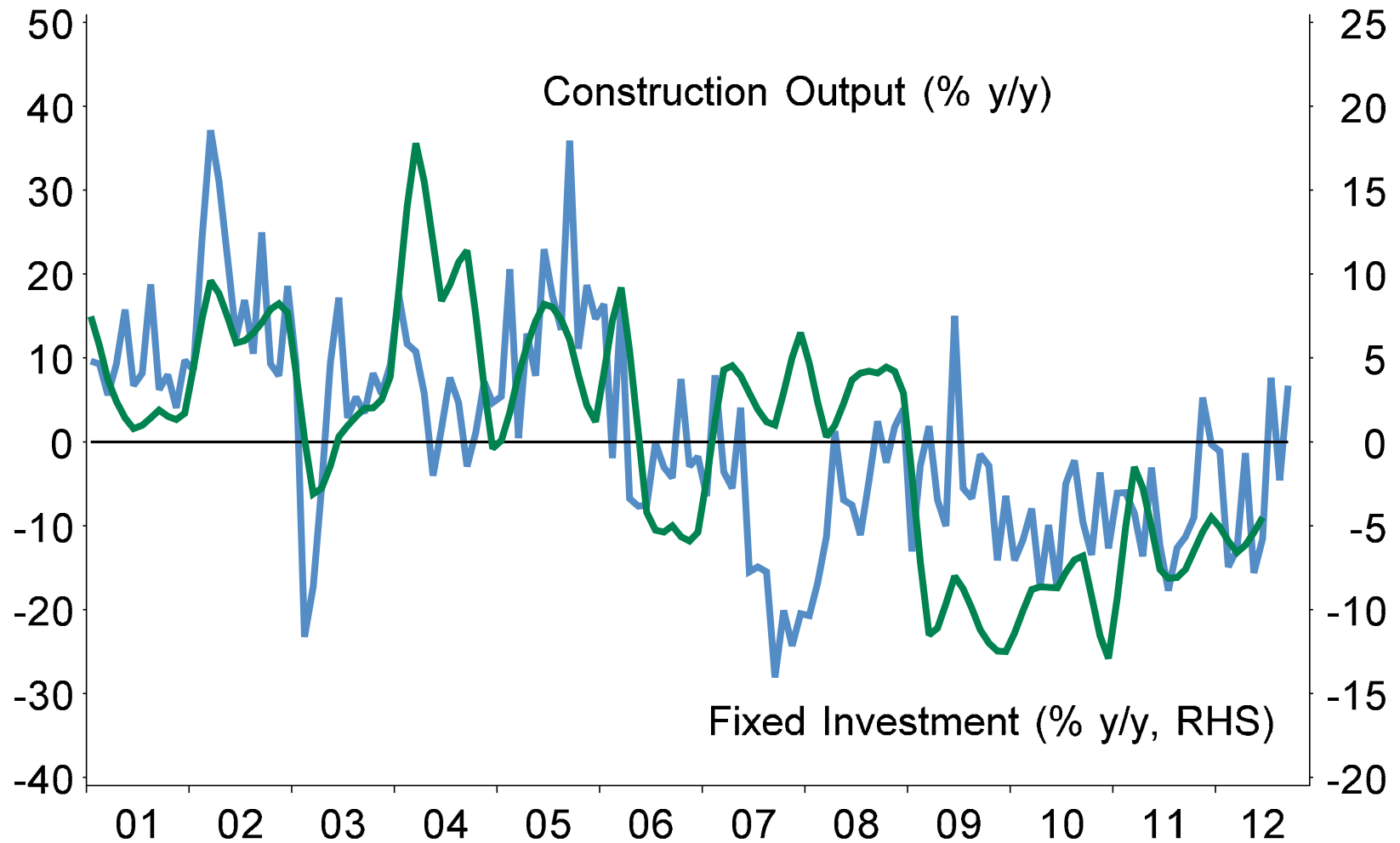
Deepening recession



Source: Reuters Ecowin Pro, BNP Paribas



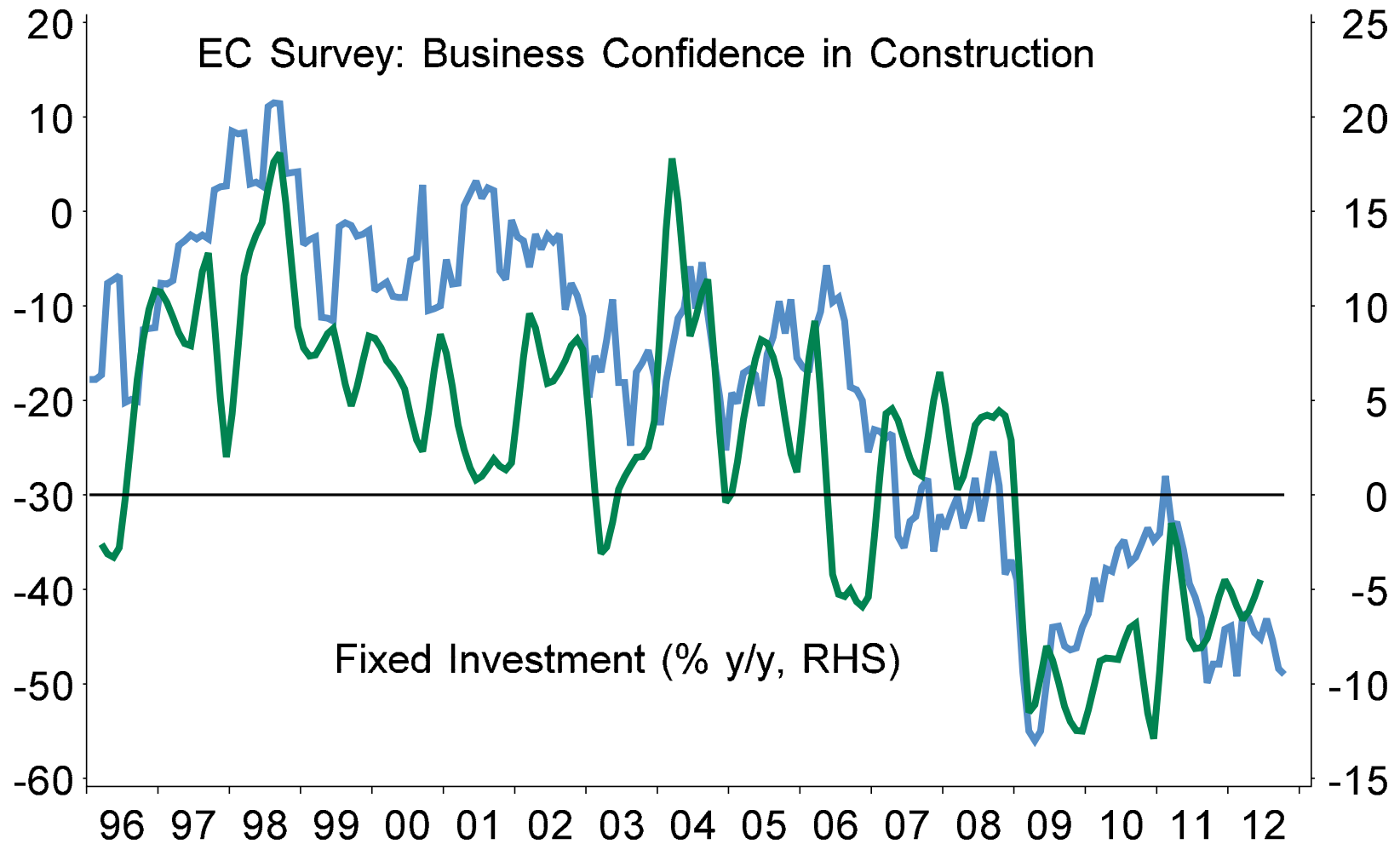
Signs of investment recovery?



Source: Reuters Ecowin Pro, BNP Paribas



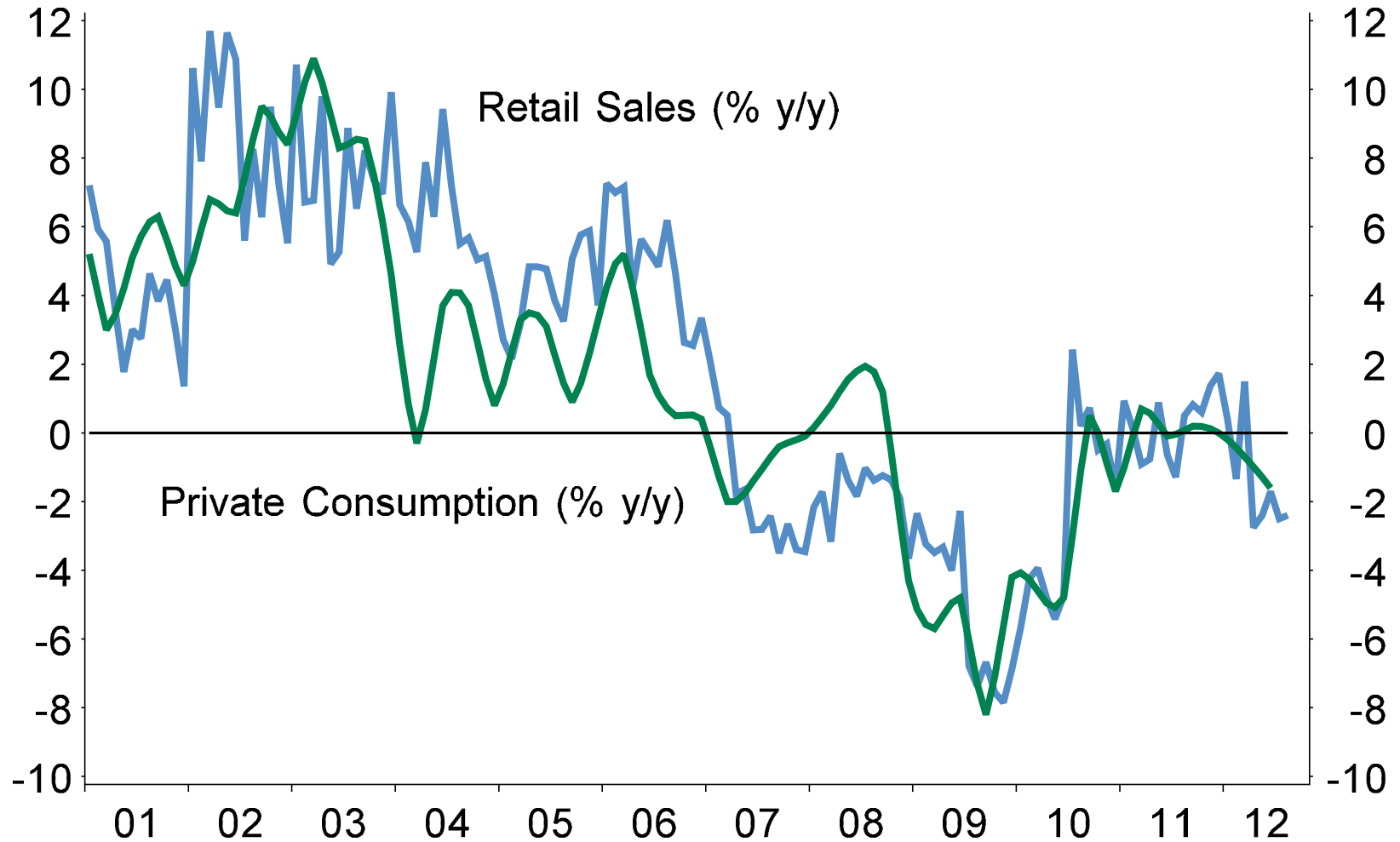
Confidence would suggest a different story



Source: Reuters Ecowin Pro, BNP Paribas



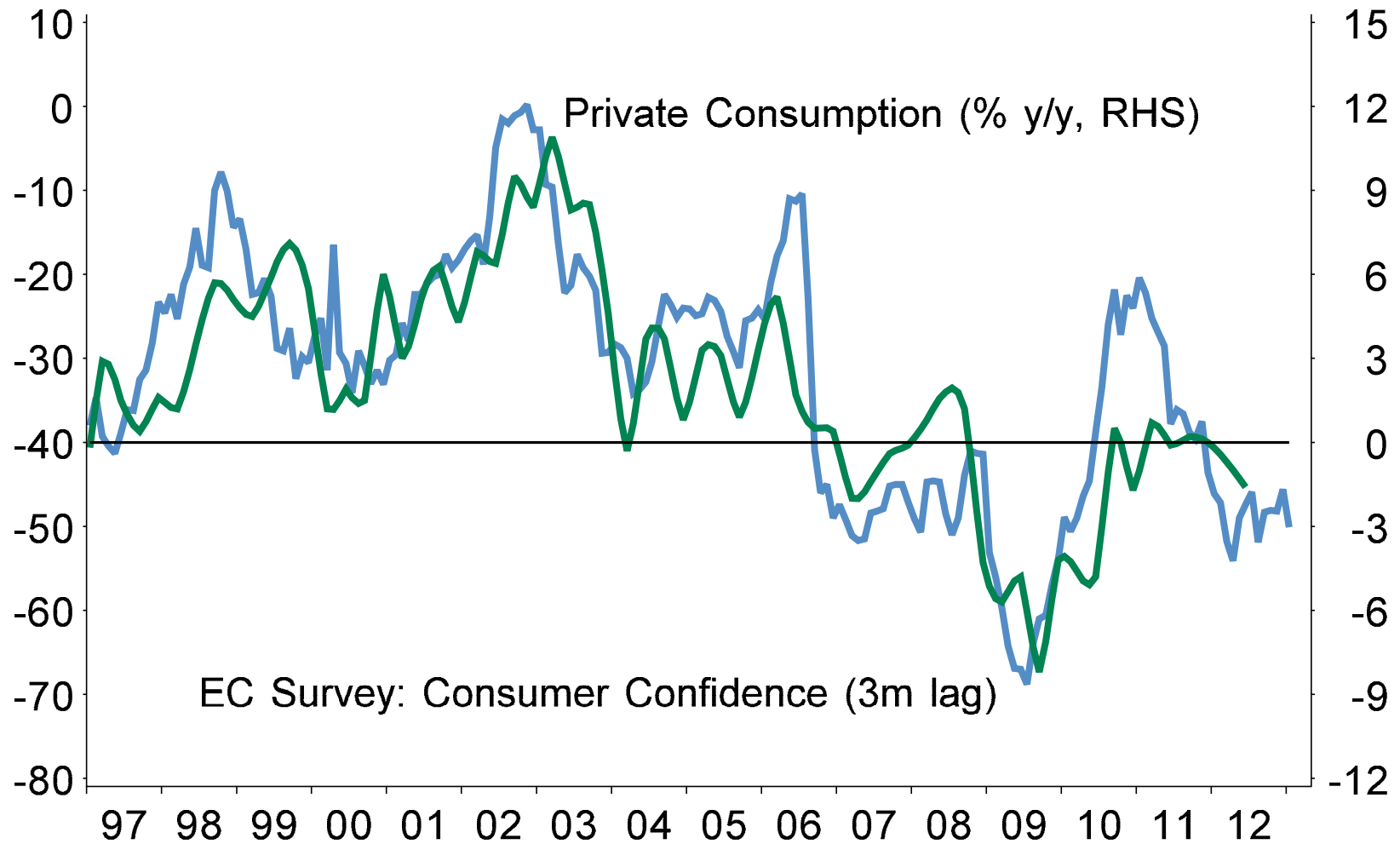
Consumer trenching in...



Source: Reuters Ecowin Pro, BNP Paribas



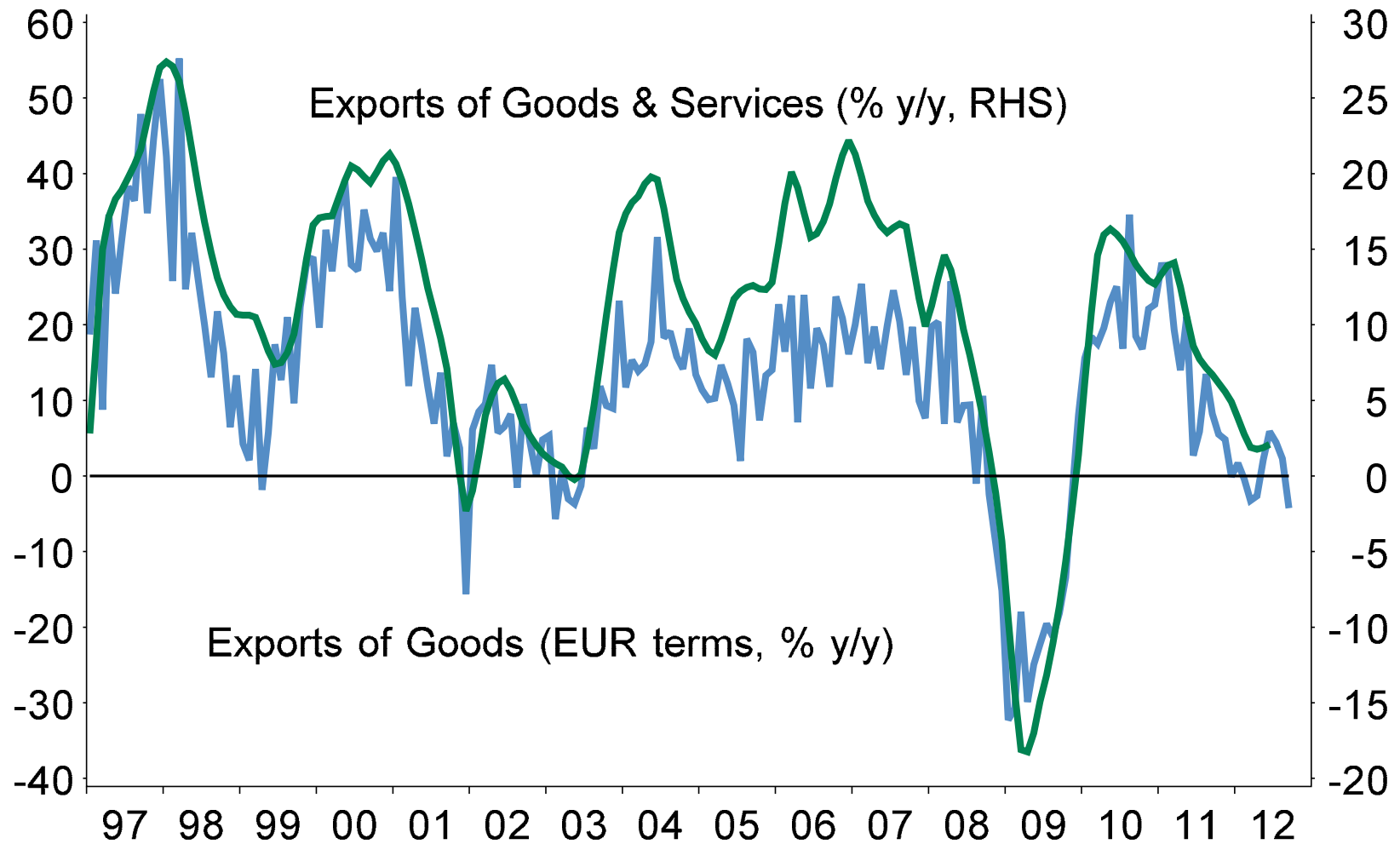
...as confidence remains depressed



Source: Reuters Ecowin Pro, BNP Paribas



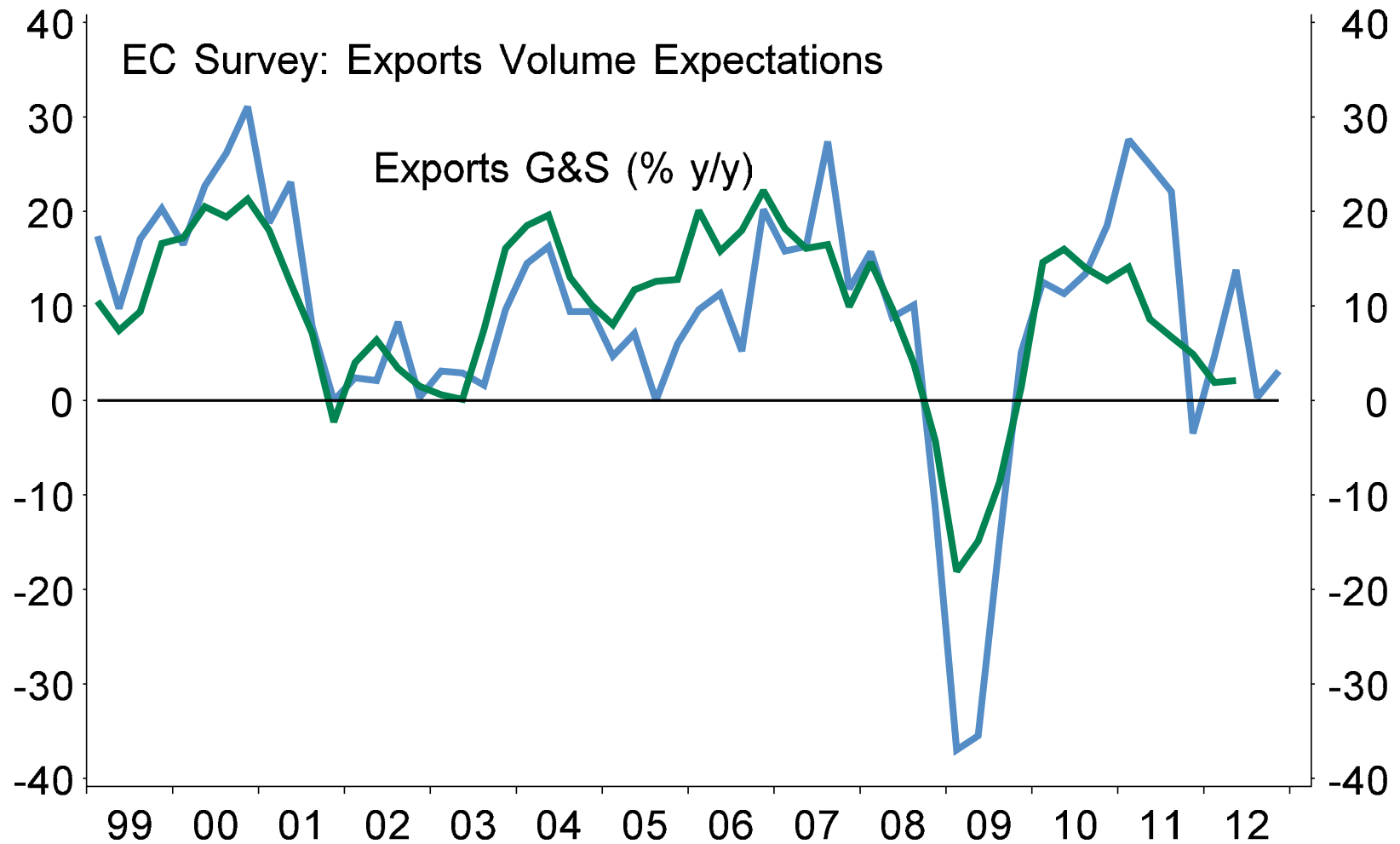
Exports falling now



Source: Reuters Ecowin Pro, BNP Paribas



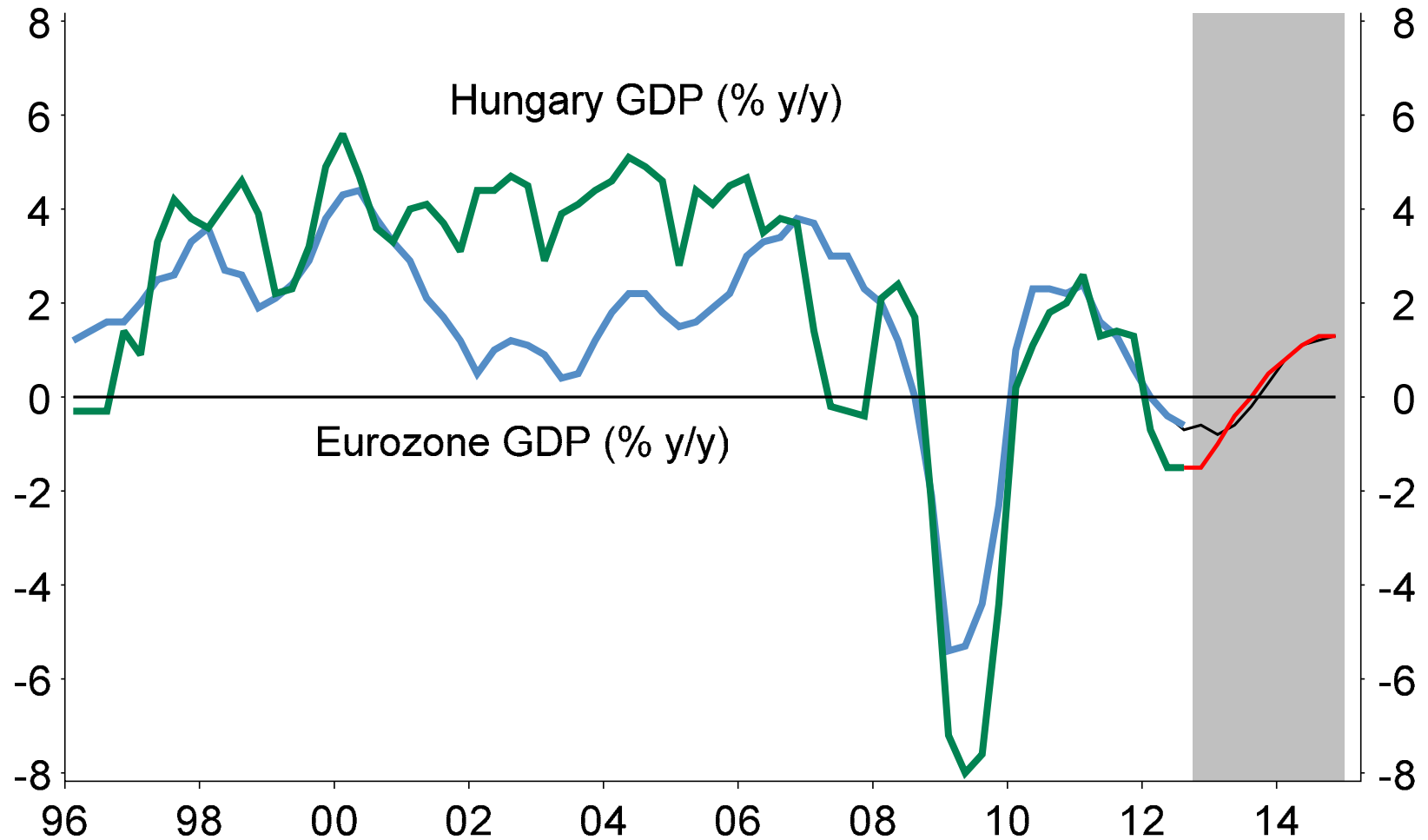
Exporters are fairly optimistic, however



Source: Reuters Ecowin Pro, BNP Paribas



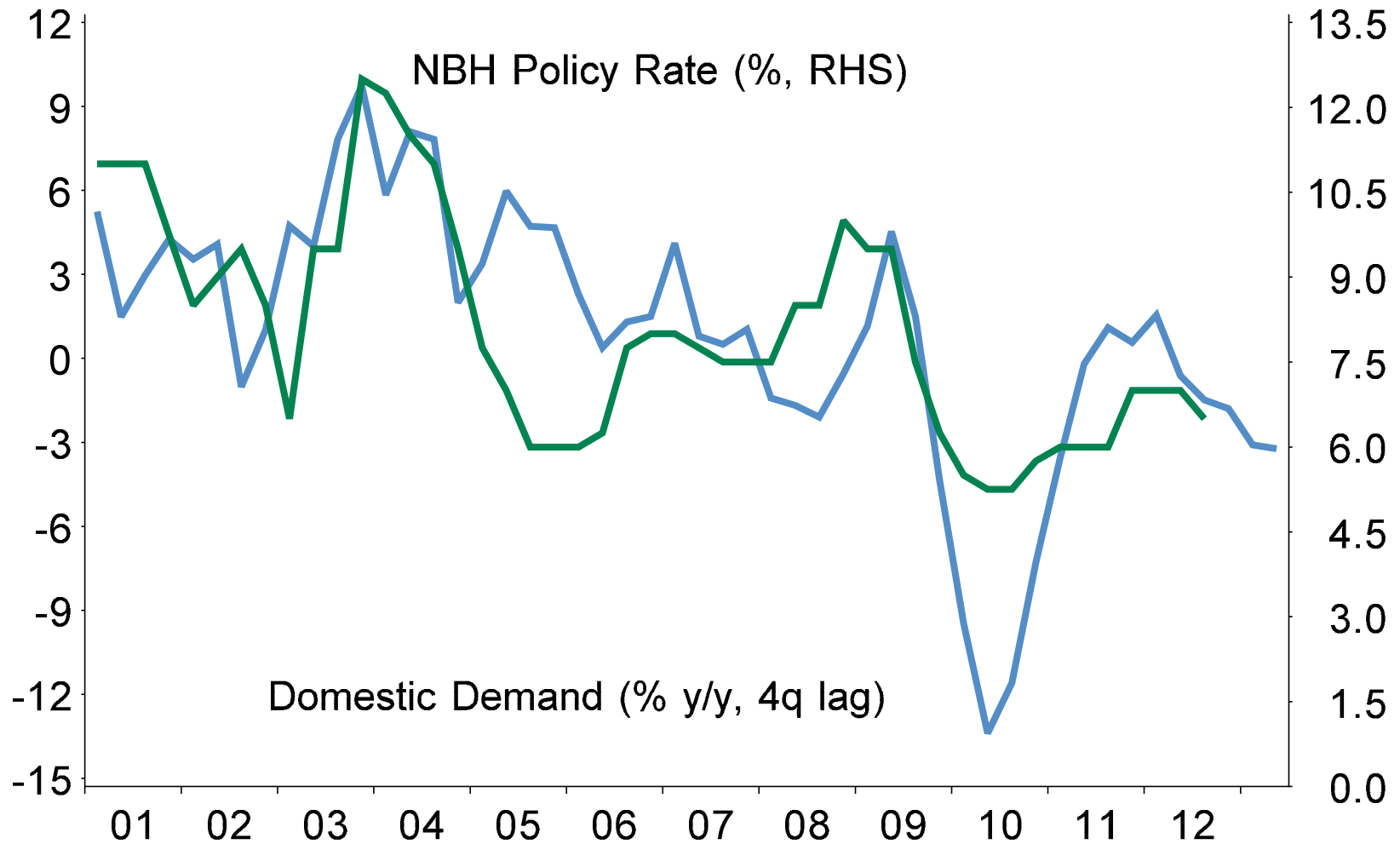
Business cycle synchronisation with the eurozone



Source: Reuters Ecowin Pro, BNP Paribas



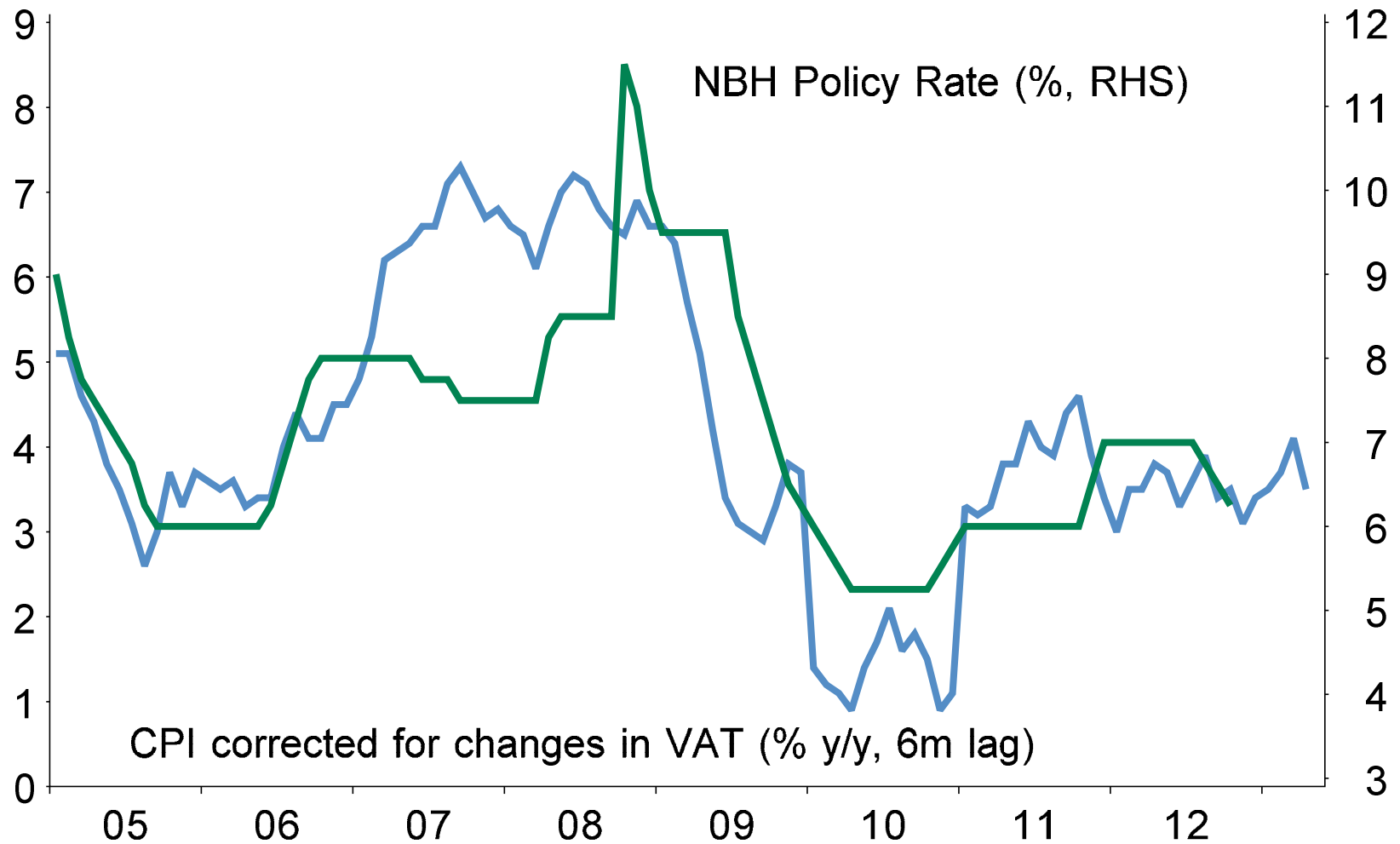
NBH in easing mode...



Source: Reuters Ecowin Pro, BNP Paribas



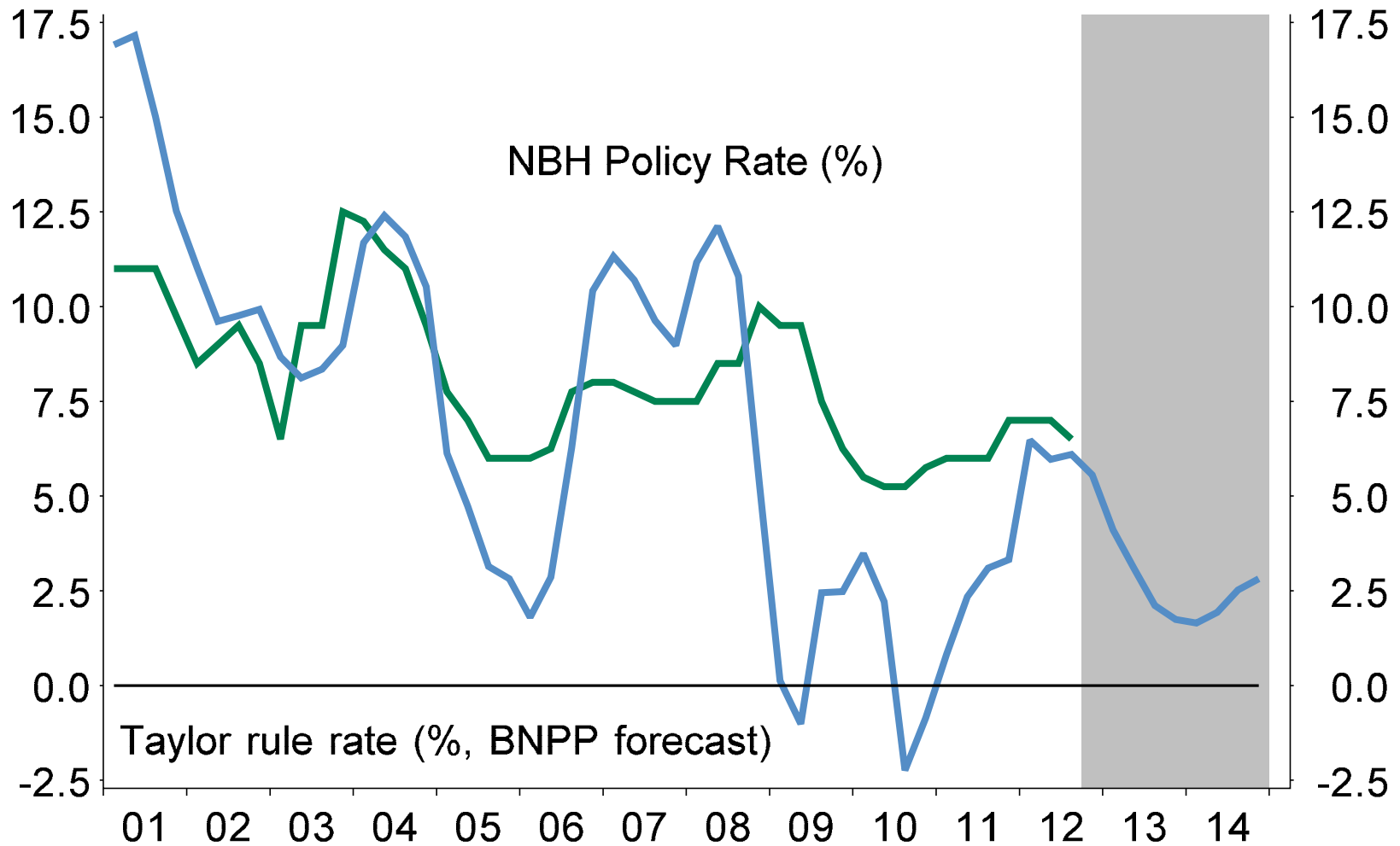
...but the previous reaction function would point to no more rate cuts



Source: Reuters Ecowin Pro, BNP Paribas



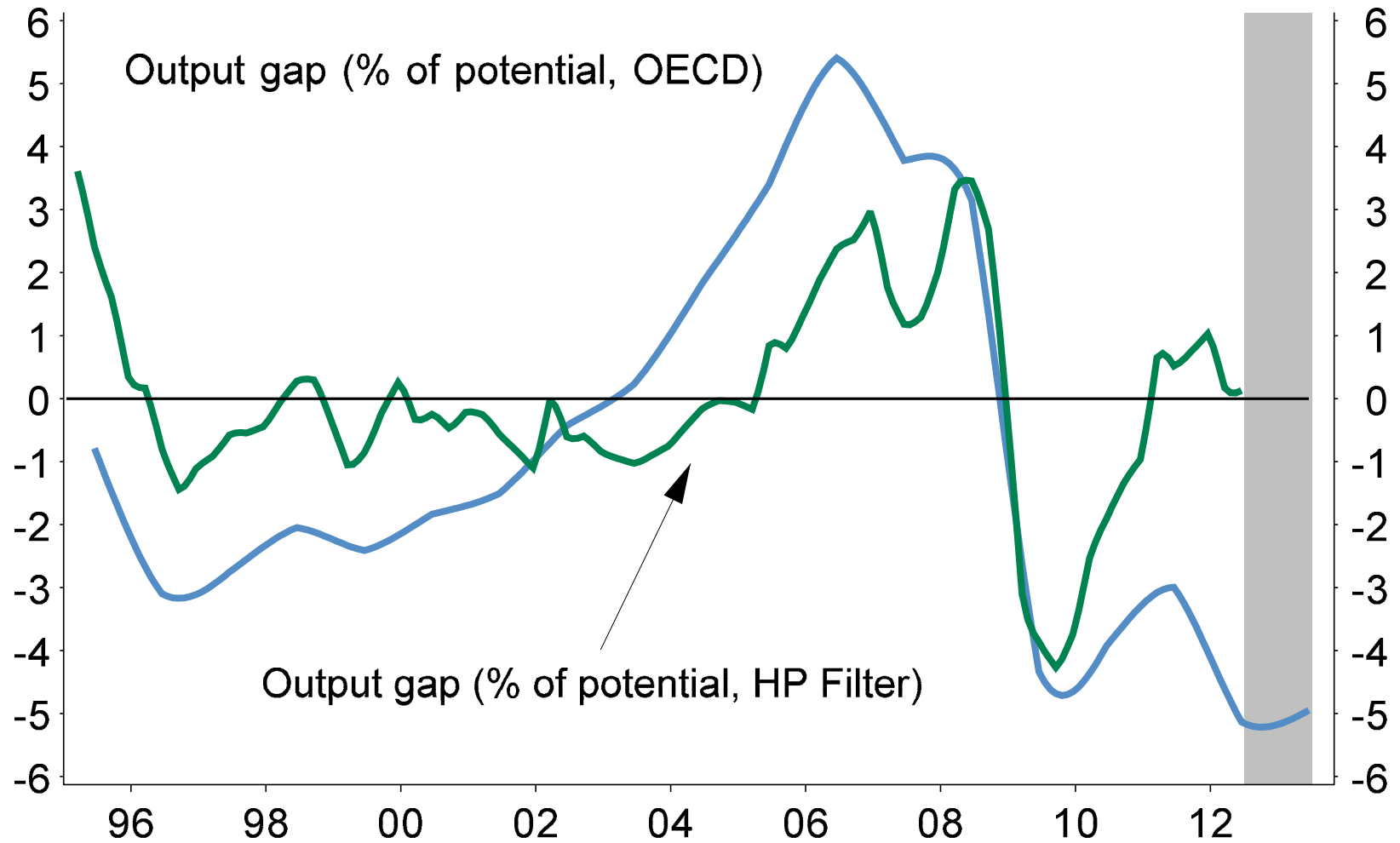
Rule-based policy rate trending down...



Source: Reuters Ecowin Pro, BNP Paribas



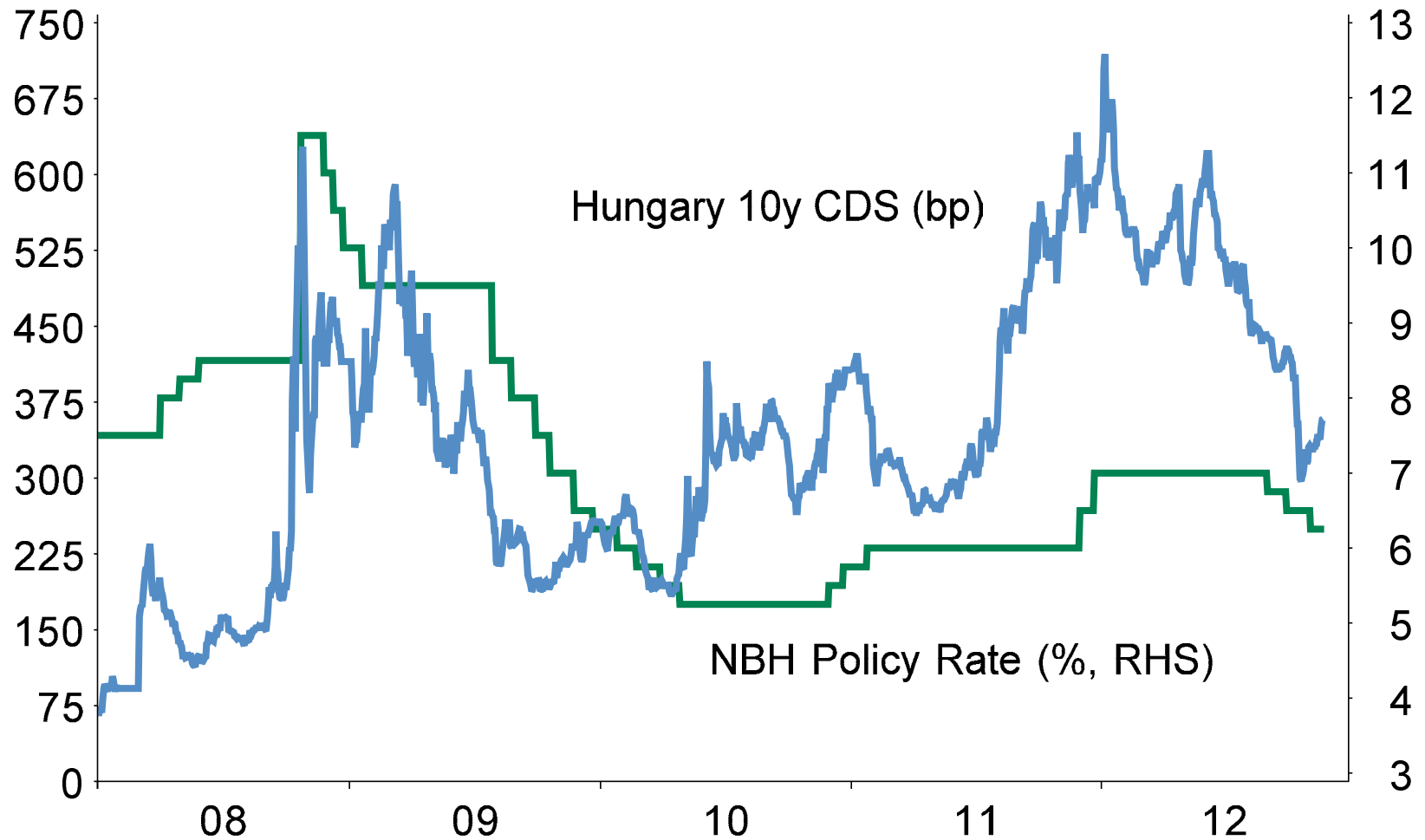
...but is there any output gap at all?



Source: Reuters Ecowin Pro, BNP Paribas



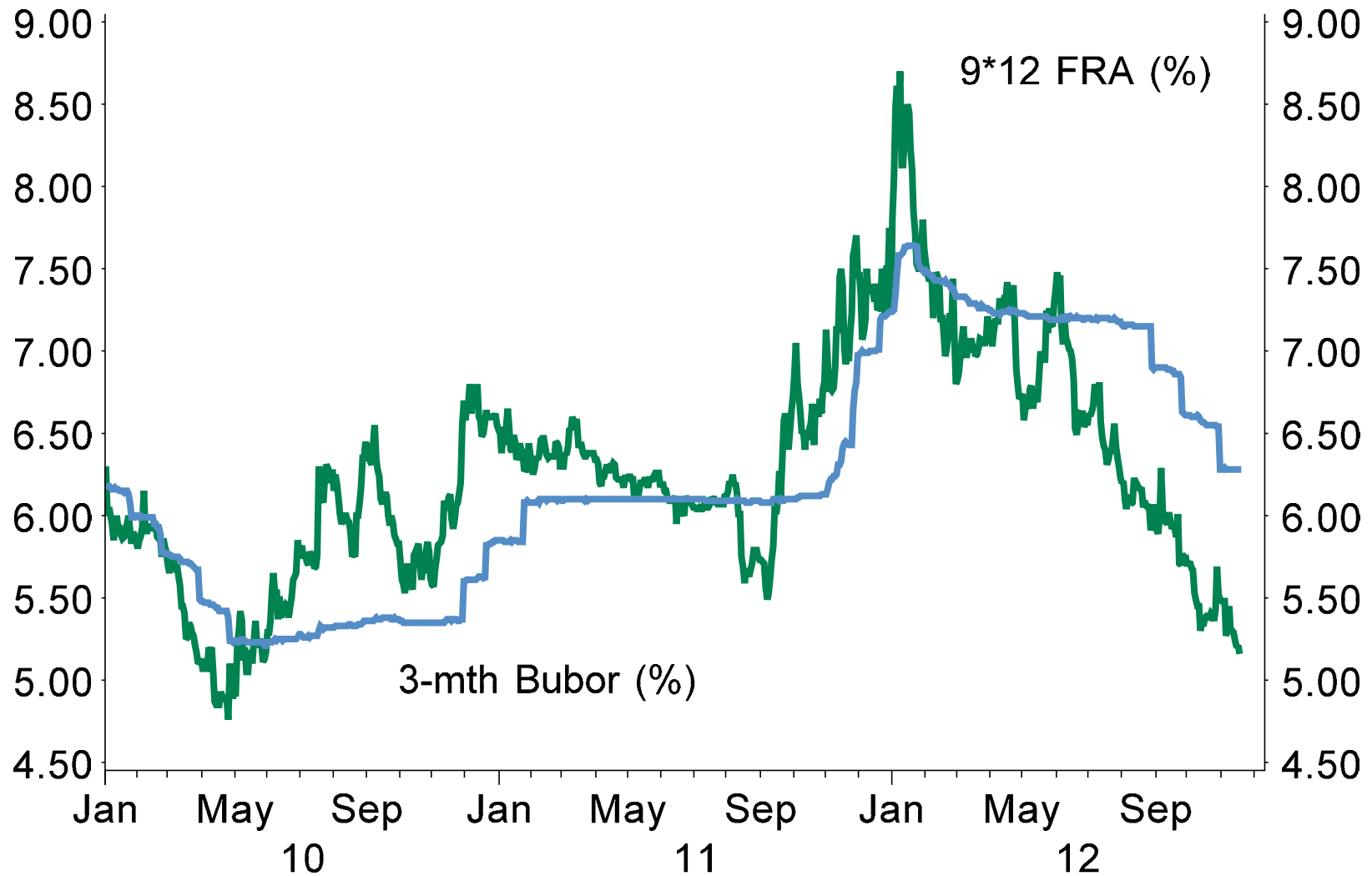
Does the link with the risk premium still work?



Source: Reuters Ecowin Pro, BNP Paribas



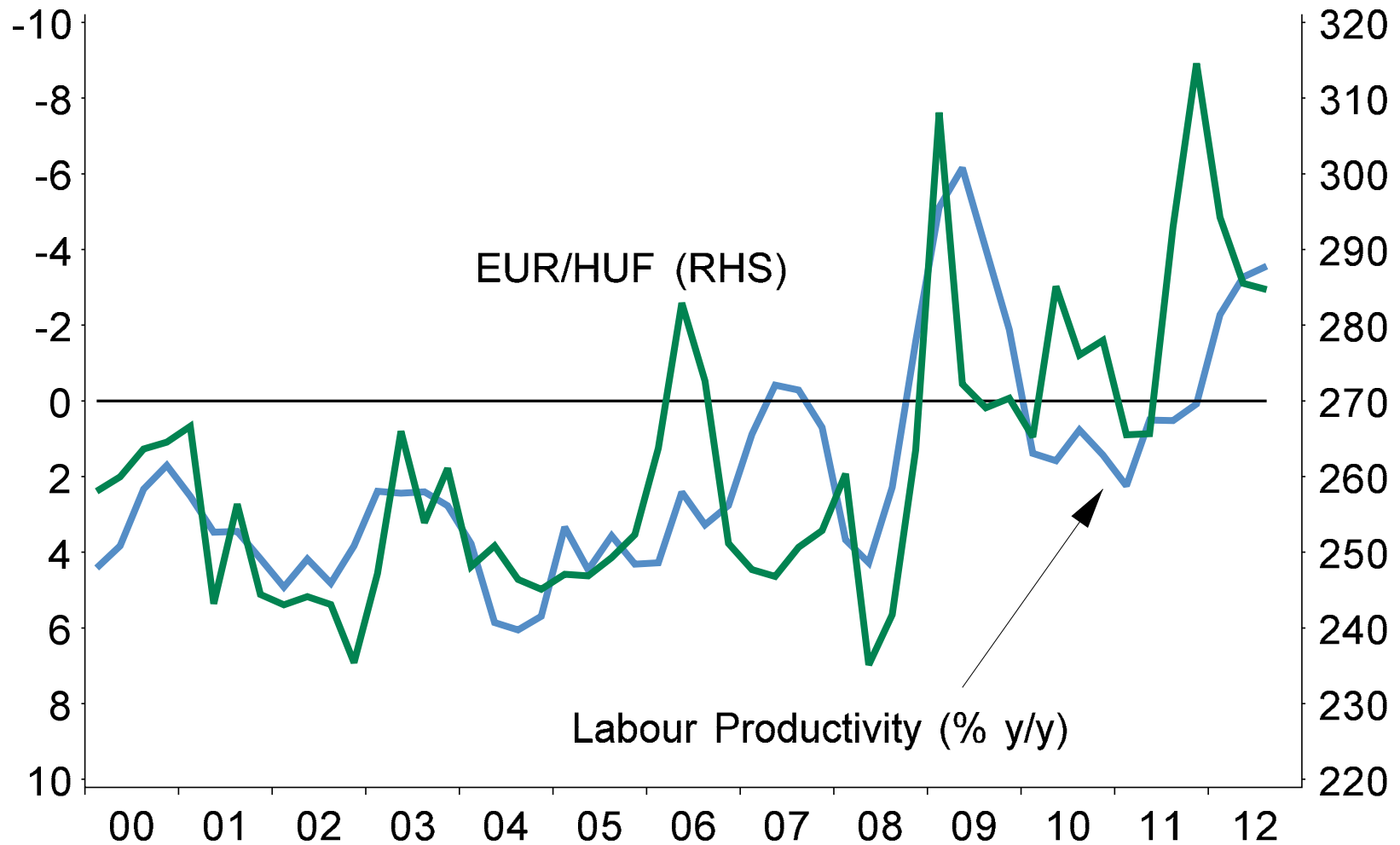
Market sees policy rate at 5.00-5.25 by the summer of 2013



Source: Reuters Ecowin Pro, BNP Paribas



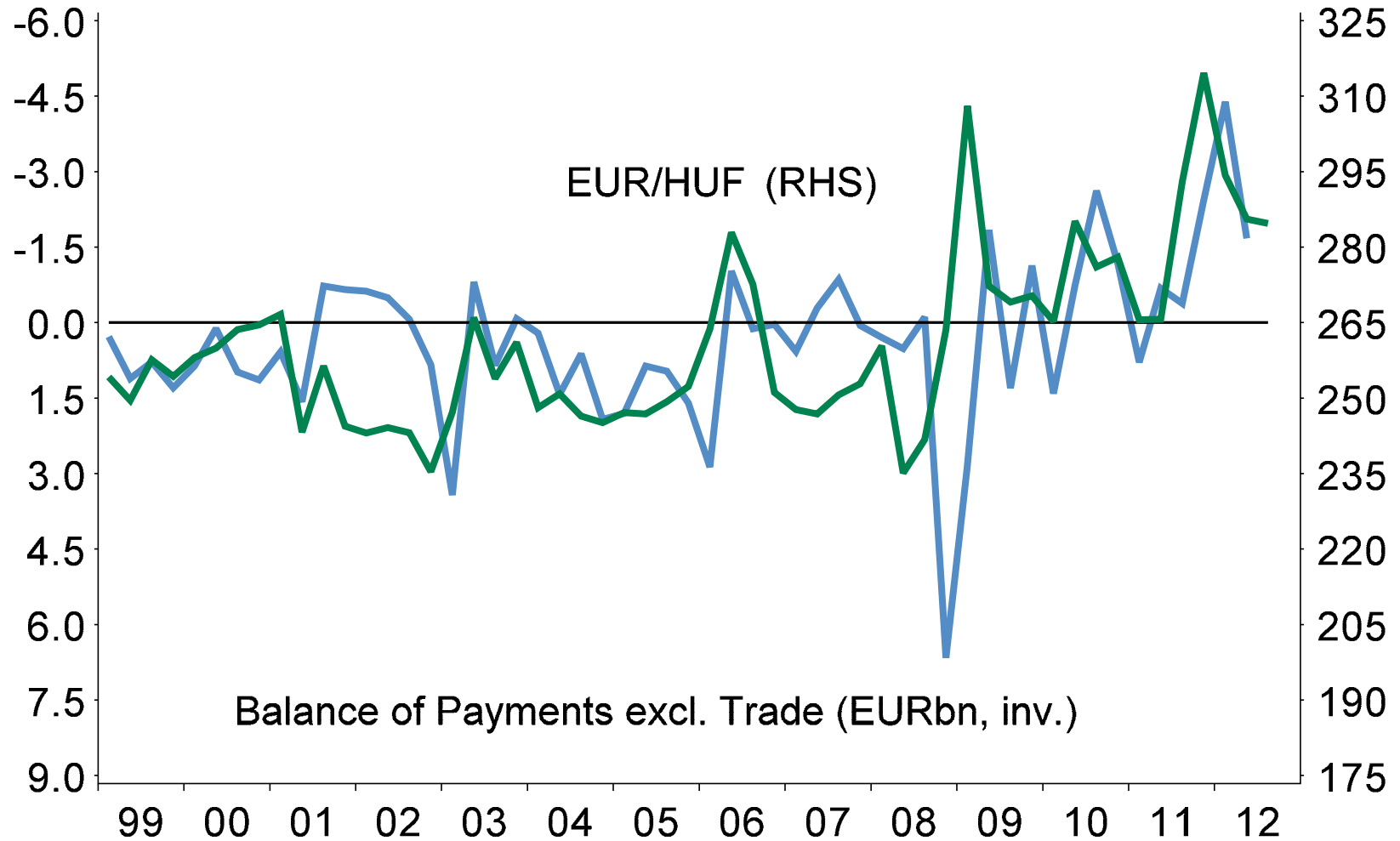
EUR/HUF in line with productivity growth (fundamentals)



Source: Reuters Ecowin Pro, BNP Paribas



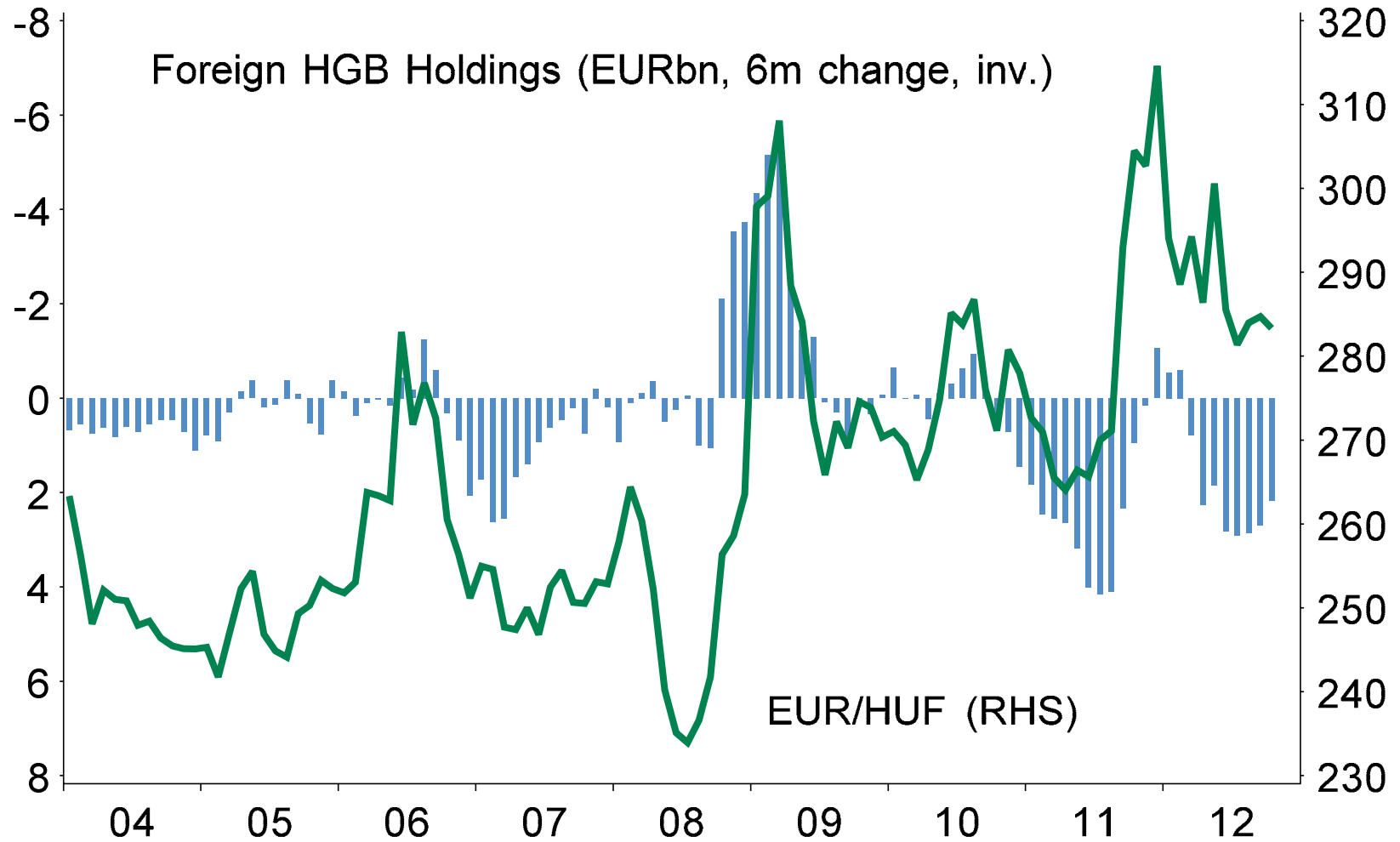
Non-trade flows drive the forint exchange rate



Source: Reuters Ecowin Pro, BNP Paribas



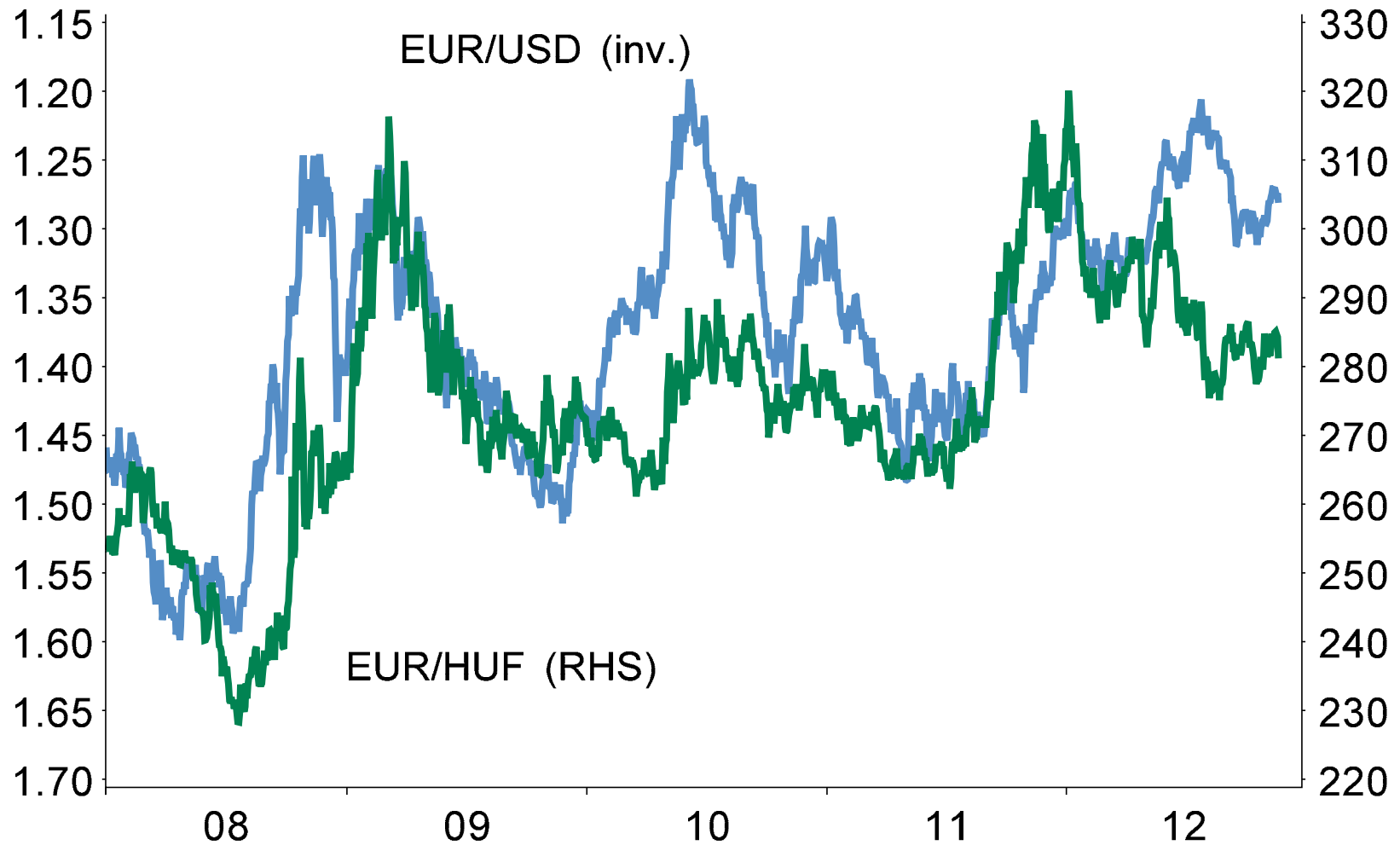
Foreign investors supporting the HUF



Source: Reuters Ecowin Pro, BNP Paribas



Correlation with EUR/USD is patchy



Source: Reuters Ecowin Pro, BNP Paribas



Economic data and forecast (1)

	Year					2012				2013			
	10	11	12 ⁽¹⁾	13 ⁽¹⁾	14 ⁽¹⁾	Q1	Q2	Q3 ⁽¹⁾	Q4 ⁽¹⁾	Q1 ⁽¹⁾	Q2 ⁽¹⁾	Q3 ⁽¹⁾	Q4 ⁽¹⁾
Components of growth													
GDP (% q/q)	-	-	-	-		-1.1	-0.4	-0.2	-0.3	-0.1	0.1	0.2	0.3
GDP	1.3	1.7	-1.3	-0.3	1.1	-0.7	-1.5	-1.5	-1.5	-1.0	-0.4	0.0	0.5
Final domestic demand	-3.8	-1.2	-2.2	-1.1	0.2	-1.4	-2.3	-2.6	-2.2	-1.8	-1.2	-1.1	-0.3
Private consumption	-2.7	0.2	-1.7	-1.3	-0.2	-0.7	-1.6	-2.4	-2.0	-1.8	-1.5	-1.1	-0.9
Public consumption	1.4	-2.4	0.0	0.1	0.0	1.0	-2.9	1.1	1.0	0.1	1.4	-0.6	-0.5
Fixed investment	-9.3	-5.3	-5.2	-1.1	1.9	-6.6	-4.5	-5.5	-4.4	-2.8	-2.0	-1.3	1.6
Stocks (cont. to growth, y/y)	3.1	0.6	-0.8	-0.3	0.0	-1.2	-0.9	-0.5	-0.7	-0.7	-0.2	-0.1	-0.4
Exports	14.3	8.6	2.0	3.8	7.0	1.9	2.1	1.9	1.9	1.8	2.9	4.3	6.2
Imports	12.8	6.6	-0.3	1.2	5.6	-0.3	0.2	-0.5	-0.6	-1.3	0.5	1.9	3.9
Industrial production	10.6	5.9	-0.8	0.2	2.0	0.0	-0.8	-1.4	-1.1	-1.2	-0.6	0.6	2.1

	Year					2012				2013			
	10	11	12 ⁽¹⁾	13 ⁽¹⁾	14 ⁽¹⁾	Q1	Q2	Q3 ⁽¹⁾	Q4 ⁽¹⁾	Q1 ⁽¹⁾	Q2 ⁽¹⁾	Q3 ⁽¹⁾	Q4 ⁽¹⁾
Inflation & labour													
CPI	4.9	3.9	5.8	5.7	3.6	5.6	5.5	6.1	5.9	5.8	5.9	5.6	5.4
Core CPI	3.0	2.7	5.1	5.4	3.2	5.1	4.9	5.2	5.1	5.4	5.8	5.3	5.0
Employment	0.0	0.8	1.2	-0.2	0.1	1.6	1.8	0.7	0.7	-0.4	-0.4	-0.2	-0.1
Wages	1.5	5.2	3.4	5.2	4.0	4.4	4.3	2.0	2.8	4.4	4.6	6.7	5.2
ULC	-2.9	1.0	0.7	-0.6	-0.5	1.6	3.5	-1.6	-0.9	-0.7	-1.6	0.8	-0.8
Unemployment rate (%)	11.2	10.9	11.1	11.4	11.4	11.7	10.9	11.0	11.0	12.0	11.2	11.2	11.1

	Year					2012				2013			
	10	11	12 ⁽¹⁾	13 ⁽¹⁾	14 ⁽¹⁾	Q1	Q2	Q3 ⁽¹⁾	Q4 ⁽¹⁾	Q1 ⁽¹⁾	Q2 ⁽¹⁾	Q3 ⁽¹⁾	Q4 ⁽¹⁾
External trade													
Trade balance (EUR bn)	3.21	3.36	5.70	6.14	6.55	1.75	1.91	1.08	0.96	1.91	1.85	1.18	1.20
Current account (EUR bn)	1.03	0.91	0.00	1.73	1.91	-0.01	0.64	-0.13	-0.51	0.53	0.81	0.25	0.14
Current account (% of GDP)	1.1	0.9	0.1	1.6	1.7	0.0	2.7	-0.5	-1.7	2.1	3.0	0.9	0.4



Economic data and forecast (2)

	Year					2012				2013			
	10	11	12 ⁽¹⁾	13 ⁽¹⁾	14 ⁽¹⁾	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Financial variables													
General gov. budget (HUF bn)	-1185	1544	-894	-882	-1057	-	-	-	-	-	-	-	-
General gov. budget (% GDP)	-4.5	5.5	-3.1	-2.9	-3.3	-	-	-	-	-	-	-	-
Primary budget (% GDP)	-0.3	9.7	1.6	1.2	0.6	-	-	-	-	-	-	-	-
General gov. debt (% GDP)	81.4	80.8	78.6	77.1	76.8	-	-	-	-	-	-	-	-

	Year					2012				2013			
	10	11	12 ⁽¹⁾	13 ⁽¹⁾	14 ⁽¹⁾	Q1	Q2	Q3	Q4 ⁽¹⁾	Q1 ⁽¹⁾	Q2 ⁽¹⁾	Q3 ⁽¹⁾	Q4 ⁽¹⁾
Interest rates & bonds⁽²⁾													
Policy rate (%)	5.75	7.00	5.75	5.00	5.00	7.00	7.00	6.50	5.75	5.00	5.00	5.00	5.00
3-month rate (%)	5.85	7.24	5.90	5.10	5.10	7.25	7.20	6.61	5.90	5.10	5.10	5.10	5.10
3-year bond (%)	7.85	9.21	5.95	5.15	6.50	8.87	7.67	6.71	5.95	5.65	5.40	5.30	5.15
5-year bond (%)	7.99	9.79	6.55	5.75	6.95	9.08	7.92	6.84	6.55	6.25	6.05	5.95	5.75
10-year bond (%)	8.09	9.90	6.75	6.05	7.45	9.21	8.02	7.36	6.75	6.45	6.30	6.20	6.05
Spread over Bund (bp)	513	807	550	430	510	740	642	593	550	525	500	470	430
Interest rate swaps⁽²⁾													
3-year swap (%)	6.80	7.37	5.50	5.00	6.30	7.21	6.61	6.15	5.50	5.15	5.05	5.20	5.00
5-year swap (%)	7.05	7.40	5.60	5.25	6.80	7.14	6.53	6.18	5.60	5.35	5.20	5.30	5.25
10-year swap (%)	7.28	7.55	5.90	5.40	6.80	7.36	6.71	6.58	5.90	5.65	5.50	5.55	5.40
FX rates⁽²⁾													
EURHUF	278	315	285	275	270	294	286	285	285	288	280	280	275
USDHUF	208	243	214	208	216	220	226	221	214	213	212	207	208

Footnotes: (1) Forecast (2) End period

Figures are year-on-year percentage changes unless otherwise indicated

Source: BNP Paribas



Back of the envelope calculations for GDP growth, incl. fiscal measures

- Size of fiscal austerity packages is a HUF 854 billion (in gross terms):
 - 1st package – HUF 397bn;
 - 2nd package – HUF 367bn;
 - 3rd package – HUF 90bn;
- which combined equals to approximately 3% of GDP
- Let's assume the net impact on the economy to be half of the gross amount, i.e. In the order of 1.5pp of GDP;
- The fiscal multiplier is about 0.7 (potentially more);
- Fiscal measures will thus subtract some 1pp of GDP next year;
- Potential GDP growth in Hungary is about 0.5% y/y;
- Thus next year's actual GDP growth should be around -0.5% y/y.
- If the fiscal multiplier is higher (and/or potential GDP growth lower), the sacrifice in GDP will be bigger.



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