MONTHLY MONITOR

SZÁZADVÉG GAZDASÁGKUTATÓ

September 2020

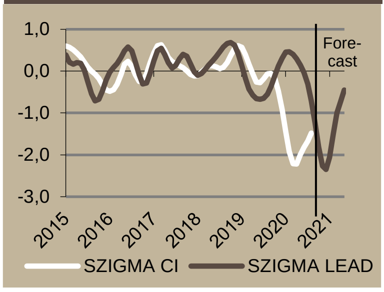
Q2 saw a 13.6% downturn

The coronavirus pandemic hit the Hungarian economy in Q2 2020, the GDP shrank by 13.6%. Compared to the same period of the previous year, the pandemic caused a downturn in almost all sectors.

The virus affected consumption as well. Household consumption spending shrank by 8.4% on a year-on-year basis, which is explained by the lockdown and the unavailability of some services during that period. In contrast, community consumption increased by 5.8%. Investments shrank by 13.5% because of the increasing economic uncertainty and the drop in sales. The change of the foreign trade balance also contributed to the downturn: exports shrank by 24.0%, imports shrank by 15.8% on a year-on-year basis.

With the lifting of the lockdown, the economy could restart, although this is still far from complete. Although June's retail sales were already 0.4% higher than one year before, its industrial output was still 8.1% below the figure recorded one year before. This downturn was, however, much less severe than the one seen during April and May. The construction industry does, however, not show any signs of restarting and, because of the weak demand, its July output was also about one fifth below the level measured in the same period of 2019. Taking all these factors into account, this year's economic output could be 5.2% lower than one year before and the next year might see a growth of 4.5%.

SZIGMA indicators

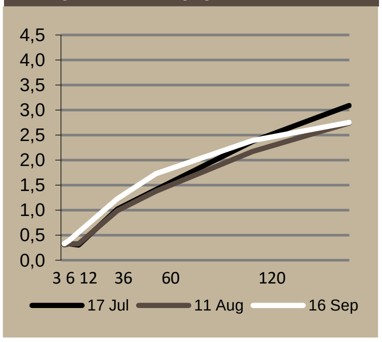


Source: Századvég

Forecast (10 September 2020)

	2020
GDP volume change (%)	5.2
Inflation (annual average, %)	3.7
Gross wages (annual change, %)	9.8
EUR/HUF	349

HUF yield curve (%)



Source: Datastream

Economic overview

External environment

The European Central Bank predicts a downturn rate of 8.0% in the eurozone for this year.

At its September meeting, while not changing its monetary conditions, the European Central Bank published its latest forecasts for the eurozone. This forecasts a possible economic downturn rate of 8.0% in 2020 and a possible growth rate of 5.0% for 2021 and one of 3.2% for 2022. In other words, the eurozone economy could reach its pre-crisis level only in 2023. The inflation rate could persistently remain below the central bank's target and be 0.3% in 2020, 1.0% in 2021 and 1.3% in 2022. The forecasts show that employment in the eurozone could resume increasing only in 2022; the unemployment rate could, therefore, peak at 9.5% in the next year. The crisis might entail loose fiscal policies in the eurozone, which could in turn lead to a budget deficit-to-GDP ratio of 8.8% in 2020, which could then reduce only to 3.6% by 2022. Consequently, the sovereign debt-to-GDP ratio could increase from last year's 84.0% to 100.7% this year and could reduce by less than 2 percentage points in the next two years.

After increasing by 0.4% in Q1, the number of employees in the European Union decreased by 2.9% in Q2, falling back to its early-2017 level. The primary cause of the downturn is the economic difficulties caused by the coronavirus pandemic, which some businesses tried to manage by introducing reduced working hours instead of layoffs, reducing the number of hours worked by 13.8% on a quarter-on-quarter basis. This pushed the number of hours worked to the lowest level since the start of the data series in 1995. Among the larger Member States, the number of employees shrank by 1.3% in Germany, 7.6% in Spain, 3.0% in France and 3.6% in Italy during Q2. Compared to the same period of the previous year, however, a more significant downturn could be seen in terms of working hours, i.e. 10.0%, 24.6%, 18.7% and 20.1%, respectively. Employment with reduced working hours, however, also means reduced incomes, which makes the recovery more difficult through decreasing consumption demand.

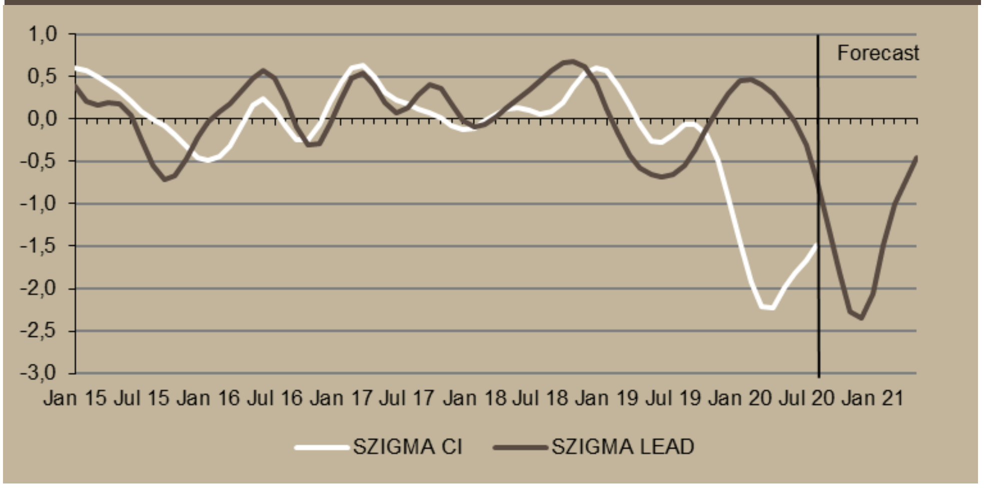
SZIGMA indicators

The virus caused the Hungarian economy to perform way below the trend.

The SZIGMA CI indicator, which provides a picture of the current status of the Hungarian economy, indicated a slight improvement in August 2020; its negative value, however, means that the Hungarian economy has continued to grow below the trend. In July 2020, domestic and export industrial sales remained below their levels measured for the same period (by 8.5% and 6.5%, respectively), but they increased on a month-over-previous-month basis. On a year-on-year basis, new domestic and export sales orders slightly decreased in volume (by 4.8% and 6.1%, respectively), while on a month-on-previous-month basis, new domestic sales orders increased in volume. Industrial output is expected to expand in the remainder of this year; its contribution to growth is, however, still a question and greatly depends on the second wave of the pandemic and the recovery of external demand. The end-of-month volume of contracts in the construction industry was substantially, 21.1% below the level measured in July 2019. The number of new non-residential building projects was 39.8% lower in July 2020 than in July 2019, which is explained by the coronavirus pandemic and the high base value.

The SZIGMA LEAD indicator, which expresses our expectations for the short-term performance of the Hungarian economy, indicates that growth will be below the trend in the entire forecast period. The Ifo Business Climate index, which shows the changes of the of the German economy’s business climate, improved on a month-on-previous-month basis (by 2.2 index points) but was still below the August 2019 level (by 2.0 index points). The improving sentiment of the external environment is encouraging; its contribution to Hungarian economic output is, however, expected to be negative because of the slow recovery (indicated by the data) and the uncertainty regarding the second wave. Retail sales could slightly increase on a year-on-year basis in July 2020, indicating that the slow recovery could continue. In the remainder of this year, retail could contribute to the growth of the Hungarian economy. The consumer trust index measured by Eurostat improved by 2.7 index points on a month-over-previous-month basis but was 17.0 index points below the level measured in August 2019. The negative index value implies that trust needs to be improved for increasing sales in the segment. Overall, the economic shock resulting from the coronavirus pandemic could reduce the output of the Hungarian economy by 5.2%; this could, however, be materially affected by the reopening of the economy, the development of external demand, and any potential subsequent waves of the pandemic.

Fig 1 Szigma simultaneous (CI) and leading (LEAD) indicators



Source: Századvég

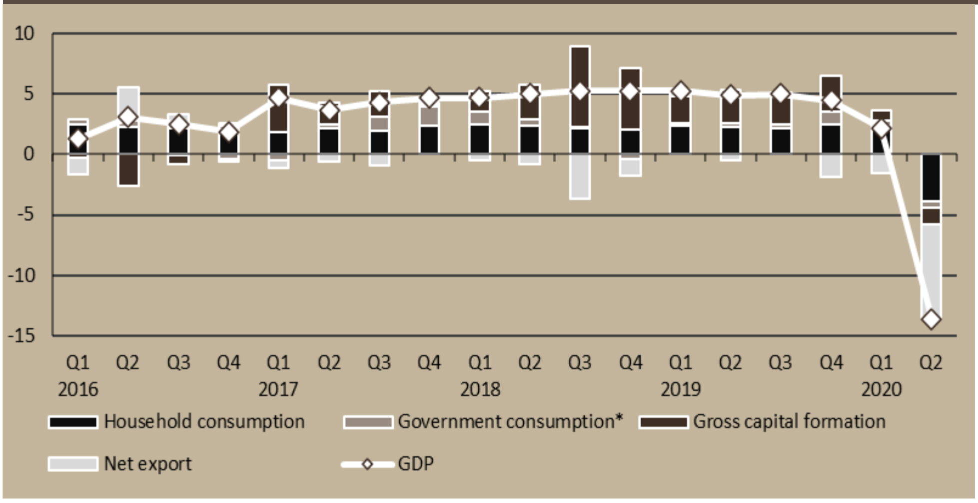
Real economy

The output of the Hungarian economy shrank by 13.6% in Q2.

The second estimate of the Hungarian Central Statistical Office for Q2 2020 showed a 13.6% decrease in the Hungarian gross domestic product because of the state of danger caused by the coronavirus pandemic. Seasonally and calendar-adjusted data show that the GDP volume was 13.5% smaller than in the same period of the previous year and 14.5% smaller than the figure for the preceding quarter.

On the production side, the added value generated by agriculture was 2.1% lower than one year before. In the period under review, the added value generated by the industry decreased, relative to Q2 2019, by 20.1%; within it, the manufacturing industry decreased by 21.7%. The added value generated by the construction industry in Q2 2020 was 13.2% smaller, that of services was 12.2% smaller than one year before. Agriculture meant 0.1 percentage points, the industry meant 4.3 percentage points, the construction industry meant 0.7 percentage points and services meant 6.8 percentage points in the decrease of the GDP.

Fig 2 Contribution to y-o-y GDP-growth (expenditure approach; %)



Source: HCSO. *: with any kind of social transfers

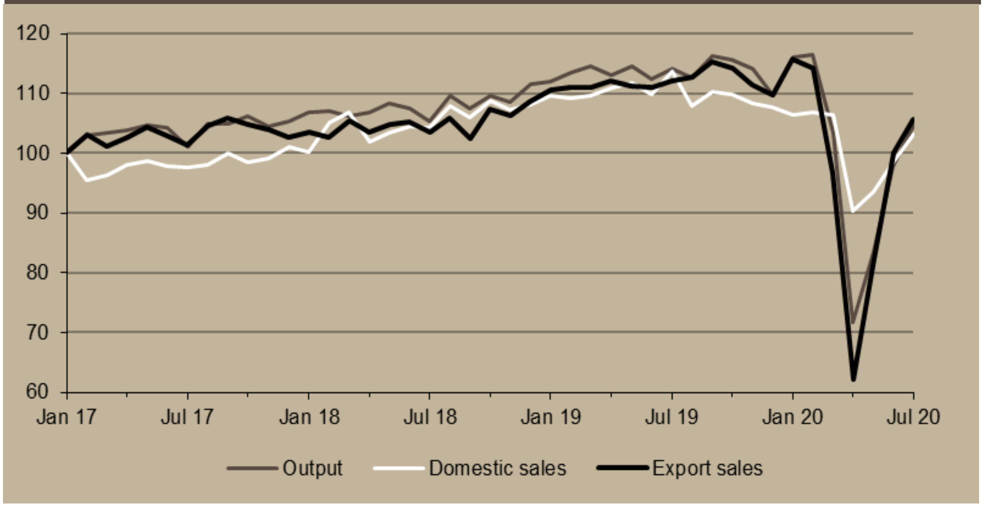
In terms of consumption, household consumer spending decreased by 8.6% in one year, the volume of community consumption increased by 5.8% relative to Q2 2019. The state of danger and the lockdown caused by the coronavirus pandemic played a key role in the decrease of household consumption, while the increase in public consumption is attributable to the increased government expenditure. In contrast to its considerable growth in the previous quarters, the gross accumulation of fixed assets decreased by 13.5% relative to the same period of the previous year, also because of the coronavirus pandemic.

In Q2 2020, the volume of exports was 24.0% smaller, that of imports was 15.8% smaller than the level recorded for the same period of the previous year. The foreign trade balance accelerated the shrinking of the GDP by 7.7 percentage points. Within total exports, the exports of services decreased by 7.2%, and the exports of goods decreased by 13.1% on a year-on-year basis. As for imports, the imports of services decreased by 2.6%, and the imports of goods decreased by 10.0%, compared to the same period of the previous year.

Industrial output shrank by 8.1%.

Raw data show that in July, the output of the industry as a sector was 8.1% smaller, while workday-adjusted data show that it was 7.7% smaller than one year before. The downturn rate was, however, much lower than in the April-May period; the sector has, however, not fully recovered yet. In July, the output of the industry was 7.2% higher than in June. The sales volume of the industry as a sector was 7.1% below the output recorded one year before. More specifically, domestic sales reduced by 8.1%, export sales reduced by 6.5% in a year.

Fig 3 Industrial output and sales (January 2017= 100%)



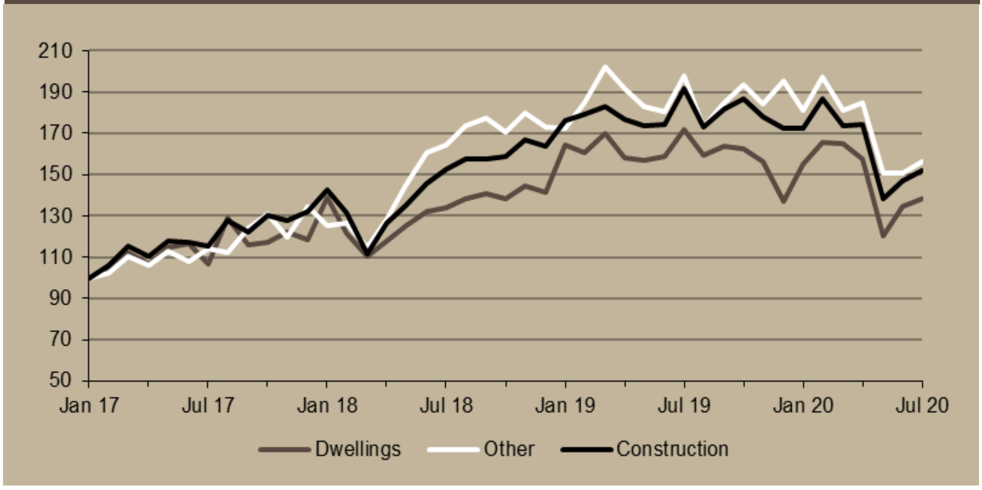
Remark: Seasonally and working-day adjusted data
Source: HCSO, Századvég

Breaking down the output of the entire industry as a sector, one can see that the output of the mining industry shrank by 31.2%, that of the manufacturing industry shrank by 8.0% and that of the energy industry shrank by 4.1% relative to what was recorded on year before. In the manufacturing sector itself, the largest drops were seen in the metals industry (22.8%), the textile industry (20.4%), the automotive industry (13.2%) and the rubber industry (10.6%). On a year-on-year basis, however, some industries managed to increase their outputs: that of the chemical industry grew by 6.7%, that of computer manufacturing grew by 2.3% and that of electrical equipment manufacturing grew by 1.6%. The sales order volume of the manufacturing sectors followed up by the Hungarian Central Statistics Office was 0.8% higher than what was measured one year before. More specifically, the volume of domestic sales orders increased by 9.3%, that of export sales orders increased by 0.2%. The volume of new sales orders was, however, 5.9% smaller than what was measured on year before; more specifically, the volume of new domestic sales orders shrank by 4.7%, and that of new export sales orders shrank by 6.1%.

The output of the construction industry was about one fifth less than one year before.

July continued to see a construction industry output considerably, 21.0% smaller than what was measured for the same period of the previous year, which is explained by the weak demand and the high level measured for the reference period. The output of this sector grew by 3.5% relative to the previous month. The annual comparison shows that the output shrank in both building groups: the output in buildings shrank by 18.8%, that of civil engineering works shrank by 22.9%. The order volume also continued to shrink, indicating that the output of this sector will continue to be lower on the long run as well. The volume of new contracts was 41.5% smaller than what was measured one year before; more specifically, the volume of contracts for building construction projects shrank by 38.7%, that for civil engineering works shrank by 43.6%. The end-of-month volume of contracts was 21.0% smaller than what was measured in the same period of the previous year; taking a closer look, one can, however, see that the two building groups show different pictures: the volume of contracts for buildings was 5.0% larger, while that for civil engineering works was 31.4% smaller than what was measured for the reference period. The latter item is explained by the phasing out of EU funds.

Fig 4 Construction sector (January 2017 = 100%)



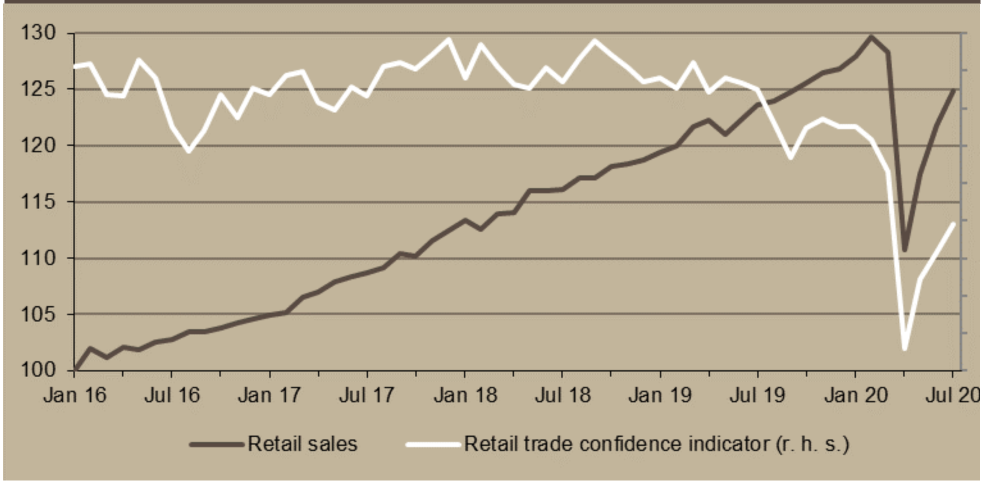
Remark: Seasonally and working-day adjusted data
Source: HCSO, Századvég

Retail sales had reached the level of the previous year by July.

In July 2020, retail outlets could be open with no COVID-19 restrictions. Raw and calendar-adjusted data also show that their sales volume was 0.4% higher than in the same period of the previous year. In the seventh month of 2020, the calendar-adjusted volume of sales increased by 3.3% in specialised and non-specialised food shops and by 0.4% in nonfood shops, but it decreased by 7.0% in fuel retail, relative to July 2019.

Parcel companies and web-shops continued to dynamically increase their sales in July as well: calendar-adjusted data show that, relative to July 2019, their sales volume increased by 19.6%. A considerable decrease in sales was, however, recorded in the case of second-hand shops (19.3%), shops selling books, newspapers, and stationery (21.8%), as well as shops selling furniture and electric goods (13.9%). Additionally, the volume of sales of shops selling computers and other manufacturing goods also decreased (by 2.3%). In contrast, sales increased in the case of shops selling fragrances (9.0%), shops selling a mixed range of manufactured goods (5.6%) and shops selling textile products, clothing and footwear (2.0%) relative to the same period of the previous year. Calendar-adjusted data show that, in July 2020, the sales volume of pharmaceuticals and medicinal products increased by 1.9%, that of non-specialised foodstuffs increased by 3.5% relative to the same period of the previous year. Vehicle fuel sales were in turn 7.0% below the figure recorded for July 2019.

Fig 5 Retail sales volume (January 2016 = 100%) and retail trade confidence indicator

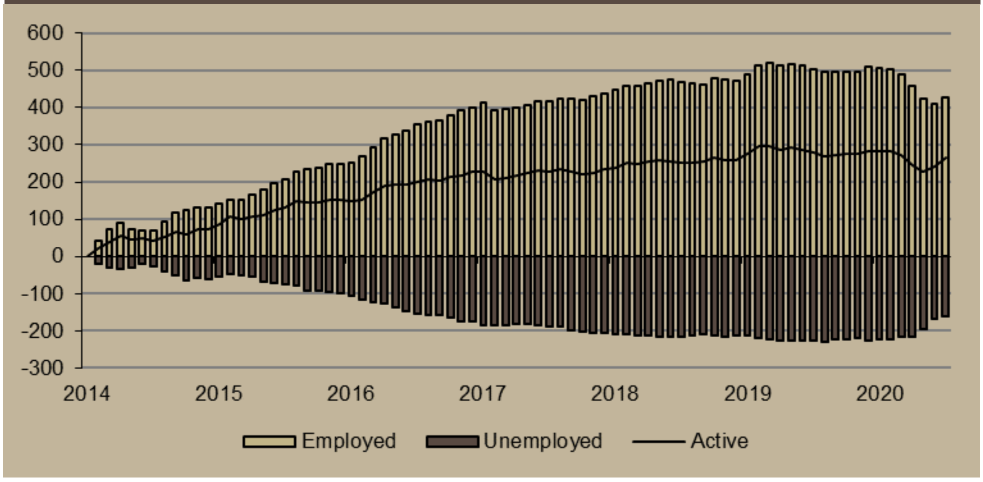


Remark: Seasonally and working-day adjusted data
Source: HCSO, Eurostat, Századvég

As the economy restarted, employment started to grow.

In July, the seasonally adjusted number of employees increased by approximately 15,000 to nearly 4,428,000 on a month-over-previous-month basis; this is, however, still over 78,000 less than in the same period of the previous year. In other words, the lifting of the restrictions imposed because of the coronavirus pandemic and the restarting of the economy are gradually restoring employment; reaching the level measured in the last year will, however, take longer. As another positive trend, the seasonally adjusted number of the active population increased by more than 23,000 in one month; in other words, those who became inactive because of the restrictions are gradually returning to the labour market. A slow recovery is, however, implied by the fact that the number of the unemployed also increased in July, by nearly 9,000, to 225,000, which means that the people who are returning to the labour market could not immediately find jobs. Consequently, the unemployment rate increased above 4.8%. The last time when the unemployment rate was at that level was in October 2016. In June, the seasonally adjusted number of the employees increased by 12,000 on a month-over-previous-month basis. This was, however, not necessarily driven by the increasing number of employees but could have been driven by a more intense employment of the employees who previously did not work 60 hours a month because of the pandemic. The entire growth was driven by the business sector, where the seasonally adjusted number of employees increased by 20,000 in one month. The number of people employed in public employment schemes did, however, remain low, 88,000, in June, corresponding to a minimum increase of 3,000 relative to May, i.e. the government still did not want to employ the people who lost their jobs during the crisis in public employment schemes.

Fig 6 Labour market trends (January 2014 = 0, thousands of persons)

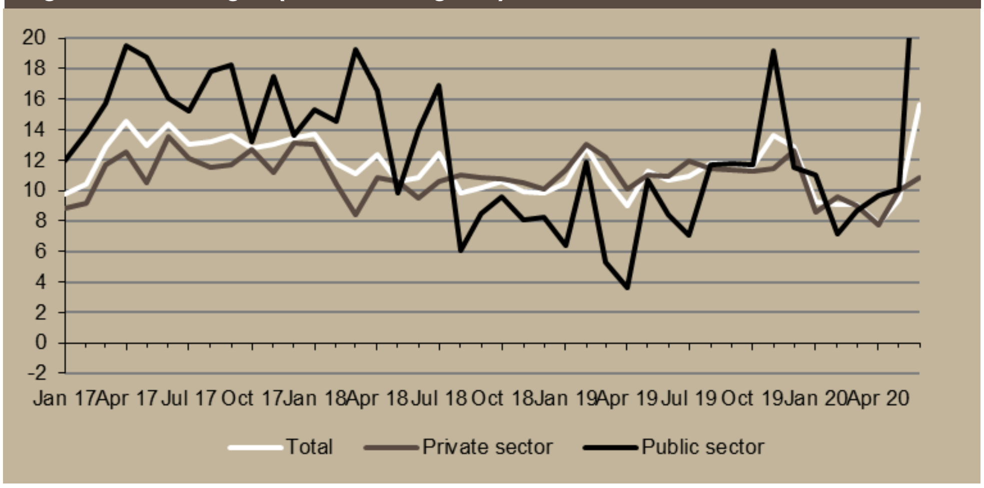


Remark: Seasonally and working-day adjusted data
Source: HCSO, Századvég

The one-off benefit paid to healthcare workers caused the average wage to increase dynamically.

The gross average monthly wage in the national economy rose above HUF 420,000 in June. This corresponds to a 15.6% increase relative to the same period of the previous year. This outstanding increase was, however, driven by a one-off effect, the one-off payment of HUF 500,000 to every healthcare worker in early July for their efforts in the pandemic. Consequently, an over 30% wage increase was recorded in the public sector in June, while business sector wages increased only by 10.8%. We must also emphasise that business sector wage trends still do not reflect actual wage dynamics. Businesses employ many employees part-time; hence, their wages are not included in the statistics, while the layoffs of low-productivity and therefore low-wage employees increase the average wage through the composition effects. Taking that into account, the average net monthly wage increased by 15.6%, above HUF 280,000, and, taking the tax allowances into account, it was above HUF 290,000. Taking the 2.9% inflation rate into account, this corresponds to a 12.4% increase in real wages.

Fig 7 Gross wages (annual change, %)



Remark: Seasonally and working-day adjusted data
Source: HCSO, Századvég

External balance

Foreign trade surplus increased in June and July, despite the decrease in turnover.

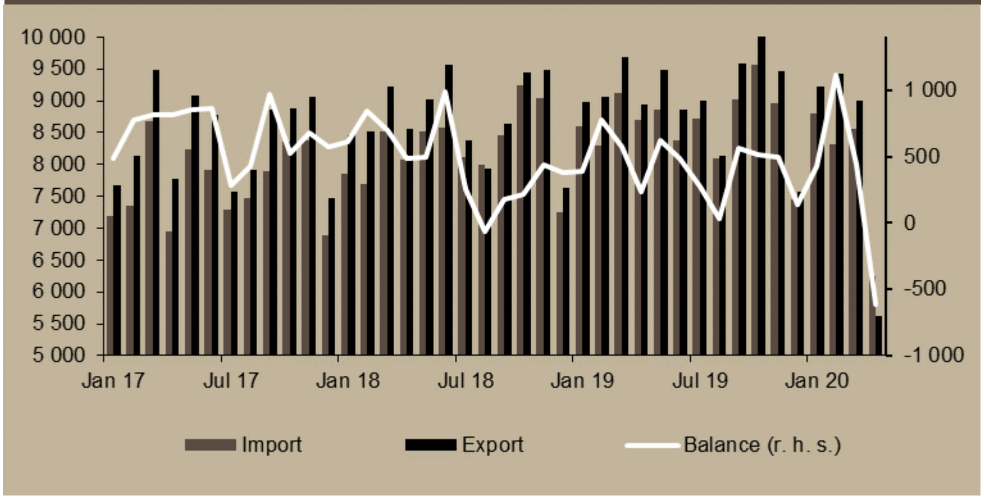
In June, product exports decreased by 3.2% and product imports decreased by 5.1% in EUR value, on a year-on-year basis. This means that the foreign trade balance was EUR 655 million, which is EUR 145 million more than last year.

In June, the volume of food product imports increased by 5.5%, and food product exports increased by 12% on a year-on-year basis. As for energy carriers, import dropped by 25% and exports dropped by 17%. As for processed products, imports dropped by 8.3%, exports dropped by 0.2% on a year-on-year basis. As for machinery and transport equipment, imports decreased by 1.3%, and exports increased by 0.2%.

In July 2020, the EUR value of exports was 5.6% lower, while the EUR value of imports was 7.7% lower than one year before. The foreign trade balance was therefore EUR 262 million, which is 184 million more than one year before.

In June 2020, the current account balance was EUR 246 million. For H1 2020, this means that the cumulative current account balance for this year increased to minus EUR 1,011.8 million, which is much worse than the EUR 103.4 million balance of the January–June period of 2019.

Fig 8 Balance of trade (in million EUR)



Remark: The data relating to July 2020 derive from the first estimates.
Source: HCSO

Fiscal outlook

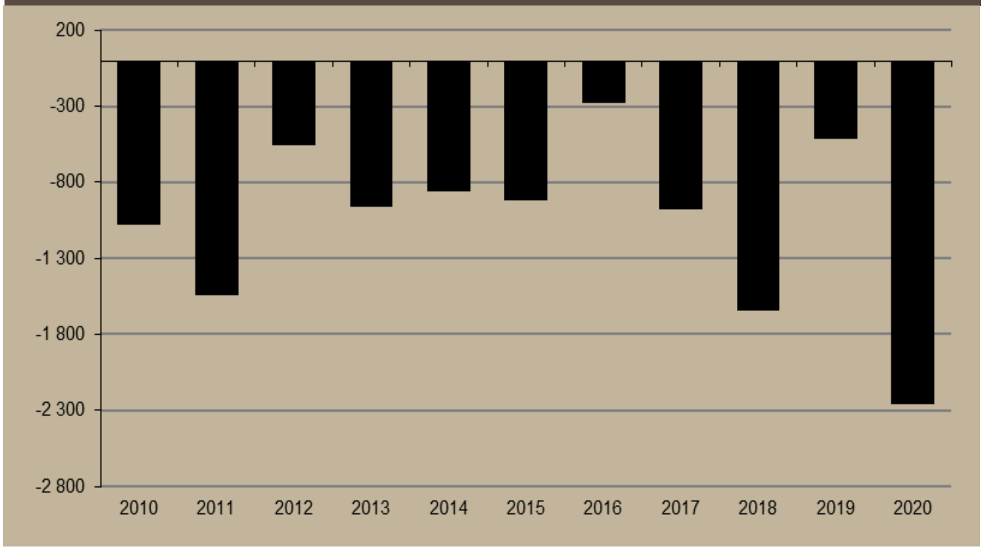
The coronavirus crisis caused the budget deficit to increase sharply.

By the end of August 2020, the deficit of the general government subsector increased to HUF 2,261.3 billion. This is attributable to the general government deficit of HUF 1,873.1 billion, the HUF 2.3 billion deficit of extra-budgetary funds and the HUF 385.9 billion deficit of the social security funds subsector.

The coronavirus pandemic had its economic impacts on the revenue side as well. As for the value added tax, 56.6% of the amount foreseen for this year arrived in the first eight months, while this indicator was at 67.7% this time last year. This means that value added tax revenues are 3.1% (HUF 90.8 billion) less than they were in January–August 2019. As for the personal income tax, 63.2% of the amount foreseen for this year arrived by the end of August 2020, while this indicator was 67.0% at the end of August 2019. End-August cumulative revenues show that personal income tax revenues were 4.2% (HUF 67.0 billion) higher than in the first eight months of 2019. As for the social contribution tax, the pension insurance and healthcare insurance contributions and labour market contribution, 62.4% of the amounts foreseen for this year arrived by the end of August 2020; in other words, these amounts were 3.1% (HUF 114.0 billion) lower than the amounts received in the same period of the previous year.

The revenues from EU programmes were at HUF 772.4 billion and the related expenditures reached HUF 1,374 billion at the end of August 2020. HUF 553 billion were paid by the end of August 2020 for healthcare equipment for the coronavirus pandemic. Among the programmes implemented from Hungarian state funds, we should mention the amounts spent on competitiveness subsidies (HUF 150.6 billion), the priority public road projects (HUF 140.0 billion) and the expenditures covered from the Earmarked Scheme for Tourism Development (HUF 122.2 billion).

Fig 9 Cumulated budget deficit (Jan–Aug, in bn HUF)



Source: Ministry of Finance

Monetary developments

Dynamic underlying inflation trends pushed the inflation rate to 3.9%.

In August 2020, consumer prices increased by 3.9% on average relative to the same period of the previous year. In the past year, the highest price increase was recorded for food products, alcoholic beverages and tobacco products. In comparison with the same period of the previous year, the price of alcoholic beverages and tobacco products increased by 6.8% on average, while that of food products increased by 7.9%. Taking a closer look at alcoholic beverages and tobacco products, one can see that the excise tax increase caused the price of tobacco products to increase by 10.3% as compared to the same period of 2019.

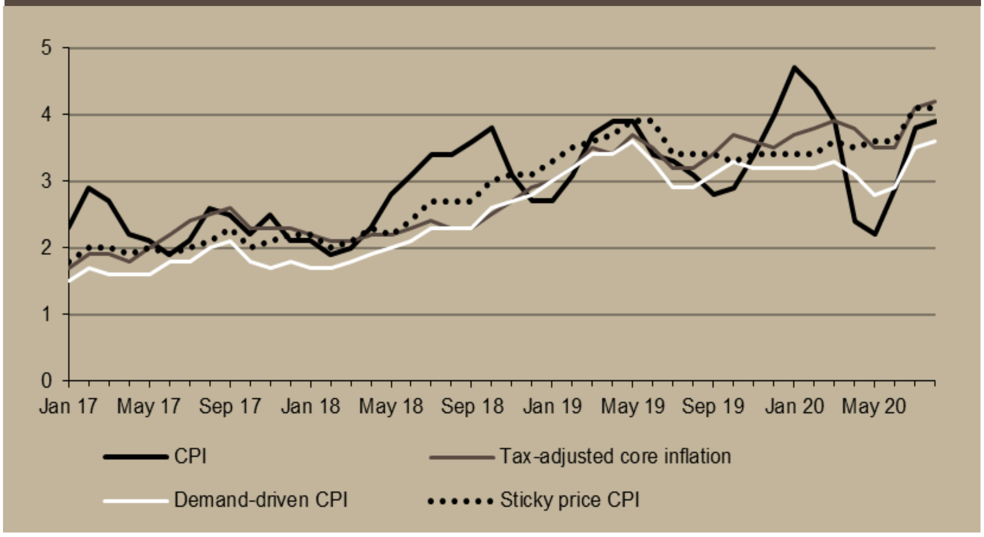
The 7.9% average price increase of food products was driven mainly by the 18.1% increase in Extrawurst and sausage prices, the 9.8% increase in pork prices and the 46.0% increase in fresh Hungarian and tropical fruits. The increase in pork prices is attributable to the swine fever virus, while the increase in fruit prices is attributable to the poor harvest caused by unfavourable weather. The drop in potato prices (8.0%), fresh vegetable prices (6.6%) and poultry prices (2.3%) held back the average inflation of food products.

In August, prices of other products and fuels dropped by 0.4% on average, mostly because of the 4.7% decrease in vehicle fuel prices. This was caused by the decrease of oil prices, which is explained by the drop in demand as a result of the coronavirus epidemic. In addition to vehicle fuels, sports gear and toy prices also decreased by 1.8%. The average increase in household energy prices was 0.2% in August as compared to the same period of the previous year. Within household energy, fuelwood prices increased by 2.8% and coal prices increased by 3.3%, while the prices of bottled gas decreased by 0.2% in one year. The price of electricity, pipeline gas and district heating remained unchanged.

In August, the prices of services increased by 3.5% on average, which was driven by the 11.5% increase in home repair and maintenance prices, the 8.5% increase in vehicle repair and maintenance prices, the 7.8% increase in gambling prices and the 5.2% increase in the prices of healthcare services. The average price increase of services was moderated by the 6.6% decrease in long-distance travel prices and the 1.9% increase in motorway tolls, vehicle renting and parking prices. Clothing prices increased by 0.9% and the prices of durable consumer goods increased by 2.6% on average in a single year. Taking a closer look at the latter, one can see that jewellery prices increased by 24.4%, new car prices increased by 12.3%, but used car prices dropped by 5.1%.

Based on the base inflation indicators disclosed by MNB, the seasonally adjusted core inflation rate was 4.7%, while the core inflation rate excluding the effects of indirect taxes was 4.2% in August. The demand-sensitive inflation rate was 3.6%, the sticky price inflation rate was 4.1% in August.

Fig 10 Inflation (y-o-y, %)



Source: NBH, Századvég

The major economies did not change their monetary conditions.

Both the ECB Governing Council and the Federal Open Market Committee met in the recent period. Eurozone interest rates did not change, i.e. the reference interest rate is still 0.00%, the active and deposit rates of central bank availability are 0.25% and -0.50%, respectively. The Federal Open Market Committee did not change its base interest rate with a target range from 0% to 0.25%.

Fed: forwards or backwards?

At this year's Jackson Hole conference, Fed Chair Jerome Powell announced a change of monetary policy strategy, and the Federal Open Market Committee unanimously approved that on 27 August. The most important change is that the 2% inflation target applied so far is replaced with an average 2% target rate. This does not seem to be a big change, but it could have considerable consequences. The goal of full employment has also changed. Earlier, deviations from full employment were analysed; from now, shortfalls from full employment will be the target variable. The latter is rather about realising that full employment is, unlike inflation, not a symmetric target variable, meaning that deviations from it are only possible in one direction.

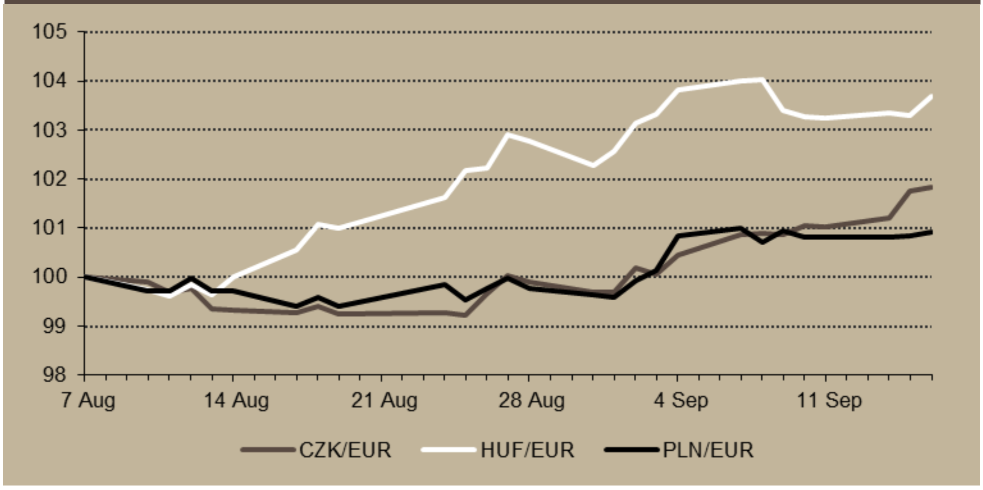
Inflation targeting is one of the greatest monetary policy innovations and started in New Zealand in the 1990s. It has been so successful, that almost all countries that implemented it have been using it ever since. No two inflation targeting systems are, however, the same, but one can distinguish 3 basic system types. The central bank (or the government in some countries) could define an inflation target range, i.e. an inflation target with or without a tolerance range. Shifting between these systems, however, implies a trade-off between system flexibility and the efficiency to anchor market expectations. An inflation target range could mean a considerable room for maneuvering for monetary policy, but this room for maneuvering could also make anchoring expectations less efficient. In the case of a defined specific inflation target, however, central bank credibility can make expectations easy to anchor, but they also narrow down the central bank’s room for maneuvering.

The system announced by the Fed is a fourth type and somewhere in the middle between inflation targeting with a tolerance range and inflation targeting without a tolerance range. In a certain respect, this could be seen as a step back from a system that could efficiently anchor expectations into one that is less efficient. This is supported by the fact that the Fed did not provide the timespan for reaching the average 2% inflation rate. In exchange for less efficiency, however, the central bank can more flexibly react to the changes in the economic environment. The development direction of inflation targeting is usually the opposite; more specifically, central banks try to anchor expectations more. They are, however, often not credible enough and, therefore, sustain the tolerance range. Exceptions to this exist, of course, i.e. when a central bank chooses more flexibility.

The reasoning for this move allows important conclusions. The communication implies that after periods of persistently below-the-target inflation, monetary policy may temporarily target at higher-than-target inflation rates. This could effectively mean a short-term increasing of the inflation target, something that was proposed by many after the last crisis. This is, however, exemplary, because the Fed expects that the inflation would rather be below than above the target. The latter is also supported by the fact that, in the view of the Fed, the lower limit would be the effective limit in the coming period of interest policy. In other words, the central bank does not expect that the current low interest rate environment would pass in the medium term either and reinforces it by transforming the monetary policy framework.

Our region showed a mixed picture. In the past period, the Czech koruna weakened by 1.8%, the Polish zloty weakened by 0.9% against the euro. The CDS spread (5-year CDS) dropped by 1 base point in the Czech Republic and Poland, to 38 base points and 56 base points, respectively.

Fig 11 Regional exchange rates (start date = 100%)



Source: Thomson Reuters Datastream

The HUF continued to weaken.

Indicators of the Hungarian financial and foreign currency markets have shown a mixed picture in the past period. The value of the 5-year CDS dropped by 12 base points to 63 base points. The HUF weakened by 3.7% against the euro, by 4.1% against the Swiss franc and by 3.4% against the US dollar. This means that on 16 September, one euro was worth 359 forints, one US dollar was worth 303 Forints and one Swiss franc was worth 334 forints. Sovereign debt held by foreigners has recently decreased by HUF 277 billion to HUF 4,080 billion.

The central bank did not change its reference interest rate.

At its interest rate setting meeting in September, the Monetary Council of the MNB did not change the reference interest rate; the base interest remained therefore 0.6%. This decision met the expectations and the prior communications of the MNB. The MNB Monetary Council did not change the interest rate corridor either and left the overnight deposit interest rate at -0.05% and the credit rate at 1.85%. The one-week deposit instrument's interest rate follows the reference interest rate, and the MNB currently accepts any offer without limitation.

The Monetary Council launched two programmes on 4 May: a government bond purchase programme on the secondary market to ensure the stable liquidity of the government securities market and relaunched its mortgage bond purchase programme to increase the long-term supply of funds for the banking system. The MNB bought further government securities in the value of HUF 135 billion in the past period, meaning that the total value of the secondary-market government securities held by the MNB increased to HUF 313.87 billion. The MNB purchased mortgage bonds in the total value of HUF 13.5 billion from the primary market (total value: HUF 83.94 billion) and HUF 18 billion on the secondary market, i.e. the total value of this portfolio increased to HUF 96.5 billion. The MNB's FX swap portfolio is currently HUF 1,786 billion, which did not change in comparison to the previous month.

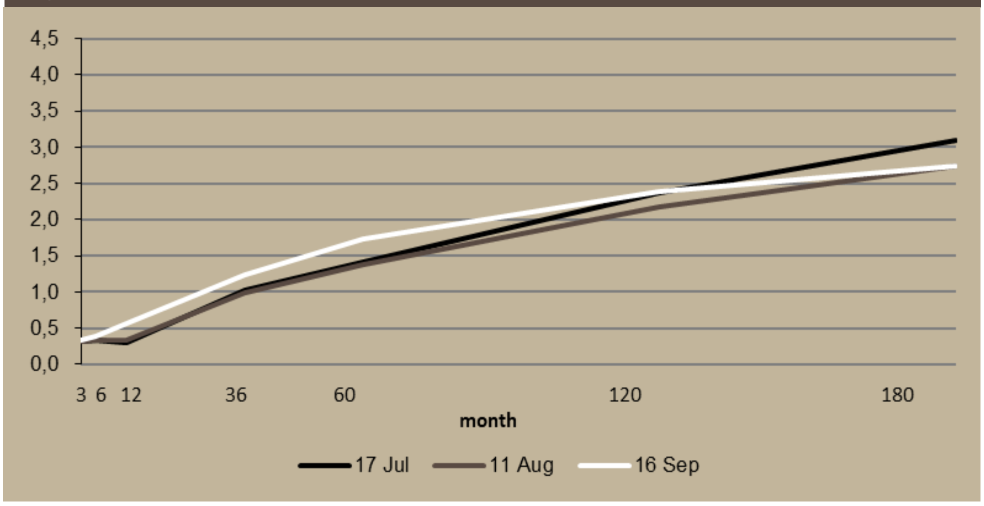
In the last month, shorter-term yields decreased by between 2 and 23 base points on the secondary market yield curve of the government securities market. This means that the 3-month yield was 0.33%, the 6-month yield was 0.39% and the 1-year yield was 0.56% on 16 September. The 3-year yield increased by 24 base points to 1.23%. On a month-over-previous-month basis, 5-year yields increased by 35 base points, 10-year yields increased by 22 base points, and 15-year yields increased by 1 base points. These three yields changed, therefore, to 1.73%, 2.39% and 2.75%, respectively. The still low short-term yields are attributable to the excess liquidity, the interest rate cut, and the still loose monetary policy, while the change of longer-term yields is in line with international trends. In the case of the 5-year and 10-year securities, the yield increase was caused by the replacement of benchmark securities, where the term became longer relative to the previous securities.

Since 1 June 2019, individuals can buy super government bonds (MÁP+) with a relatively high interest rate that gradually increases during its term. A total of HUF 4,791 billion had been issued from this government bond by end August 2020. The total value of the 2019 issues was HUF 3,163 billion (in 7 months), and the January 2020 issue was worth HUF 286 billion, the February 2020 issue was worth HUF 239 billion, the March 2020 issue was worth HUF 184 billion, the April 2020 issue was worth HUF 67 billion, the May 2020 issue was worth HUF 206 billion, the June 2020 issue was worth HUF 178 billion, the July issue was worth HUF 179 billion and the August 2020 issue was worth HUF 282 billion.

The share of foreign currency debt in the sovereign debt changed to 18.23% in July (corresponding to a decrease of over 0.74 percentage points), which is in the range (10–20%) specified in the financing plan for 2020 of the Government Debt Management Agency Ltd. The lower share of foreign currency debt was primarily caused by the Chinese yuan-denominated government bonds' reaching maturity.

None of the big international credit rating agencies rated the riskiness of Hungarian government securities in the past period. The Hungarian government debt is, therefore, rated as Baa3 with a stable outlook by Moody's, BBB with a stable outlook at S&P, and BBB with a stable outlook by Fitch. This means that Moody's rates the risk of Hungarian government securities at the lowest level of the category recommended for investment, the other two big international credit rating agencies rate it one category higher. Japan's international credit rating agency, the Japan Credit Rating Agency (JCRA) gave a better (two categories higher) rating, A–, to Hungarian government securities. In their latest analyses (of 14 August 2020), Fitch and S&P pointed out that they expected that the real GDP would decrease by around 5-6%; so, taking the higher government deficit into account, Hungary's sovereign debt-to-GDP ratio would also increase, but currently there is no threat of downgrading.

Fig 12 The HUF yield curve (%)

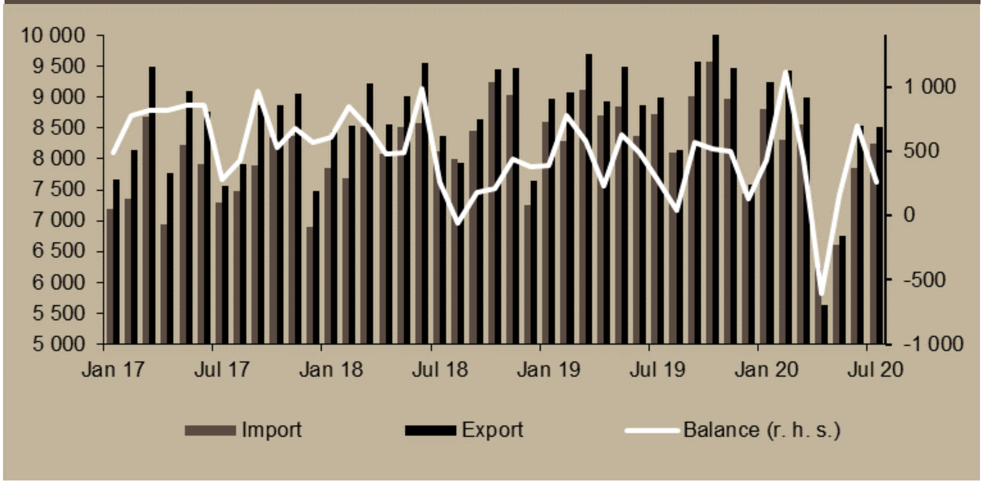


Source: Government Debt Management Agency, Századvég

Corporate credits increased.

Seasonally adjusted data show that the net borrowing of HUF loans in the business sector was HUF 94.1 billion in July 2020. The net repayment of foreign currency debt was HUF 49.7 billion in July 2020, i.e. the aggregated value of business credits decreased. This means that, based on seasonally adjusted data, total net borrowing was HUF 31.8 billion in July. At EUR 21.59 billion, corporate borrowing remained high, relative to the previous month, in the eurozone in July 2020.

Fig 13 Corporate borrowing (in billion HUF)



Source: NBH, ECB, Századvég

In July, the value of gross loan placement in Hungarian forints over and above bank overdrafts was HUF 95.9 billion, which is HUF 13.2 billion more than the amount of the previous month. The sum of newly granted euro-loans was HUF 30.4 billion, which is HUF 22.3 billion less than the figure for June.

Macroeconomic update by Századvég Economic Research Institute

The economic downturn rate could be higher than 5% this year.

The second wave of the pandemic has arrived in Hungary since the mid-June forecast of Századvég Economic Research Institute in the previous quarter, which, according to our expectations, will cause less economic damage than the first one. As a result, based on our latest forecast and data received since June, the economic downturn in Hungary may be slightly above 5 percent this year and will not reach its 2019 level until 2022. However, it is important to emphasize that the evolution of the viral situation remains a significant risk for forecasting.

As a result of the measures against the coronavirus, the performance of the Hungarian economy in the second quarter was significantly lower, by 13.6, compared to last year. The crisis has been felt by most sectors of the economy, but to varying degrees. For example, tourism, vehicle manufacturing or the entertainment industry have been affected much more severely than the average, while the ICT or financial sector has been less affected by the crisis. At the same time, the recovery began with the lifting of restrictions, which is also shown by the fact that the volume of retail turnover already reached that of last year in July. In the case of several sectors (such as tourism and vehicle manufacturing already mentioned), it is only possible to reach the previous level of volume over a period of several years due to the change in demand.

After the increase in consumption before the crisis, and then its decline and rise to the previous level, we expect that the volume of household consumption expenditure may stagnate in 2020, while in 2021 it may grow by about 4 percent.

Investments are also affected by the situation caused by the virus, which can be curbed by businesses, state and municipal actors alike due to a more uncertain economic vision and the scarcity of financial resources. This can be partially compensated by public loan programs, which cheaply provide resources to businesses. When estimating the investment volume, we also had to take into account the previously high investment value and the cyclicality of EU funds. Thus, in the case of investments, we presume a 4.9 percent decline, while next year we presume a 3.1 percent expansion.

In the case of exports, first there was a significant slowdown due to supply chain disruptions and then a drop in demand, and the recovery also appears to be slow. We expect an 8.6 percent decline in 2020, followed by a 7.2 percent rebound in 2021. In addition to the development of consumption, investment and exports, the development of imports is determined by individual items such as the purchase of health equipment. The decline in imports could thus be 3.6 percent this year, which might be followed by a 5 percent expansion next year.

Regarding the labor market, employment was reduced by more than 100,000 when restrictions were imposed. Some of the jobs were reopened with the relaunch of the economy, thus some of those who became unemployed were able to get a job. However, given the slower relaunch of some sectors, the previous high level of employment will only recover slowly, thus, this year, the unemployment rate could be

4.2 percent and next year 3.7 percent as an annual average. A relatively small increase in unemployment is supported by the pre-crisis labor shortage and the high number of job vacancies. However, regarding the full recovery of the previous labor market situation, the question is not only the development of the unemployment rate but also whether those who have entered part-time employment can return to full-time work again. This requires the relaunch of the most severely affected sectors.

Inflation has been around the top of the central bank's target range in the recent period, and core inflation, which describes the underlying processes, has substantially exceeded it. The increase in the pace of monetary deterioration was driven by rising food prices and the weak forint exchange rate, while it was held back by fuel prices. Inflation may be around 3.7 percent this year and 4.1 percent next year, assuming that the forint does not further substantially weaken.

The coronavirus epidemic has had a significant impact on both the revenue and the expenditure side of the budget. Regarding the revenues, in addition to the measures taken (tax relief, payment facilities, extension of the tax return deadline), the deteriorating economic performance also reduced the amounts received by the state treasury. The expenditure side has been substantially determined by the measures for the protection of jobs, help in the protection of health and the restart of the economy. Overall, as a result of the preventive measures against the pandemic and the decline in economic performance, we forecast a deficit of 7.3 percent of GDP this year, which may drop to 3.5 percent next year. As a result, public debt may reach 75.6 percent of GDP in 2020, from which it may decline to 73.3 percent in 2021, provided that the budgetary discipline is strengthened next year.

Századvég forecast[1]

Fig 14 Q3 2020 projection

	2019	2020				2020	2021				2021
	annual	Q1	Q2	Q3	Q4	annual	Q1	Q2	Q3	Q4	annual
Gross domestic product (volume index, %)	**4,9**	2,0	-13,6	-5,7	-3,3	**-5,2**	-3,4	13,5	3,4	4,6	**4,5**
Household consumption expenditure (volume index, %)	**5,0**	5,0	-8,4	2,6	2,9	**0,5**	3,2	9,8	2,6	0,9	**4,1**
Gross fixed capital formation (volume index, %)	**15,3**	-2,6	-13,5	-2,5	-0,9	**-4,9**	-2,5	13,5	1,8	-0,5	**3,1**
Export volume index (based on national accounts, %)	**6,0**	-0,5	-24,0	-5,8	-4,0	**-8,6**	-5,1	26,8	1,4	5,8	**7,2**
Import volume index (based on national accounts, %)	**6,9**	1,3	-15,8	0,9	0,3	**-3,3**	-0,2	21,6	-1,2	1,2	**5,4**
Foreign trade balance (bn EUR)	**4,9**	1,87	0,2	-1,0	-0,2	**0,2**	0,5	1,3	-0,4	1,0	**0,6**
Consumer price index (%)	**3,4**	4,3	2,5	4,0	4,1	**3,7**	3,4	4,9	4,0	4,1	**4,1**
Central bank's base rate at the end of the period (%)	**0,9**	0,90	0,75	0,60	0,60	**0,6**	0,60	0,60	0,60	0,60	**0,6**
Unemployment rate (%)	**3,5**	3,7	4,6	4,4	4,1	**4,2**	3,9	3,7	3,6	3,4	**3,7**
Gross average earnings (year-on-year change, %)	**11,4**	9,1	11,0	10,2	8,9	**9,8**	8,8	5,2	4,3	4,2	**5,6**
Current account balance as a percentage of GDP	**-0,3**					**-4,1**					**-3,2**
External financing capacity as a percentage of GDP	**1,6**					**-1,9**					**-0,8**
General government ESA-balance as a percentage of GDP	**-2,0**					**-7,3**					**-3,5**
GDP based external demand (volume index, %)	**4,9**	2,0	-13,6	-5,7	-3,3	**-5,2**	-3,4	13,5	3,4	4,6	**4,5**

Source: HCSO, NBH, Századvég

Fig 15 Changes compared to our previous forecast

	2020			2021		
	June 2020	Sep 2020	Difference	June 2020	Sep 2020	Difference
Gross domestic product (volume index, %)	-3,1	**-5,2**	-2,8	5,1	**4,5**	1,7
Household consumption expenditure (volume index, %)	-0,3	**0,5**	0,8	4,4	**4,1**	-0,3
Gross fixed capital formation (volume index, %)	-5,6	**-4,9**	0,8	4,3	**3,1**	-1,3
Export volume index (based on national accounts, %)	-6,8	**-8,6**	-1,8	11,6	**7,2**	-4,3
Import volume index (based on national accounts, %)	-5,2	**-3,3**	1,9	10,3	**5,4**	-5,0
Foreign trade balance (bn EUR)	0,4	**0,2**	-0,2	0,7	**0,6**	-0,1
Consumer price index (%)	3,2	**3,7**	0,0	3,7	**4,1**	0,0
Central bank's base rate at the end of the period (%)	0,90	**0,60**	-0,3	0,90	**0,60**	-0,3
Unemployment rate (%)	4,7	**4,2**	-0,5	4,4	**3,7**	-0,7
Gross average earnings (year-on-year change, %)	9,4	**9,8**	0,4	7,4	**5,6**	-1,8
Current account balance as a percentage of GDP	-1,6	**-4,1**	-2,5	-1,0	**-3,2**	-2,2
External financing capacity as a percentage of GDP	0,4	**-1,9**	-2,3	0,9	**-0,8**	-1,7
General government ESA-balance as a percentage of GDP	-3,9	**-7,3**	-3,4	-3,3	**-3,5**	-0,2
GDP based external demand (volume index, %)	-7,1	**-7,1**	0,0	5,4	**6,1**	0,7

Source: HCSO, NBH, Századvég

[1] The forecast is valid as of 10 September 2020.

Disclaimer