

Hungary Business Forecast Report Q3 2014

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Abstracts

Core Views

Hungary's economic recovery remains at risk due to its reliance on government current and capital spending, rather than the promotion of private sector fixed investment. Hungary's debt burden is already high by regional standards, and with the poor business environment continuing to deter businesses from investing, we remain reluctant to forecast a stronger recovery.

Rising inflationary pressures in Hungary on the back of increasing demand-pull factors, pass through effects from forint depreciation and fading base effects will press the central bank into hiking the main policy rate by end-2014.

Hungary's current account surplus will remain one of the most robust in emerging Europe in 2014 and 2015, as a eurozone recovery boosts exports. However, we continue to highlight the substantial short-term external liabilities that could leave the country rapidly if the country's business environment continues to deteriorate.

Following the re-election of the governing Fidesz party on April 6, Hungary's policy programme will remain centred around supporting government revenues via punitive taxes on business, and populist rhetoric railing against the EU. With radical nationalists Jobbik now the main opposition we expect a more overtly nationalist agenda from the government in order to mitigate right-wing dissent.

Major Forecast Changes

Given the extent of cuts to the policy rate in 2014 we have revised our forecast for the year-end policy rate in 2014 and 2015, from 3.50% and 4.00%, to 3.10% and 3.60% respectively. We believe the central bank will be forced into hiking the policy rate by

rising consumer price inflation in Q414, as base effects from the 2013 cuts to household energy tariffs wears off.

We have revised up our forecast for Hungarian real GDP growth in 2014 and 2015, from 1.7% and 1.9%, to 1.9% and 2.1% respectively. This is as a result of increased government spending ahead of the April general election, as well as the continued expansion of state fixed investment.

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Following the re-election of the governing Fidesz party on April 6, Hungary's policy programme will remain centred around supporting government revenues via punitive taxes on business, and populist rhetoric railing against the EU. With radical nationalists Jobbik now the main opposition we expect a more overtly nationalist agenda from the government in order to mitigate right-wing dissent.

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Long-Term Political Outlook

Western Convergence Story Will Continue

Our core view is for Hungary to continue to converge both economically and politically with Western Europe over the next decade. The country will face substantial challenges, including the continuing rise of far-right parties, sustained poor relations between ethnic Hungarian and minority groups as well as rising fiscal pressures from an ageing population.

CHAPTER 2: ECONOMIC OUTLOOK

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Hungary's economic recovery remains at risk due to its reliance on government current and capital spending, rather than the promotion of private sector fixed investment. Hungary's debt burden is already high by regional standards, and with the poor business environment continuing to deter businesses from investing, we remain reluctant to forecast a stronger recovery.

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Hungary's current account surplus will remain one of the most robust in emerging Europe in 2014 and 2015, as a eurozone recovery boosts exports. However, we continue to highlight the substantial short-term external liabilities that could leave the country rapidly if the country's business environment continues to deteriorate.

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Inflation To Rise As Base Effects Dissipate

Rising inflationary pressures in Hungary on the back of increasing demand-pull factors, pass through effects from forint depreciation and fading base effects will press the central bank into hiking the main policy rate by the end of 2014. However, given the extent of the ratecutting cycle so far, we have revised down our forecast for the year-end policy rate in 2014 and 2015.

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The Hungarian forint is set for short-term consolidation as the central bank halts its rate cutting cycle in the wake of January's sell-off, implying that the monetary council is not ready to allow significant currency weakness. However, in the longer term, the currency will remain on a depreciatory trajectory, as a toxic business environment and weak net international investment position will outweigh an improving growth outlook.

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