Koninkrijk der Nederlanden

Holland Pioneers in international business

Hungary Economic News Letter

Embassy of the Kingdom of the Netherlands

February 2014

Editorial

As the date of the general elections in Hungary is getting closer, the government's promises of further spending and wage increases in various sectors are on the rise. Although the budget contains a significant, HUF 230bn (EUR740mn) buffer to cover over-spending, many believe that after the elections a moderate budgetary adjustment will be needed.

However, the announced further cut in the utility prices was implemented mostly only on the rethoric level, in contrast with the initial plans to reduce further on the network fees. However, the government makes no secret that if they win the elections the all utilities will become a non-profit sector. The latest economic indicators show economic recovery both on the domestic market and on the main export markets of Hungary.

The favourable fourth quarter GDP figure (2.7%) demonstrates that the economy's overall performance is still determined by exporters, who can benefit from a weakening currency. Several investment banks and analysts raising their 2014 forecasts for growth from around 2% to closer to 2.5%.

The HUF weakened to a two-year low of 314.5 against the euro, fuelled by worries about events in Ukraine, and lower than expected indicators in China and Japan, but also due to the insistence of the National Bank of Hungary (MNB) on lowering the base rate. Contrary to the markets expectations rate-setters at the MNB went ahead and decided on another 15-bp cut at their February meeting.

As to the Embassy news, a Hungarian journalist accepted the invitation of the Holland Branding Team of RVO-Netherlands Entreprising Agency for a sports media-tour. He was offered the opportunity to get acquainted with the sports in general (mass sport, youth sport, sport for the disabled) and the top sports (speed skating, football, swimming, baseball) and sports infrastructure in the Netherlands. Upon returning from the trip he said: *"In this short period I came to know a nation which sees its relatively small size and population as an opportunity instead of a disadvantage. It "buries" itself in innovation, looking for new and better ways, but behind the serious work there is always a hint of a smile*".

Bert van der Lingen	***Martijn Homan***	***Marina Varga***	***Éva Szabó***
Deputy Head of Mission	***Agricultural Counsellor***	***Senior Policy Adviser***	***Trade Promotion Officer***

EU relations

The sectoral tax in the retail ruled discriminatory

The European Court of Justice (ECJ) ruled that Hungary's sectoral tax on retailers is discriminatory, putting companies with owners in other EU states at a disadvantage. The ruling came in a case filed by the franchise of sporting goods retailer Hervis against the National Tax Authority which argued companies must pay the tax based on consolidated turnover, which raises the rate for large - often foreign-owned – corporate groups. Hungary-based retailers with annual revenue of over HUF 500mn (EUR1.6mn) are required to pay 0.1% to 2.5% in additional tax, based on revenue; only those enterprises with turnover exceeding HUF 100bn (EUR 0.3bn) are required to pay this top rate.

In its ruling, the ECJ noted that combining the turnover of chain stores with the purpose of applying a progressive tax rate went against the Treaty on the Functioning of the EU, if the persons taxable for the turnover have their office in another member state.

The partnership agreement submitted to the EC

The Hungarian government submitted the agreement outlining Hungary's use of European Union funding for the 2014-2020 budget period to the European Commission before the deadline, deputy state secretary for development policy Nándor Csepreghy announced.

The first tender applications will be invited in the second half of the year. Hungary plans to allocate HUF 800bn (EUR2,6bn) for innovation and R&D, including HUF 140bn (EUR 450mn) for start-ups.

State secretary Zoltán Cséfalvay highlighted opportunities for Hungarian companies to participate in the Horizon 2020 programme, which has EUR 77bn (EUR 248mn) of EU funding. In his view, Hungarian companies could win EUR 300-350mn from the programme. The first tenders could be called by mid-year, and tenders for all of the operative programmes will be called by October at the latest.

Member states have until April 22 to formally submit partnership contracts to Brussels and another three months after that to turn in operative programmes. According to the draft plans there will be the Environmental and Energy Efficiency Operative Programme (KEHOP) with a foreseen budget of HUF 1120bn (EUR), which will be of special interest given our priority sectors.

Macroeconomy

Gross debt at 79%

Hungary's gross state debt, calculated at nominal value according to Maastricht criteria, fell to 79.0% of GDP at the end of last year from 80.2% at the end of September, a preliminary report released by the MNB shows. Net state debt came to 63.2% of GDP at the end of last year. Net borrowing of the general government came to 2.5% of GDP and in the fourth quarter alone, the general government's net borrowing reached 1.6% of GDP.

However, the EC noted that the two-percentage point drop in state debt from 2012 to 2013 was entirely the result of a year-end reduction of state cash deposits and said the level would rise because of the revaluation of FX state debt. With the weakening of the HUF, the real debt figure is likely to be higher, thus the level is practically the same as before the "nationalisation" of the private pension funds.

The EC forecasts 2.1% growth in GDP

The European Commission (EC) raised its projection for GDP growth in Hungary this year to 2.1% in a forecast released. The projection in the winter economic forecast was raised from 1.8% in the EC's autumn forecast published in November. The new projection is slightly over the government's forecast for 2.0% growth. The EC put GDP growth in 2015 at 2.1% as well. The EC said growth would be supported by a further pickup in domestic demand as net exports have a neutral effect, while household consumption is expected to start growing again from 2014 because of higher real disposable income lifted by regulated price cuts, public sector wage rises and looser lending conditions.

There are, however, warnings signs in fiscal developments, as Hungary's structural balance is deteriorating alarmingly, which puts into question the sustainability of the low budget shortfall and the success of the debt reduction. The government, however, still has time to ponder about this, at least if we consider only the external pressure from the EU, web site portfolio.hu concludes.

Investment activity recovers

Fixed capital investments were up 15% y-o-y in the fourth quarter, a high increase not seen for a decade, the Central Statistics Office (KSH) announced. The increase was led by public-sector investments, up 50%, while private-sector investment was 4.8% higher. Fixed capital investments were up 25.4% in the energy sector and 11.5% in manufacturing. For 2013 as a whole fixed capital investments saw 7.2% growth. According to the EC forecast, a high absorption of EU funds would contribute to an increase in investment activity as well as a slight growth in net borrowing by companies.

Exports show good performance in 2013

Figures for December 2013 released by the KSH show that the volume of exports was up 14%, while that of imports was 13% more in external trade in goods than in the same month of the previous year. For the year, export and import volumes increased by 4.8% and 5%, respectively, year-on-year. For 2013, the value of exports was EUR 81.7bn (HUF 24.24trn), while that of imports was EUR 74.7bn (HUF 22.15 trn). The surplus on the trade balance amounted to EUR 7bn (HUF 2.1trn), which was EUR 354mn (HUF 168bn) more than in the same period of the previous year. Trade of road vehicles grew by 20% and imports of power-generating machinery and equipment increased 10%.

In 2013, the share of exports to EU member states was 77%; in imports 72%.

Economic and monetary policy

Monetary Council goes for further cut despite the warnings

The MNB’s monetary council surprised observers with a larger base rate cut than expected, lowering the figure from 2.85% to 2.7%, causing the HUF/EUR rate to weaken to 310. The monetary council argued that the Hungarian economy is fundamentally different from those of other emerging market countries, which are considered vulnerable. The MNB considers the recent hit on emerging markets a one-off event, when investors realised that Hungary is not Turkey. The rate cut leaves Hungary more exposed to the markets, as tension concerning emerging markets will not go away, analysts warn.

There is some market speculation that the MNB is deliberately pursuing a monetary policy that will weaken the HUF with the aim of supporting exporters. The argument here is that the central bank’s determination to support economic growth has only produced muted results so far through the launch of its extensive stimulus programme.

Low demand for second phase of MNB stimulus programme

The second phase of the MNB's funding for growth programme has got off to a slow start, as the amount of loans laid out by banks is only a small fraction of the HUF 700bn (EUR 2.3bn), that was extended in the first four months in the first phase, *Világgazdaság* reports.

The main conditions of this lending programme have not changed, as the MNB continues to offer zero-interest loans to banks to be lent to SMEs at rates of no more than 2.5% for up to 10 years. One major difference, which explains the decline, is that banks have to disburse 90% of the funds in the form of new loans and only 10% for refinancing existing loans. Last year, more than 60% of the funds went for loan refinancing or the conversion of foreign-currency debt into HUF loans, and some 40% for new loans. The MNB said it expects demand for the low-rate loans to pick up in the second half of the year.

Construction/Infrastructure

International contest for design of Museum Quarter in Budapest announced

The Hungarian government announced an international design competition for the construction of a Museum Quarter and the renewal of Budapest’s City Park. Five museums are to be built on Dózsa György út and in the City Park, and the park itself will be renovated in the Liget Budapest project.

As part of the plans, the Petőfi Csarnok concert hall will be demolished, the circus will be relocated and the Zoo and Transport Museum will be renovated.

The contest – a two-round affair with EUR 0,87mln in prize money – is described by Museum of Fine Arts director László Baán as the first open international architectural design tender in Hungary for more than 100 years. Architectural firms are invited to submit plans for a new National Gallery, to be combined with the Ludwig Gallery of contemporary art, a new Ethnographic Museum, a new museum of architecture, a museum of photography and a House of Hungarian Music. Design and conceptual plans are to be presented to an 11-member international jury by May 27. The results will be announced on December 19.

The jury will be co-chaired by Baán and Wim Pijbes, director of Amsterdam's Rijksmuseum. The five new museum buildings are expected to cost HUF 70-75bn (EUR 230mn). Contracts are expected to be signed with the winners in the autumn of 2015, who will be expected to carry out the work in 18-24 months. Completion is scheduled for 2018. For more information see the Liget project's English website: http://www.ligetbudapest.org/index.php

The development concept of regional logistic hub is ready

The implementation of the Development of Hungary 2030 – National and Regional Development Concept adopted by the government will also help Hungary to become one of the leading economic and intellectual powerhouses of Central and Eastern Europe within the next sixteen years, state secretary for Planning Coordination István Komoróczki said at a press conference in Budapest.

The measures formulated in the concept may narrow the gap between regional differences and speed up the integration of disadvantaged regions. He also emphasised that under the National and Regional Development Operative Programme counties, cities with county rights and related regions will be allocated separate funds in order to help achieve their objectives. As far as counties are concerned, a total of HUF 450bn (EUR 1.5bn) was earmarked.

For the next seven years, resources of HUF 220bn (EUR0.7bn) were set aside for 22 cities with county rights, except for Budapest and Érd. Among these, Debrecen, Miskolc, Szeged and Pécs will each receive between HUF 17.9 and 24.6bn. The principles of allocation included the level of economic development, the amount of local business tax, the number of inhabitants and the public duties of the county seat, Komoroczki pointed out.

The CEO of Hungarian Society for Urban Planning, Richárd Ongjerth, called the endorsement of the concept a milestone in the history of Hungarian regional planning. It happens for the first time ever, he stressed, that there is a good chance for introducing a balanced and proportionate system.

Services/Financial services

Majority of service centres plan further investments

Two-thirds of the office service centres operating in Hungary plan further investments, mostly to expand financial and customer services, according to a report by business consultants EY, (formerly known as Ernst & Young). In a survey, 90% of respondents said they had achieved their business goals in Hungary, with 50% describing their results as beyond expectations. The majority said they value Hungary's highly qualified workforce, language knowledge and low costs.

Hungary is now home to almost 80 service centres, which employ more than 30,000 people, said State Secretary for Foreign Affairs and External Economic Relations, Péter Szijjártó. State investment and trade agency HITA is managing 30 projects related to the opening or expansion of service centres, which could create an additional 9,000 jobs, he added.

Competitiveness

Hungary first in per capita FDI

Hungary is ranked first in the CEE-region in terms of foreign direct investment (FDI) per GDP and second in terms of FDI per capita, despite the slowdown of FDI after the crisis in 2008, *Napi Gazdaság* writes. The total amount of FDI stood at EUR 76.4bn at the end of the third quarter.

The recapitalisation of foreign-owned banks, which continued last year, lifted the figure, as these funds were classified as FDI. However, the full-year figure for FDI, to be released on March 31st, will probably be negative, the newspaper writes, due to changes in intra-company loans and a decline in companies' capital reserves, analysts said. Investments managed by the trade and investment promotion agency HITA last year led to the creation of 7,100 jobs and EUR 1.2bn of investment.

According to Gábor Hunya researcher at the Vienna-based WIIW institute, the new green-field industrial investments are a better gauge of the impact of foreign capital investment. Hungary has the highest proportion of new green-field projects in the manufacturing sector, but is doing far worse in other sectors, he said, pointing out the specifics of the government's investment policy which is supportive of the manufacturing sector, but has imposed extra taxes on some service sectors.

Business environment

CEOs are positive about growth prospects

A total of 72% of CEOs participating in the fresh PricewaterhouseCoopers (PwC) Hungarian CEO Survey said they are optimistic that their companies will grow over the next year, PwC Hungary Tax and Legal Services Director Tamás Lőcsei announced. 34% of CEOs cited expanding markets as a factor contributing to improved competitiveness, while 28% mentioned structural transformation and 26% client-centered business practices.

Among the factors contributing to deteriorating competitiveness, the CEOs identified taxation, narrowing markets, loss of markets and the unpredictability of the legislative environment.

A total of 61% of CEOs said their companies paid more taxes in 2013 than in 2012, while 60% said they expect their companies to pay more taxes in 2014 than in 2013. A significant number of the CEOs interviewed said growth risks included lack of trust, the unavailability of professionals and corruption. As to the later, 89% of Hungarians agree that corruption is widespread in their home country, the first Corruption Report published by the EC shows. Furthermore 81% of the Hungarian business respondents consider that favouritism and corruption hamper business competition (EU average: 73%) and 59% of the respondents to the same survey say that corruption is a problem for their company when doing business in Hungary (EU average: 43%).

Registered companies getting fewer

The number of registered companies saw a 13.9% decline last year to 35,000, well below a peak of 50,000 in 2008, according to consulting firm Bisnode Magyarország. New company registrations picked up in 2011 but fell in the past two years. The new rules raising the minimum capital requirement for a limited company to HUF 3mn (EUR 9700) after March 15th will not help in the creation of more businesses. Existing companies have two years to meet this new requirement.

Dutch presence in Hungary

Heineken Hungaria signs a cooperation agreement

State Secretary Péter Szijjártó highlighted the importance of Hungarian-Dutch economic relations after a declaration of intent on cooperation was signed in Sopron on February 20 by the President of the Hungarian Investment and Trade Agency János Berényi, representing the PM's Office and the CEO of Heineken Hungária, Joris Huijsmans.

Szijjartó noted that the Netherlands is the third largest investor in Hungary, in addition to which bilateral trade amounted to EUR 5bn last year. The company is the most significant representative of Hungarian-Dutch economic relations. He also said that the government had set the goal of making Hungary Europe's production centre, to which end the continent's most advantageous business environment must be created. Huijsmans said that the company's Sopron brewery, established 120 years ago, is now the largest in Hungary. Regarding its production and logistical capacity, the Sopron plant is Heineken's ninth biggest unit with 550 employees, and it delivers goods to six countries in the region. In his view, Hungary provides a beneficial business environment for Heineken.

Unilever Hungary is the price winner of CSR Hungary 2013

Unilever was the top performer overall with a 91% score and also led the Food and Beverage sector in the Tomorrow Value's Rating (TVR) 2013 of corporate sustainability practices compiled by the agency Two Tomorrow's. The TVR examined the sustainability programmes of 50 companies in the 2012 Dow Jones Sustainability Index (DJSI) and assessed how well these companies have embedded sustainability in their core business model and strategy, how well they involve and manage stakeholder expectations and how well they use sustainability risks as a lever to drive innovation across the value chain. As to the Hungarian unit, Unilever Hungary won the CSR Hungary 2013 prize in the Sustainable Corporate category in recognition of achieving its aim to reduce its CO2 manufacturing output by 7% in 2012 and for its educational campaigns for women.

Energy/Sustainable energy

MVM to expand further

State-owned energy group MVM signed a letter of intent to buy German company E.ON's Hungarian gas distribution companies. The agreement covers the possible partial or full acquisition of electricity and natural gas distributors E.ON Energiaszolgáltató, E.ON Közép-dunántúli, E.ON Dél-dunántúli and its client service centre. MVM declared that it has taken important steps toward greater energy security in line with the government's energy policy and national energy strategy. It is worth recalling that MVM purchased the gas storage and trade unit of E.ON for HUF 280bn (EUR 933mn) last year. If the transaction takes place, the state will gain control of 18,000km of pipeline. E.ON decided to sell its stakes after the government lowered the prices that energy distributors can charge to consumers, and preventing them from including the costs of pipeline losses and leaks in their prices, *Népszabadság* writes. E.ON Energiaszolgáltató, which provides 2.5 mn clients with electricity and 0.5 mn with gas, incurred losses of HUF 15bn (EUR 50mn) last year.

Moreover, the MVM wants bigger role in Mátrai Erőmű power plant too. MVM would like to increase its stake in the Mátrai Erőmű to play a more active role in it, Development Minister Zsuzsa Németh said when visiting the plant. MVM has already a 26% stake in Mátrai Erőmű, RWE has 51% and fellow German energy concern EnBW has 22%. EnBW has been wanting to sell its stake for a long time, but RWE has not, *Népszabadság* commented.

Research/Innovation

ELI's cornerstone laid in Szeged

The cornerstone of the ELI Attosecond Light Pulse Source (ELI-ALPS), a European Union-supported superlaser centre in Szeged, was laid in a ceremony attended by PM Viktor Orbán. Hungary, the Czech Republic and Romania won a joint bid for the EU's Extreme Light Infrastructure (ELI) project in October 2009, with the University of Szeged hosting the project in Hungary. The ELI-ALPS will "also pursue research with ultrahigh intensity lasers." In the first phase, the research building will be constructed and part of the laser technology installed. EU funding will cover 85% of the project's HUF 37bn (EUR 120.3mn) cost. More equipment will be installed in the second, HUF 24.3bn (EUR 78mn) phase which is expected to be completed by 2018.

Creative industries

Design Terminal develops long-term strategy

Design Terminal (DT), an NGO set up to boost the Hungarian creative industry, became a budgetary institute this year. Located in bus terminal that had been built in 1949 in the Bauhaus style in centre of Budapest, the Design Terminal building was first set to become a design hub in 2003.

Now Design Terminal will have an overall budget of HUF 1bn (EUR 3.2mn) for 2014, plus a seven-year plan to help well qualified and talented creative experts tap their business potential and attract capital. Design Terminal's new, long-term strategy is now adjusted to the EU's 2014-2020 budgetary period, a policy frame in which creative industries has emerged as a strategic priority. DT's strategic director, Gergely Böszörményi-Nagy was promoted to general director. Innovation forums, international design exhibitions and Christmas fairs are among the major events Design Terminal has organised and supported. This spring, Design Terminal will have a team of economists prepare the first-ever horizontal study of the Hungarian creative industry: its state and value added to the economy. Beyond running its own talent projects from 3D printing to fashion industry contests, Design Terminal's downtown HQ is a home to major events of the Budapest start-up community.

Transport

Budapest-Baku cargo flights begin

Azeri airline Silk Way West announced that it will operate two cargo flights a week between Baku and Budapest from March 1 with its Boeing 767-300F planes. The airline started passenger flights between the two cities last June. In a separate event it was announced that Russian airline UTair will fly between Moscow's Vnukovo airport and the Lake Balaton airport at Sármellék from March 23, according to *Airline Route* magazine. The Boeing 737-800 planes will fly on Sundays.

Events

RENEXPO® Central Europe, International Energy Trade Fair
Date: March 12-13 2014
Location: SYMA Event & Congress Centre
More information: http://renexpo-budapest.com/index.php?id=7&L=1

SIRHA Budapest, International Food Trade Exhibition
Date: 10-12 March 2014
More information: http://sirha-budapest.com/?nyelv=1

AGRIBUSINESS EVENT
Date: 13 March 2014
Location: Koninklijke Instituut voor de Tropen, Linnaeusstraat 35F, 1093 EE Amsterdam
More information: http://www.huchamber.nl/nl/agenda/agrifood-evenement?goback=%2Egde_1072297_member_5836364750996410368

CONSTRUMA 33rd International Building Trade Exhibition
Date: 2-6 April 2014
More information: http://www.construma.hu/?nyelv=1

INDUSTRY DAYS
Date: 27-30 May 2014
More information: http://www.iparnapjai.hu/?nyelv=1