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Hungary Economic News Letter

Embassy of the Kingdom of the Netherlands

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Editorial

New years are supposed to be about turning over new leaves, thus our monthly Hungary Economic Newsletter is also to undergo some changes. From now on, the newsletter will be somewhat shorter, but will be better focused on our priority sectors, namely water management, sustainable energy, transport and logistics, and last but not least the creative industries. We hope that these changes - partly triggered by reshuffling within the Embassy - will make easier for our readers digesting the newsletter.

While the recent macroeconomic statistical indicators show improving trend in the Hungarian economy, the OECD in its country report published in January warns that Hungary's growth potential is "worryingly low" because it is hampered by a low rate of investment and low employment among low-skilled workers, "making structural reforms essential".

The OECD also cautioned against the negative effects of a deteriorating business climate, unpredictable regulatory environment and market distorting economic policy. The vulnerability of the country was demonstrated few days later, when HUF was put on rollercoaster together with some other EM currencies. Hungary's low interest rates are not protecting the HUF and it might find itself in a new band of trading.

As to the Embassy activities, the most important event of the month was a seminar organised by Transparency International and the Fiscal Responsibility Institute which was supported by our Embassy. Beside launching a new project that will calculate the budgetary impacts of the parties' election programmes similar to the practice of the Netherlands, a report on the need to enhance transparency in policy making was presented.

In his opening speech Dutch Ambassador Gajus Scheltema emphasised that the Dutch consider transparency and openness important, that is why we support this project. It is important to share experiences and best practices, especially before the election. Johannes Hers, head of the Public Finance Sector at the CPB Netherlands Bureau for Economic Policy Analysis, presented the methodology of putting election manifestos of political parties in the Netherlands to a tough but objective fiscal reality test.

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

EU relations

EC may withhold 25% of road investment funding

The European Commission could decide to keep some HUF 170bn (EUR 0.5bn) in funding from Hungary because of restrictions on road construction tenders in place since 2007, according to local news daily *Magyar Nemzet*. Brussels objects to Hungary's exclusion of bidders from road construction projects without nearby asphalt units. The rule prevents companies with mobile asphalt units from participating in tenders, the paper reported. The Commission could withhold some 25%, or HUF 170bn, of the HUF 675bn (EUR 2.2bn) of funding for road investments. All of the funding has already been committed and HUF 150bn has been paid out, according to *Magyar Nemzet*, which reckons that funding could be reallocated but only for investments to be completed by the end of 2015, "*an impossibly short timeframe*."

The spokesperson for Commissioner for Regional Policy Johannes Hahn confirmed that Hungarian authorities had been asked to review the contracts because of suspicion they contained discriminative restrictions. There is no complete list of projects objected to by the EU, *Népszabadság* observes, but a source close to the Commission speaking on condition of anonymity said that about 70 contracts could be affected in the matter.

Government to facilitate EU project applications

The cabinet submited the partnership agreement on the use of the EU funds for the 2014-20 period to the European Commission and the operative programmes will be submitted a month later, Prime Minister's Office deputy state secretary for development funds, Nándor Csepreghy said. For better planning, the ministries will publish the schedule for new tenders on a quarterly basis, he said. Rolling funding will be introduced for successful applicants. Paperwork administration will be phased out and the evaluation of tenders will be simplified. The government wants to make the process of submitting tender applications easier to save costs, Csepreghy said. Note that in the previous EU budget period, the costs associated with managing projects took up 15-20% of all development expenses.

Macroeconomy

Remittances up to 1.8% of GDP

A newly-released report from the World Bank shows that a whopping USD 2.4bn was sent into the country from Hungarian citizens living abroad in 2013, the equivalent of 1.8% of GDP or about USD 5,200 per émigré. Interestingly Romania received transfers worth about 2.1% of GDP and in Slovakia the same figure is 2.1%. In reporting on the statistics, local newspaper *Népszava* recalled recent National Economy Ministry statistics which reckon that at least 450,000 Hungarians are working in European Union member states alone. The World Bank further noted that some 12.3% of Hungary's university graduates are living and working outside the country at present.

OECD calls growth potential weak

The OECD maintains its GDP forecasts for Hungary in its latest report, seeing growth of 2% in 2014 and 1.7% in 2015, just as in its November report. However, the OECD warns that Hungary's "worryingly low" growth potential is hampered by a low rate of investment and low employment among low-skilled workers, "making structural reforms essential". Although Hungary has significantly better access to international financing, its debt remains high, leaving the country vulnerable, according to the OECD. The report said special taxes helped to keep the budget deficit below 3% of GDP in recent years, but have undermined the stability and simplicity of the tax system. The OECD recommends that Hungary phase out such special taxes and implement growth- and environmentally-friendly measures.

Hungary has proved that it is capable of pursuing a new, independent and successful economic policy, Economy Minister Mihály Varga has written in a guest post on the

Financial Times website. Varga wrote that last year's results have justified the government's blend of conventional and innovative measures. Varga noted that GDP was up 1.8% in the third quarter of last year, exceeding analysts' expectations, employment is at a 21-year high, while wages have gone up in real terms.

Monetary policy

Monetary Council continues cutting the base rate

At its regular meeting, the Monetary Council of the National Bank of Hungary (MNB) decided to reduce the central bank's key rate by 15 bp to 2.85%, in line with general expectations. The Council reduced the base rate by 25 bp at each of its monthly rate-setting meetings for twelve months from August 2012 until last August, when it started making 20 bp cuts.

In a statement published after the meeting, the Monetary Council acknowledged the effect of government mandated cuts to utilities prices on slowing inflation, but said inflationary pressures in the economy was "*likely to remain subdued over the medium term*," noting the negative output gap, weak domestic demand and low inflation on external markets. The Council said economic growth was "expected to continue" in the coming quarters, supported by domestic demand as well as higher exports. While corporate investment is set to rise because of the MNB's Funding for Growth scheme and European Union-funded government infrastructure projects, the recovery in household consumption "*is likely to be gradual*."

However in the last days of January the EM sell-off partly triggered by FED's tapering has spilled over into Central and Eastern Europe, and HUF was particularly affected. Actually it fell to the lowest level in two years, 312 HUF/EUR rate. The MNB governor György Matolcsy defended the monetary policies as the HUF continued its decline, in line with other emerging-market currencies. Addressing a business forum hosted by the American Chamber of Commerce, he said it was a good decision to reduce interest rates, based on the current account surplus and the successful management of state debt. Matolcsy went even further, and said there is room for more rate cuts, as inflation remains below 3%. Many analysts said this comment contributed to the further sell-off in the HUF.

Countries where low rates are not necessarily justified can easily become targets, analysts warn, so it is no surprise that markets are questioning the sustainability of the MNB's low base rate policy. As to the future exchange rate, analysts at Commerzbank do not believe Hungary's central bank will take action - hike rates - before the forint weakens to over 325 versus the euro.

Inflation at lowest level since 1970

Inflation was up 0.4% year-on-year in December, the lowest level since March 1970, the Central Statistics Office announced, beating expectations. November's second round of utility price cuts drove prices downwards, as their effects first appeared in the December bills. December inflation was 0.5% lower than in the previous month, when the year-on-year figure was 0.9%. Average inflation for 2013 came in at 1.7%.

Core inflation – which excludes energy prices – was 3.5% both in December and for 2013 on average. ING analyst András Balatoni said strong harvests were behind the 15% fall in agricultural producer prices last year, which trickled into consumer prices. Companies may be inclined to increase prices as economic growth picks up this year, he forecast.

Budgetary policy

ÁKK unveils financing plan for 2014

The state debt manager ÁKK plans to borrow less in foreign currency this year, as it looks to lower foreign-currency debt to 38% of the total from the current 41%, deputy CEO László András Borbély announced at the presentation the ÁKK's financing plan for

2014. A related target is to have 46% of debt in domestic hands, up from the present 44%. The ÁKK intends to issue EUR 4.6bn in foreign-denominated debt, down from some EUR 10bn in 2013. The bond issue would come on top of an EUR 850mn international development loan and from domestic sources. Households increased their holdings of Hungarian government bonds from HUF 1.2trn to HUF 1.9trn (EUR 6.15bn.) last year, Borbély added.

Hungary has HUF 5.96trn (EUR 19.2bn) of debt maturing this year, of which HUF 4.37 trn is denominated in HUF and EUR 5.6bn in foreign currency, including EUR 1bn which was due in January. Hungary does not need to rush to the international bond markets, Borbély told reporters, as it secured EUR 1.5bn with the issue of dollar bonds in November, he said. Hungary needs to produce sound economic figures for a sustainable period before its credit rating will change, he remarked.

Employment

Apprentice programme seen success

A total of 48,000-49,000 skilled labour students are participating in dual training apprenticeship schemes at about 7000 companies, labour affairs state secretary Sándor Czomba announced. In this scheme, students are trained onsite in workplaces, as well as in classrooms. Companies now get an annual Ft 453,000 subsidy for each apprentice student, up from Ft 440,000 last year.

Siemens Hungary chairman and CEO Dale A. Martin said German companies in Hungary are not only creating jobs but have a significant role in training high-quality skilled workers, as well as in research and development. The government will soon announce a new subsidy to help young people from families facing several challenges, Czomba said.

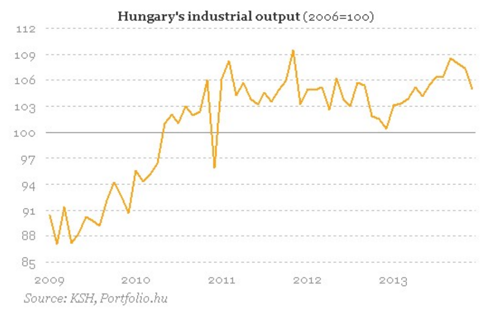
Hungarians of foreign employees

Hungarians notice the consequences of foreign employees arriving in the country less than their peers in southern and western Europe but still have a negative attitude to inflows of foreign workers, Dutch HR consulting firm Randstad said, citing the company's recent Workmonitor 2013 survey. There were twice as many Hungarians who thought the working environment had changed negatively due to foreign employees than those who reported a positive change. Only a third of Hungarians said that working together with foreign employees added value to their jobs. "*The international survey shows that foreign workers are generally seen in a more negative light in countries where competition on the labour market has increased correspondingly. But the situation is different in Hungary and several other central European countries; for instance in the Czech Republic, where foreigners pose a relatively low pressure on the job market but they are still assessed negatively*," Randstad Hungary managing director Sándor Baja said in a statement. This is probably rooted in fear of the unknown: the proportion of foreign employees is relatively low in Hungary and people think that a change may have negative consequences, he added. Figures of the Central Statistical Office show that 141,000 foreign nationals live in Hungary in 2013, representing less than 1.5 percent of the population.

Production/Construction

Industrial output down in December

The volume of Hungary's industrial production dropped 1.9% month on month in December, according to figures of the Central Statistics Office (KSH). According to the flash estimate, Hungary's IP grew by 1.4% year-on-year in 2013, driven mainly by the vehicle manufacturing sector.



Construction up by 19%

Construction industry output was up 18.9% year-on-year in November, from 10.7% in the previous month, helped by weak base numbers and EU-financed projects, according to data from the Central Statistics Office. Output rose 3% from October and was up 9.5% over the first 11 months of the year. Growth came mostly from the construction of health institutions, industrial buildings and infrastructure projects. With the robust increase, November's output reached the average monthly figure for 2010, but was still at only 50% of the pre-crisis levels, website Origo observes.

Services

Raiffeisen decides not to sell Hungary subsidiary

Raiffeisen Bank International (RBI) decided not to sell its Hungarian unit under the current conditions, the Austrian bank announced, ending days of speculation about the sale of the loss-making Hungarian subsidiary. RBI received and evaluated several offers, but the owners decided that selling the bank at a depressed price would trigger further losses, Reuters news agency reported. Not only is RBI not selling, but the bank also announced that it is ready to boost capital reserves at its Hungarian unit by EUR 2-2.5bn in order to meet Basel III standards on capital adequacy. The tiny Széchenyi Bank, with 49% state ownership, reportedly offered €1 for Raiffeisen's Hungarian operations, with the promise of taking over all of its claims and non-performing loans. Actually Raiffeisen's non-performing loans amount to HUF 424bn (EUR 1.3bn), 30% of the total, one of the highest rates in the sector.

As to the other exit rumours, despite bad profit outlooks and pressure from authorities in consolidating the bank sector, K&H bank's Belgian owner KBC will not leave Hungary, K&H CEO Hendrik Scheerlinck told Reuters.

Business environment

Companies more optimistic about financing

The majority of company executives in Hungary consider access to credit as improving and Hungarian decision-makers are more optimistic about credit conditions than the regional and international average, the latest Capital Confidence Barometer issued by EY. EY (previously Ernst and Young) interviewed 1,600 company decision-makers in 72 countries. A total of 56% of Hungarian company executives said that credit availability was improving on an international level, as against 42% in the region and 48% globally. EY transaction advisory services senior partner Margaret Dezse said company executives in Hungary are increasingly optimistic about financing. "*This is especially good news considering that around half of Hungarian company executives are clearly focusing on growth. The availability of sufficient credit level is an unavoidable condition for this because the Hungarian corporate sector is traditionally affected by capital shortage*," she said.

Acceleration indicator gains momentum

The acceleration indicator GYIA, a measure of future economic growth compiled by *Világgazdaság*, was up 2.19% year-on-year in January and 0.37% from December, the fastest rise since February 2008. The index has gained over 2% in the last four months. The growth came as nine of the ten sub-indices improved, with new orders in industry the only exception. Thus the economy is expected to show noticeable growth in the coming months, but it is unlikely that January's growth in the index could be repeated, *Világgazdaság* adds. Hungary had the highest economic sentiment indicator (ESI) in the EU in December, the figures released by the European Commission show. Hungary had an ESI of 115.3 points in December, up from 110.9 in November. (The ESI indicator has five components, measuring industry, the services sector, construction, retail trade and consumption.)

Money laundering cases on rise

According to the National Tax and Customs Authority (NAV), reports of money laundering in Hungary totalled 6,160 in the first half of 2013, representing a year-on-year increase of over 80%. In reporting on the statistics, local business news daily *Napi Gazdaság* noted that NAV report offered no explanation for the massive jump in laundering activity. Much of Hungary's money laundering is thought to involve legitimate bank deposits, and NAV also reported that a total of 66 transactions with financial institutions were halted in the first six months of 2013. As of 2011, the National Tax and Customs Office (NAV) estimated money laundering in Hungary to represent USD 15bn per year.

Legislation

Mandatory audit rules relaxed

Only companies with annual revenues of at least HUF 300mn (EUR 1mn) are required to have their books audited from January 1, as the limit has been increased from HUF 200mn. The change affects more than 6,000 companies, company information service provider Opten observes.

Dutch presence in Hungary

Dutch biogas plant to start production

Pilot operations at a biogas plant in Várda (Somogy county) built from a HUF 2.5bn (EUR 8.3mn) greenfield investment, are set to begin in March after the necessary licenses are issued, *Napi Gazdaság* reports. Dutch company Kurstjens has built its first such plant in Central and Eastern Europe via its subsidiary Bio-E. The power plant will draw on biological waste from agriculture activities nearby and also community waste. The Dutch Embassy visited the plant together with officials from HITA some time ago in order to sort out some administrative issues concerning the necessary licences that had been hindering the implementation of the project.

Transport/Logistics

More border crossing points with Slovenia

Prime Minister Viktor Orbán and his Slovenian counterpart Alenka Bratušek signed a declaration of intent on developing road infrastructure and creating six border crossing points between the two countries. At their meeting in Apátistvánfalva, one of Hungary's westernmost villages bordering Slovenia. The crossings will be built using funds available in the European Union's 2014-2020 development program.

E-toll revenues beat projections

Revenues from the electronic road toll fee reached HUF 78.8bn (EUR 263mn), exceeding the HUF 75bn (EUR 250mn) target, state motorway manager NÚS, (formerly known as ÁAK) announced. Proceeds in 2014 could reach HUF 150bn (EUR 500mn) from the usage-based tolls and HUF 43.4bn (EUR 145mn) from motorway stickers. Hungary introduced usage-based tolls in July for trucks heavier than 3.5 tonnes, at a cost of HUF 35bn (EUR 117mn), including the HUF 1bn (EUR 3.3mn) monthly operating costs. Info-communications affairs state secretary Vilmos Vályi-Nagy emphasised that the tolls are lower than in Slovakia. Nearly 40% of the trucks using Hungarian roads pay via on-board equipment and 60% buy tickets.

Airport passenger numbers up slightly

Budapest Airport handled 8.5 mln passengers in 2013, up 0.2% from 2012, the airport manager announced. The number of flight movements was 4.3% higher, at 83,300. Average seat occupancy was 76.2%. Low-cost airlines carried 4.5 million passengers to and from Budapest, a 53% market share, while traditional airlines carried 3.586 million passengers, a 42% share, and chartered flights carried 352,000 passengers or 4% of the total. Air cargo traffic was down 1.1% to 92,100 tonnes.

As to the future plans, in the beginning of summer, Norwegian will add a fifth route to its Budapest network, launching a thrice-weekly service to London Gatwick. Connections to the UK will be boosted further by the inauguration of services by Jet2.com from Leeds Bradford.

Wizz Air continues to be an active airline at Budapest, basing its eighth aircraft at the airport this summer and starting its 30th service on June 4 with a weekly flight to Alicante, Spain. The airport will also welcome its first flight from Wizz Air's subsidiary airline, Wizz Air Ukraine, inaugurating a twice-weekly service to Donetsk, Ukraine, on April 30. Two more new airlines, Vueling and Air Serbia, will begin services in 2014, with routes to Barcelona and Belgrade, Serbia, respectively.

Energy/Sustainable energy

Consortium lends HUF 100bn to MMBF

Gas storage company MMBF signed a EUR 114mn and HUF 60bn (EUR 200mn) loan agreement with a consortium of Hungarian banks and the EBRD, OTP announced. The other participating banks are ING, MKB and Raiffeisen, while OTP acted as an agent in the deal. MMBF, which controls the Szőreg-1 gas reserves in Algyő, southern Hungary, with storage capacity of 1.9 bcm, signed seven-year contracts with the banks, which will also be used for refinancing purposes. State development bank MFB bought 51% of MMBF from MOL in October, after which all Hungarian gas storage facilities are all in state hands, *Napi Gazdaság* points out.

Fidesz keen to fight EU on energy rates

The government will most firmly resist EU attempts to attack and impede utility rate cuts, Prime Minister's Office leader János Lázár told reporters. Brussels will not be able to prevent further cuts in energy prices, "although we have no doubts that it will try" he declared. Lázár said he is convinced that complaints from private or political players are behind the proceedings in Brussels.

The European Commission is in bilateral talks with all 18 member states that impose some form of price control on energy prices, news website Portfolio reports. The Commission would like member states to gradually phase out this practice to facilitate competition among market players, consistent with the ideal of a single European market. Energy Commissioner Günther Oettinger informed EU members of this aim last year. The Commission said recently that the EU would start infringement proceedings, if necessary, against any country that does not phase out regulated energy prices, and might take them to the European Court.

Environment/Water Management

Cabinet okays Budapest port project

The cabinet has approved the Budapest free port intermodal development project on Csepel Island, it was announced in the official gazette *Magyar Közlöny*. The free port Mahart Szabadkikötő will receive a HUF 3bn (EUR 10mn) grant to cover 92.5% of the costs. The project will improve the internal links of the port, especially between different modes of transportation. Logistics capacity will also be increased.

Ministry to buy mobile dam

The Interior Ministry announced in *Közbeszerzési Értesitő* an open tender for purchasing a mobile dam, with a budget of HUF 591mn (EUR 2mn). The portable barrier must be 10km long and should be stored in no more than five containers. The deadline is March 17.

Research/Innovation/Creative industries

Record spending on R&D last year

A record HUF 118bn (EUR 0.4bn) was devoted to research and development in Hungary last year, Economy Ministry state secretary Zoltán Cséfalvay announced. Of that amount, EU funding accounted for HUF 96bn (EUR 0.3bn). A further HUF 211bn of grants have been approved for 2013, but are yet to be paid, HUF 146bn of it under the EU's Operative Programme for Economic Development. Hungary plans to double the amount of funding for innovation and R&D in the EU's 2014-20 budget cycle to HUF 706bn (EUR 2.35bn). Plans to raise total R&D spending to 1.8% of GDP by 2020 can be achieved, Cséfalvay said, adding that the figure has grown from 1.17% in 2009 to 1.29% in 2012.

Government makes progress in IT

State info-communications company NISZ presented a new mobile-phone application that allows employers to quickly register part-time employees. The launch is part of a government drive to restructure the IT sector with the aim of increasing efficiency and reducing operating costs, communications state secretary Vilmos Vályi-Nagy told reporters. Investments in the sector grew to HUF 42bn (EUR 140mn) last year, partly because the time cycles in tender operations have been shortened, he added. More generally, the IT-focused research and development projects and digital learning in depressed regions are important priorities for the government. Vályi-Nagy said Hungary can achieve full coverage for access to broadband internet by 2018, two years ahead of the EU deadline. The government also wants to see consumer spending on IT rise and to see the spread of mobile applications that ease bureaucracy.

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

With the participation of the Agricultural Counsellor of the Embassy, Mr. Martijn Homan.

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