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HUNGARY Outlook 2021E: Growth-thirsty, SMEs remain key to the strategy

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2021E:
In a nutshell

- PM Orban achieved a significant political goal by securing, simultaneously, ample EU funds support and a de facto major watering down of the new rule of law directive, which entered into force in January 2021. EU funds access, plus a highly growth-focused MNB, in our view, means that GDP growth potential in Hungary should be unaffected by COVID-19, even though 2021E will remain challenging, given the drag on tourism.

- According to recent comments from PM Orban and the public recommendations of the MNB on long-term growth potential and productivity prospects, the policy mix will remain geared towards supporting SMEs, probably shifting the focus somewhat to agriculture and services relative to manufacturing in the next five years. There is a strong policy objective to support large Hungarian companies to leverage on the stock market and to invest abroad.

- In the coming year, our fair value HUF model signals scope for some appreciation of the currency, especially once tourism returns.

2021E:
In a nutshell

However, over the coming years, the trajectory for the currency remains that of a contained depreciation, stemming from a higher credit stimulus than in the Euro area and domestic capital, on the margin, moving abroad.

- We expect continuing friction with the EU and increasing geopolitical pressures from the US.

- Household confidence has taken a sharp leap down in recent quarters and remains frail, given the high perceived uncertainty with regards to inflation and the labour market. We suspect that, for the coming year, possibly 18 months, households are likely to maintain a high savings preference, which helps to fund the budget deficit, de facto.

- Public debt has risen meaningfully, but the trajectory does not appear overly challenging to fund or to correct. Renewed concerns about the outlook for the epidemic suggest potential for further yield compression in the near term; although, on a medium-term perspective, the 10- year sovereign yields appear fairly priced.

Note: this is an extract of our Hungary 2021 outlook, if you would like to discuss Hungary in detail please contact us.

Cyclical momentum

- Economic sentiment improved in January, but consumer confidence is soft
- The labour market remains strong in international comparison, but too weak to allow a brisk rebound of household consumption
- Credit activity, in our view, is at an appropriate pace: not too inflationary, not too tight
- The housing market should find new strength thanks to the lower VAT rate and the MNB's green mortgage bond initiative; however, non-resident investment will be lower than before
- Households' higher appetite for savings is helping to fund the budget deficit
- Inflation should moderate in the coming months, but not significantly below the 3% MNB target

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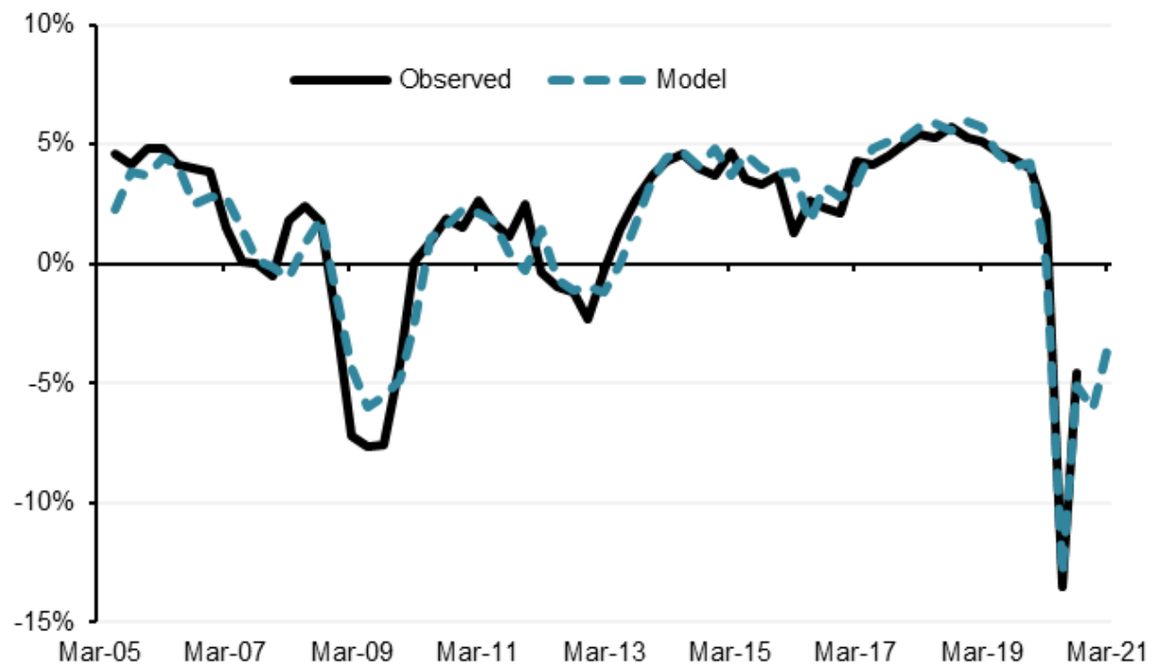
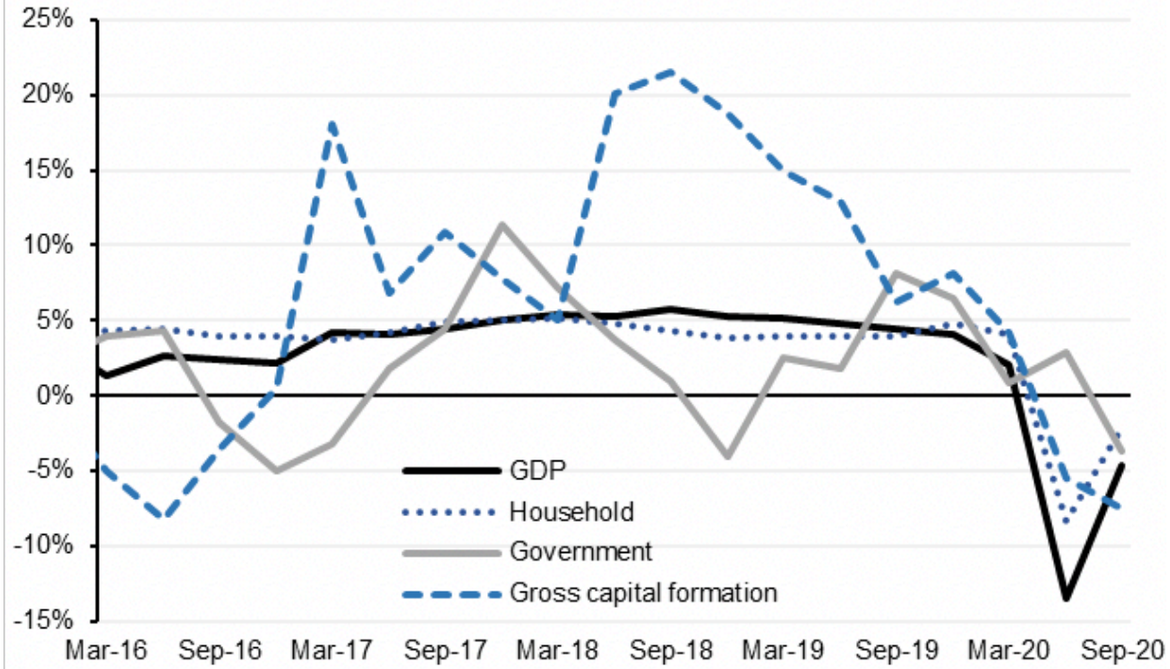
GDP prospects in the near term

- Our model, based on high-frequency indicators, suggests that real GDP is on track to drop by around 8% yoy in 4Q20E, implying a drop of around 6.2% in the GDP for 2020E as a whole.
- For 1Q21E, our model expects the GDP to drop by 3-4% yoy – keeping in view the protraction of restrictions and limited retail mobility.

Projected 4Q21E real GDP yoy growth



Real GDP growth, yoy



Sources: ADA Economics, CEIC

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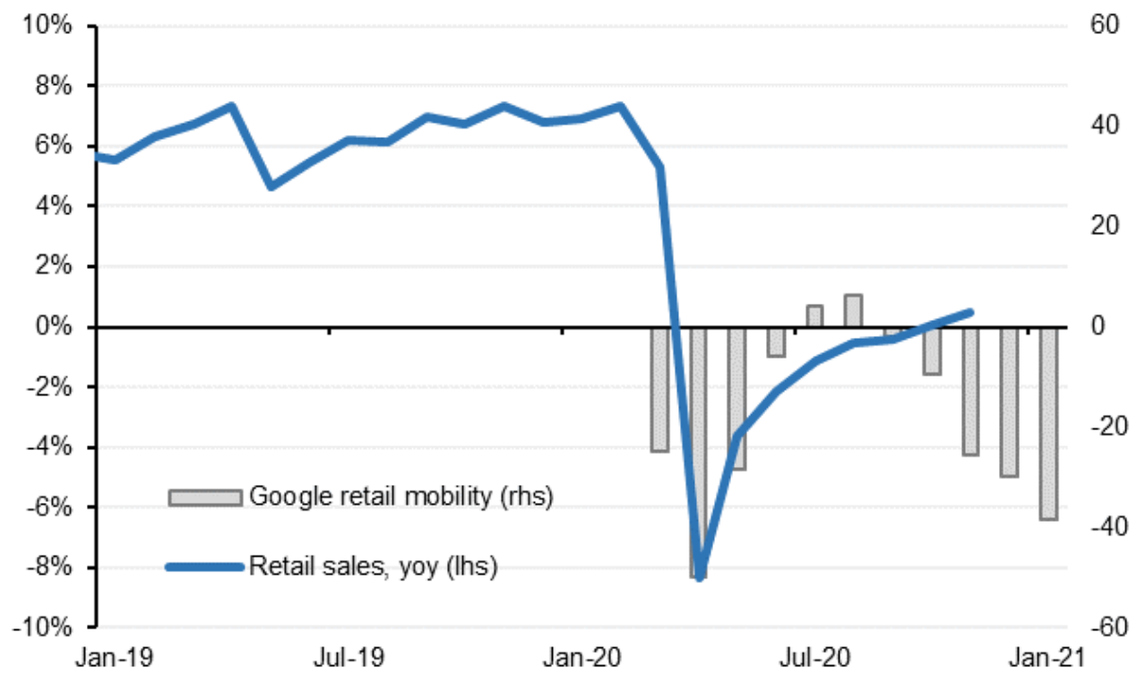
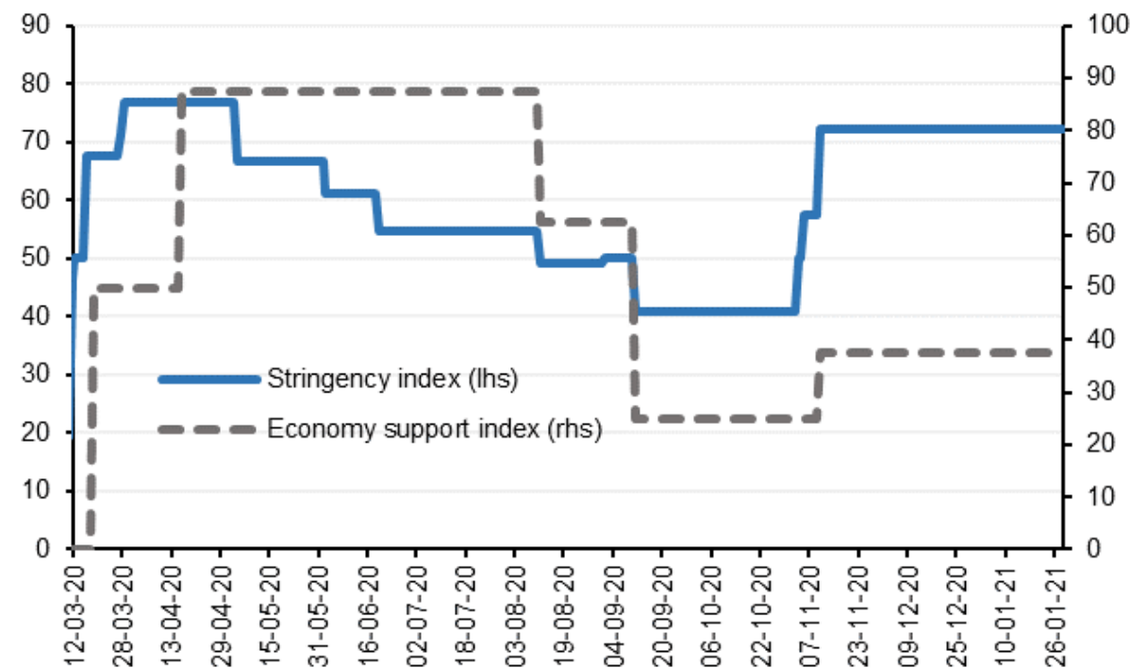
GDP prospects in the near term

- High frequency data, such as Google's retail and recreation mobility index, point towards a drop in household spending, as the restrictions were tightened from November; nonetheless, the drop has not been as severe as it during the first wave.
- Unemployment fears among Hungarian households remained relatively stable in response to the second wave vs. its peers; as a result, spending appetite appears to remain less affected, which should support household consumption this year.

Household spending



Restrictions and economic support



Sources: ADA Economics, CEIC

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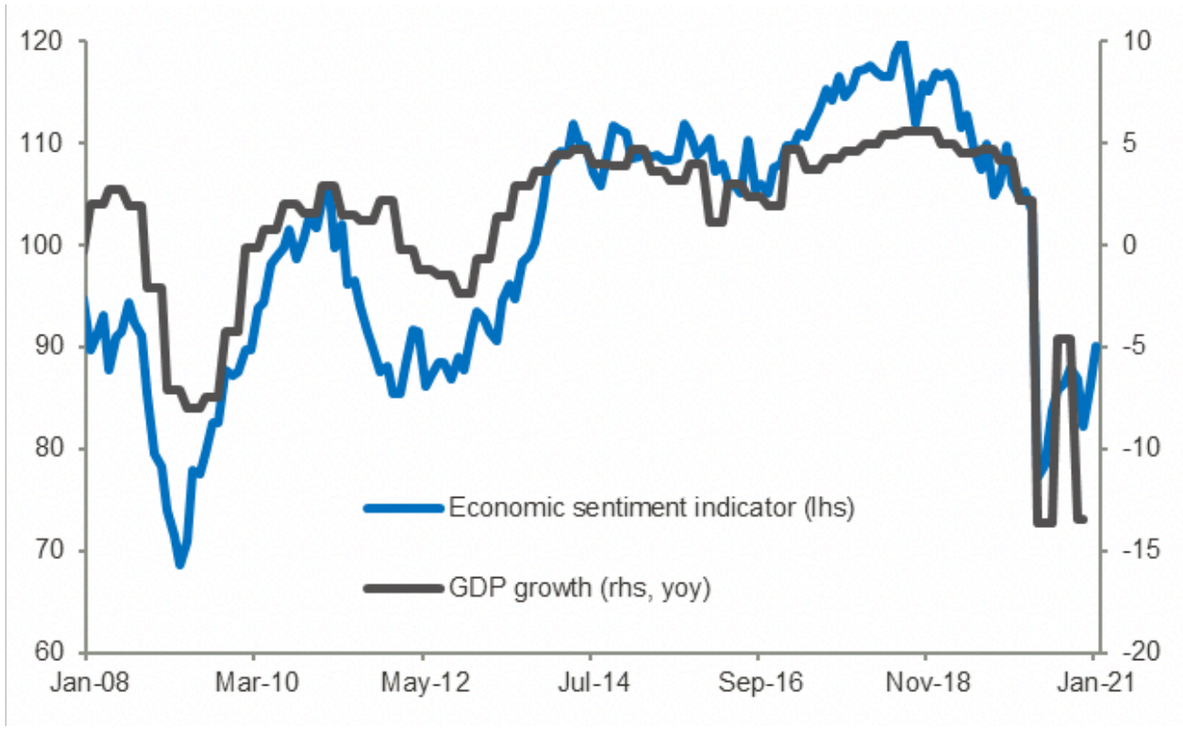
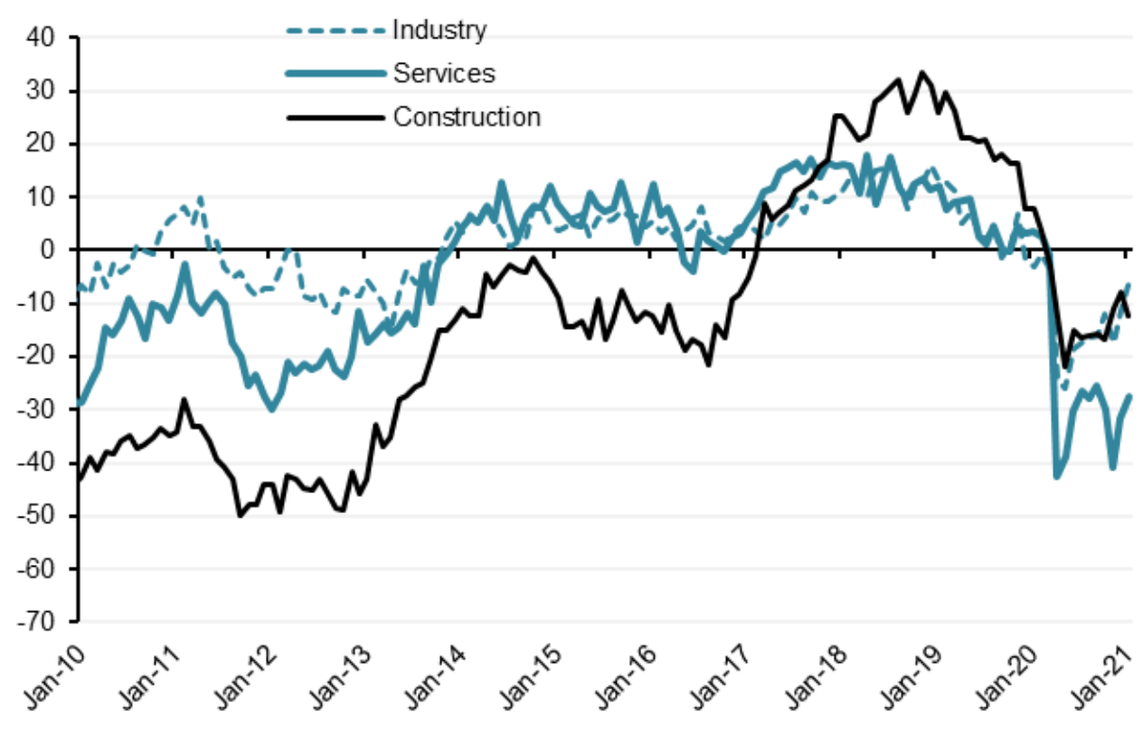
Business sentiment is flattening

- The ESI rose further in January, at almost the same pace as in December 2020 (+3.8pts vs. +4pts).
- The improvement in business sentiment was led by industrial confidence (+4.8pts vs. +6pts in December), driven by a steep pick-up in hiring appetite; followed by the services sector (4.1pts vs. 9.2pts in December), buoyed by a better assessment of demand over the past three months. In contrast, construction confidence dropped sharply, by 4.3pts, due to weaker hiring appetite and order book levels.

Economic sentiment improved in January



…driven by the industrial sector



Sources: ADA Economics, CEIC

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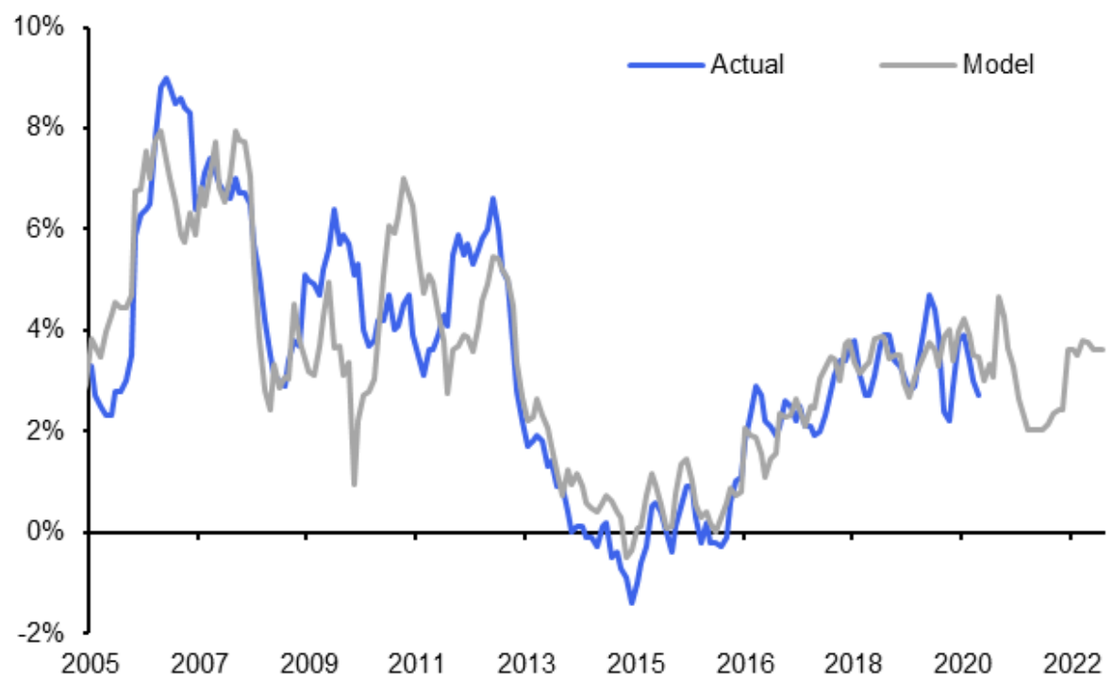
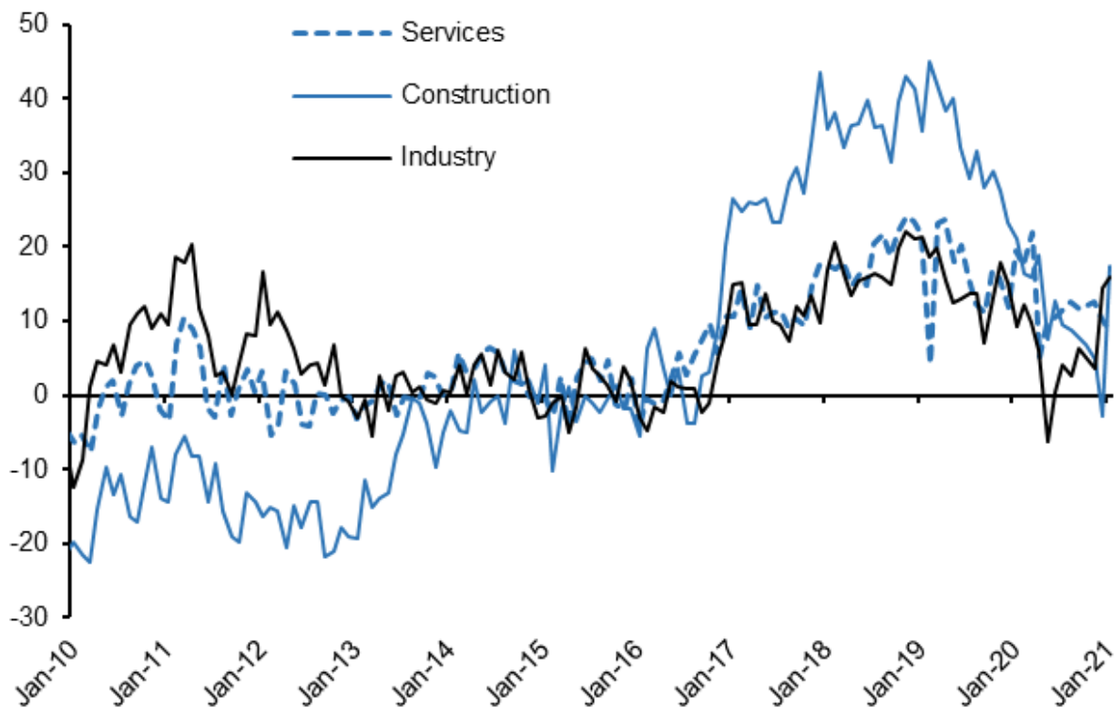
Inflation dynamics

- Inflation stood at 2.7% yoy in December, slightly below our expectations and the market consensus. Core inflation increased marginally, to 4%, with food and energy the main drivers behind the observed movement. Services inflation slowed down, driven partially by energy- related services, but also by rentals.
- Looking ahead, we project inflation (aop) at 3.0% yoy in 2021E and 3.2% in 2022E. The MNB, as of December, sees inflation at 3.5-3.6% in 2021E and 2.9-3.0% in 2022E. According to the Bloomberg consensus, the market's expectations are 3.1% and 3.2% for 2021E and 2022E, respectively.

Inflation model



Inflation expectations of sectors



Sources: ADA Economics, CEIC

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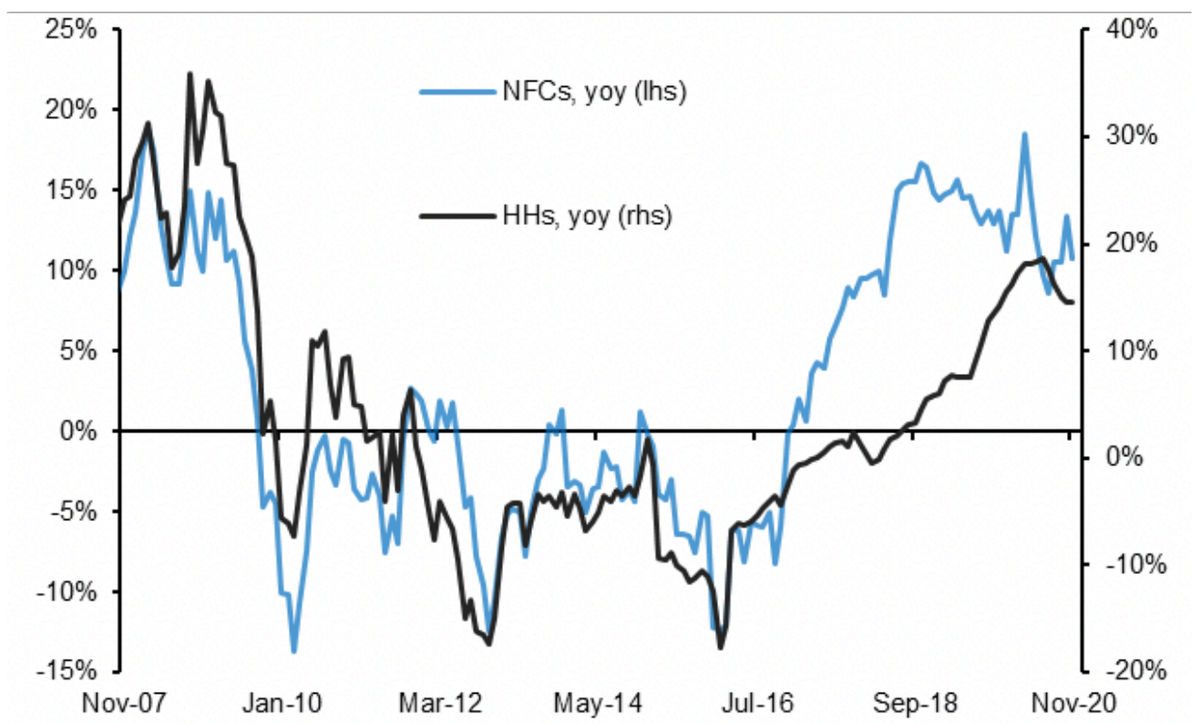
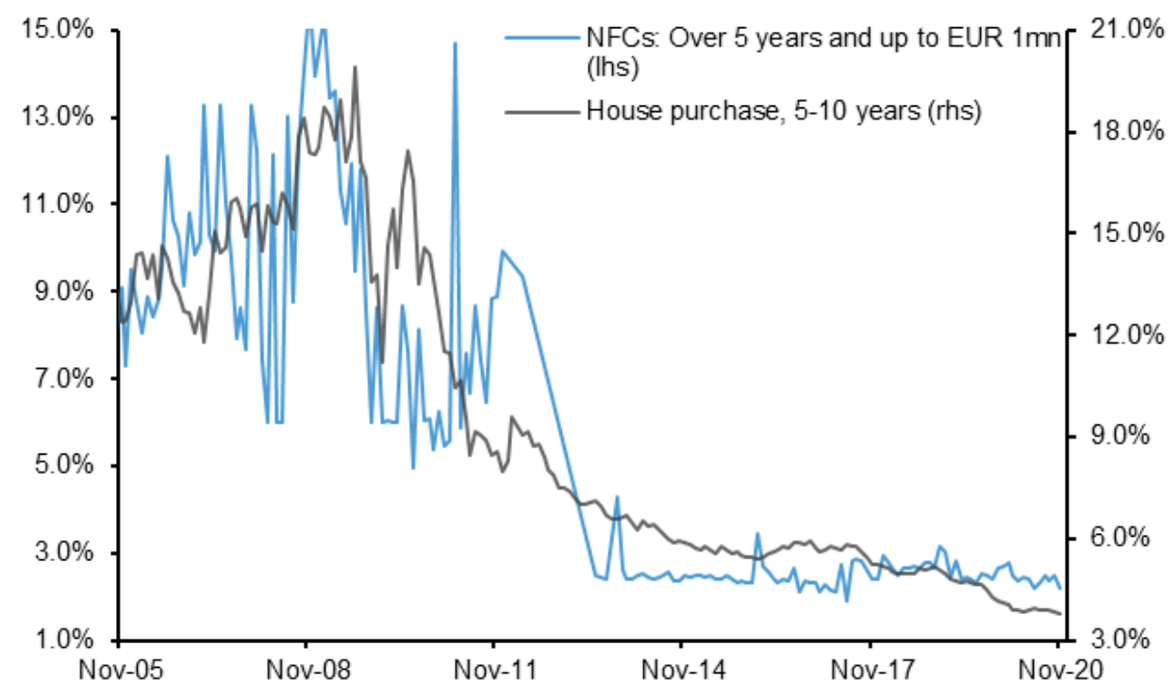
Retail credit remains soft, with weak near-term prospects

- Lending to households has been on a softening trend since June 2020, and eased to 14.5% yoy in November 2020, from the peak of 18.7% yoy. On the other hand, credit uptake by NFCs weakened in November, to 10.8% yoy, from 13.4% yoy in October, as tighter restrictions were imposed.
- According to the latest MPC statement, the cheap funding for SMEs under the FGS Go! reached close to HUF 1,500bn by December; however, the banks expect the credit conditions to tighten for businesses towards the first quarter of 2021E, despite an increased willingness to extend credit.

Retail credit growth



Borrowing costs



Sources: ADA Economics, CEIC, MNB

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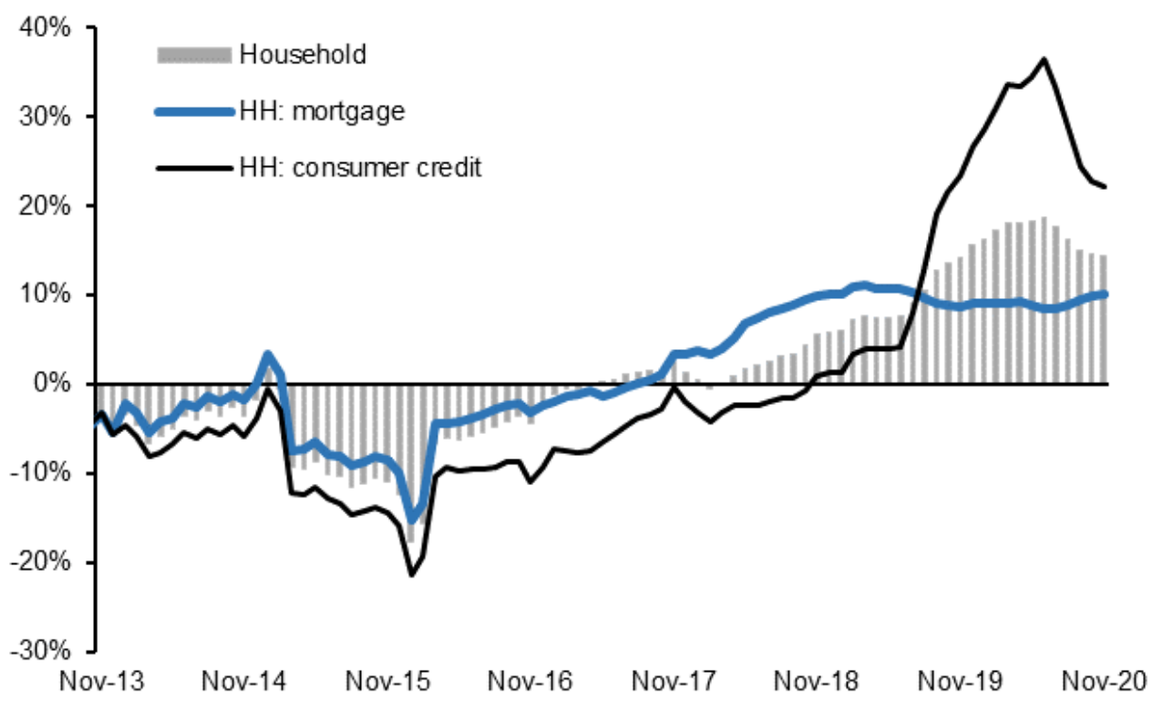
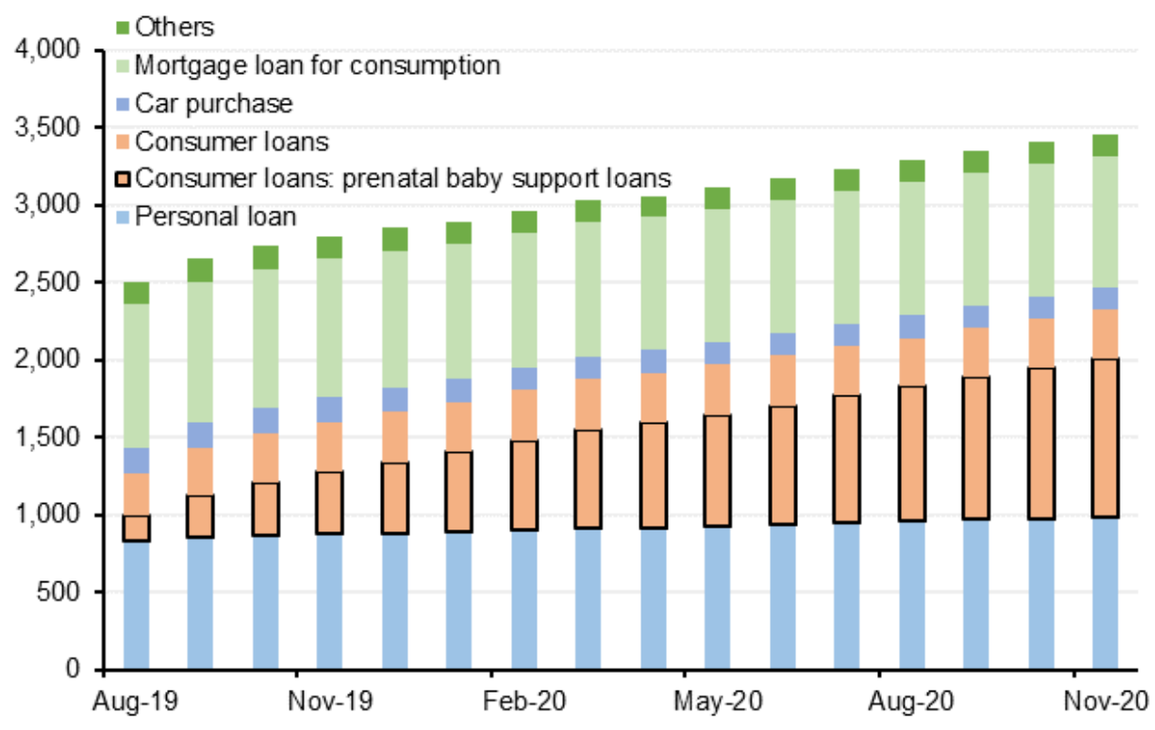
Household credit remains driven by housing intentions

- Mortgage lending remained flat around 9% yoy in 1H20, but has picked up recently, in the four months to November (10.1% yoy), as a result of a 16bps decline in mortgage rate for the maturity segment of 10 years – which accounts for half of the mortgage market share. In the coming year, mortgage lending should benefit further from the VAT tax break for purchases, as well as from the 50% subsidy for home renovation from the government.
- Consumer credit has been softening since March – a trend that has been apparent almost everywhere; however, lending under the prenatal baby support has risen at a gradual pace, due to its free-purpose nature.

Lending to household (yoy)



Household: consumer credit (HUF bn)



Sources: ADA Economics, CEIC, MNB

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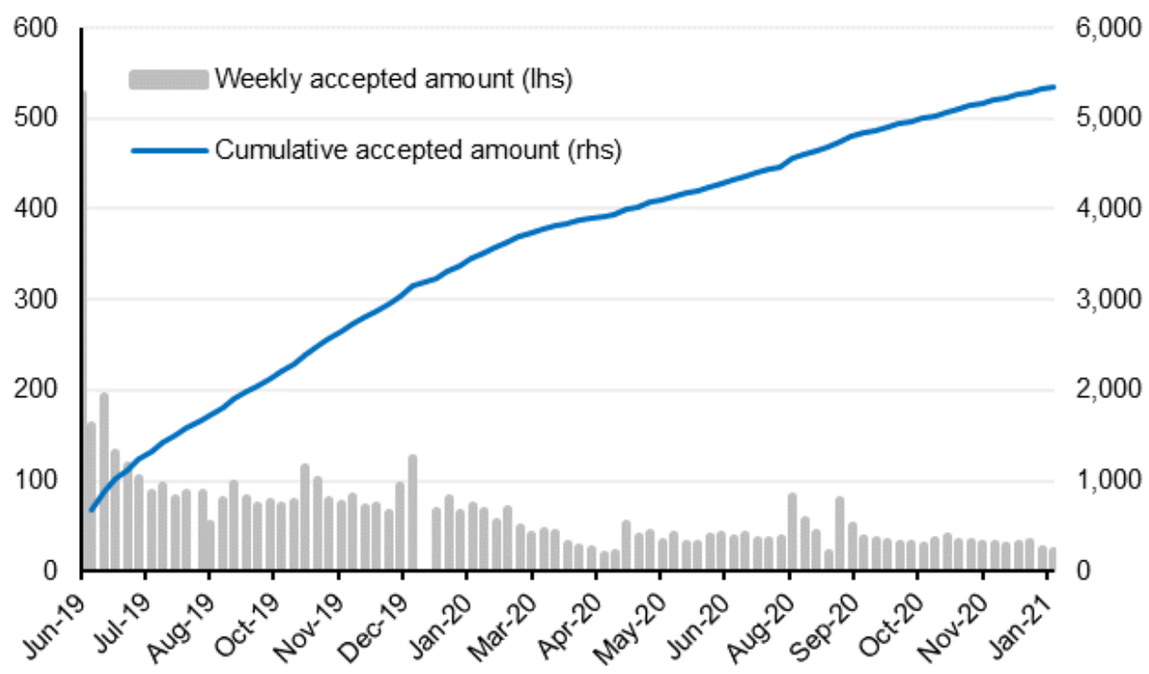
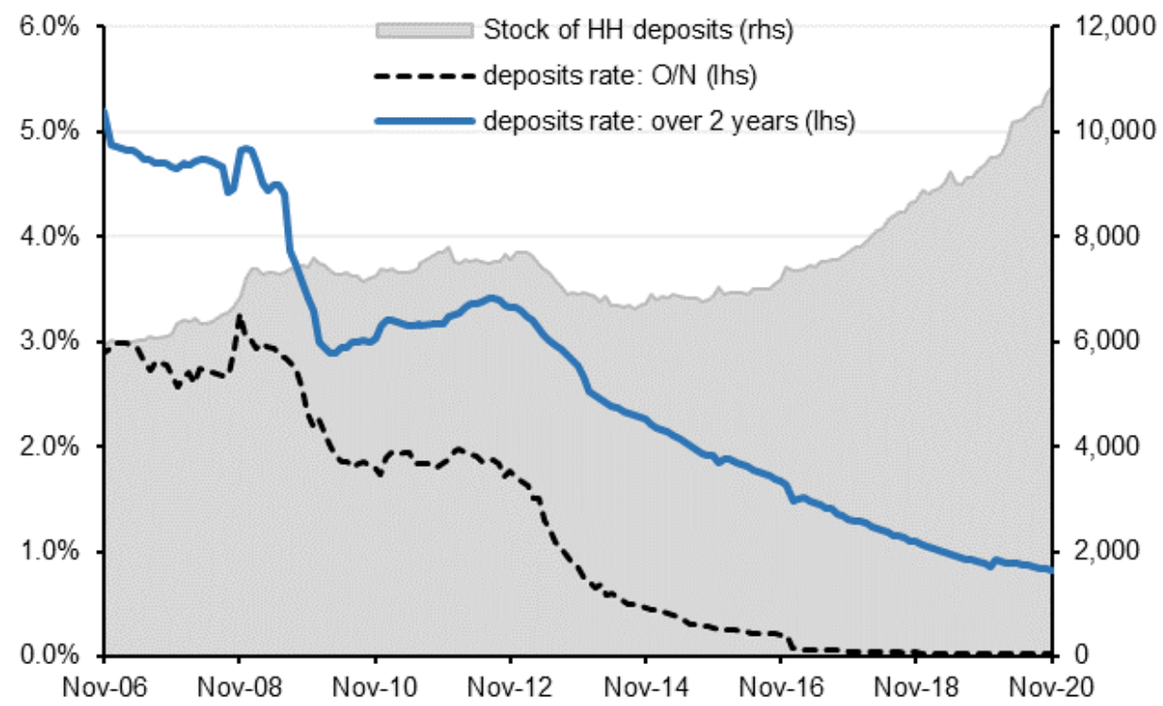
Household deposit growth and pricing

- Household deposits witnessed a rise in 2020, incited mainly by precautionary motives. However, a larger sum of deposit inflows went towards the government's security (MÁP Plusz) bond (around HUF 2.4trn in the first 11 months of the year) vs. the banking sector (HUF 1.35bn), owing mainly to the better returns on the former, which are also tax exempt.
- The government security bonds are issued for a five-year tenor, with fixed interest rates for a set period, which rises over time – starting from 3.5% and rising to 6% in the final year. This dwarfs the returns offered by the banking sector, which are less than 1% for over two years' maturities.

Take-up of government security plus bond (HUF bn)



Household deposits with MFIs and deposit rates (HUF bn)



Sources: ADA Economics, CEIC, AKK

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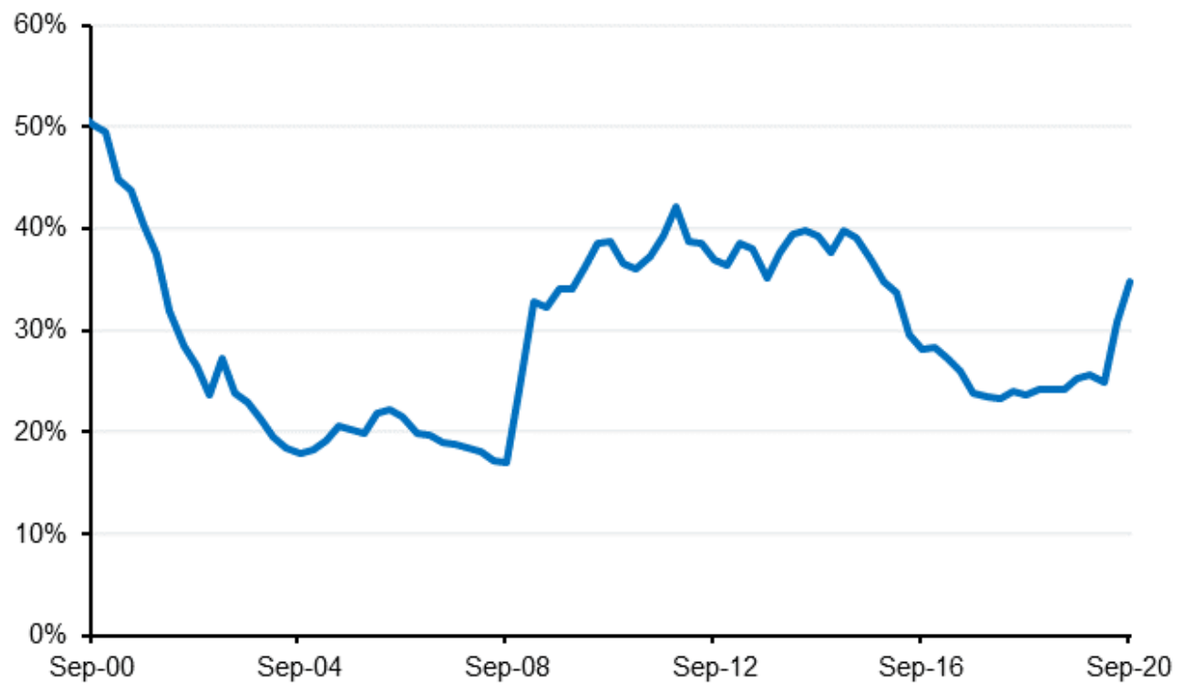
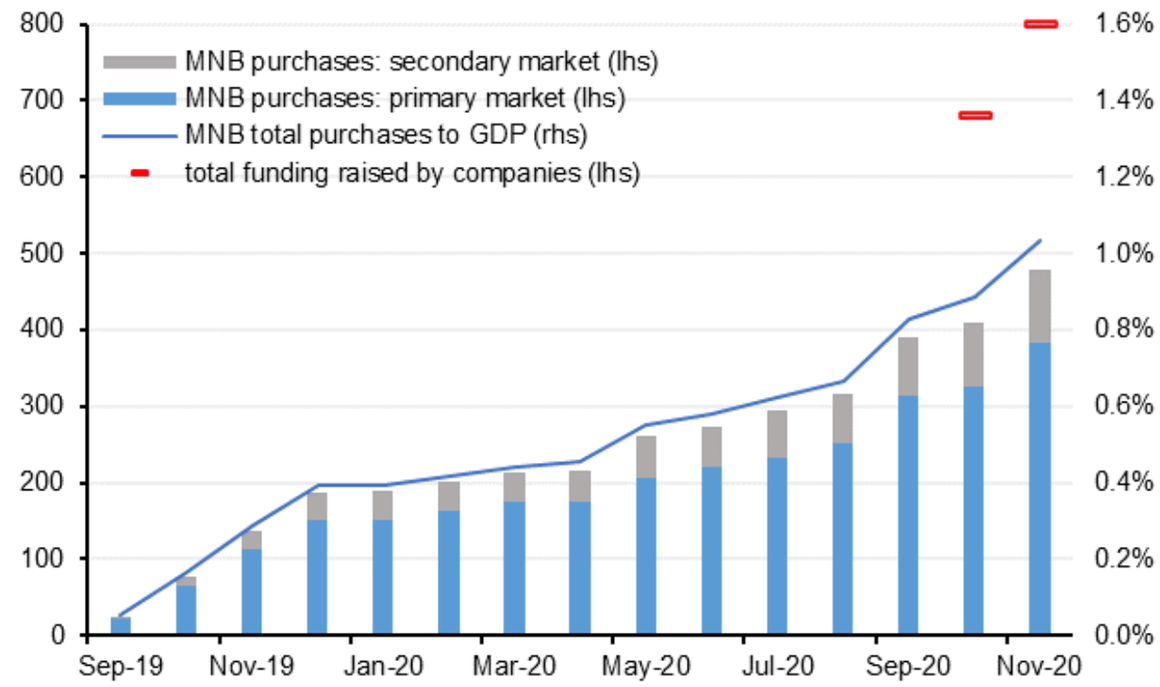
MNB's presence in public and private debt markets

- As of December, the MNB's stock of government bond purchases stood at HUF 1,042bn – of which HUF 994bn government bonds and HUF 48.3bn for government-guaranteed bonds.
- At its latest meeting in January, the MPC increased the amount available under the BGS programme to HUF 1,150bn (2.3% of GDP), from HUF 750bn (1.5% of GDP), which aims to increase the liquidity in the corporate bond market.
- Furthermore, the MPC also announced that it will increase the pace of its QE programme in the coming months , with the possibility of purchasing government securities with less than 10 years' maturity.

MNB's assets to GDP



Bond funding for growth programme (HUF bn)



Sources: ADA Economics, CEIC, MNB

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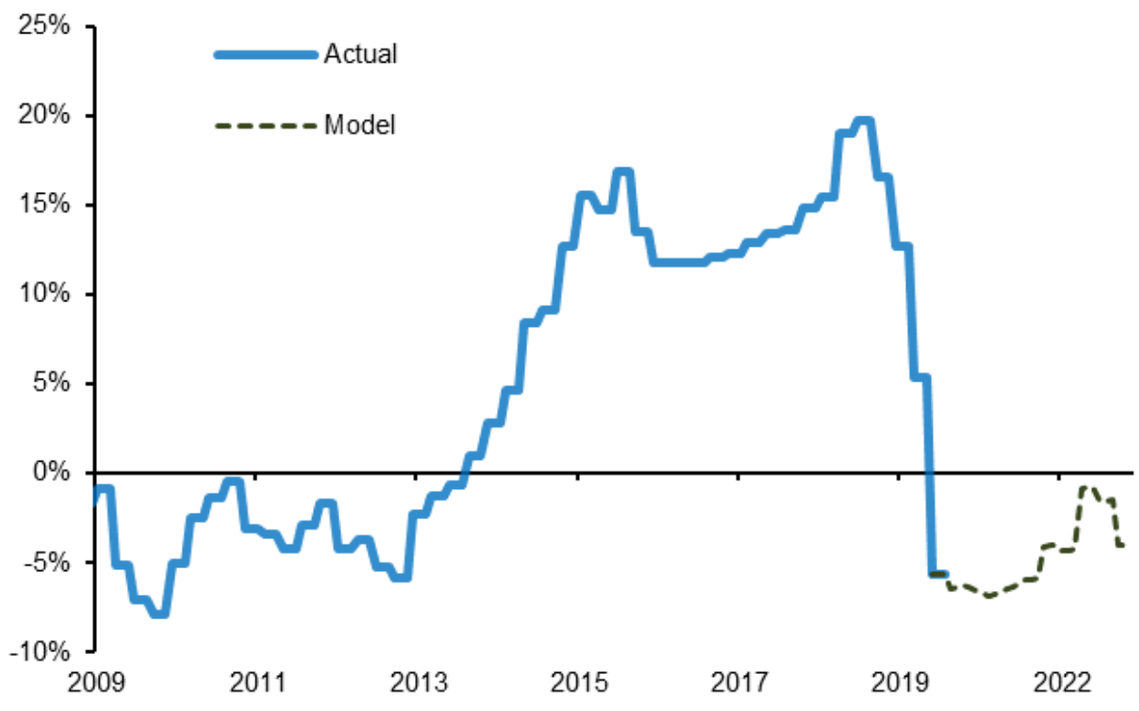
House prices and affordability

- House prices dropped by 5.6% yoy in 2Q20, after easing to 5.3% yoy in the first quarter. Despite the drop, the housing market's prospects have strengthened materially for the coming years, as a result of the incentives provided by the government. We expect to see a positive gain in momentum in the latter half of the year.
- Starting from 2021, the VAT rate on newly-built residential properties has been reduced significantly, from 27% to 5% for the next six years, provided that the permits are issued by December 2022. Moreover, properties purchased with the "home purchase subsidy" (HPS) will be exempt from VAT. Furthermore, the prenatal support loans provided to families have been used increasingly for house purchases, as reported by the MNB.

House price model



Construction permits issued for dwellings

Sources: ADA Economics, CEIC, KSH

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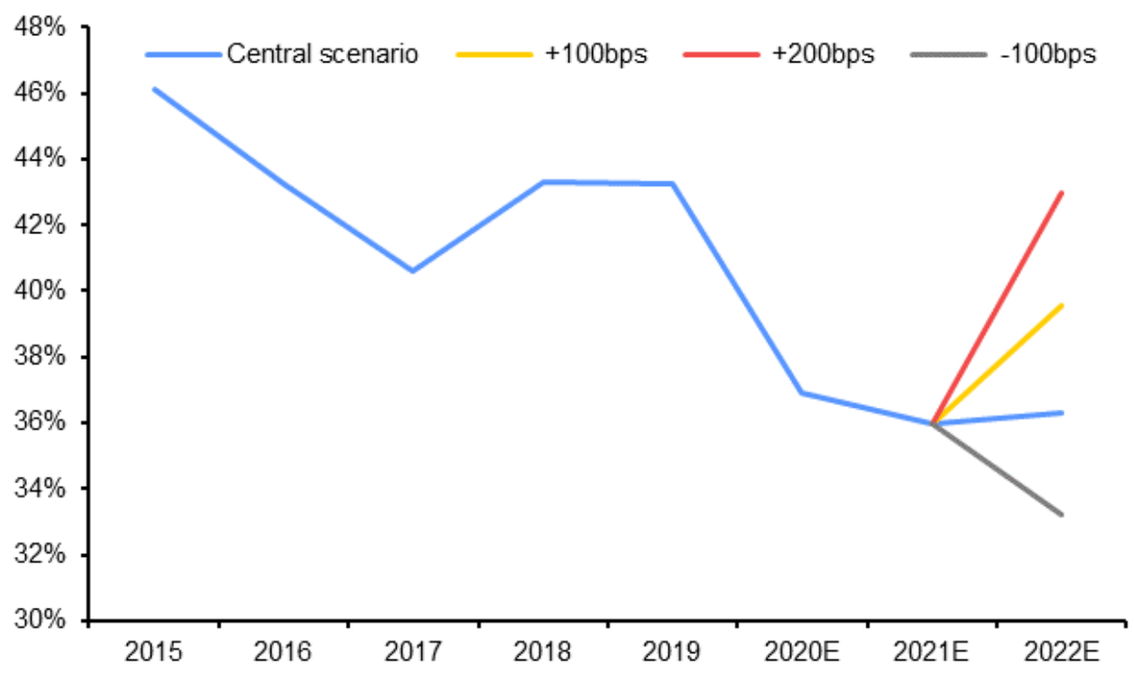
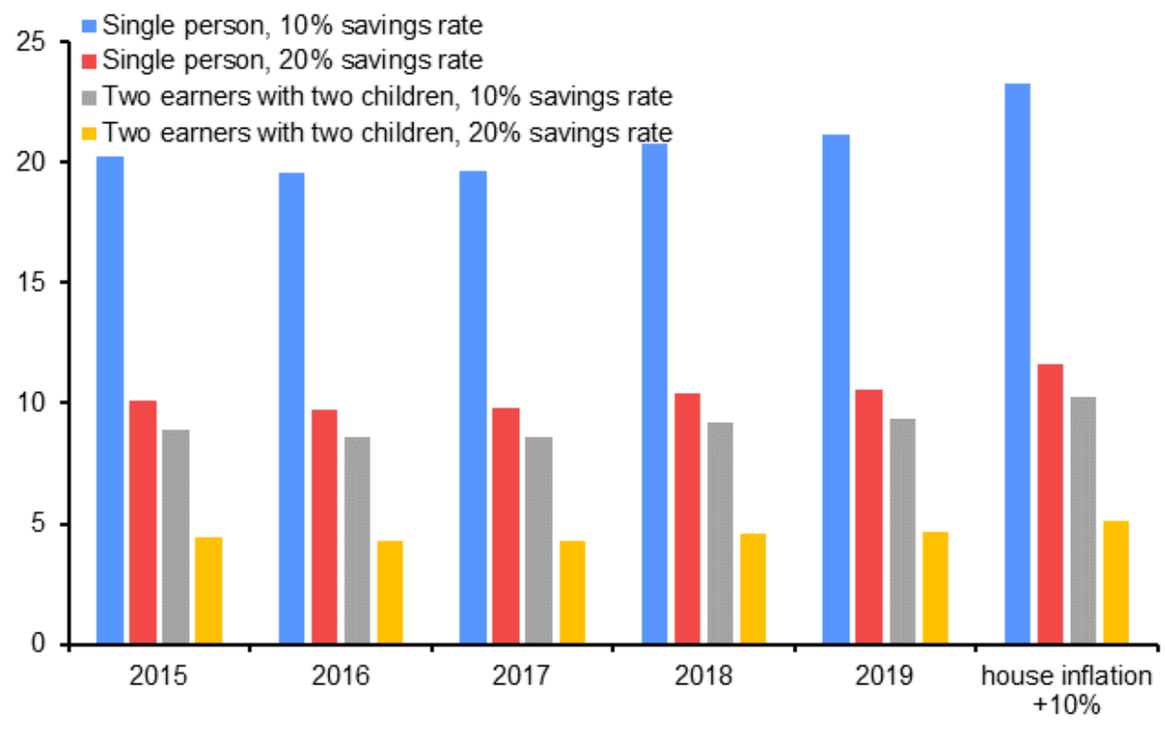
House prices and affordability

- Our housing affordability index (measured as the ratio of the average monthly mortgage payment to the average monthly wage) is currently at its lowest level in five years and we believe it should continue at affordable levels in historical terms, monetary tightening is unlikely in the near-to-medium term.
- In recent years, wage growth and monetary easing has offset the growth in house prices – therefore, the number of years necessary for a standard 20% downpayment have remain roughly unchanged.

Housing purchase affordability



Number of years necessary for a 20% downpayment



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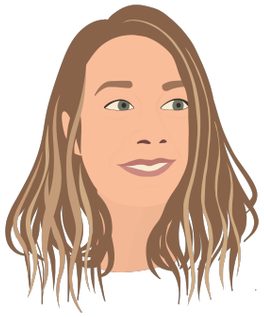

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