Macroeconomic and financial environment in 2013

MACROECONOMIC AND FINANCIAL DEVELOPMENTS IN HUNGARY

In 2013, Hungary's economy was shaped by weak external demand, supportive money market environment, and the stabilization of domestic demand. A fragile quarter-on-quarter recovery began in the eurozone, but the area's 2013 GDP contracted in year on year terms, chiefly because of the peripheral countries.

The eurozone's weak recovery had an adverse effect on export-driven economies, causing most countries in the CEE region to slow down.

Nevertheless, money markets were helpful, as the Bank of Japan embarked on a major stimulus programme in March, following the Fed's example. The huge excess liquidity resulted in a permanent, albeit interrupted, capital influx into emerging economies' bond markets.

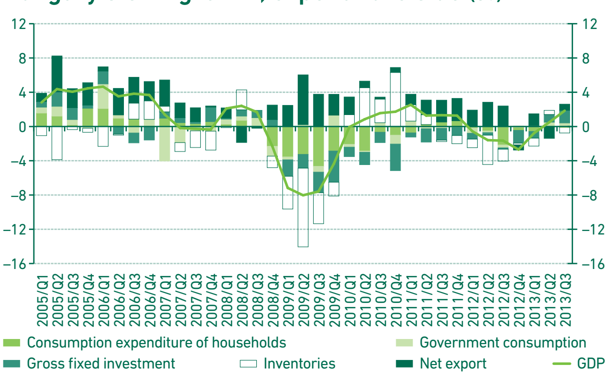
In 2013, Hungary's economy grew by 1.1%, recovering from its 1.7% contraction in 2012. Looking at the expenditure side, net exports remained vital to bolstering growth, but the first signs of improvement in domestic demand have already come into sight.

Even though investments dropped in year-on-year terms, a quarter-on-quarter growth began in the second half of the year.

At this point, the recovery is chiefly linked to the EU funds that surged at the end of the seven-year budget period, to the flood protection investments, and to other publicly financed projects.

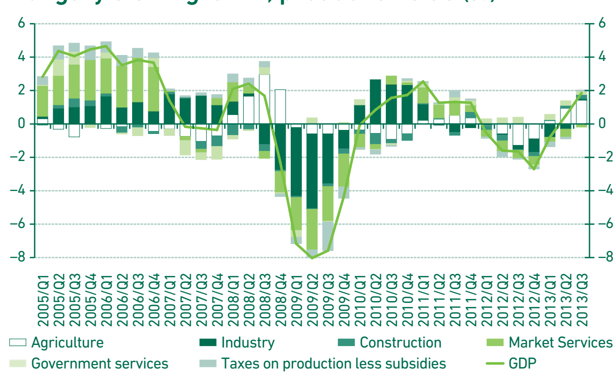
The private sector's investment activity remained subdued.

Hungary's GDP growth, expenditure side (%)



Sources: HCSO, OTP Research

Hungary's GDP growth, production side (%)



Sources: HCSO, OTP Research

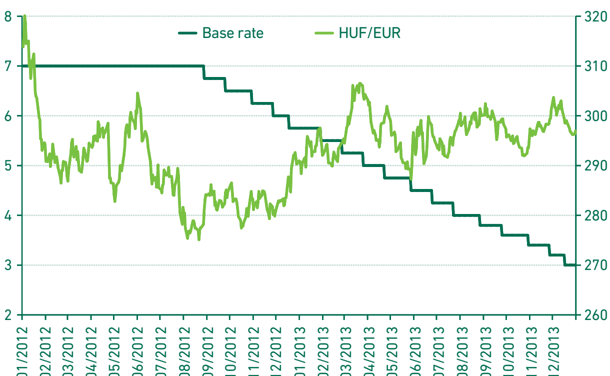
Consumption also seems to have bottomed out. The key labour market statistics signify major improvement, while the indices that exclude the effect of public work schemes indicate a smaller rate of advance, but households' income position clearly improved last year. Private sector wages grew by 3–4%, while the government raised pensions and public employees' wages at a slightly higher rate than the near 5% inflation that had been expected at the beginning of the year. Given the strong disinflation in 2013, which was supported by the cut in retail utility tariffs, the real value of households' disposable income could meaningfully increase. Although this did not raise households' final consumption expenditure by the same rate because of the persisting uncertainty on the labour market, the almost steady fall that started in 2006 seems to have ended.

In a huge fall, inflation came down to 1.7%, from 5.7% a year earlier. The government measures' (e.g. utility rate cuts vs. the duty on financial transactions, higher excise tax) effect of inflation was practically zero. But the subdued domestic demand, the decline in commodity and food prices, and the 27% VAT rate's drop from the base have significantly reduced inflation in Hungary.

The above facts gave underlying principle of the National Bank of Hungary's statements issued after the rate cut decision each month. In the first half of the year, the benchmark rate was trimmed in 25 basis point steps, then a 20-basis-pont lowering sequence started in August, which led the benchmark rate to 3% by the end of year.

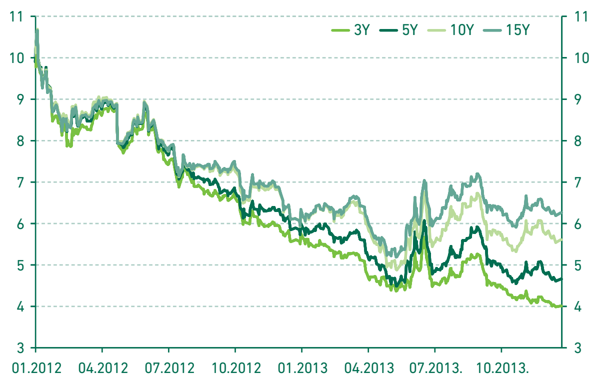
Thanks to the supportive global environment (ample liquidity), government bond yields followed the rate cuts in the first half of 2013, but long-term yields decoupled from the central bank's base rate in the summer.

HUF/EUR and base rate



Sources: Reuters, MNB, OTP Elemzés

Government bond yields (%)



Sources: ÁKK, OTP Research

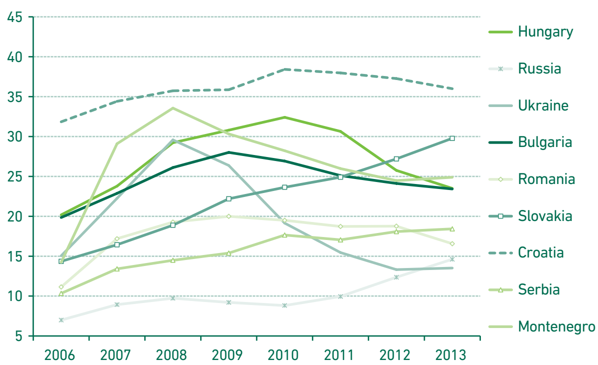
Because of the major central banks' monetary stimulus programmes, and owing to Hungary's encouraging external balance indicators, the forint was not under significant pressure in 2013. Hungary's current account surplus exceeded 3% of GDP, and its net financing capacity surpassed 7% of GDP last year. No wonder that the rapid deceleration of external indebtedness continued: gross external debt fell to 89% of GDP, down from 100%. Nevertheless, the Hungarian currency steadily depreciated versus the euro throughout 2013, by an average of more than 2%.

Macroeconomic and financial developments in the countries of OTP Bank's foreign subsidiaries

Because of the weak domestic demand, net exports remained the main engine of growth in most countries. However, the eurozone's slow growth had an adverse effect on other countries of the CEE region too; only Romania could achieve exceptional growth, Serbia's and Montenegro's GDP might have increased by 2%, while the growth in other countries where OTP has presence was 0–1.3%. Croatia's GDP contracted further. The positive development in most countries is the declining inflation, but fiscal adjustment measures have not borne fruit for the budget balance in all countries yet.

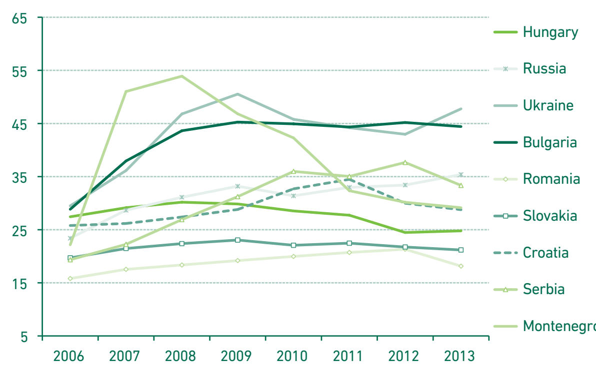
Looking at the banking market, Central and Eastern Europe's countries remained largely diverse. Both retail and corporate loan stock grew in Russia, Ukraine, and Montenegro. Net lending, both retail and corporate, was negative in Romania and Croatia. In most of the remaining countries, net lending to the household sector was positive, while the debts non-financial corporations repaid were bigger than the loans they took out.

Banking system's retail loan penetration (as % of GDP)



Sources: National bank, OTP Research

Banking system's non-financial corporate loan penetration (as % of GDP)



Sources: National bank, OTP Research