Monthly Bulletin of Economic Trends

April 2017

Corporate credits in Hungary, 2012-2016

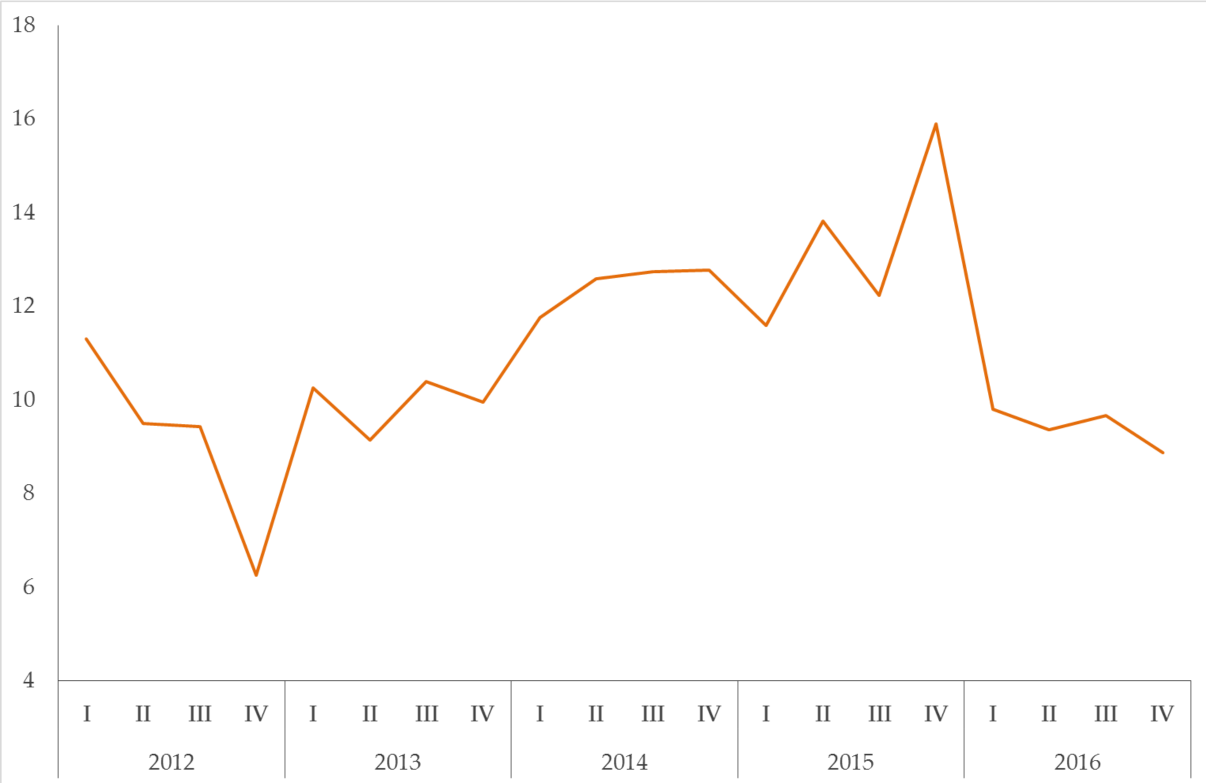
In the following short analysis the Institute for Economic and Enterprise Research (IEER) examines the factors determining corporate borrowing and willingness to invest in Hungary. In the recent years several policies aimed to stimulate borrowing activity among Hungarian companies such as the reduction and the continuously low level of the central bank's base rate or the Growth Loan program announced by the Hungarian National Bank. In our analysis three factors influencing the willingness to invest are examined: (i) interest margin and the development of interest rate environment, (ii) the quality of institutional and regulatory environment and (iii) the business climate and expectations of companies. Despite the policies implemented by the Hungarian National Bank interest margin is relatively high in Hungary in regional comparison making it difficult for companies to access financial resources. The uncertainty of institutional environment can make market players cautious as well. Business climate however, shows positive prospects, which means that business outlook does not explain the low demand for loans. In the future the reduction of interest margin, the improvement of institutional environment and competitiveness could have a positive effect on corporate borrowing and investments.

Investments and volume of loans

Among the various economic indicators those referring to investments deserve special attention as these have a major influence on the future performance and potential growth of the economy. One of the most frequently examined indicators is the ratio of the value of investments to the periodic gross domestic product; its development over time is shown in Figure 1 for Hungary. After the low level of 2012, between 2013 and 2015 the rise of investments could be seen, however, at the beginning of 2016 investment rate fell sharply and there was no significant growth during the year.

In the case of investments in the economy, it is important to separate the investments created by the government (i.e. budgetary entities) and those by the private sector (companies). In Hungary, a large part of the investments are created by the state using funds provided by the European Union, thus, the engine of the investments is fundamentally the investments of the budgetary entities and this have become especially true since 2012.

Figure 1: Proportion of the value of national investments in the GDP in Hungary (percentage, Q1 2012–Q4 2016) [1]



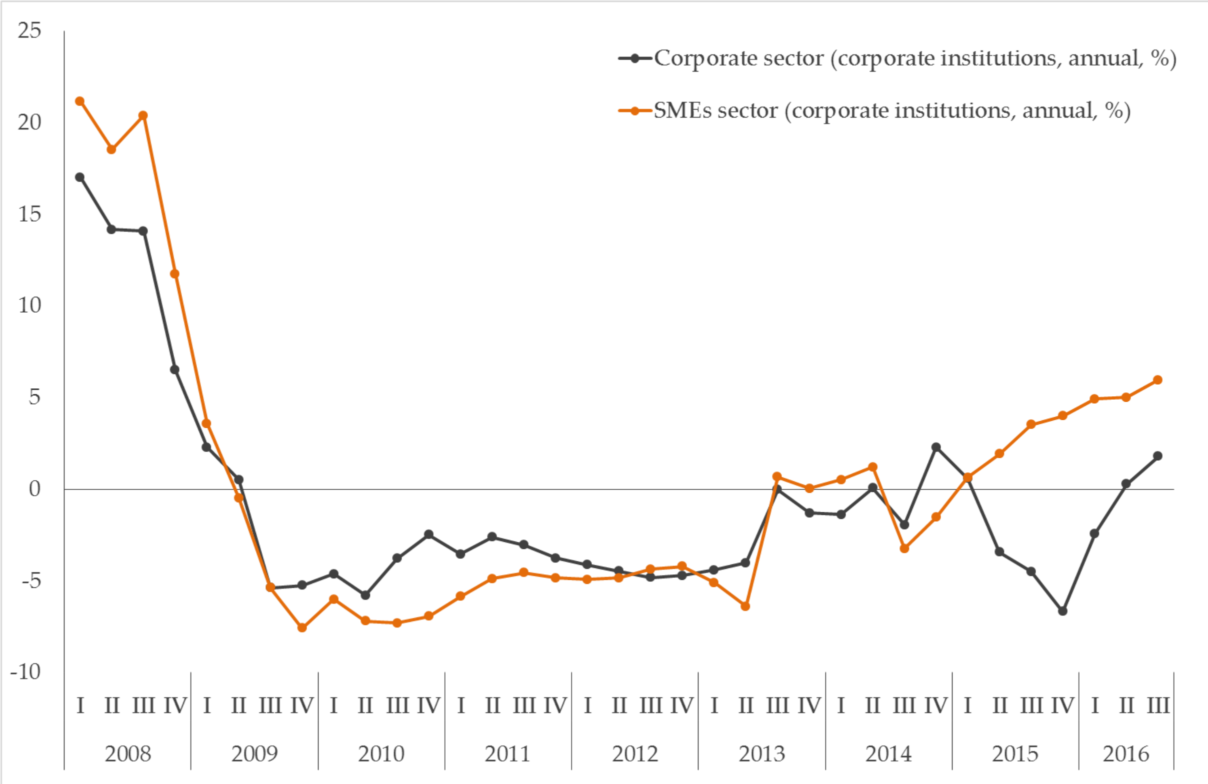
Source: HCSO, IEER

One of the possible reasons behind the stagnation of corporate investments is that the rate of corporate credit stock growth remained below expectations. The overall amount of corporate credit has declined steadily over the past few years, falling from HUF 8,000 billion to HUF 3,500 billion between 2009 and 2016. In the post-crisis period, corporate credit growth decreased by 2.5-5% in every quarter compared to the same period of the previous year (see Figure 2). The financial crisis had an even larger impact on the SME sector with a drop over 7% in certain quarters.

During the post-crisis period, the corporate sector expanded only in three quarters (Q2 and Q4 2014, Q1 2015) compared to previous years. Looking at the SME sector, it can be seen that in the second half of 2013 and in the first half of 2014 an increase of credit growth was recorded due to the Growth Loan Program announced by the Central Bank. After the crisis, the growth rate of the corporate credits has been permanently negative (excluding one or two exceptional periods), it has stagnated or slightly increased between Q3 2013 and Q4 2014, then slightly decreased, and turned positive again in Q2 2016 . In the case of the SME sector, it can be seen, that although the crisis has affected SMEs more than the entire corporate sector, there has been a slow expansion of total amount of credits since 2015.

[1] Both in the case of investments and in the case of gross domestic product raw data was used, and was controlled for seasonal effects using the TRAMO-SEATS method, the method that is used by the Hungarian Central Statistical Office and by the Hungarian National Bank.

Figure 2: Rate of corporate and SMEs' credit growth (compared to the same period of the previous year, Q1 2008 – Q3 2016)



Source: Hungarian National Bank, IEER

The factors influencing corporate crediting

The relatively low level of the volume of credits raises the question whether the conditions of loans inhibit companies' decisions on borrowing. Time-series data on the neighboring countries and the Eurozone show that in the years following the outbreak of the crisis interest margin of small corporate loans increased continuously in Hungary: by the end of 2009 it was 4.02% which was by far the highest in the region. Following a stable and clear decrease, from the second quarter of 2014 the interest margin has increased again, and in the second quarter of 2016 the Hungarian interest margin was the highest in the region. Although it has decreased in the third quarter of the last year, interest margin remains the highest in regional comparison. Beside the interest margin, the central bank's base rate, which is also very important in terms of lending, from the second quarter of 2012 has decreased significantly in Hungary, from 7% to 0.9%.

The Hungarian National Bank's research conducted among banks show that credit conditions has eased significantly in Hungary. The results of IEER's business climate survey of small and medium enterprises (SMEs Outlook) between 2014 and 2016 also show the perception of improving conditions, although almost half of the respondents have not reported any significant change, and in 2016 the proportion of companies that perceive worsening credit conditions has slightly increased. In addition, other factors may influence the expansion of credits and investments.

Such an important factor can be the quality and stability of the institutional and regulatory environment. While the promotion of corporate loans has been facilitated by several measures (like the Growth Loan Program) and the decreasing level of the base rate has a similar effect, the amount of corporate credit continues to be far from the pre-crisis level. Based on the World Bank's indicator on institutional and regulatory environment Hungary can be characterized by a continuously deteriorating trend since 2006 and it was in the last place in the region in 2014.

Beside the unpredictability of the institutional environment, it is worth examining whether the relatively low volume of investments can be explained by the business climate environment or by any change in the competitiveness of the country. Concerning this factor both the IEER's Business Climate Indicator and the Hungarian GDP have been in the positive range since 2014 indicating an upswing (it is important to note, though, that based on these indicators no conclusion can be drawn about the sources and reserves of the growth). Thus, it can be stated that regarding business conditions there is no particular reason for the low level of corporate loan demand. At the same time, according to the WEF's Global Competitiveness Index Hungary lags behind the Visegrad countries. While it was at the second place in the regional competition in 2006, currently it is at the last place, thus it cannot be excluded that the low and worsening level of competitiveness could be an explanation for the low level of investments.

OECD recommendations for Hungarian economic growth

In the following, it will be summed up what OECD recommends to Hungary to promote strong and sustainable growth. According to *Going for Growth* recommendations, Hungary is proposed to ease administrative procedures for businesses, reduce work disincentives for the elderly, improve outcomes and equity in education, enhance competition in services sectors and reduce the tax wedge on labour income.

The aim of *Going for Growth* is to help promote the vigorous sustainable economic growth and improve the well-being of OECD citizens[2]. It provides policy makers with a set of concrete recommendations on reform areas identified as priorities for strong and inclusive growth. The priorities cover product and labour market regulation, education and training, tax and transfer systems, trade and investment rules, as well as innovation policies.

In Hungary, GDP per capita is today about half of the average of the most advanced OECD countries[3]. Inequality has increased, partly due to a deterioration of the households' living standards at the bottom end of the distribution, in contrast with unchanged inequality on average across the OECD countries. Nonetheless, overall inequality in Hungary remains below the OECD average.

Complex and frequently changing regulation have deterred business sector investment and productivity growth. Therefore, there is still scope for further reductions of administrative burdens, through further cuts in red tape. Moreover, Hungary is recommended to improve transparency, stability and formulation of regulatory policies, and make better use of regulatory impact assessments. The competition authority should comment systematically on law proposals and mandatory public consultations are proposed to introduce.

The government should reduce work disincentives for the elderly. Low albeit rising statutory and effective retirement ages have led to low employment rates for older workers. The retirement age is scheduled to reach 65 years-old by 2022. A tool set, including individual learning accounts is recommended to create, to promote lifelong learning. The wage subsidy programme targeted at older unemployed workers should be scaled up and supplemented with job search assistance and monitoring measures.

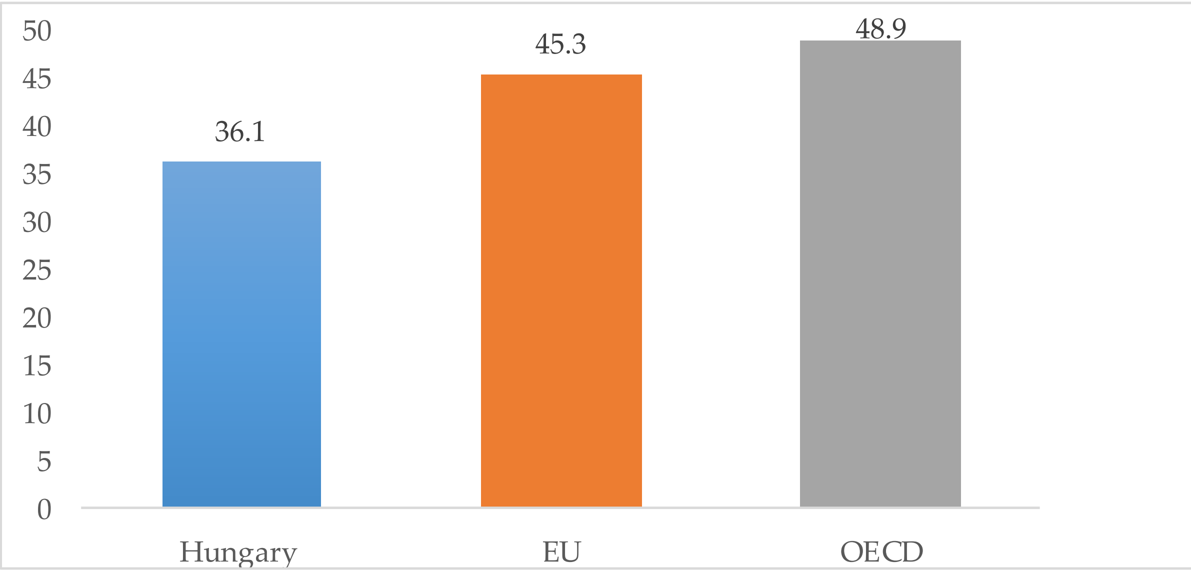
Declining PISA scores, low graduation rates in tertiary education (see Figure 1), shortcomings in vocational education and training have, together with inequalities in education, hampered job creation and productivity growth. The period of compulsory grammar school is proposed to extend, to enhance general skills and promote equity, potentially benefitting Roma people. In apprenticeship places, sufficient instruction time should be

[2] Source: http://bit.ly/1fmOuHc

[3] Source: http://bit.ly/2pheYDY

ensured relative to productive work. In tertiary education, all disadvantaged students need to be supported. Career counselling and the responsiveness to labour market needs are recommended to strengthen.

Figure 1: The graduation rate in tertiary education[4] (2014)

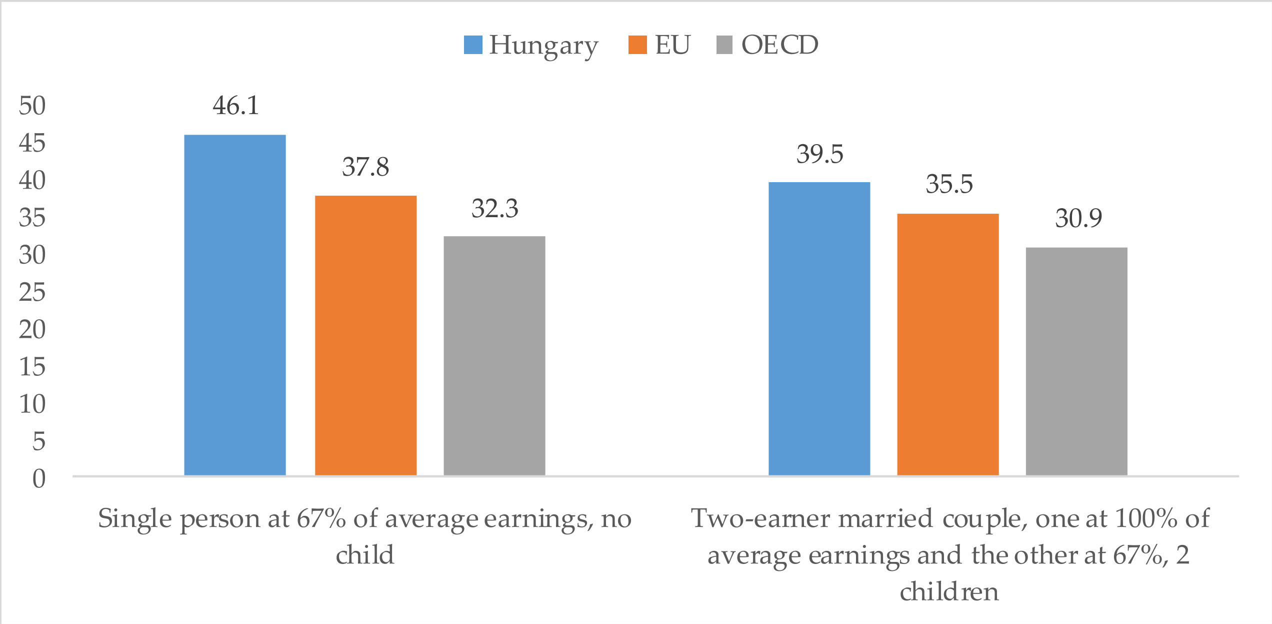


Insufficient competition in retail, professional services, and network industries is holding back new products and technologies, leading to a lack of productivity growth. Therefore, competition could be strengthened further by removing sector exemptions and subject all potentially competition-reducing mergers to full review by the competition authorities. In telecommunication, a new spectrum with full band width should be rewarded to a new entrant and entry of MVNOs (resellers of mobile network capacities) is proposed to facilitate. Market based energy pricing is as well recommended. Defining more narrowly public service obligations could be subject to public tendering, opening for such providers to be compensated for the associated costs.

The average tax wedge on labour income is relatively high in Hungary in international comparison (see Figure 2), especially for workers with low wages, leading to reduced work incentives and labour demand. Hence, the tax wedge should be lowered by reducing the reliance on social security contributions by moving tax burdens to less distortive tax sources.

[4] Graduation rate represents the estimated percentage of people who will graduate from tertiary education over their lifetime. Source of data: http://bit.ly/2p8oXxd

Figure 2: The average labour tax wedge[5] (percentage of total labour compensation, 2016)



[5] Source of data: http://bit.ly/2oQUEbK

International trends

Development of production, consumption and employment in certain globally significant economies, compared with expectations and values of the previous period.

		Period in review	Actual data	Expectations	Previous period
Germany	Unemployment Rate	(Apr)	**5.8%**	5.8%	5.8%
	Manufacturing Purchasing Managers Index	(Apr)	**58.2**	58.2	58.2
	IFO Business Climate Index[1]	(Apr)	**121.9**	121.1	121.1
France	INSEE Business Climate Index[2]	(Apr)	**104**		104
USA	Unemployment Rate	(Apr)	**4.4%**	4.6%	4.5%
	CB Consumer Confidence Index	(Apr)	**120.3**	122.5	124.9
	Manufacturing Purchasing Managers Index	(Apr)	**52.8**	52.8	52.8
China	Manufacturing Purchasing Managers Index	(Apr)	**51.2**	51.6	51.8

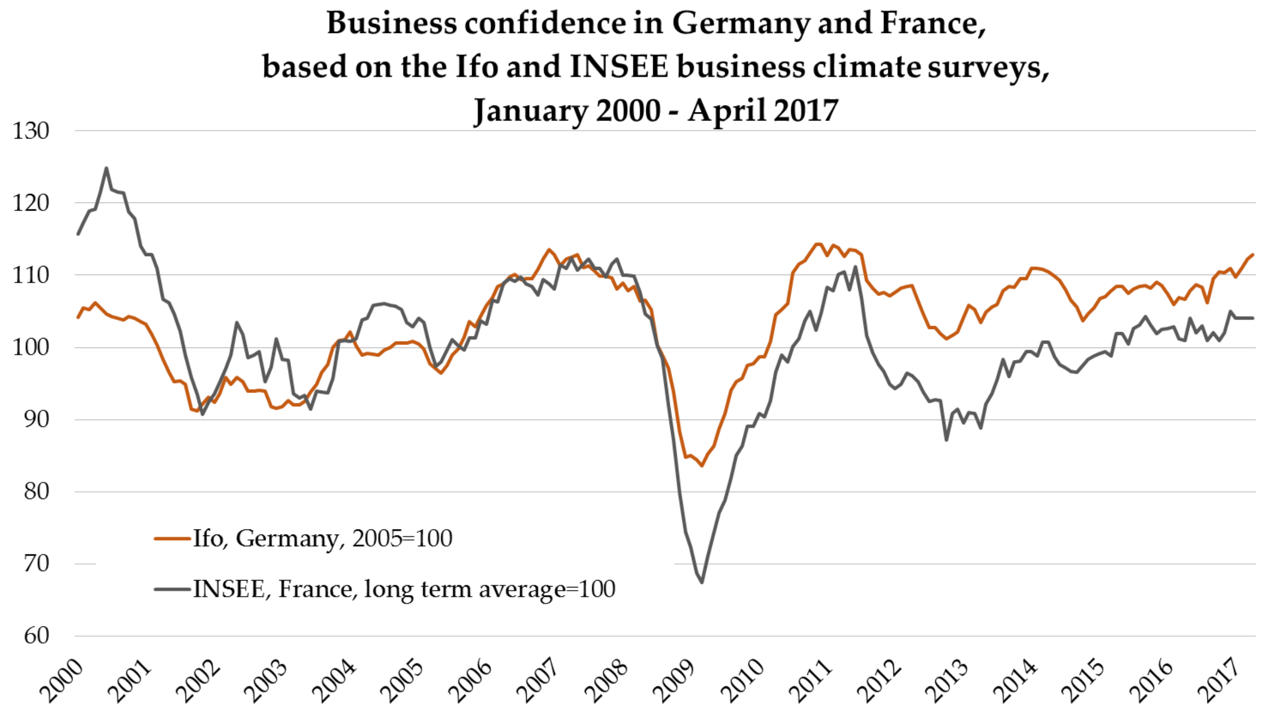
https://www.cesifo-group.de/ifoHome/facts/Survey-Results/Business-Climate/

[2] http://www.insee.fr/en/themes/indicateur.asp?id=105

Source of the remaining data: http://worldeconomiccalendar.com

The performance of the German economy continued to improve in April. As in the previous months the manufacturing purchasing manager index (PMI) has stagnated, and the unemployment rate has remained at the same level as well. The IFO business climate index, however, has increased significantly compared to the previous month, and it is higher than expected. The French INSEE business climate index as in the previous months continues to stagnate in April. In the United States the unemployment rate has decreased in April. The CB consumer confidence index fell significantly compared to the last month and to the expectations. At the same time the manufacturing PMI performed slightly worse than expected. The Chinese manufacturing PMI after the rise seen since the end of last year, decreased in April.

Long-term changes in business confidence indices



Source: www.cesifo.de, www.insee.fr

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