

DEVELOPMENT OF KEY MACROECONOMIC INDICATORS AND COMMERCIAL INSURANCE IN V4 COUNTRIES IN 1995 – 2004

HUNGARY

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The objective of this contribution was to monitor the development of key indicators of commercial insurance in the period 1995-2004 against a background of changes in the macroeconomic environment. Using a trend analysis we attempted at the same time to make a short-term (12-month) forecast for the development of the insurance industry in relation with the expected development of the Hungarian economy as a whole. Theoretical level of the subject matter is explained in Biatic issues 8/2005 and 9/2005.

Macroeconomic Environment

Our monitoring of macroeconomic development began in 1995. Since the results for this year were determined by the previous development, it is necessary to give a brief outline of that.

The economy absorbed a microeconomic shock with the adoption and simultaneous implementation on these acts: the Act on Bankruptcy and Settlement, the Act on Banks, the Act on Accountancy, the Act on the National Bank of Hungary, and the Securities Act in 1992. These laws were in full accordance with the standards of Western Europe and resulted in series of enterprises becoming bankrupt or going into liquidation. The corollary of these changes was the relatively fast growth in the rate of unemployment (from 9.3% in 1995 to 11% in 1996), the decline in tax revenues for the state budget and a steep rise in spending on unemployment benefits. Although the real financial discipline was put into economic practice, the government's fiscal position deteriorated and there were growing negative trends in the development of the balance of payments. When a similar development occurred in 1995, it was clearly unbearable and the government was forced to adopt a "package of stability measures" aimed at creating conditions for future sustainable economic growth. The basic objective was to ensu-

re, on the one hand, fiscal discipline and, on the other hand, current account stability. Consequently, a tolerable level of fiscal imbalance was achieved and there began the process of economic revival and external stabilisation. Improvement in the fiscal position was a sine qua non for the overall stabilisation of the economy. Consolidated government debt, which had reached as high as 90% of GDP, was reduced to 60% by using privatisation revenues for debt payment. Another aspect of the fiscal consolidation was the reduction in public sector spending and a lower rate of redistribution through public finances.

A new concept for monetary policy was realised in 1995: responsibility for external stability was shifted to fiscal policy and the central bank could devote itself to the primary objective of decreasing inflation. The process of reducing inflation was supported by a selected regime of directed or regulated devaluation (a crawling peg) with a depreciation rate set in advance and a narrow fluctuation band. The year-on-year inflation rate was gradually lowered by 4% – 4.5%. After 12 years of double-digit inflation, a rate of 9.8% was achieved in 2000 and the falling trend began.

In macroeconomic terms, 2000 was generally evaluated as a balanced year. Hungary and Slovenia were the only countries in this economic area to report GDP growth of more than 5%.

Table 1 Development of Inflation and Unemployment

Indicator	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Inflation (in %)	5 689	6 894	8 541	10 087	11 394	13 172	14 850	16 740	18 574	20 216	21 601*
Unemployment (in %)	1.5	1.3	4.6	4.9	4.2	5.2	3.8	3.5	3.0	4.0	3.9**

*Estimate of the National Bank of Hungary

Source: Annual reports of the Association of Hungarian Insurance Companies (MABISZ) and own calculations.

**Table 2 Development of the Average Gross Monthly Wage**

Indicator (in HUF)	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005*
Nominal wage	28.2	23.6	18.3	14.3	10.0	9.8	9.2	5.2	4.7	6.8	3.8
Real wage	9.3	11.0	8.7	7.8	7.0	6.4	5.8	5.9	5.8	5.9	6.3

** Estimate by polynomial trend

Source: Annual reports of the Association of Hungarian Insurance Companies (MABISZ) and own calculations.

Economic growth in 2001 slowed down from the high pace achieved in previous years, reflecting a decline in foreign demand and a decrease in private sector investment activity. Household demand and government demand thus became the main drivers of growth. The change in the monetary policy framework for inflation targeting and the change in the exchange rate regime – replacing the crawling peg with a floating exchange rate – helped to dampen inflationary expectations and reduce the rate of inflation. Hungary also had a low and falling unemployment rate.

From 2002, the core macroeconomic indicators began to develop negative trends: consumption, substantially supported by public sector wage growth and the increased minimum wage, expanded at more than twice the pace of GDP, at 8% compared to 3.5%.

Fiscal policy in 2002 was exceptionally expansive. The large public finance deficit was the result of both one-off expenditures related to the statistical reclassification of large off-budget items into the central budget, and the growth in several permanent expenses, especially wages and pensions, health-care spending, social benefits and certain subsidies. The government was again forced to resort to a package of belt-tightening measures, in the amount of HUF 185 billion. The restrictions had an impact on finance for ministries of economy, defence, health and education, and also local authorities, whose investment expenses were reduced by the government.

The strong appreciation of the Hungarian forint along with growth in domestic demand led to an acceleration in import growth and a worsening of the current account.

Further slowing down of economic growth in 2003 was caused by low investment activity and the negative contribution of net exports. On the other hand, the growth rate was supported by the high level of domestic consumption, pressed by the fiscal expansion and subsequently by excessive growth in both public and private sector wages. Behind the deepening current account deficit were the delayed effects of the loss of competitiveness caused by the strong appreciation of the forint; another factor was the high level of imports, driven by the spending of hou-

sehold savings under the influence of an over-generously subsidised mortgage system for home financing. A turnaround came in 2004 when Hungary reported a relatively high pace of economic growth (4%) due to the significant acceleration of economic activity in the second half of the year. Compared to the previous years, the growth had a more balanced character. While the growth in private consumption was almost twice as slow, the growth in investments and especially exports picked up pace to the extent that the external sector made a positive contribution to GDP growth. The main factor of this shift was the dampening of the disproportionately high growth in public sector real wages, which over the previous three years had averaged over 10%. Whereas prices had a growing trend in the first half of the year, largely caused by administrative regulations on prices and taxes, inflation fell in the second half mainly due to the firming of the forint. As regards the labour market, the employment rate fell slightly while the unemployment rate did not change significantly and totalled 5.9%. The public finances ended 2004 with a deficit of 4.5% of GDP, down by 1.7% in comparison with 2003. Given the improving outlooks for inflation, the Hungarian central bank cut key interest rates over the course of the year by a total of 300 basis points, to 9.5%.

Selected Insurance Industry Indicators

One of the most significant performance indicators for insurance as an industry of the national economy is the flow quantity of written premiums for the given insurance period. The volume of written premiums is shown in Table 3.

The development of the insurance industry is to a large extent determined by the volume and dynamism of one of the most important performance indicators for the economy as a whole – gross domestic product (GDP). We tested this causality using a correlation analysis, where written premiums represented the dependent variable and GDP in current prices the explanatory variable.

The closeness of the examined correlation may be expressed through a coefficient of the correlation. The absolute value of the coefficient (0.99797) in this case

Table 3 Development of Written Premiums

Indicator (in HUF)	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005*
Nominal wage	38 900	46 837	57 270	67 764	77 187	87 645	105 049	122 453	137 000	145 357	166 107
Real wage	27 891	35 830	46 789	58 141	69 468	79 055	95 384	115 963	126 340	125 456	100 284

*Estimate by polynomial trend

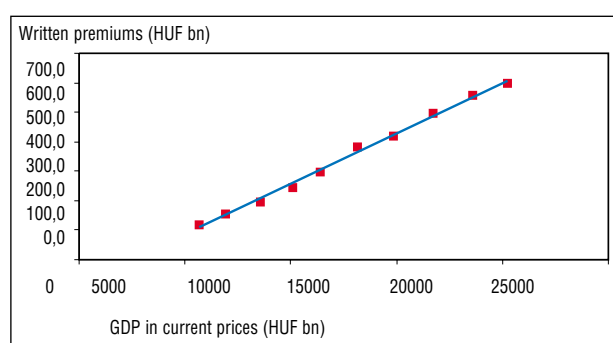
Source: Annual reports of the Association of Hungarian Insurance Companies (MABISZ) and own calculations.

Table 4 Insurance Penetration

Indicator	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005*
Written premiums (HUF bn)											
Total	119.0	152.7	194.6	244.6	297.8	384.1	419.5	494.6	559.4	599.0	682.7
Life insurance	35.4	48.2	63.7	88.8	120.0	177.6	175.0	202.5	224.5	243.7	223.1
Non-life insurance	83.5	104.5	130.9	155.7	177.7	206.5	244.4	292.1	334.9	355.3	358.4
Written premiums per capita (HUF)											
Total	11 635	14 985	19 218	24 113	29 519	38 245	41 185	48 690	55 226	59 268	61 754
Life insurance	3 466	4 733	6 278	8 755	11 898	17 687	17 186	19 937	22 163	24 113	17 337
Non-life insurance	8 169	10 252	12 940	15 357	17 621	20 558	22 868	28 756	33 062	35 155	36 357

*Estimate by polynomial trend

Source: Annual reports of the Association of Hungarian Insurance Companies (MABISZ) and own calculations.

Chart 1 Correlation Between Written Premiums and GDP


Source: Annual reports of the Association of Hungarian Insurance Companies (MABISZ) and own calculations.

indicates the existence of a close linear correlation between written premiums and GDP in current prices (in c. p.). The suitability of the model is also shown by the high value for the coefficient of determination (0.9959), which makes clear that 99.59% of the variability of written premiums is explained by the variability of GDP (in c. p.).

The indicator for the development of the insurance industry is insurance penetration. This indicator represents written premiums as a share of GDP (in c. p.). Shown clearly in Table 4 is the growing long-term growth in insurance penetration, interrupted by a slight decline in 2001 and 2004.

Hungarian Insurance Market Concentration

In terms of concentration, the insurance industry has for the past seven years been a medium concentrated and well-fragmented sector of the Hungarian national economy. This is demonstrated by the fact that the value of the Herfindahl-Hirschman Index (HHI) has been fluctuating

within the interval from 1,000 to 1,800. No insurance company in the Hungarian insurance market has a dominant position that could lead to disruption in the functioning of market forces and ultimately the failure of the market.

Indemnity

If an insurance event occurs, the insurance company pays the indemnity in accordance with the terms and conditions agreed in the concluded insurance contract. The indemnity costs of insurance companies operating in the Hungarian insurance market show a long-term growing trend during the period under review. The volume of indemnities in 2003 was 4.5 times higher compared with 1995 – eleven times higher in life insurance and 3.2 times in non-life insurance.

Technical Reserves

The development of written premiums as well as the costs related to the payment of indemnities are reflected in the long-term increasing volume of technical reserves created by insurance companies for the purpose of covering future liabilities arising under insurance contracts.

The volume of technical reserves held by insurance companies operating in the Hungarian insurance market was 6.3 times higher in 2003 than in 1995. The recorded growth is even higher than the growth in written premiums (4.7 times) and in insurance benefits (4.6 times).

Investment Activity of Insurers

Insurers as market entities have at their disposal temporarily free funds arising from the time mismatch between

Table 5 Insurance Penetration

Indicator	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005*
Insurance penetration (in %)	2.09	2.21	2.28	2.42	2.61	2.92	2.82	2.95	3.01	2.96	2.77

Estimate by polynomial trend

Source: Annual reports of the Association of Hungarian Insurance Companies (MABISZ) and own calculations.

**Table 6 Herfindhal-Hirschmanov index**

Indicator	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005*
HHI	2 089.76	1 959.78	1 874.74	1 795.66	1 728.84	1 590.68	1 577.16	1 560.05	1 480.13	1 354.45	1 159.81

* Estimate by polynomial trend

Source: Annual reports of the Association of Hungarian Insurance Companies (MABISZ) and own calculations.

Table 7 Development of Indemnity Costs in Hungary

Indicator (HUF bn)	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004*	Index 03/95
Total	69.98	87.40	119.98	154.00	185.41	210.65	247.46	271.19	318.71	369.32	455.43
Life insurance	11.97	14.60	34.54	54.49	74.43	94.37	103.16	110.99	132.56	163.54	1107.44
Non-life insurance	58.01	72.80	85.44	99.51	110.98	116.28	144.30	160.20	186.15	205.78	320.89

* * Estimate by polynomial trend

Source: Annual reports of the Association of Hungarian Insurance Companies (MABISZ) and own calculations.

en receiving premiums, on the one hand, and paying out the indemnities, on the other hand. They are thus becoming direct participants in the financial market by engaging in the supply side.

Through their investment activities, insurance companies determine not just the pace of economic development and economic growth, but also the overall performance of the economy.

The figure representing investments by Hungarian insurers as a percentage of GDP has a growing trend. Yet this share remains relatively

Table 8 Technical Reserves of Insurers

Years	Total (HUF bn)	Life insurance		Non-life insurance	
		mld. Ft	%	mld. Ft	%
1995	140.74	71.72	50.96	69.01	49.04
1996	180.78	99.02	54.77	81.76	45.23
1997	244.69	135.37	55.32	109.32	44.68
1998	338.31	199.03	58.83	139.28	41.17
1999	418.30	270.61	64.69	147.70	35.31
2000	529.33	346.80	65.52	182.53	34.48
2001	605.57	445.30	73.53	160.27	26.47
2002	770.98	545.88	70.80	225.10	29.20
2003	891.85	586.71	65.79	305.14	34.21
2004*	1 206.2	831.59	68.94	374.61	31.06
Index 03/95	633.70	818.01	x	442.15	x

* Estimate by polynomial trend

Source: Annual reports of the Association of Hungarian Insurance Companies (MABISZ) and own calculations.

Table 9 Investment Activity of Insurers

Indicator	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	Index 03/95
Investments (HUF bn)	170	222	300	414	490	626	760	906	1042	1188	613.92
TR (HUF bn)	141	181	245	338	418	529	606	771	892	1206*	633.70
I/TR 100(%)	120.61	122.97	122.61	122.34	117.16	118.34	125.57	117.54	116.84	98.52	96.88

* Estimate by polynomial trend

Source: Annual reports of the Association of Hungarian Insurance Companies (MABISZ) and own calculations.

low in comparison with the average figure recorded among the 31 countries of the CEA (Comité Européen des Assurances) in 2002 (48.8%).

Having monitored the key indicators for the insurance industry in relation to the core macroeconomic indicators, it may be concluded that one of the most significant determinants of the growth in volume of written premiums between 1995 and 2004 was the increase in real wages during the previous period. As a result of the fiscal restriction currently being applied, there may soon be a decline in real wages and a consequent fall in the pace of growth in the life insurance industry. Indeed, the previous long-lasting period of double-digit inflation continues to cause

some uncertainty in the economic behaviour of market entities as regards savings. Since life insurance is often tied in various forms of investment insurance and supplementary insurance, the upshot may be a decline in the volume of written premiums.

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