

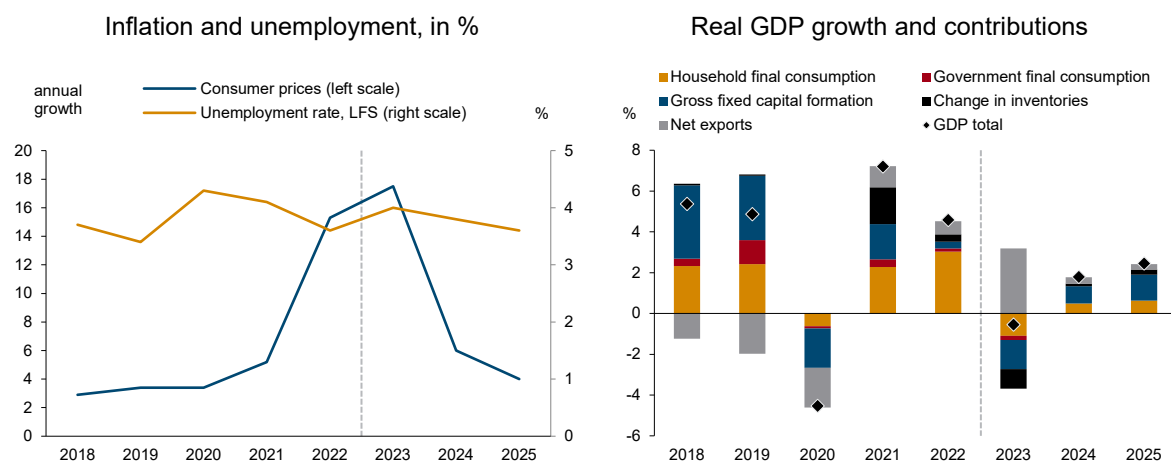


HUNGARY: A bumpy road to recovery from the recession

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Hungary has slipped into recession, with private consumption and investment contracting in H1 2023. Net exports mitigated the decline. The economy may soon see a slight recovery, but the annual growth rate will remain at below zero. Only a modest recovery is expected in 2024 and 2025. Growth would receive a fillip from EU transfers and a strong recovery of the main export markets, but neither of those things is currently on the horizon. Fiscal consolidation and continued high interest rates may slow the pace of recovery. Inflation will likely fall to below 10% later in 2023 and slowly sink further over the next two years.

Figure 6.8 / Hungary: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

The Hungarian economy has slipped into recession, with GDP declining for four quarters in a row. Very high inflation ate up the extraordinary revenues pumped into the economy last year in the run-up to the general election in April. Back in H1 2022 there was an expansion of over 10% in household consumption, in sharp contrast to the 3.6% decline reported for the corresponding period this year; retail trade data painted an even worse picture, with a 10.3% contraction. Investments have been dropping steeply as well. EU transfers remain suspended, which is handicapping public investment. Business-sector investment has been discouraged by the high interest rates. Nor have the country's main export markets been in very good shape: Hungarian exports barely grew. Nevertheless, net exports contributed positively to GDP growth in H1 2023, thanks to a sharp decline in imports. Summarising the sectors: industry declined, as did construction, as did services. Agriculture rode to the rescue, thanks to a record harvest this year.

Inflation has gradually declined since the beginning of the year, with headline inflation amounting to 14.2% in August. The reason for this is twofold: first, a very high basis last year; and second, decreasing private consumption, with real wages down 8.1% in H1. Inflation in Hungary has been considerably higher than the EU average, and also substantially in excess of the country's regional peers. An exceptionally painful feature of the inflation has been that food prices have risen much faster than the average, hitting people on low incomes hard. One might expect public uproar in such circumstances, but so far that has failed to materialise: the popularity of the Orbán government has barely been dented – as yet. Government propaganda has successfully conveyed the message that this is 'war inflation' caused by 'Brussels' and the collective West, which support Ukraine with weapons, rather than trying to achieve 'peace' (i.e. the surrender of Ukraine to Russia). It is hard to fathom why the public does not ask how it is that all the peer countries, which have been just as badly affected by the war as Hungary, have managed to curb inflation much more successfully.

The GDP slump is likely to end in H2 2023. The pace of quarter-on-quarter GDP decline has diminished over the last four quarters, and the final two quarters of 2023 will see a return to growth – albeit marginal, due partly to the low statistical basis. With lower inflation, the rate of decline in real incomes will also diminish. Nevertheless, households were spoilt by a formidable increase in real wages over the previous ten years, and the shock suffered this year has been extreme. Households have become cautious and now consume less, while high interest rates make credit very expensive. All in all, a rapid upward turn in household consumption is not on the cards.

Nor are there any grounds for optimism in the field of investment. There is no sign of de-escalation in the conflict between the Hungarian government and the EU over the 'rule of law' issues. This implies that no EU transfers will be forthcoming soon and therefore public-sector investments will likely be minimal. The business sector is none too eager to invest either, as the interest on credit is high, the domestic market is depressed, and the export markets are weak. The only exception to all this is the special raft of large foreign direct investment (FDI) projects in the production of batteries for electric vehicles. This has become a flagship project for the reindustrialisation efforts of the government. With substantial (mostly non-transparent) support from the government, this sector is booming, bringing in badly needed foreign currency. However, the intensely unfavourable environmental impact, the inadequate water supply, the labour shortage (on account of inauspicious demographic trends and outward migration) and the lack of public consultation on controversial issues render the initiative highly problematic. The order of importance of countries behind inward FDI has shifted: the previously dominant Western countries have been losing ground, while China and South Korea, the main players in the battery-production projects in Hungary, are gaining in importance.

Net exports – the only positive component of GDP in H1 2023 – will also contribute to growth in 2024 and 2025, but to much lesser extent than this year. In 2023, imports have been developing in a favourable direction, due to lower imported energy prices and shrinking domestic demand because of the recession. This latter effect will disappear as growth returns.

The budget deficit this year will be much larger than planned. The government is addressing the deficit in a half-hearted fashion: on the one hand, several initiatives have been curtailed or suspended; on the other, huge outlays are in the pipeline – e.g. the planned purchase of Budapest airport, which has a price tag of billions of euros. The interest burden on public debt is high and increasing: it could reach 4% of GDP next year. All the uncertainty over the pace of recovery and the suspension of EU transfers means

that a return to a fiscal deficit of below 3% of GDP is not very likely in 2024. The resumption by the EU of the excessive deficit procedure is, therefore, a real danger. In the current circumstances, there is no scope for fiscal support for recovery over the forecast horizon. Nor is a growth-friendly monetary policy on the cards. Even if cuts in the effective policy rate have started, the fragile HUF/euro exchange rate means that interest rates will remain too high for the business sector en masse to resume the expansion of production and to step up investment. Economic policy must choose between rapidly reining in inflation or spurring economic growth; currently moderating inflation seems to be the preferred option.

This year GDP will shrink slightly (0.5%), while 2024 and 2025 will likely see a modest recovery (1.8% and 2.4%) from the very low basis, with downside risks. A fillip to growth could come from EU transfers and a strong recovery of the main export markets, but there is no sign of either at the moment. The tight fiscal and monetary policy, as well as the imprudence and chaotic decision making shown at the highest level, could result in slower-than-expected growth. Inflation will likely dip below 10% later in 2023, and slowly sink further in 2024 and 2025 to approach the EU average.

Table 6.8 / Hungary: Selected economic indicators

	2020	2021	2022 ¹⁾	2022 January-June	2023	2023 Forecast	2024 Forecast	2025
Population, th pers., average ²⁾	9,750	9,710	9,643	.	.	9,600	9,600	9,590
Gross domestic product, HUF bn, nom.	48,425	55,255	66,616	29,974	33,990	72,200	77,900	83,000
annual change in % (real)	-4.5	7.2	4.6	7.3	-1.7	-0.5	1.8	2.4
GDP/capita (EUR at PPP)	22,380	24,380	27,260	.	.	.	.	.
Consumption of households, HUF bn, nom.	22,947	25,538	31,941	14,923	17,636	.	.	.
annual change in % (real)	-1.3	4.8	6.5	10.1	-3.6	-2.3	1.0	1.3
Gross fixed capital form., HUF bn, nom.	12,841	15,139	18,909	7,957	8,378	.	.	.
annual change in % (real)	-7.1	6.5	1.2	8.0	-11.8	-5.0	3.0	4.5
Gross industrial production								
annual change in % (real)	-6.0	9.6	6.1	5.5	-4.8	-3.0	4.0	5.0
Gross agricultural production								
annual change in % (real)	-2.4	-0.7	-18.2	.	.	.	.	.
Construction industry								
annual change in % (real)	-9.8	11.9	1.9	6.0	-7.1	.	.	.
Employed persons, LFS, th, average ³⁾	4,461	4,642	4,709	4,697	4,721	4,730	4,740	4,750
annual change in %	-1.1	0.7	1.4	2.1	0.5	0.5	0.3	0.2
Unemployed persons, LFS, th, average ³⁾	198	196	176	169	196	200	190	180
Unemployment rate, LFS, in %, average ³⁾	4.3	4.1	3.6	3.5	4.0	4.0	3.8	3.6
Reg. unemployment rate, in %, eop ⁴⁾	6.2	5.1	4.8	4.8	4.6	.	.	.
Average monthly gross wages, HUF ⁵⁾	391,194	425,915	499,980	489,932	556,673	575,700	616,300	651,800
annual change in % (real, gross)	6.3	3.6	2.5	7.7	-8.1	-2.0	1.0	1.7
Average monthly net wages, HUF ⁵⁾	260,144	283,234	332,487	325,804	370,187	382,900	409,900	433,500
annual change in % (real, net)	6.3	3.6	2.5	7.7	-8.1	-2.0	1.0	1.7
Consumer prices (HICP), % p.a.	3.4	5.2	15.3	9.7	23.9	17.5	6.0	4.0
Producer prices in industry, % p.a.	4.3	13.6	33.6	27.8	18.2	12.0	4.0	4.0
General governm. budget, EU def., % of GDP								
Revenues	43.6	41.2	41.6	.	.	44.5	44.0	44.0
Expenditures	51.1	48.3	47.8	.	.	49.3	48.2	47.3
Net lending (+) / net borrowing (-)	-7.5	-7.1	-6.2	.	.	-4.8	-4.2	-3.3
General gov. gross debt, EU def., % of GDP	79.3	76.6	73.3	.	.	73.0	72.0	70.0
Stock of loans of non-fin. private sector, % p.a.	13.4	12.8	11.6	13.4	7.0	.	.	.
Non-performing loans (NPL), in %, eop ⁶⁾	3.6	3.2	3.2	3.5	3.0	.	.	.
Central bank policy rate, % p.a., eop ⁷⁾	0.60	2.40	13.00	7.75	13.00	11.00	7.00	4.00
Current account, EUR m ⁸⁾	-1,570	-6,252	-13,730	-4,824	166	-4,300	-1,200	100
Current account, % of GDP ⁸⁾	-1.1	-4.1	-8.1	-6.0	0.2	-2.3	-0.6	0.0
Exports of goods, BOP, EUR m ⁸⁾	88,655	100,885	124,340	60,274	66,303	128,100	134,500	141,200
annual change in %	-4.2	13.8	23.2	19.6	10.0	3.0	5.0	5.0
Imports of goods, BOP, EUR m ⁸⁾	89,990	105,311	139,246	65,949	66,211	139,200	144,800	152,000
annual change in %	-6.5	17.0	32.2	31.7	0.4	0.0	4.0	5.0
Exports of services, BOP, EUR m ⁸⁾	19,889	22,777	29,265	13,743	15,258	32,500	36,400	40,000
annual change in %	-26.1	14.5	28.5	38.2	11.0	11.0	12.0	10.0
Imports of services, BOP, EUR m ⁸⁾	15,885	17,863	21,245	10,070	10,544	22,700	24,700	26,700
annual change in %	-19.9	12.5	18.9	27.9	4.7	7.0	9.0	8.0
FDI liabilities, EUR m ⁸⁾	3,153	7,304	11,404	3,330	-66	4,000	.	.
FDI assets, EUR m ⁸⁾	803	4,345	7,218	3,750	2,293	2,000	.	.
Gross reserves of CB excl. gold, EUR m	32,115	33,501	33,533	32,195	34,539	.	.	.
Gross external debt, EUR m ⁸⁾	111,754	130,525	150,115	.	.	143,000	144,000	145,000
Gross external debt, % of GDP ⁸⁾	81.1	84.7	88.2	.	.	77.2	73.9	71.6
Average exchange rate HUF/EUR	351.25	358.52	391.29	374.71	380.71	390	400	410

1) Preliminary - 2) From 2022 according to census 2022. - 3) From 2021 the new LFS methodology is applied in line with the Integrated European Social Statistics Regulation (IESS). - 4) In % of labour force (LFS). - 5) Based on tax administration data. - 6) Loans more than 90 days overdue and those unlikely to be paid. - 7) Base rate. - 8) Excluding SPE.

Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.