HUNGARY: Fiscal consolidation ahead

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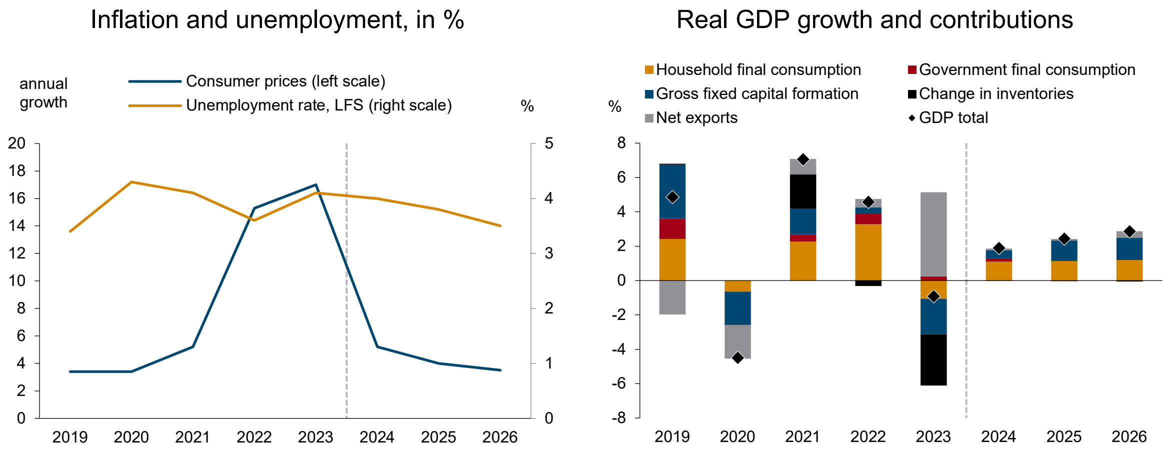
Runaway inflation was curbed by the end of 2023. The current account closed with a surplus, largely because of a decline in imports due to shrinking consumption, a drop in investment and lower import prices. GDP declined last year and there will be no spectacular recovery of economic growth in 2024 either. A chronic deficit in the general government balance necessitates painful measures, which in turn will put a brake on the pace of economic growth. Inflation continues to be of concern, while the current account will likely remain balanced or in surplus over the forecast horizon.

Figure 6.8 / Hungary: Main macroeconomic indicators



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

The Hungarian economy suffered a hard landing in 2023. Contrary to the government's initial GDP growth target of over 4%, the sad reality turned out to be a 0.9% decline. The doling out of 'helicopter money' prior to the spring 2022 general election was followed by an inflation shock in late 2022 and early 2023. Though slowing, the still very high average rate of inflation (17%) last year meant that household consumption fell considerably (by 2.5%). Especially hard hit were low-income households, which had to cope with the runaway food price rises (annual average: 25.9%). Better-earning households also consumed less, became more cautious and boosted their rate of saving through the purchase of government securities offered with enticing yields. Government consumption dropped, too. Investment recorded a poor result, as well, with a decline of over 7%. Aside from the falling inflation, the only good news came from foreign trade: a considerable improvement was reported in the trade balance. The explanation for this was stagnating goods exports, coupled with a sharp contraction of imports on account of lower imported energy prices and reduced demand for imports generally, due to the recession. The current account booked a small surplus in 2023 – a big improvement after the deficit of over 8% of GDP the previous year. On the production side of GDP, agriculture had an excellent year, contributing 2.2 percentage points to the GDP change. All the other main segments of the economy reported negative growth rates last year: industry -5.2%, construction -5.6% and services -1.6%.

Late 2023 and early 2024 witnessed sharp consumer price disinflation – from 25.7% in January 2023 to 3.6% in March 2024. This was the combined outcome of reduced domestic demand and a monetary policy that had turned strongly restrictive. Lower imported inflation helped curb inflation as well. Shrinking consumption led to falling government revenue from consumption-related taxes, primarily VAT. Government expenditure also surpassed the planned level: the payment of interest on the public debt and the purchase of property played the main role here. The general government deficit amounted to 6.7% of GDP, higher than in 2022 and much higher than originally planned.

The government has stated that while 2023 was the year of disinflation, 2024 will bring a revival of growth, with GDP expansion of about 4%. However, the first two months of the year belied this optimism. Although Q3 2023 did show early signs of a recovery, Q4 heralded stagnation, while the economic indicators in the first months of 2024 were frankly disappointing. Industrial output declined in January and the order books showed substantially lower stock than a year previously. Retail trade reported only a marginal upturn. The worst news has come from the Ministry of Finance: in Q1 2024, the general government deficit amounted to 92% of the sum originally planned for the whole year. After just the first two months of the year, the official GDP growth target for 2024 was halved and the fiscal deficit target was revised substantially upwards.

Economic policy faces a dilemma now: should it focus on kick-starting growth, thereby risking a combination of resurgence of inflation and a worryingly high fiscal deficit, with the danger of the forint weakening considerably? Or should it prioritise consolidation of the budget and a cautious easing of monetary policy (with an eye on exchange rate stability), and just accept that GDP growth will pick up only slowly over the entire forecast period? All this must be seen in the political context, bearing in mind the forthcoming municipal and European Parliament elections and the declining popularity of the ruling Fidesz party in the wake of recent political scandals. Any economic policy option will have to take into consideration the fact that inflation has been successfully tamed, but not vanquished. Risks abound. One is that nominal wage rises may be too high if the high inflation rate of the recent past is used as a reference point in the bargaining process. A further risk is that the forint exchange rate could weaken – either as a result of a too-early and too-radical cut in the policy rate, or else triggered by the faltering trust of international investors in the government's economic policy. Should fiscal consolidation rely primarily on raising taxes, that may also push up inflation. The current level of the fiscal deficit cannot be sustained: the only question is to what extent and by what means will consolidation be initiated? High interest payments on public debt have been a critical issue: last year they already attained 4.5% of GDP. This component of fiscal expenditure can be reduced only gradually. An improvement in the primary fiscal balance is therefore imperative; but irrespective of whether that is achieved by increasing budget revenue or by reducing public expenditure, the consequences will be painful.

While macroeconomic dilemmas and the expected rate of GDP growth are the focus of attention, the economy's structural problems have recently become more visible. The domination of the domestic market by a handful of companies is greater in Hungary than in any other OECD country.[15] A

[15] OECD Economic Surveys: Hungary 06 March 2024, p. 64. https://www.oecd-ilibrary.org/economics/oecd-economic-surveys-hungary-2024_795451e5-en

study of the top 50 high-tech companies in Central and Eastern Europe, ranked in terms of their revenue growth over the years 2019-2022, reveals that Czechia and Poland can boast 18 firms apiece, while Croatia has 5, Slovakia has 4, Romania has 3, and Serbia and Bulgaria have 1 firm apiece: not a single Hungarian enterprise was found to be in the top 50.[16] This finding seem closely correlated with the political circumstances in Hungary, where in an increasingly large section of the economy competition has been significantly weakened over the past decade and a half.

The confrontation between the government and the EU gained momentum last year, while the government's anti-EU propaganda inside Hungary shifted into a higher gear. The government's strategy of negotiating with the EU on the basis of blackmail and obstruction of decision-making procedures has become standard. Although over EUR 10bn of the EU funds potentially available to Hungary has recently been released, further tranches are hedged around with a considerable number of conditions. Even the disbursement of recently released transfers is far from certain. The European Parliament is threatening to sue the Commission, as it perceives no guarantee that the resolutions approved by the Hungarian government to restore the rule of law in Hungary will actually be implemented. Currently either extreme scenario – the disbursement of all EU funds earmarked for Hungary and the near-total suspension of further payments – is possible. wiiw considers the most probable scenario (at least over the forecast horizon) to be a partial mobilisation of the EU funds; but transfers disbursed will fall short of the sum that would be available were the country to have unfettered access to the funds earmarked for it.

As for the outlook, wiiw reckons on no clear victory for either of the currently competing economic policy strategies. Up until the June elections, the government's growth-promoting rhetoric will remain strident; thereafter, steps may be taken to improve the fiscal stance. Should a forced easing of monetary policy and a less strict management of the fiscal deficit be pushed through by the main protagonist of this approach – Mr Márton Nagy, the minister of economy and (more importantly) Mr Orbán's currently most influential advisor and confidant on economic questions – then the likely major devaluation of the forint, flare-up of inflation and unfavourable reception from international investors would make short shrift of that particular adventure. Nevertheless, any fiscal consolidation will be cautious, and it will probably take the next three years to produce any convincing results. Inflation will remain of concern: by the end of the year and in 2025 it will be higher than it was in the first months of 2024. The current account position is expected to be roughly in balance this year and slightly positive in the following two years. Industrial production will expand moderately, closely related to the absorption capacity of the main export markets in Western Europe. Agriculture is unlikely to come close to the exceptionally good performance of last year. The labour market remains tight and one of the obstacles to more dynamic growth. The required workforce for the new plants being built with foreign direct investment to produce batteries for electric vehicles will partly come from abroad – in direct contradiction to the anti-migration rhetoric of the government. The weak start to 2024 and the unavoidable fiscal consolidation will enable only moderate GDP growth of about 1.9% this year. That may be followed by a somewhat better growth performance in both 2025 and 2026.

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[16] Deloitte Technology Fast 50 Central Europe 2023. https://www2.deloitte.com/ce/en/pages/about-deloitte/topics/technology-fast-50.html

Table 6.8 / Hungary: Selected economic indicators

	2020	2021	2022	2023 1)	2024	2025 Forecast	2026
Population, th pers., average 2)	9,750	9,710	9,644	9,600	9,570	9,530	9,500
Gross domestic product, HUF bn, nom.	48,444	55,205	65,952	74,992	79,700	84,900	90,400
annual change in % (real)	-4.5	7.1	4.6	-0.9	1.9	2.4	2.9
GDP/capita (EUR at PPP)	22,380	24,370	26,930	28,720	.	.	.
Consumption of households, HUF bn, nom.	22,946	25,528	31,471	35,572	.	.	.
annual change in % (real)	-1.3	4.8	7.1	-2.2	2.3	2.4	2.5
Gross fixed capital form., HUF bn, nom.	12,845	15,036	18,391	19,759	.	.	.
annual change in % (real)	-7.1	5.7	1.4	-7.4	1.8	4.5	5.0
Gross industrial production							
annual change in % (real)	-6.1	9.6	6.1	-5.6	4.0	5.0	6.5
Gross agricultural production							
annual change in % (real)	-2.4	-1.1	-16.5	25.0	.	.	.
Construction industry							
annual change in % (real)	-9.8	11.9	1.9	-5.0	.	.	.
Employed persons, LFS, th, average 3)	4,461	4,642	4,709	4,738	4,750	4,760	4,760
annual change in %	-1.1	0.7	1.4	0.6	0.3	0.2	0.1
Unemployed persons, LFS, th, average 3)	198	196	176	203	200	190	170
Unemployment rate, LFS, in %, average 3)	4.3	4.1	3.6	4.1	4.0	3.8	3.5
Reg. unemployment rate, in %, eop 4)	6.2	5.1	4.8	4.6	.	.	.
Average monthly gross wages, HUF	391,194	425,915	499,980	571,182	621,900	661,000	701,900
annual change in % (real, gross)	6.3	3.6	2.5	-2.9	3.5	2.2	2.6
Average monthly net wages, HUF	260,144	283,234	332,487	379,836	413,600	439,600	466,800
annual change in % (real, net)	6.3	3.6	2.5	-2.9	3.5	2.2	2.6
Consumer prices (HICP), % p.a.	3.4	5.2	15.3	17.0	5.2	4.0	3.5
Producer prices in industry, % p.a.	4.3	13.6	33.7	5.8	4.0	4.0	3.5
General governm. budget, EU def., % of GDP							
Revenues	43.8	41.2	42.7	42.3	42.5	42.5	42.5
Expenditures	51.4	48.4	48.9	49.0	47.5	46.5	46.0
Net lending (+) / net borrowing (-)	-7.6	-7.2	-6.3	-6.7	-5.0	-4.0	-3.5
General gov. gross debt, EU def., % of GDP	79.2	76.7	74.0	73.0	72.8	71.0	69.8
Stock of loans of non-fin. private sector, % p.a.	13.4	12.8	11.6	3.3	.	.	.
Non-performing loans (NPL), in %, eop 5)	3.6	3.2	3.2	2.6	.	.	.
Central bank policy rate, % p.a., eop 6)	0.60	2.40	13.00	10.75	6.00	4.50	4.00
Current account, EUR m 7)	-1,571	-6,553	-14,096	431	0	500	900
Current account, % of GDP 7)	-1.1	-4.3	-8.4	0.2	0.0	0.2	0.4
Exports of goods, BOP, EUR m 7)	88,655	100,269	122,214	126,131	128,300	134,100	141,500
annual change in %	-4.2	13.1	21.9	3.2	1.7	4.5	5.5
Imports of goods, BOP, EUR m 7)	89,990	104,712	137,450	125,852	128,100	134,100	142,100
annual change in %	-6.5	16.4	31.3	-8.4	1.8	4.7	6.0
Exports of services, BOP, EUR m 7)	19,889	22,800	29,920	33,377	36,000	40,700	46,400
annual change in %	-26.1	14.6	31.2	11.6	8.0	13.0	14.0
Imports of services, BOP, EUR m 7)	15,885	18,043	22,067	23,550	25,200	28,200	32,900
annual change in %	-19.9	13.6	22.3	6.7	7.0	12.0	16.5
FDI liabilities, EUR m 7)	3,037	8,776	14,064	3,194	.	.	.
FDI assets, EUR m 7)	826	5,024	9,061	646	.	.	.
Gross reserves of CB excl. gold, EUR m	32,115	33,501	33,533	35,725	.	.	.
Gross external debt, EUR m 7)	112,135	133,991	154,903	167,937	165,000	165,000	150,000
Gross external debt, % of GDP 7)	81.3	87.0	91.9	85.5	82.4	79.7	68.9
Average exchange rate HUF/EUR	351.25	358.52	391.29	381.85	398	410	415

Note: Introduction of new index 2021=100 (new weights) for gross industrial production and producer prices in industry.

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

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