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FDI in Central, East and Southeast Europe

Geo-economic uncertainty taking its toll

Navigating political risks: The resilience of FDI in Hungary's evolving economy

The Vienna Institute for International Economic Studies
Wiener Institut für Internationale Wirtschaftsvergleiche

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Geo-economic uncertainty taking its toll

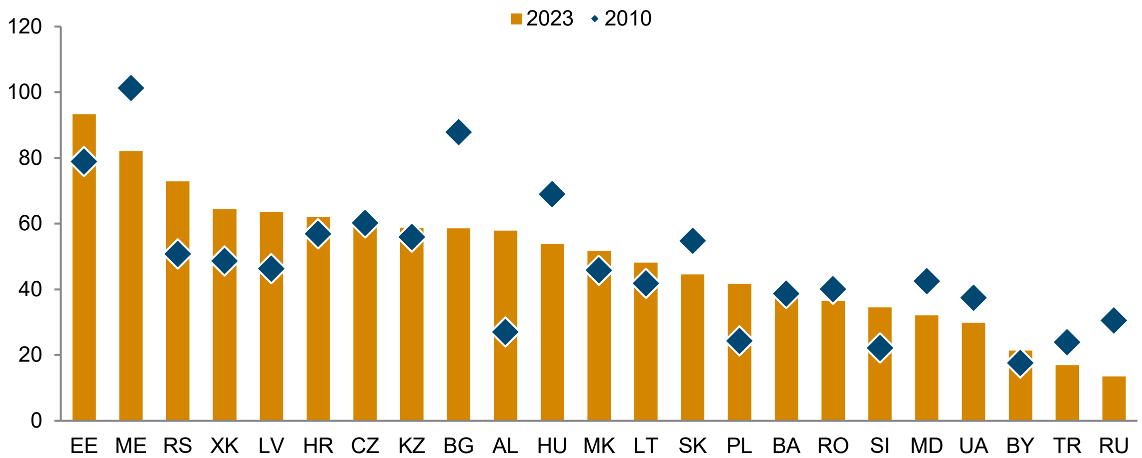
BY OLGA PINDYUK

Long-term FDI developments in CESEE point to a structural shift in many countries, especially in Central Europe. Recently, investor confidence in the region has been badly affected by rising uncertainty. Data on greenfield investment projects announced reveal a significant weakening of investment performance in most countries of the region. China has been cementing its role as the biggest investor in the region.

LONG-TERM FDI DEVELOPMENTS: INDICATIONS OF A STRUCTURAL SHIFT IN MANY COUNTRIES

A look back at the last 14 years reveals a significant transformation of the role of foreign direct investment (FDI) in the CESEE region. In many countries of CESEE, the importance of FDI has grown significantly – especially in Albania, Serbia, Latvia, Poland, Kosovo, Estonia and Slovenia, where the share of inward FDI stock in GDP increased in the period 2010-2023 by more than 10 percentage points (pp) (Figure 1). In 2023, inward FDI stocks as a share of GDP were highest in Estonia, Montenegro, Serbia, Kosovo, Latvia and Croatia, in excess of 60%. At the same time, in many other countries, the share of FDI inward stock in GDP has declined – by as much as 29 pp in Bulgaria, 19 pp in Montenegro, 17 pp in Russia and 15 pp in Hungary. Russia, Turkey, Belarus and Ukraine are – quite predictably – the worst performers in the region in terms of attracting FDI: in those countries, FDI stocks accounted for less than 30% of GDP in 2023.

Figure 1 / FDI inward stock as % of GDP



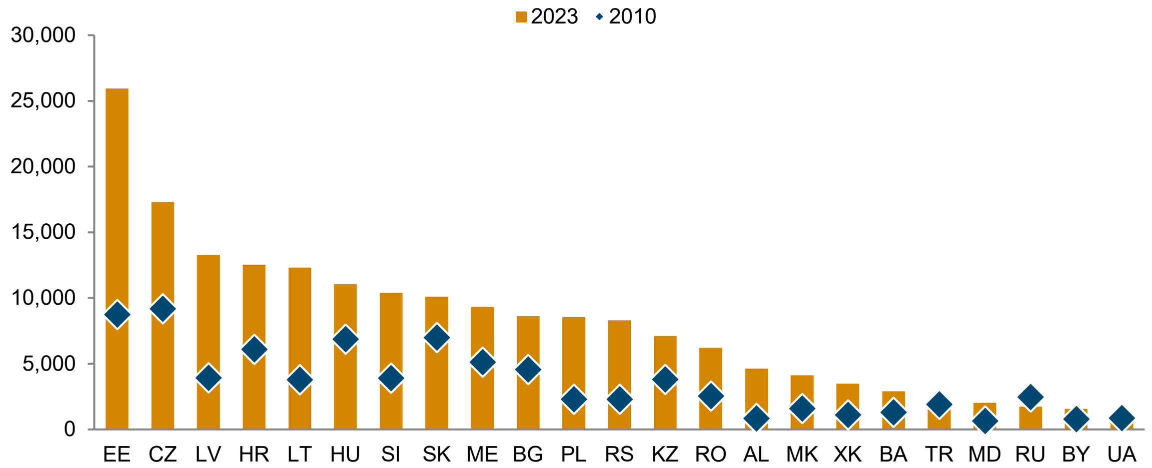
Note: Data are based on direct investment statistics (directional principle), excluding special purpose entities (SPEs).
Sources: wiiw FDI Database based on direct investment statistics of the respective central banks, wiiw calculations.

A comparison of FDI inward stocks per capita reveals even more striking differences between the countries (Figure 2), with Estonia leaving the rest of CESEE significantly behind in terms of FDI attraction.[1] In 2023, it accumulated almost EUR 26,000 of inward FDI stock per capita – almost 50% more than Czechia, which had the second highest figure. Overall, the Baltic states had the fastest accumulation of FDI per capita in the region during 2010-2023, followed by Czechia, Slovenia and Croatia.

Among the Western Balkan countries, there was a noticeable heterogeneity in FDI accumulation per capita, with Montenegro and Serbia proving far more successful at attracting FDI than Albania, Bosnia and Herzegovina, Kosovo and North Macedonia. The two former countries together attracted more inward FDI per capita than the rest of the Western Balkan sub-region.

Ukraine, Belarus, Russia, Moldova and Turkey significantly underperformed with respect to inward FDI stock per capita, compared to the rest of the region. Moreover, Russia is the only country where inward FDI stock per capita decreased over that period, due to the disinvestment that occurred after the start of the full-scale invasion of Ukraine.

Figure 2 / FDI inward stock in EUR per capita

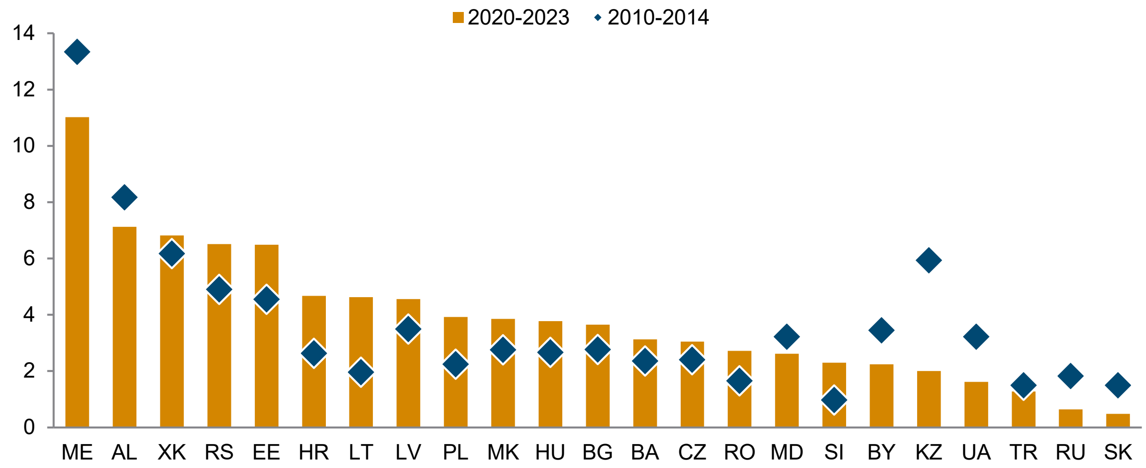


Note: Data are based on direct investment statistics (directional principle), excluding special purpose entities (SPEs).
Source: wiiw FDI Database based on direct investment statistics of the respective central banks, wiiw calculations.

A glance at the last four years of FDI inward flows suggests that the FDI landscape of the region could change further in the near future (Figure 3). Montenegro, Albania, Kosovo, Serbia and Estonia had the greatest average annual FDI inflows as a share of GDP in the period 2020-2023 – in excess of 6% of GDP per annum. Western Balkans as a sub-region showed by far the best performance here, with average annual FDI inflows exceeding 6% of GDP during 2020-2023. At the same time, for the four countries of the Visegrád Group, this indicator was on average below 3% of GDP. Moreover, Slovakia recently appears to have become CESEE's worst performer in terms of attracting FDI inflows, even lagging behind Russia. This is yet another indication that Central Europe's model of economic growth based on FDI-attraction may have run its course.

[1] Aside from variations in economic performance, population change, different inflation levels and changes in the valuation of assets and in exchange rates all contribute to the differences in the trends of FDI inward stocks measured as a share of GDP and in EUR terms. This can sometimes make interpretation of the trends difficult.

Figure 3 / FDI inflow as % of GDP, annual average for the period



Note: Data are based on direct investment statistics (directional principle), excluding special purpose entities (SPEs).
Source: wiiw FDI Database based on direct investment statistics of the respective central banks, wiiw calculations.

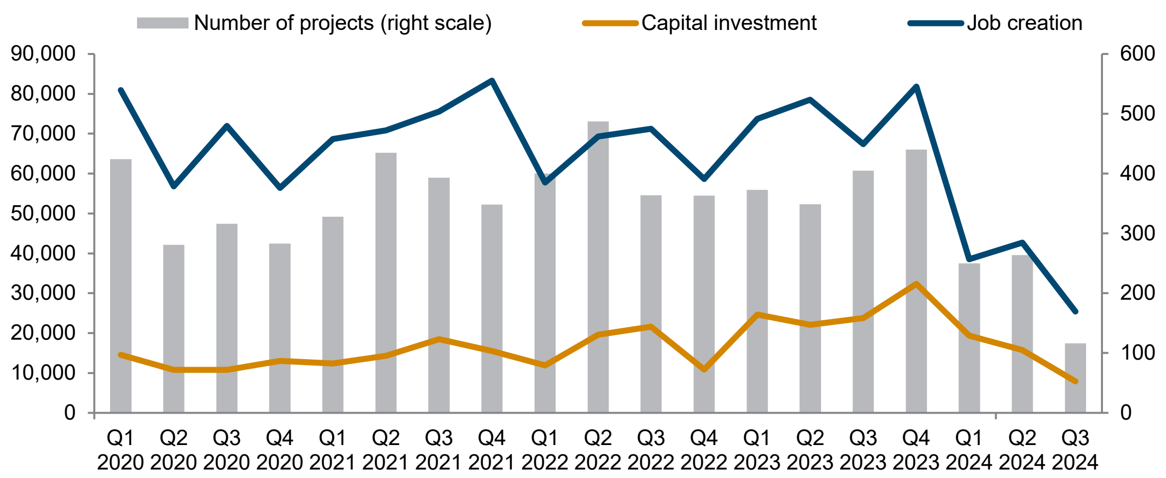
CESEE CONTINUES TO LOSE ITS ATTRACTIVENESS TO INVESTORS AMID RISING UNCERTAINTY

Data on greenfield investment projects announced, which can be interpreted as a forward-looking indicator of investment trends, point to a significant weakening of investment performance in the region: between January and September 2024, the number of greenfield projects announced in CESEE decreased by 44% year on year, with pledged capital falling only slightly more slowly – by 39% year on year. In Q3 2024, as geo-economic uncertainty soared in the run-up to the US presidential election,[2] the contraction of greenfield investment announcements was even more drastic: their number tumbled by over 70% compared with the same period last year, to reach their lowest level in the period 2020-2024. Thus, in Q3 2024 investors appear to have had even less confidence than at the height of the COVID-19 pandemic or in the wake of Russia's full-scale invasion of Ukraine. Pledged capital (as well as job creation linked to the greenfield projects announced) fell at a similar rate and was also at its lowest level for five years (Figure 4).

A closer look reveals that the number of greenfield projects announced fell in January-September 2024 in all CESEE sub-regions (Figure 5), with the sharpest decline recorded in Turkey – 72% year on year. Both EU-CEE and Western Balkans experienced a significant contraction in greenfield project announcements – of more than 40% year on year. The mildest decline was recorded in Moldova and Ukraine, and in Russia. In the case of the latter, the result can be explained by the rather low base of comparison, since the number of greenfield projects announced has been very low ever since the start of the country's full-scale invasion of Ukraine. Moldova is the only country in the region that managed to increase the number of greenfield projects announced, albeit by only one project. In Ukraine the number of announcements did fall, but in relative terms the decline (21% year on year) was the second smallest in the region (after Russia).

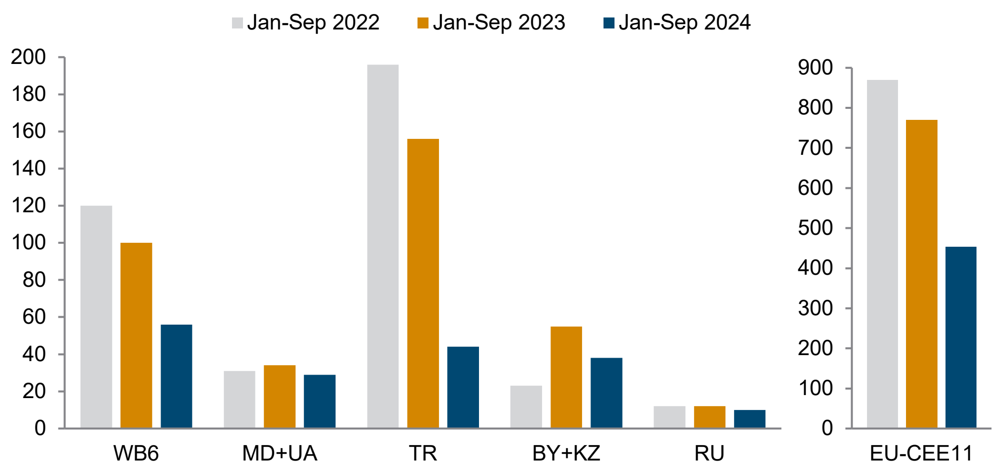
2 On the importance of the results of the 2024 US presidential election for CESEE, see R. Grieveson (2024), Global assumptions: Steady growth; all eyes on the US election, in wiiw Forecast Report, Autumn.

Figure 4 / Greenfield FDI projects announced in CESEE: number of projects, pledged capital in EUR million and number of jobs to be created



Source: fDi Markets.

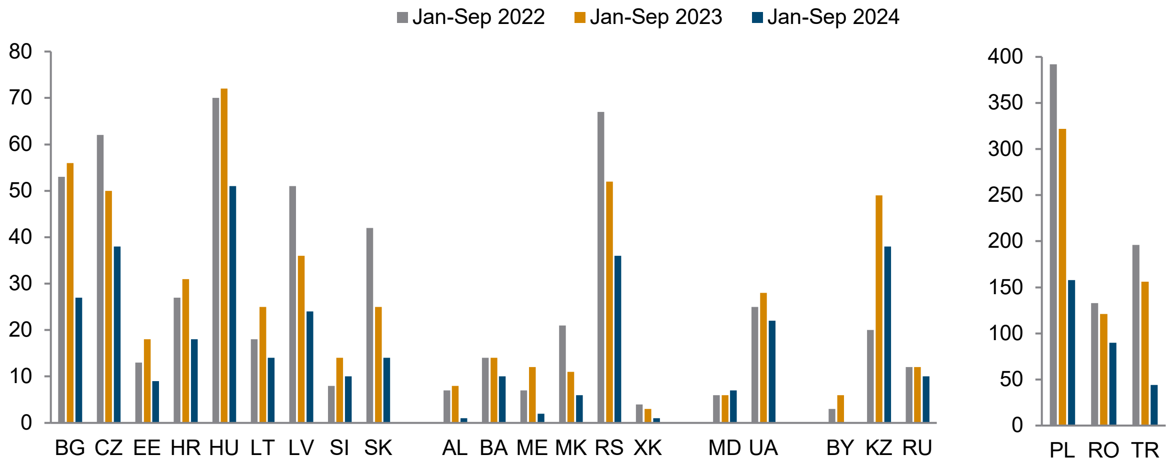
Figure 5 / Number of greenfield projects announced, by country group



Source: fDi Markets.

A glance at the performance of individual countries reveals a uniformly rather bleak picture, with the number of greenfield investment projects announced falling in January-September 2024 in all countries, bar Moldova (as already mentioned) (Figure 6). Among the EU-CEE countries, Bulgaria, Poland and Estonia stand out as those with the sharpest declines – of 52%, 51% and 50%, respectively, year on year. In the Western Balkans, Albania, Montenegro and Kosovo had the worst performance, with the number of greenfield investment projects announced falling by as much as 88%, 83% and 67%, respectively, year on year.

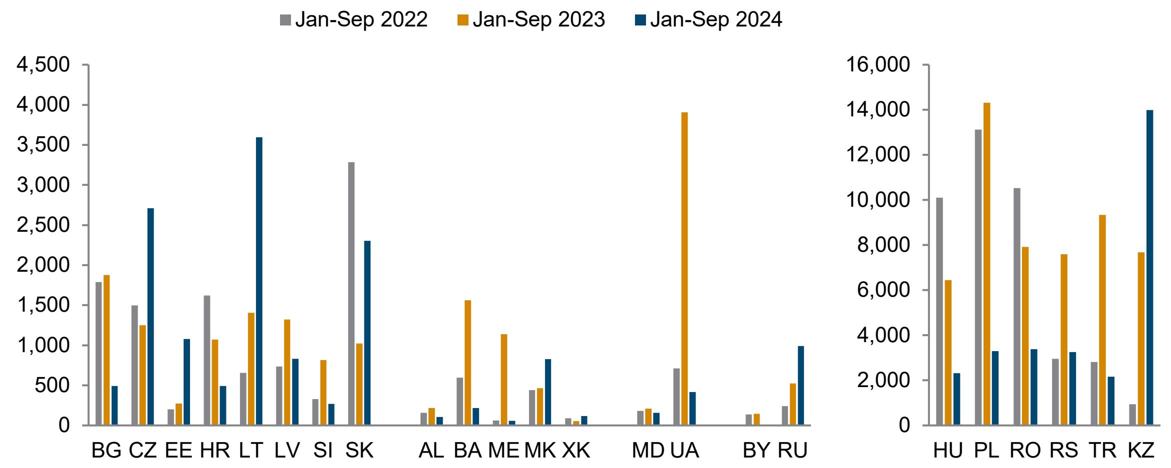
Figure 6 / Number of greenfield projects announced, by country



Source: fDi Markets.

Interestingly, the data on capital pledged in the period January-September 2024 show a more mixed picture, with eight CESEE countries registering an increase over the same period last year (Figure 7). The biggest relative expansion of pledged capital was recorded in Estonia, Lithuania and Kosovo. At the same time, in Montenegro, Ukraine and Bosnia and Herzegovina, pledged capital contracted much more rapidly than the number of projects – by 95%, 89% and 86%, respectively, year on year, pointing to the changing structure of the investment projects towards sectors that are less capital intensive. There were fewer projects in food processing (in all three countries), renewable energy (Bosnia and Herzegovina and Montenegro), automotive components and metals (Bosnia and Herzegovina), the hotel and tourism sector (Montenegro) and communications (Ukraine). Instead, there was an increase in the share of projects in service sectors.

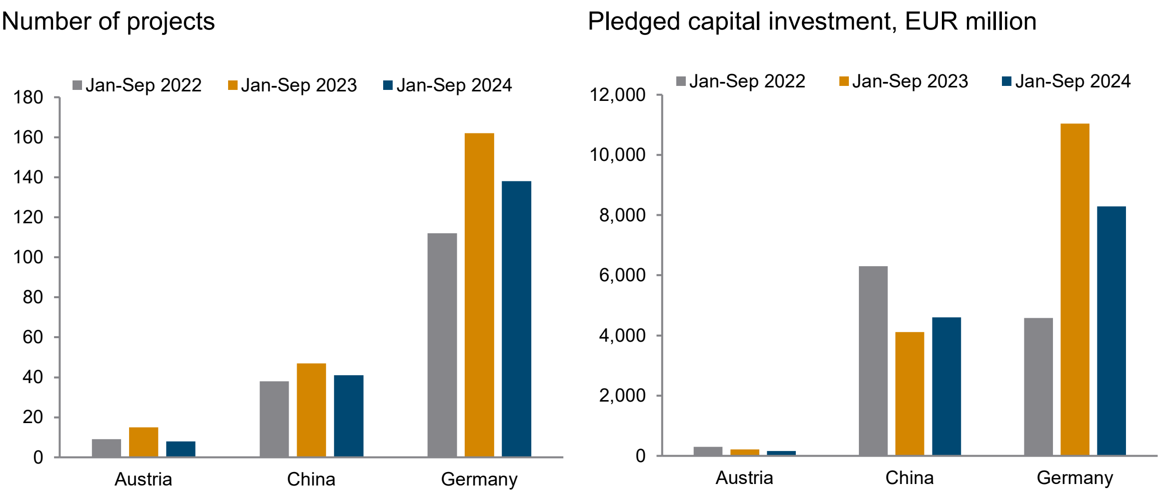
Figure 7 / Pledged capital in greenfield projects announced, by country, EUR million



Source: fDi Markets.

In terms of their attractiveness to greenfield investment, the CESEE regions appear to have been losing out to the US, largely on account of the tax incentives introduced by the Biden administration to promote the green transition (Inflation Reduction Act). As Figure 8 shows, although the number of greenfield projects from China and Germany in the US decreased in January-September 2024 compared with the same period of 2023, it was still noticeably higher than the number of Chinese and German projects in CESEE – 13 projects more in the case of China and 42 projects in the case of Germany (see Figure 10 below). The reorientation of German investors to the US is even more visible when we look at the capital pledged – whereas in January-September 2022, capital pledged for greenfield projects in CESEE was 40% higher than for projects in the US, in January-September 2024, capital pledged to the US was almost three times that pledged to CESEE. Interestingly, China's greenfield projects in the US tend to be on average significantly smaller than its projects in CESEE – likely an indication of differences in the sectoral structure of the investment. Austria does not appear to have followed the example of Germany and China: it continues to invest more in the CESEE region than in the US – in terms of both the number of projects and the value of the capital pledged.

Figure 8 / Greenfield investment commitments of Austria, Germany and China in the US

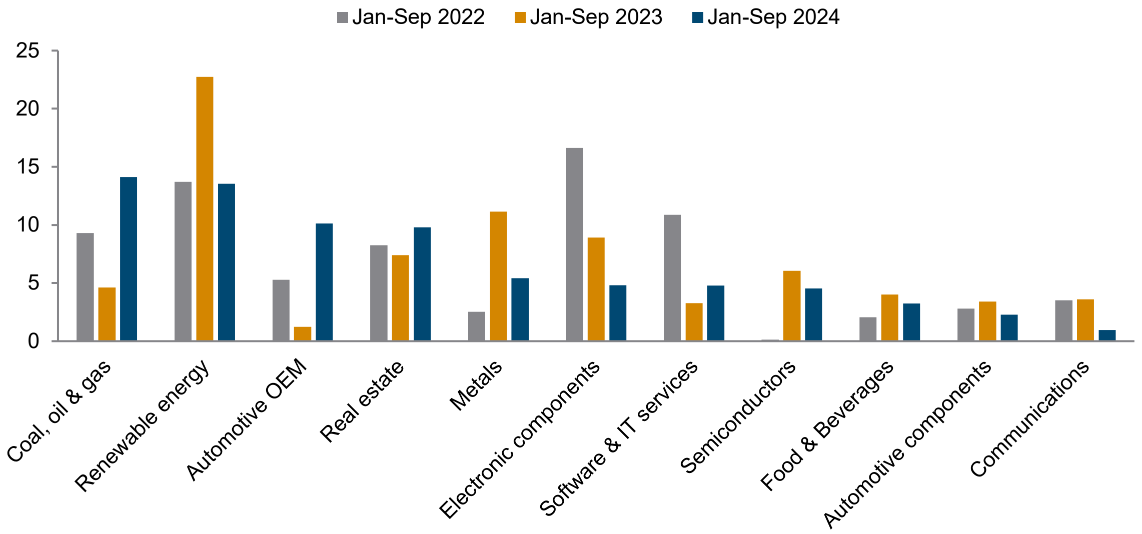


Source: fDi Markets.

INVESTMENT IN TRADITIONAL ENERGY SECTORS GAINING MOMENTUM

As Figure 9 shows, there was a significant increase in the share of traditional energy sectors in the pledged capital of greenfield investment projects in CESEE: in January-September 2004, their share exceeded 14%, whereas in the same period of 2023 it had been below 5%. This increase came primarily on the back of projects announced in Kazakhstan. At the same time, the share of capital pledged by investors in the renewable energy sector fell during this period by about 9 pp: the commitment of capital from companies in this sector was lower than in the same period of 2023 in all the sub-regions, with the exception of Moldova and Ukraine. In Ukraine, renewable energy was the main sector of investing companies, accounting for 37% of total capital pledged in January-September 2024; the second biggest sector was space and defence (31%).

Figure 9 / Share of main sectors of investing companies in the pledged capital of greenfield projects in CESEE, in %



Source: fDi Markets.

The second biggest increase in the share of pledged capital in January-September 2024 was in the automotive original equipment manufacturers (OEM) sector (9 pp up on January-September 2023), while the shares of metals and electronic components decreased by 6 pp and 4 pp, respectively, year on year.

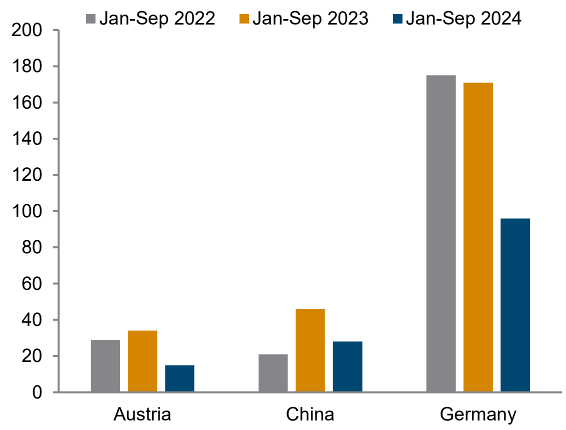
INCREASING ROLE OF CHINESE INVESTMENT

In January-September 2024, China maintained its status as the biggest investor in CESEE in terms of capital pledged for greenfield investment projects – more than twice the amount pledged by Germany (Figure 10). However, the capital pledged by both countries was much lower than in January-September 2023 – 30% lower in the case of China and 67% in the case of Germany. Austria, by contrast, expanded the capital it pledged for greenfield investment projects in CESEE – by 20% year on year, although this was due primarily to the low statistical base; compared with January-September 2022, the value of capital remained more than 80% lower. China's projects continued to be, on average, much bigger than those of Germany and Austria – the value of an average greenfield investment project planned by China during January-September 2024 was almost eight times greater than the average German project.

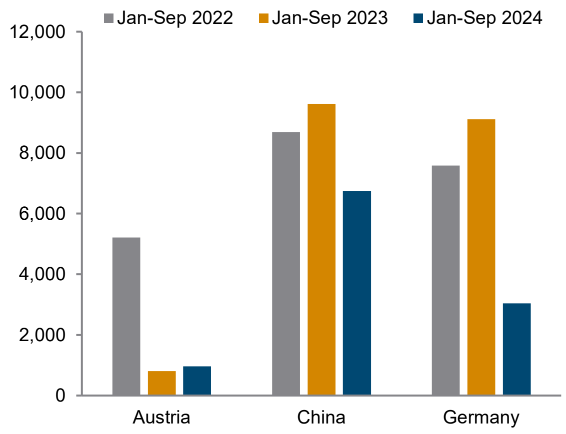
Of the CESEE countries, Romania attracted the largest number of Chinese greenfield investment projects in January-September 2024, followed by Turkey, Serbia, Hungary and Poland (Figure 11). However, from the perspective of the value of the capital pledged, it was Slovakia that became the primary destination for China's greenfield investment, closely followed by Kazakhstan and Turkey: these three countries together accounted for three quarters of pledged capital in January-September 2024. In fact, the showing by Slovakia came on the back of a single greenfield project: SAIC, the Chinese state-owned car producer, announced its intention of investing in the production of electric vehicles there. Apart from these three countries, the value of capital pledged by China increased in Romania, Slovenia and Bulgaria.

Figure 10 / Greenfield investment commitments of Austria, Germany and China in CESEE

Number of projects



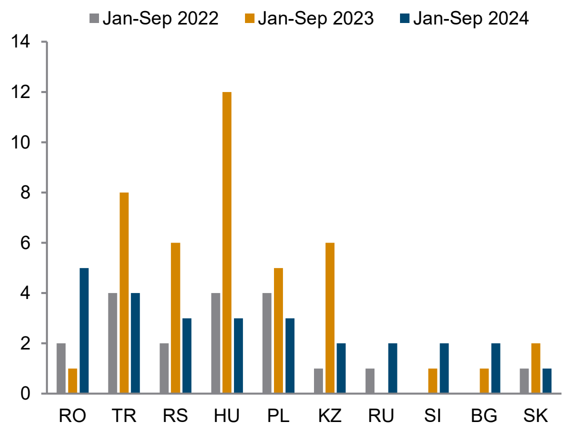
Pledged capital investment, EUR million



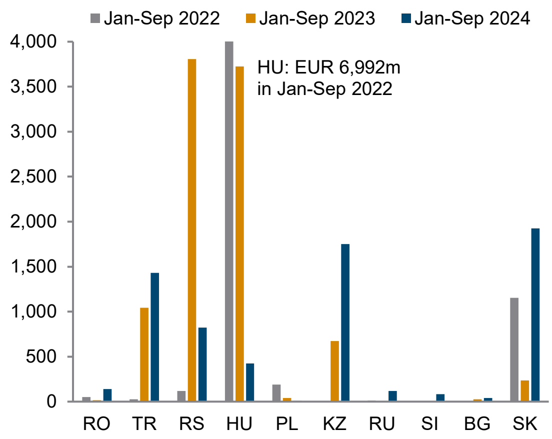
Source: fDi Markets.

Figure 11 / Greenfield investment commitment by China in selected CESEE countries

Number of projects



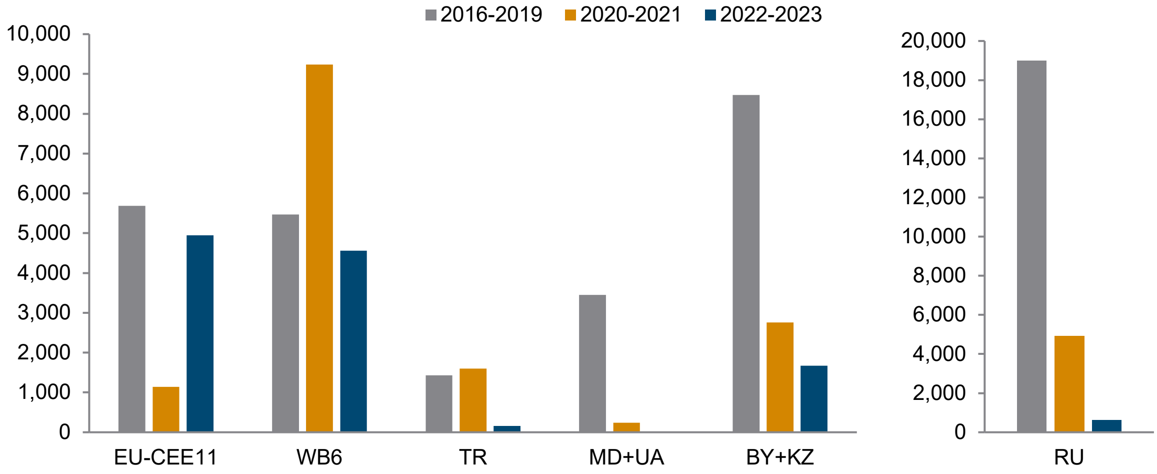
Pledged capital investment, EUR million



Source: fDi Markets.

Of course, the greenfield investment data reveal only one element of the story of China's economic involvement in the region, since a large part of the capital from the country comes in the form of loans, mostly within the framework of the Belt and Road Initiative. Particularly in the Western Balkans, China appears to have a much bigger presence than the standard investment statistics would suggest – in 2022-2023, the sub-region on average attracted investment and construction projects worth only slightly less than projects in EU-CEE (Figure 12). Moreover, during 2020-2021, the years of the COVID-19 pandemic, there was a boom in Chinese investment projects in Western Balkans, whereas in other CESEE sub-regions China's investment and construction presence collapsed or stagnated (as was the case in Turkey). By contrast, Russia appears to have lost its attractiveness to Chinese investors: in 2022-2023, it accounted for only 5% of total Chinese investment and construction projects in the region – compared to more than 40% in 2016-2019.

Figure 12 / Value of China's overseas investment and construction projects, USD million



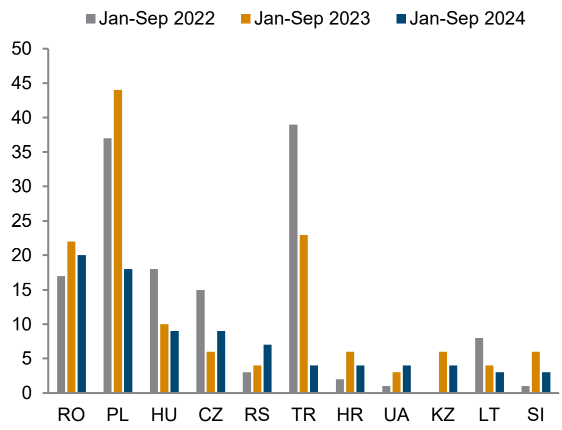
Source: China Global Investment Tracker by the American Enterprise Institute.

GERMAN INVESTMENTS ON THE RETREAT

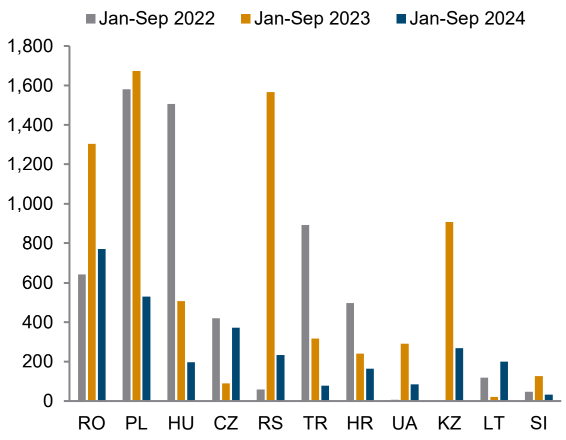
By contrast, with only a few exceptions, German investors appear to have been retreating from the CESEE region (Figure 13). The number of German greenfield projects announced increased during January-September 2024 compared to the same period of 2023 only in Czechia, Serbia and Ukraine, while an increase in the value of the capital pledged was recorded only in Czechia and Lithuania. The steepest decline in the value of pledged capital has been in Bulgaria, Bosnia and Herzegovina, North Macedonia and Slovakia – in January-September 2024, it declined by 99%, 96%, 96% and 93%, respectively, year on year.

Figure 13 / Greenfield investment commitment by Germany in selected CESEE countries

Number of projects



Pledged capital investment, EUR million



Source: fDi Markets.

In January-September 2024, Romania became the biggest destination for German investors (as well as Chinese) – in terms of both the number of projects and the value of pledged capital. Although the values of these indicators declined in Romania compared to the same period of 2023, in other traditional destinations for German investment the decline witnessed was much steeper. As a result, Poland and Serbia, which (in terms of the value of pledged capital) were the first and second biggest destinations for German greenfield investors in January-September 2023, now hold second and fifth place, respectively.

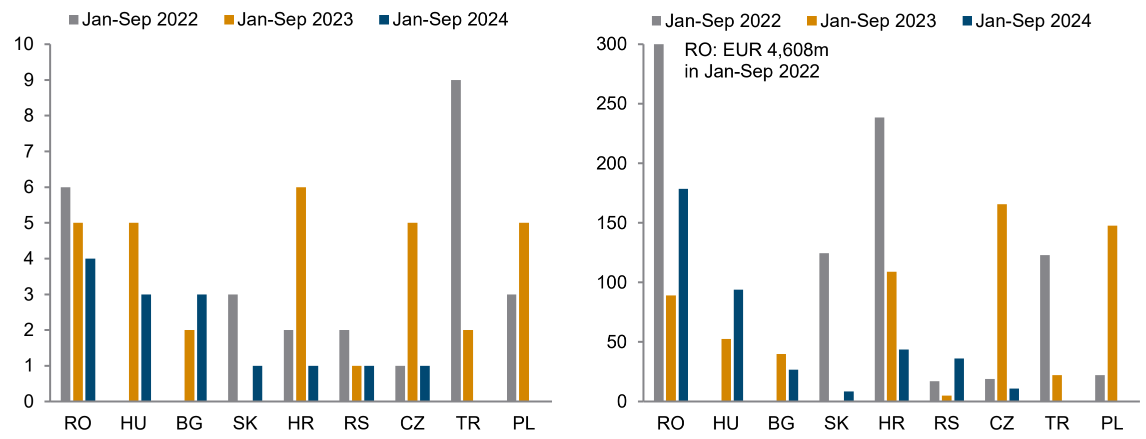
EU-CEE STILL PLAYS A KEY ROLE AS AN INVESTMENT DESTINATION FOR AUSTRIA

For Austrian investors, Romania accounted for the largest number of greenfield projects announced and the greatest value of capital pledged in CESEE in January-September 2024 (Figure 14). Although during this period the number of greenfield projects announced originating from Austria declined in most of the region (only in Bulgaria and Slovakia was there a slight increase in the number of projects), the value of capital pledged to three countries – Romania, Hungary and Serbia – expanded significantly.

Figure 14 / Greenfield investment commitment by Austria in selected CESEE countries

Number of projects

Pledged capital investment, EUR million



Source: fDi Markets.

However, as it will take time for the recent shifts observed in the greenfield investment dynamics to impact the accumulated FDI stocks, Austrian direct investment will continue to play a key role in most CESEE countries. Although its share in FDI stock decreased in 2023 in a number of countries of the region (most notably Bosnia and Herzegovina, Slovenia and Croatia), Austria remained among the top 10 investors in all countries, apart from the Baltic states, Kazakhstan and Turkey (Table 1). As of 2023, Austria ranked number 1 by share of FDI stock in Croatia, Slovenia and North Macedonia.

From the perspective of Austrian investors, EU-CEE countries continue to be the most important investment destination in CESEE, accounting for 80% of Austria's total outward FDI stock in the region. Looking at individual countries, Czechia, Romania, Hungary and Poland continue to play the biggest role, together accounting for about 55% of Austrian outward FDI stock in CESEE in 2023.

Table 1 / Austrian FDI stock in CESEE

		2022	2023	2022	2023	2022	2023
		EUR m		as % of the FDI stock of the host country		Austria's ranking in host country	
BG	Bulgaria	4,317	4,800	8.4	8.7	3	2
CZ	Czechia 1)	19,072	19,072	9.9	9.9	4	4
EE	Estonia	369	416	1.1	1.1	17	17
HR	Croatia	7,319	7,986	17.5	16.5	1	1
HU	Hungary	11,545	14,487	11.8	13.7	3	3
LT	Lithuania	240	236	0.7	0.7	19	21
LV	Latvia	290	325	1.3	1.3	14	15
PL	Poland	9,997	11,241	3.8	3.6	8	7
RO	Romania	12,901	14,714	12.0	12.4	3	3
SI	Slovenia	4,665	4,778	23.0	21.6	1	1
SK	Slovakia 1)	8,569	8,569	15.9	15.9	2	2
	EU-CEE11	**79,283**	**86,623**	**8.6**	**8.6**	.	.
AL	Albania	675	760	6.1	5.7	7	7
BA	Bosnia and Herzegovina	1,390	1,363	15.3	13.7	1	3
ME	Montenegro	173	259	3.3	4.5	10	8
MK	North Macedonia	1,053	1,199	15.0	15.9	1	1
RS	Serbia 2)	4,739	5,047	10.9	10.5	2	3
XK	Kosovo	329	394	6.1	6.3	5	5
	WB6	**8,359**	**9,022**	**10.3**	**10.0**	.	.
MD	Moldova	165	157	4.1	3.6	8	10
UA	Ukraine	1,552	1,698	3.2	3.4	6	7
	MD+UA	**1,717**	**1,856**	**3.3**	**3.4**	.	.
TR	Turkey	7,950	4,232	3.4	2.6	11	12
BY	Belarus	703	811	4.9	5.7	3	3
KZ	Kazakhstan	102	200	0.1	0.1	29	25
RU	Russia 3)	5,925	5,925	1.3	1.3	.	.
	CIS3	**6,729**	**6,936**	**1.1**	**1.2**	.	.
	CESEE23	**104,039**	**108,668**	**5.5**	**5.7**	.	.

Note: 1) Data refer to 2022. - 2) Cumulated inflows. - 3) Data refer to 2021.
Source: wiiw FDI Database incorporating central bank statistics.

Navigating political risks: The resilience of FDI in Hungary's evolving economy

BY MARCUS HOW[1]

Hungary has experienced institutional decline under Prime Minister Viktor Orbán's administrations, while nationalisation and 'indigenisation' have reduced FDI in sectors such as banking, utilities and energy. However, FDI in manufacturing and construction has remained stable – or has even grown – due to discretionary policy incentives. Despite the overall political risks, Hungary's FDI inward stock exceeded EUR 100bn by 2023, with robust macroeconomic fundamentals, a low rate of corporate tax and the country's EU membership serving to attract investors.

Political risk is a key determinant in the confidence of investors that over time they can generate a sustainable return on a project. Higher political risk tends to indicate a greater likelihood that private investment will be adversely impacted by politically driven developments, such as government instability, policy changes, institutional weakness or even violence (e.g. war, terrorism or civil unrest).

The 'doomsday' risk scenario in this respect is loss of the asset, whether through revocation of ownership (i.e. expropriation) or its physical destruction. Such risks have declined overall since the 1980s, owing to the development of investment safeguards that have accompanied the processes of globalisation (e.g. bilateral investment treaties), although they are currently experiencing an upswing due to growing geopolitical instability. Furthermore, softer risk scenarios have proliferated, with investors confronted with 'creeping' forms of expropriation, such as special taxes and regulations, politicised institutions and informal power.

The prime example of such soft risks is Hungary. Once a frontrunner among EU-CEE countries, it has since become the chief backslider. This process began in 2010 with the election of the right-wing Fidesz party of Viktor Orbán. (Although Fidesz had already been in government between 1998 and 2002, without any such backsliding being observed, it doubled down on its 'illiberalism' when it returned to power.) The constitutional majority it succeeded in winning enabled not only a wholesale restructuring of the Hungarian state, but also a change in its political economy. This has been sustained for well over a decade now, with Fidesz currently serving its fourth consecutive term in office. The result has been an increase in political risk for certain categories of investors, even as Hungary remains one of the most attractive destinations for foreign direct investment (FDI) in EU-CEE.

[1] Head of Analysis at VE Insight. The author thanks Gábor Hunya, wiiw, for valuable comments and suggestions on the first draft.

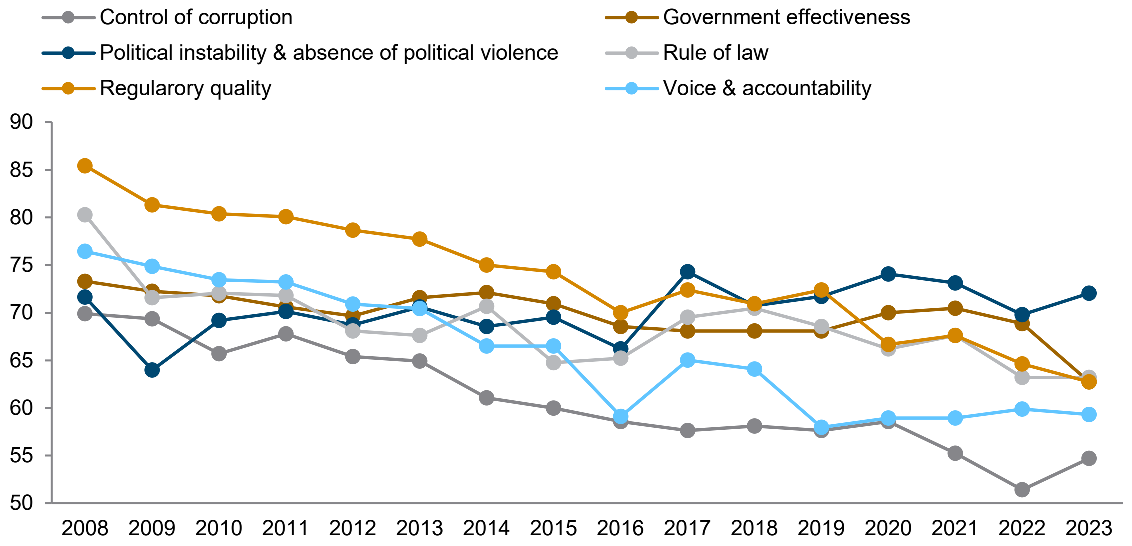
MEASURING POLITICAL RISK

Political risk is typically measured by collecting qualitative indicators, which are then quantified and converted into an index. For the purposes of this article, the index used to measure political risk is the World Bank's Worldwide Governance Indicators (WGI). There are six WGIs: voice and accountability; political stability and the absence of violence; government effectiveness; regulatory quality; rule of law; and control of corruption. These are rated on a scale of 1-100 (the higher the value, the lower the risk), with the overall score per country being the average of the six WGIs.

The data according to which the WGIs are compiled are perception based: this means that they do not necessarily correspond to objective reality, but they may feed into it, since no investment decision will be made if there is not an adequate level of confidence that the host country will provide the predictability required for an investment to become profitable. The WGIs should be interpreted as reflecting wider trends relevant to political risk, rather than measuring it precisely. They are macro rather than micro, neglecting differences between economic sectors and geographical regions, for example.

Figure 1 tracks the performance of Hungary across the WGI categories over time. A decline is observable across all categories, with the exception of political instability and the absence of political violence, which was able to recover to 2008 levels.

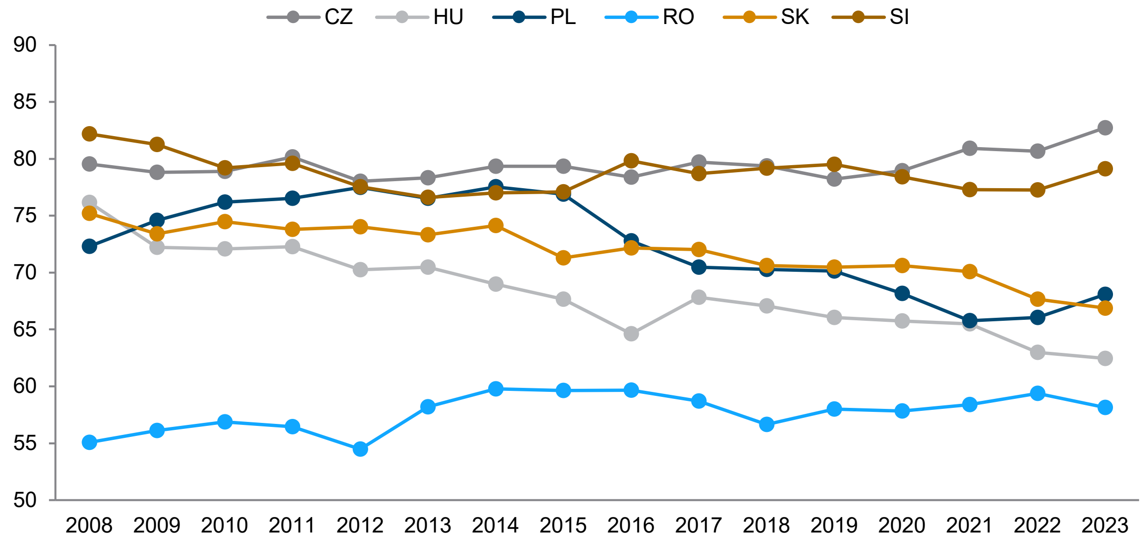
Figure 1 / Hungary WGI scores in 2008-2023, in %



Source: World Bank WGI dataset.

Figure 2 tracks the average annual WGI score for Hungary between 2008 and 2023, alongside some of its key regional peers for comparison. As one can see, Hungary registered the steepest overall decline; it was matched only by Poland (which, however, has recently registered a tentative improvement).

Figure 2 / WGI average scores in selected EU-CEE countries, 2008-2023, in %



Source: World Bank WGI dataset.

POLITICAL RISK IN HUNGARY

Since its return to power in 2010, the Orbán government has introduced numerous measures across the judiciary, prosecution, regulatory and legislative domains that collectively have intensified political risk by reducing institutional checks and balances and by amplifying executive power. These policies have been framed by the Orbán government as reflecting an ideology of 'illiberal democracy'.

Judicial reforms have allowed Fidesz to control the nomination and appointment of Constitutional Court judges, reduce court autonomy and enable the appointment of a pro-government president of the Supreme Court (reformed as the Curia). Restrictions on judicial independence have included dismissing older judges and transferring administrative and labour court responsibilities to regular courts. The Chief Prosecutor's Office has also gained unassailable authority and maintains its competence to handle corruption cases.

In the informational sphere, a Media Council and a state-controlled media fund ensure editorial oversight of most public media outlets. Additionally, in the wake of the COVID-19 pandemic, the government expanded its legislative powers, frequently ruling by emergency decree under a 'state of danger' that has been in place since 2020.

For the most part, these measures pose no direct risk to foreign investors. However, they do have an impact on the predictability of policy making. Moreover, the undermining of the independence of the judiciary may increase the risk that the courts issue arbitrary rulings in relation to the enforcement of contracts to which foreign investors are subject. Yet the Orbán government has also engaged in policy making that has increased the costs for certain foreign investors very significantly. This has been informed by two policy priorities.

The first has been to raise revenue so that the government can avoid cutting public spending. This was the strategy used by the Orbán government to tackle the dire budgetary situation in the wake of the 2008 financial crisis, which had a particularly severe impact on the Hungarian economy. It has relied on this approach again in its response to the economic fallout from the COVID-19 pandemic and the Russian invasion of Ukraine, which prompted heavy stimulus spending and fuelled inflation.

The second priority has been to strengthen domestic capital in certain strategic sectors of the economy, whether through the direct nationalisation of those sectors by the state or their 'indigenisation'; that is, monopolisation by private companies owned by oligarchs close to Fidesz. These state and privately owned companies are supported by the friendly institutional environment engineered by the government, allowing them to operate with relative impunity as they come to monopolise certain sectors and secure privileged access to public contracts. This centralised public-private nexus has proved conducive to corruption.

It has also been supported by a system of economic policy making that favours such companies, while penalising foreign competitors. Since 2010, the government has introduced extensive regulatory and fiscal measures across various sectors, often arbitrarily. Foreign currency loans were converted to forints (HUF) between 2010 and 2015, inflicting significant losses on banks. Domestic ownership in strategic sectors exceeded 50% from 2010 onward, encompassing banking, energy, media, and later utilities and telecoms. The gas market was fully state owned by 2016, while private pension funds were nationalised in 2011, raising nearly EUR 10bn. In 2012, permanent restrictions were placed on farmland purchases; and in 2013, price caps were imposed on household gas, electricity and other utilities, while companies could be designated as strategically important, meaning they were exempted from antitrust scrutiny. Windfall taxes that targeted excess profits were imposed in 2021, with banks facing a peak rate of 13% by late 2023. There were 16 different types of extra tax in place in 2022, some of which will be reduced or phased out in 2025. Between 2021 and 2024, price caps were also applied to essential food items and (from time to time) to retail petrol.

These policies reflect significant state intervention across Hungary's economy. Yet the Orbán government is not the only source of political risk in Hungary – even if it is the ultimate one. In 2022, in response to concerns over the rule of law, the European Commission suspended payment of approximately EUR 27bn in funds that had been allocated to Hungary as part of EU Cohesion Policy and the Recovery and Resilience Facility (RRF).

FDI AND POLITICAL RISK

In light of these trends, this article examines whether there is any correlation with FDI trends in Hungary. In other words, it looks at whether the increased perception of risk is leading foreign companies to withhold investment – or even withdraw it.[2]

Figures 3 and 4 indicate that the political risks as they have manifested themselves in Hungary have not been enough to prevent the upward trend in both overall FDI inward stock and FDI inflows.

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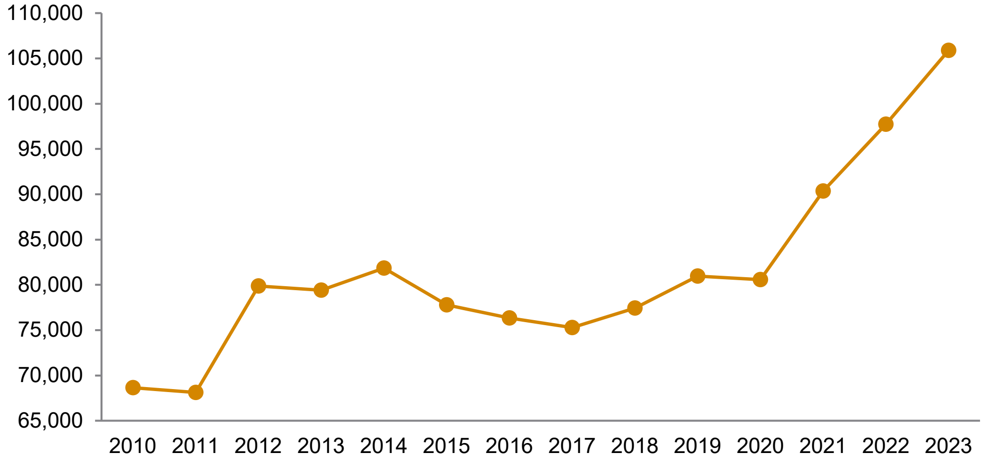
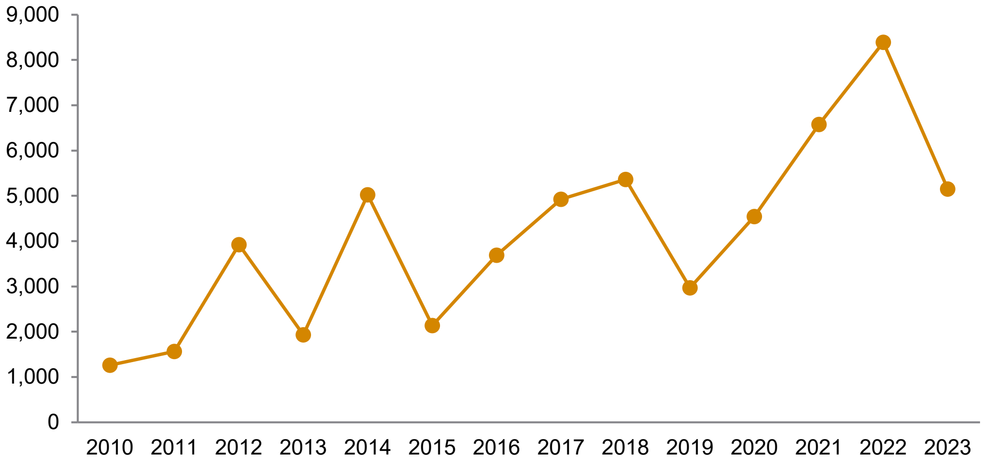
2 Any correlation is illustrative rather than indicative of direct causality. Other factors may also determine FDI flows to the point that they obscure the impact of political risks altogether. These include global economic conditions, such as world economic growth, commodity prices and interest rates, as well as local currency considerations.

Figure 3 / FDI inward stock in Hungary, 2010-2023, EUR million



Source: wiiw FDI database, Hungarian National Bank.

Figure 4 / FDI inflows to Hungary, 2010-2023, EUR million



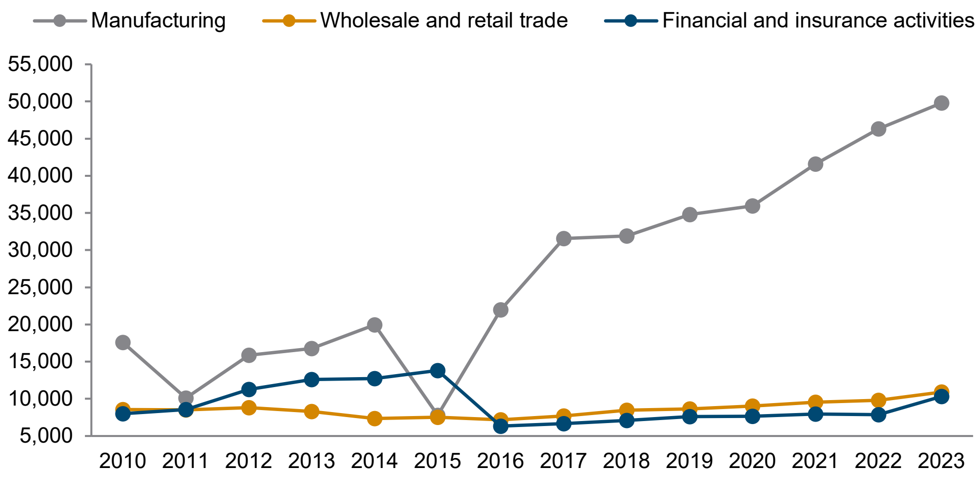
Source: wiiw FDI database, Hungarian National Bank.

The data indicate that FDI inward stock has increased steadily in Hungary, despite the rising political risk. Indeed, since 2020 the FDI inward stock has increased exponentially, reaching over EUR 100bn. A dip did occur between 2015 and 2017, but that is attributable in large part to the cyclical nature of the EU's Cohesion Policy, which indirectly impacts FDI, given that fiscal transfers have a crowding-in effect on investment.[3] In terms of FDI inflows, Hungary's performance has been more erratic, although the upward trend does broadly align with that seen in FDI inward stock. Overall, these data reflect an apparent indifference on the part of foreign investors to political risk in Hungary at the macro level. Possible reasons for this are discussed below.

[3] Richter, S. (2015), Hungary: losing momentum, in: 'Mixed prospects: Consumption leads fragile recovery in the CESEE core – CIS stumbles', wiiw Forecast Report, Autumn, pp 80-83, https://wiiw.ac.at/hungary-losing-momentum-dlp-3690.pdf

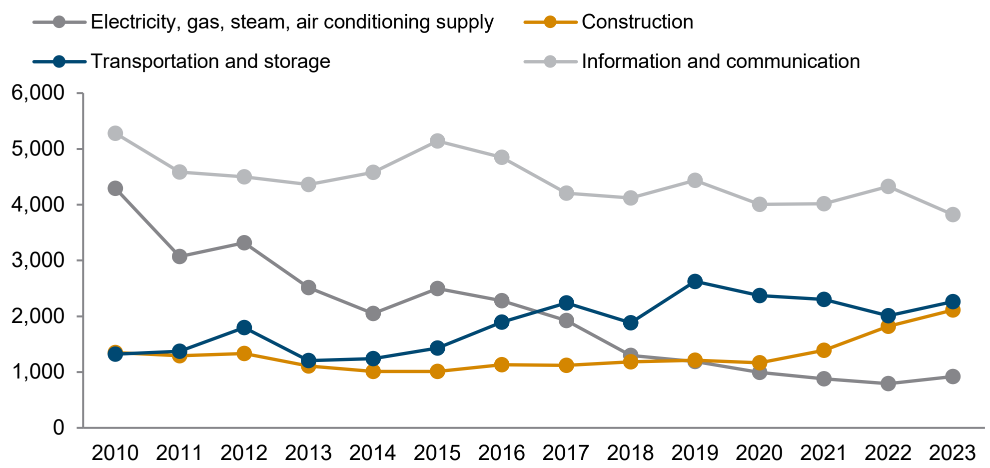
In Figures 5, 6 and 7, FDI is broken down by sector, providing a picture that is more differentiated.

Figure 5 / FDI inward stock by economic sector (high value), 2010-2023, EUR million



Source: wiiw FDI database, Hungarian National Bank.

Figure 6 / FDI inward stock by economic sector (lower value), 2010-2023, EUR million



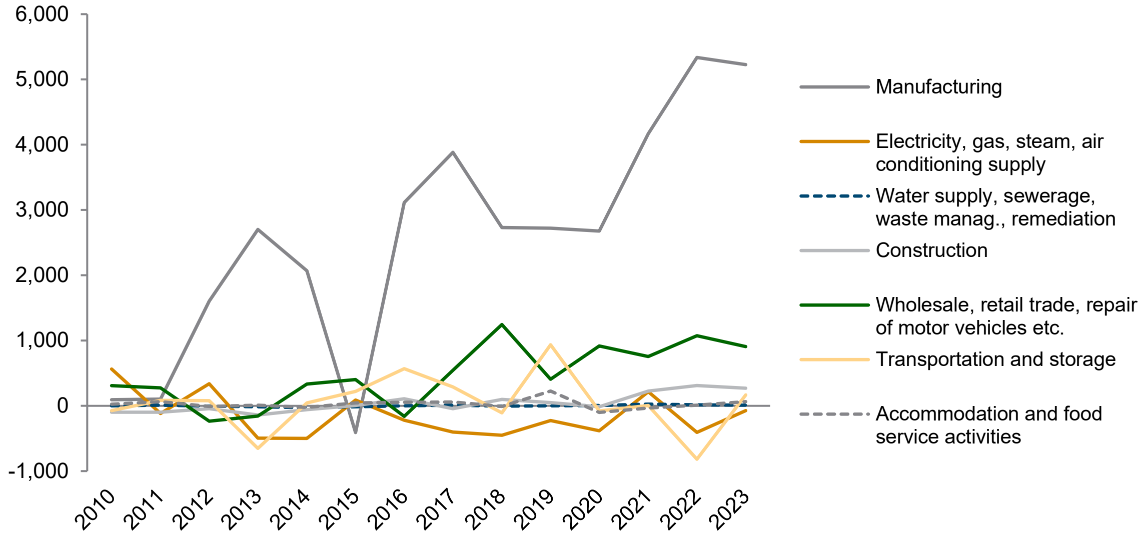
Source: wiiw FDI database, Hungarian National Bank.

In the sectoral FDI data, policy decisions taken the Orbán government become more visible. This is most evident in sectors that have either been nationalised by the government or otherwise weighted in favour of politically approved Hungarian companies.

For example, as a consequence of the government's policy to reduce foreign ownership of the banking sector to below 50%, the FDI inward stock of 'financial and insurance activities' (Figure 5) collapsed between 2015 and 2016 from a peak of EUR 14bn to EUR 6bn. Likewise, the category 'electricity, gas, steam and air conditioning supply' fell from EUR 4.1bn to EUR 2.2bn in the period 2010-2016, when the government completed its nationalisation of the gas sector. By 2023, the FDI inward stock in 'electricity, gas, steam and air conditioning supply' was down to EUR 918m.

This is not the case across the board. Other sectors that have seen domestic capital privileged over foreign have not experienced such trends: while the construction sector saw a decrease in FDI stock between 2010 and 2014, it has since recovered steadily, rising from EUR 1 billion in 2014 to a high of EUR 2.1 billion in 2023 (Figure 6). A possible explanation for this is the tendency of Hungarian construction companies to enter into joint ventures with foreign partners.

Figure 7 / FDI inflows by selected sectors, 2010-2023, EUR million



Source: wiiw FDI database, Hungarian National Bank.

Likewise, the 'wholesale and retail trade' category has remained steady. Measures taken in the sector (such as special taxes and other arbitrary measures) did lead to a drop-off in FDI, with net inflows turning negative in 2016 (Figure 7). However, the impact of those measures appears to have been only temporary: by 2021, the sector had recovered to the levels of 2010, posting inward stock of EUR 9.5bn, which increased further to nearly EUR 11bn in 2023.

Finally, both FDI inward stock and inflows into the manufacturing sector experienced a sharp decline in 2015, before then recovering. This is not attributable to political risk, as the Orbán government relies heavily on foreign participation in this systemic sector and has not acted punitively. Rather, the decline was an aberration linked to delays in the transfer of EU cohesion funds under the 2014-2021 budgetary cycle of the EU. Although cohesion funds are not registered as FDI, they do have a crowding-in effect on investment. Another sharp fall in FDI inflows into manufacturing occurred in 2023. Similarly to 2015, this was due to a decision by the European Commission the previous year to suspend payment of various EU funds to Hungary in light of concerns over the rule of law.

THE FLIPSIDE

The decision by the Orbán government to take key sectors of the economy under the control of the government (or its clients) does show up clearly in several of the categories broken down above. Yet the above data also suggest that foreign investors have overall been indifferent to the 'illiberalisation' of both Hungary's institutions and its economy. Four factors may explain this.

First, the macroeconomic fundamentals of Hungary remain strong. The country benefits from its gateway location and from a labour force that offers the necessary skills at a competitive price. Its structural integration into the EU, including the single market, has contributed to economic development that has followed an upward trajectory. Ironically, it is precisely Hungary's embeddedness in the EU's broader regulatory and economic governance structures that prevents investor flight.

Second, although the Orbán government has acted in a manner hostile to some foreign companies, its economic policies are favourable to FDI overall. Its corporate tax rate of 9% is the lowest in the EU, and the effective average rate falls further to 5% as a consequence of tax allowances provided to various investors.

The government has also acted to radically liberalise the labour market, going beyond the efforts of its regional peers. A new Labour Code was passed in 2012, which contained provisions that included the decentralisation of collective bargaining, a reduction in trade union rights, the limitation of employer liability for damages, and weakened sanctions for unfair dismissal. In December 2018, the government passed an amendment that increased the maximum possible overtime hours from 250 to 400 per year, while extending the overtime payment period for employers from one to three years.

The government has also systematised privileges for individual foreign investors: since 2012, it has offered strategic partnership agreements that provide material benefits (of a classified nature) to large corporates, in exchange for an increase in investment and workforce. Similarly, the government has also permitted discretionary amendments to land and environmental regulations to complement the needs of selected investors.

Third, the erosion of the institutional environment in Hungary, combined with the tendency on the part of the Orbán government to 'tailor' investment agreements with favoured companies, may be attractive to certain foreign investors. Indeed, in recent years Hungary has evolved into a major investment destination for Chinese interests, as it becomes a hub for the production of electric vehicles and batteries. The inward stock of Chinese FDI in Hungary is estimated to be EUR 16bn, or approximately 15% of the total. Meanwhile, in 2023 Hungary received 44% of total Chinese FDI in the continent of Europe.

Fourth, heightened political risk need not necessarily result in reduced FDI flows. Companies may acknowledge that the creeping political risk is a problem, but simply factor it in as an insurable cost. Indeed, there is a difference between political risks that raise operational costs and those that lead to a complete halt in the ability of foreign investors to repatriate profits – such as sanctions or outright expropriation.

CONCLUSIONS

Hungary stands out as a unique case in the political economy of CESEE, distinct from the typical 'new authoritarian' examples, such as Russia. While there has been institutional decline, it has been gradual and largely within tolerable limits, offering a higher degree of institutional predictability for foreign investors than in the 1990s, when governance and market structures were still evolving.

Where mass disinvestment has occurred, it has been confined to individual sectors that have been nationalised or 'indigenised'. Indeed, Hungary demonstrates the critical role of micro political risks in shaping FDI patterns, with investors actively navigating risks (and seizing opportunities), rather than passively enduring them. This underscores the potential for effective risk-management strategies to mitigate institutional risks. Consequently, the likelihood of any mass disinvestment from Hungary akin to Russia's experience of 2022 appears low. Such an outcome would require the structural attractiveness of Hungary to change – such as the country leaving the EU or otherwise having its key membership rights suspended.

Forecasts of main economic indicators for Central, East and Southeast Europe for 2024-2026

Table 1 / Real GDP growth and revisions since October 2024

Region		2024		2025		2026	
EU-CEE							
BG	Bulgaria	2.2		2.4		2.8	
CZ	Czechia	1.0		2.5		2.7	
EE	Estonia	0.2		2.6		3.0	
HR	Croatia	3.3		3.0		3.0	
HU	Hungary	0.7	▼	2.2		3.1	
LT	Lithuania	2.1		2.5		2.8	
LV	Latvia	0.8		2.1		2.4	
PL	Poland	2.9	▼	3.5	▼	3.2	▼
RO	Romania	2.0		2.5		3.0	
SI	Slovenia	1.7		2.2		2.5	
SK	Slovakia	2.0		2.2		2.6	
Western Balkans							
AL	Albania	4.0		3.8		3.9	
BA	Bosnia and Herzegovina	2.5	▼	2.9		3.1	
ME	Montenegro	4.4	▲	3.7		3.5	
MK	North Macedonia	1.8		2.3		2.6	
RS	Serbia	3.8		3.7		3.7	
XK	Kosovo	4.1		3.8		3.9	
New EU accession 2							
MD	Moldova	2.0		3.3		3.7	
UA	Ukraine	2.7		3.0	▼	5.0	▲
Turkey							
TR	Turkey	3.4		4.0		4.5	
CIS3							
BY	Belarus	4.0		2.2		1.3	
KZ	Kazakhstan	4.0		4.7		4.5	
RU	Russia	3.8		2.0	▼	2.2	

Note: Cut-off date: 15 November 2024. Colour scale variation from the minimum (grey) to the maximum (gold). Arrow signifies direction of revisions since October 2024.
Source: wiiw.

Table 2 / CPI growth and revisions since October 2024

Region		2024	2025	2026
EU-CEE				
BG	Bulgaria	2.0	3.0	3.5
CZ	Czechia	2.4	2.2	2.2
EE	Estonia	3.4	3.1 ▲	2.8 ▲
HR	Croatia	3.6	2.9	2.5
HU	Hungary	4.0 ▲	3.9	3.5
LT	Lithuania	0.9	2.0	2.5
LV	Latvia	0.7	2.0	2.5
PL	Poland	3.7 ▼	5.5 ▲	2.8
RO	Romania	5.8	4.5	3.5
SI	Slovenia	2.5	2.3	2.2
SK	Slovakia	2.9	5.1	3.4
Western Balkans				
AL	Albania	2.7	2.5	2.4
BA	Bosnia and Herzegovina	1.9 ▼	1.9	1.8
ME	Montenegro	4.8	3.0	2.5
MK	North Macedonia	3.5	3.0	2.5
RS	Serbia	4.5	3.5	2.8
XK	Kosovo	2.2	2.1	2.0
New EU accession 2				
MD	Moldova	4.5	5.0	5.0
UA	Ukraine	6.0	7.5	6.5
Turkey				
TR	Turkey	59.0	31.0	26.0
CIS3				
BY	Belarus	6.1 ▼	8.0	6.0
KZ	Kazakhstan	9.0 ▲	6.5	6.0
RU	Russia	8.2 ▲	6.4 ▲	4.4 ▲

Note: Cut-off date: 15 November 2024. Colour scale variation from the minimum (gold) to the maximum (grey). Arrow signifies direction of revisions since October 2024.
Source: wiiw.

Table 3 / Unemployment rate in % (LFS) and revisions since October 2024

Region		2024		2025		2026	
EU-CEE							
BG	Bulgaria	4.5		4.3		4.2	
CZ	Czechia	2.8		2.6		2.6	
EE	Estonia	7.5		7.2		6.8	
HR	Croatia	5.7		5.6		5.6	
HU	Hungary	4.6	▲	4.2		4.0	
LT	Lithuania	7.6		7.0		6.5	
LV	Latvia	7.0		6.8		6.5	
PL	Poland	3.0		3.1		3.3	
RO	Romania	5.3		5.2		5.2	
SI	Slovenia	3.7		3.6		3.6	
SK	Slovakia	5.4		5.2		5.2	
Western Balkans							
AL	Albania	10.4		10.0		9.7	
BA	Bosnia and Herzegovina	13.3		13.0		12.8	
ME	Montenegro	11.9		10.0	▼	9.0	▼
MK	North Macedonia	12.5		12.0		11.5	▼
RS	Serbia	8.8		8.4		8.0	
XK	Kosovo	10.8		10.7		10.6	
New EU accession 2							
MD	Moldova	4.0		3.8		3.5	
UA	Ukraine	14.0		10.0		9.0	
Turkey							
TR	Turkey	9.5		9.6		9.0	
CIS3							
BY	Belarus	3.0		3.0		3.1	
KZ	Kazakhstan	4.7		4.6		4.6	▲
RU	Russia	2.6		2.5		2.4	

Note: Cut-off date: 15 November 2024. Colour scale variation from the minimum (gold) to the maximum (grey). Arrow signifies direction of revisions since October 2024.
Source: wiiw.

Table 4 / Current account as % of GDP and revisions since October 2024

Region		2024	2025	2026
EU-CEE				
BG	Bulgaria	-0.8	-0.8	-0.6
CZ	Czechia	0.6	0.9	1.4
EE	Estonia	-1.9	-1.8	-1.8
HR	Croatia	0.0	0.8	1.1
HU	Hungary	2.1	2.3	2.5
LT	Lithuania	3.0	2.8	2.3
LV	Latvia	-3.3	-3.6	-3.2
PL	Poland	0.0 ▼	-1.0 ▼	-0.7 ▼
RO	Romania	-7.5	-6.8	-6.5
SI	Slovenia	2.7	2.6	2.4
SK	Slovakia	-1.4	-1.1	-1.0
Western Balkans				
AL	Albania	-2.9	-3.1	-2.5
BA	Bosnia and Herzegovina	-3.3	-3.1	-3.0
ME	Montenegro	-10.7 ▲	-10.6 ▲	-10.4 ▲
MK	North Macedonia	-1.2	-1.9	-2.2
RS	Serbia	-3.2	-3.5	-4.0
XK	Kosovo	-7.8	-7.8	-7.6
New EU accession 2				
MD	Moldova	-12.8	-12.0	-10.9
UA	Ukraine	-11.0 ▼	-9.0 ▲	-8.0 ▲
Turkey				
TR	Turkey	-1.8	-2.4	-3.4
CIS3				
BY	Belarus	-1.1 ▼	-1.7 ▼	-1.8 ▼
KZ	Kazakhstan	-1.0 ▲	-1.0	-1.0
RU	Russia	3.4	3.5	3.4

Note: Cut-off date: 15 November 2024. Colour scale variation from the minimum (grey) to the maximum (gold).
Arrow signifies direction of revisions since October 2024.
Source: wiiw.

Table 5 / Fiscal balance as % of GDP and revisions since October 2024

Region		2024	2025	2026
EU-CEE				
BG	Bulgaria	-3.0	-3.0	-3.0
CZ	Czechia	-2.5	-2.0	-2.2
EE	Estonia	-3.2	-4.3	-3.4
HR	Croatia	-2.3	-1.2	-1.2
HU	Hungary	-5.0	-4.0	-3.5
LT	Lithuania	-2.0	-2.5	-2.3
LV	Latvia	-2.8	-2.9	-2.5
PL	Poland	-5.9	-5.7	-5.3
RO	Romania	-7.5	-6.0	-5.0
SI	Slovenia	-2.4	-2.0	-1.2
SK	Slovakia	-6.0	-5.0	-4.0
Western Balkans				
AL	Albania	-1.5	-1.5	-1.0
BA	Bosnia and Herzegovina	-0.7 ▼	-0.7	-1.0
ME	Montenegro	0.6 ▲	-4.0 ▼	-4.0 ▼
MK	North Macedonia	-4.5	-3.5	-3.0
RS	Serbia	-1.0	-1.0	-1.0
XK	Kosovo	-0.5	0.0	0.5
New EU accession 2				
MD	Moldova	-5.0	-4.0	-4.0
UA	Ukraine	-19.0	-16.0	-10.0
Turkey				
TR	Turkey	-5.0	-4.0	-3.5
CIS3				
BY	Belarus	0.3	-0.3	-0.5
KZ	Kazakhstan	-2.3	-2.0	-2.0
RU	Russia	-1.5	-1.0	-0.8

Note: Cut-off date: 15 November 2024. Colour scale variation from the minimum (grey) to the maximum (gold). Arrow signifies direction of revisions since October 2024.
Source: wiiw.

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