HUNGARY: Heading into recession

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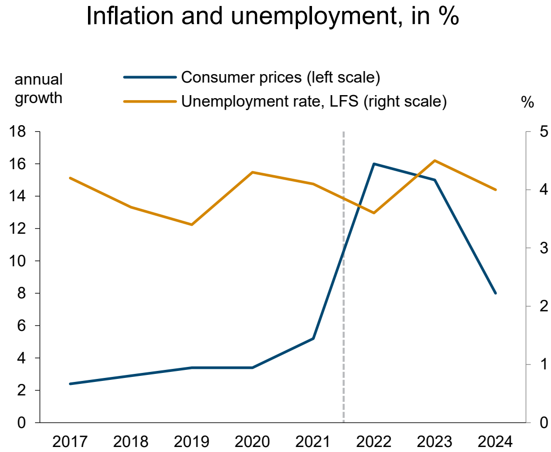
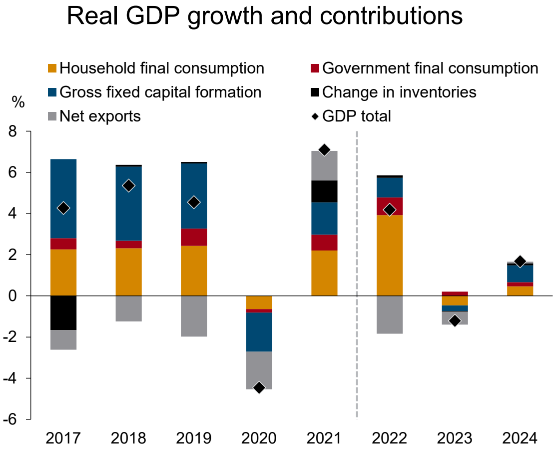
After strong first half-year growth, the Hungarian economy is heading downhill. Inflation is accelerating, consumer demand is shrinking, public investment projects are being cancelled and private investments postponed. The fragile fiscal position renders unfeasible any substantial government intervention to counterbalance shrinking domestic demand. The foreign trade deficit has been growing rapidly. Unfreezing EU transfers could ease the problems; but that money will not reach Hungary any time soon – if at all.

Figure 6.8 / Hungary: Main macroeconomic indicators





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

Inflation was a headache for Hungary well before Russia's February invasion of Ukraine – a consequence of the overheating related to the April 2022 elections. But it has been picking up further over the year: in September, consumer prices were 20.1% higher (year on year). Within the overall inflation there has been a veritable explosion in food prices: bread 76%, dairy products 66%, etc.. The relaxation of several price caps by the government has sent shockwaves that have been buffeting households in September: household energy prices were 62% higher than a year earlier. Inflation is squeezing the purchasing power of household incomes, which had soared thanks to the election cookies distributed prior to April 2022. The central bank was slow to react and stepped in only in the wake of a serious weakening of the HUF/EUR exchange rate: on 27 September, the policy rate was raised to 13.00%. After further rapid fall of the HUF on 14 October the upper bound of the interest rate corridor was substantially raised allowing for a higher effective policy rate than the official policy rate of 13%. The HUF has been volatile and has depreciated by close to 18% since the beginning of the year, reaching historically low levels in mid-October.

The budget is under intense pressure. The good news is that the taxes collected have exceeded original expectations, on account of inflation. Also, a substantial new source of revenue has appeared, thanks to the introduction of a 'windfall profit' tax on firms in selected sectors and scrapping a generous taxation system for small enterprises. The focus, however, is on the expenditure side. The soaring cost of imported energy is the key issue. For years, it has been a flagship policy of the Orbán regime to keep household overheads artificially low, and this has been a major factor in the victory of the Fidesz party at two successive elections. The price caps on household energy and other utilities – introduced long before the current worldwide energy crisis – are now unsustainable. Moreover, some elements of the election-related government spending are now 'built in' (e.g. the 13th month pension), and their withdrawal would be politically embarrassing. Meanwhile pressure is growing for substantial pay rises in some long-neglected areas of the public sector, particularly in education. Interest payments on the public debt are increasingly becoming a burden, as the yields on government securities are rising sharply. The reduction in EU transfers has had an adverse impact on fiscal expenditure, and especially on public investment, where these grants have played a decisive role in enabling modernisation and environmental protection projects to go ahead. Related to this, the government has announced the suspension of many public investment projects. All in all, the fiscal deficit could amount to 6.5% of GDP this year and 4.5% in 2023.

The deterioration in foreign balances – triggered originally by the overheated economy in 2021 and early this year – has gained momentum, due to the soaring cost of imported energy. While the government from time to time mentions just how advantageous its price agreements with Russia on imported energy are, the actual details of the deals are confidential. A further role in the worsening situation is being played by the struggling exports of the transport vehicle sector. All in all, in the first half of the year, the difference between the growth rates of goods imports and exports was no less than 10 percentage points – in favour of imports. In June 2022, the terms of trade worsened by 5.6% compared to the same month in 2021. The current account deficit showed a deterioration of over EUR 4bn in the first half year, compared to the same period last year, and it is expected to climb to over 6% of GDP by the end of 2022. The withholding of EU transfers can also be felt in the evolution of international reserves, which, relative to imports, have fallen to an uncomfortably low level.

The growth prospects are bleak. The era of excessive real wage rises is over (e.g. 9.8% in total 2020-2021, at a time of 2.3% GDP growth). Household consumption, the main driver of growth up until the middle of this year, will be in negative territory in 2023, and is expected to recover only marginally in 2024. Inflation is forecast to remain nearly as high in 2023 as this year, which will further erode the purchasing power of households; and the shock of the extraordinary rise in energy and food prices will make broad swathes of consumers uncertain and cautious in their spending. The earlier expansion of credit with very low (or even negative) real interest rates tempted households to overextend themselves, with the result that now the debt service/household income rates are uncomfortably high. The moratorium on loan repayments for households, introduced in the wake of the COVID crisis, is in the process of being phasing out, and the cap on interest rates will most probably be lifted next year. Both these moves will add to the burden of those households affected. Uncertainty on the labour market is growing, as a large number of enterprises will have to fight to survive in the wake of the huge rise in energy costs, shrinking consumer demand and more expensive credit. This will lead to unemployment rising, even if only temporarily. Investment is expected to fall slightly: several public investment projects have already been suspended and others will follow. Business sector investment will suffer under the weight of the uncertainty surrounding domestic and foreign demand, and the higher cost of borrowing. In foreign trade, the unfavourable trend will continue over the coming year, with important export markets likely slipping into recession or near stagnation and with further on high prices for imported energy. With negative GDP growth rates in Q4 of this year and Q1-3 of 2023 (year on year), the Hungarian economy will be in recession in 2023. 2024 will see a return to moderate economic growth.

Transfers from the EU budget would help enormously in ensuring a half-way soft landing for the economy. The EU's decision on whether to allow its transfers to Hungary could ease the imbalances in the economy or exacerbate them – depending on which way it goes. The Commission has proposed withholding a third of the funds allocated to Hungary under the cohesion policy programmes in the Multiannual Financial Framework 2021-2027, on account of concerns over the rule of law. The sum at stake is about EUR 7.5bn. A further EUR 5.8bn in grants from the Recovery and Resilience Facility is being withheld by the EU. The issues that have attracted EU criticism include checks and balances being undermined, the government's influence over the judiciary, its dominance of a large part of the media, deficiencies in public procurement, and corruption. Altogether, some 7.4% of Hungary's annual GDP is at stake. The government has promised substantial changes to the legal system in an attempt to comply with the Commission's requests. The Council of the European Union will make a final decision by the end of 2022, at the latest. Though it is very far from certain, currently the most likely outcome will be a compromise, under which part of the withheld transfers will be released. But the money is unlikely actually to reach the economy before the middle of next year. Thorough and conscientious monitoring of the Hungarian government's promises to make substantive changes to the disputed rule-of-law issues will most likely lead to repeated disputes and suspensions of the transfers over the whole forecast horizon.

Table 6.8 / Hungary: Selected economic indicators

	2019	2020	2021 1)	2021	2022	2022	2023	2024
				January-June			Forecast	
Population, th pers., average	9,771	9,750	9,710	.	.	9,700	9,650	9,650
Gross domestic product, HUF bn, nom.	47,531	48,276	55,257	25,373	29,981	66,200	73,900	79,700
annual change in % (real)	4.6	-4.5	7.1	7.6	7.3	4.2	-1.2	1.7
GDP/capita (EUR at PPP)	22,800	22,230	24,530	.	.	.	.	.
Consumption of households, HUF bn, nom.	22,553	22,928	25,494	11,990	15,004	.	.	.
annual change in % (real)	5.1	-1.4	4.6	1.7	12.0	8.5	-1.0	1.0
Gross fixed capital form., HUF bn, nom.	12,873	12,857	14,987	6,120	8,051	.	.	.
annual change in % (real)	12.8	-7.0	5.9	4.2	8.8	3.5	-1.0	3.0
Gross industrial production								
annual change in % (real)	5.6	-6.0	9.6	18.3	5.2	4.0	1.5	5.0
Gross agricultural production								
annual change in % (real)	-0.1	-2.4	-2.1	.	.	.	.	.
Construction industry								
annual change in % (real)	20.7	-9.8	11.9	6.8	7.3	.	.	.
Employed persons, LFS, th, average 2)	4,512	4,461	4,642	4,599	4,697	4,700	4,700	4,720
annual change in %	1.0	-1.1	0.7	0.3	2.1	1.3	0.0	0.5
Unemployed persons, LFS, th, average 2)	160	198	196	206	169	180	220	200
Unemployment rate, LFS, in %, average 2)	3.4	4.3	4.1	4.3	3.5	3.6	4.5	4.0
Reg. unemployment rate, in %, eop 3)	5.1	6.2	5.1	5.7	4.8	.	.	.
Average monthly gross wages, HUF 4)	367,833	403,616	438,814	428,191	505,249	516,700	585,300	638,400
annual change in % (real, gross)	7.7	6.2	3.4	3.9	7.8	1.5	-1.5	1.0
Average monthly net wages, HUF 4)	244,609	268,405	291,812	284,747	335,990	343,600	389,200	424,500
annual change in % (real, net)	7.7	6.2	3.4	3.9	7.8	1.5	-1.5	1.0
Consumer prices (HICP), % p.a.	3.4	3.4	5.2	4.3	9.7	16.0	15.0	8.0
Producer prices in industry, % p.a.	2.1	4.3	13.6	9.4	27.8	30.0	20.0	8.0
General governm. budget, EU def., % of GDP								
Revenues	43.9	43.4	41.1	.	.	45.0	44.5	44.0
Expenditures	46.0	51.2	47.9	.	.	51.5	49.0	48.0
Net lending (+) / net borrowing (-)	-2.1	-7.8	-6.8	.	.	-6.5	-4.5	-4.0
General gov. gross debt, EU def., % of GDP	65.5	79.6	76.8	.	.	78.0	77.0	76.0
Stock of loans of non-fin. private sector, % p.a.	13.2	13.4	12.8	10.2	13.4	.	.	.
Non-performing loans (NPL), in %, eop 5)	4.1	3.6	3.2	3.4	3.5	.	.	.
Central bank policy rate, % p.a., eop 6)	0.90	0.60	2.40	0.90	7.75	14.00	12.50	7.00
Current account, EUR m 7)	-1,148	-1,561	-6,426	-757	-5,097	-10,700	-10,000	-8,100
Current account, % of GDP 7)	-0.8	-1.1	-4.2	-1.1	-6.4	-6.3	-5.7	-4.6
Exports of goods, BOP, EUR m 7)	92,525	88,655	103,232	51,429	60,385	120,800	131,100	140,300
annual change in %	4.5	-4.2	16.4	24.4	17.4	17.0	8.5	7.0
Imports of goods, BOP, EUR m 7)	96,212	89,990	107,794	51,060	65,871	134,700	148,200	157,800
annual change in %	5.9	-6.5	19.8	20.1	29.0	25.0	10.0	6.5
Exports of services, BOP, EUR m 7)	26,918	19,889	22,120	9,739	12,592	27,000	32,400	36,300
annual change in %	6.0	-26.1	11.2	1.0	29.3	22.0	20.0	12.0
Imports of services, BOP, EUR m 7)	19,828	15,885	17,090	7,639	9,472	19,700	22,300	24,300
annual change in %	14.5	-19.9	7.6	-3.1	24.0	15.0	13.0	9.0
FDI liabilities, EUR m 7)	3,058	3,169	7,065	2,957	1,795	3,000	.	.
FDI assets, EUR m 7)	1,930	809	4,233	3,200	2,769	3,000	.	.
Gross reserves of CB excl. gold, EUR m	27,010	32,115	33,501	26,314	32,195	.	.	.
Gross external debt, EUR m 7)	107,005	111,557	130,097	122,435	137,832	140,000	143,000	144,000
Gross external debt, % of GDP 7)	73.2	81.2	84.4	79.4	81.2	82.5	81.3	81.3
Average exchange rate HUF/EUR	325.30	351.25	358.52	357.85	374.71	390	420	450

1) Preliminary - 2) From 2021 the new LFS methodology is applied in line with the Integrated European Social Statistics Regulation (IESS). - 3) Unemployed in % of LFS labour force. - 4) Enterprises with 5 and more employees. Based on tax administration data. - 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.