HUNGARY: In the grip of high inflation

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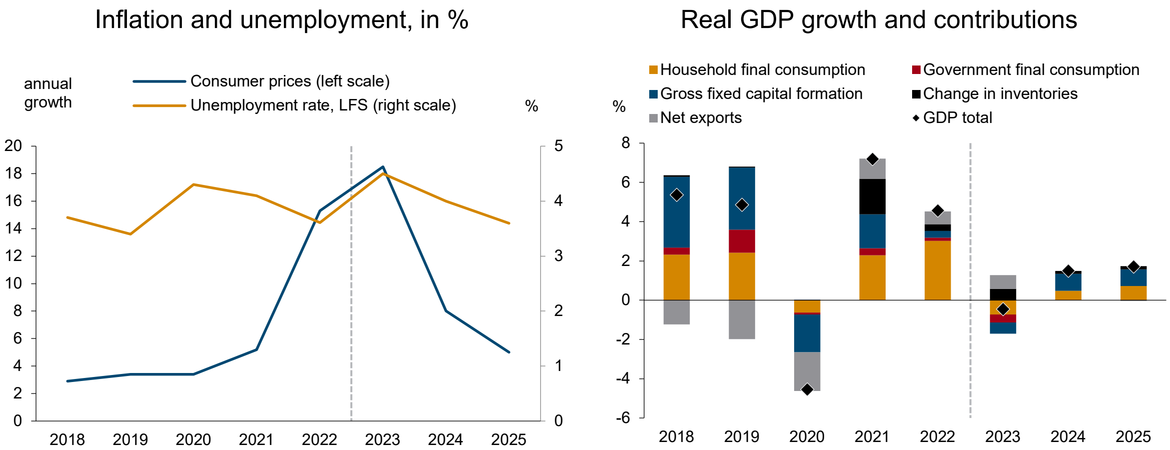
In early 2023, Hungarian inflation was the highest in the EU. Measures to rein in inflation have been unavoidable, but do little to encourage growth. Both consumption and investment will fall this year, and the only positive contribution to GDP change will come from foreign trade, where deficits are expected to shrink substantially. This year will be split between recession in the first half and moderate recovery in the second. EU transfers continue in limbo. A new industrial policy aimed at facilitating the FDI-based mass production of batteries for electric cars has the potential to turn into a costly fiasco.

Figure 5.8 / Hungary: Main macroeconomic indicators



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

Year-on-year inflation reached 25.2% in March, far higher than the EU average. Core inflation stood at 25.7%. Food prices were 42.6% higher – and the rise in the cost of certain staples even outstripped that: bread (67%), eggs (74%) and dairy products (72.8%). Household energy prices increased by 43.1%. However, inflation in March was a few decimal points lower than in January and February, suggesting that the peak may have been passed. The reasons for the high inflation do coincide in part with the situation in other countries: the rocketing cost of imported energy and the impact of the war in Ukraine. However, there are several other, more country-specific reasons as well: food inflation was exacerbated by a devastatingly bad harvest in 2022, when agricultural value added fell by 31%; during – and even before – the Covid pandemic, right up until early 2022, the government pursued a loose monetary and fiscal policy designed to maintain a ‘high-pressure economy’; and the extraordinary public spending related to the 2022 elections served to top everything off. Related to this economic policy and the tight labour market, net real wages increased by 12.7% in the three Covid years (2020-2022), while in the same period real GDP growth amounted to just 7%. A spur to more recent price rises has also come from the business sector, where profits last year grew far more strongly than wages and other cost elements. The exchange rate made its own contribution to the high inflation: from a monthly average of HUF 358 to the euro in January 2022, it deteriorated gradually to arrive at a record-weak HUF 431 to the euro by the middle of October – a depreciation of over 20%.

The dangerous weakening of the forint brought about a turning point in monetary policy. On 14 October, the central bank took an extraordinary step: while the policy rate remained at 13%, the benchmark indicator – the interest rate offered at daily overnight deposit tenders – was raised to 18%. This helped halt the depreciation of the forint, even if the exchange rate has remained fairly volatile. The government has promised to cut inflation to single digits by the end of this year. Meanwhile, the central bank is reckoning on average consumer price inflation of 15-19.5% this year – an unusually broad range – keeping inflation expectations close to the higher end of the band. The social impact of extremely high food inflation is devastating, and the lower-income strata of the population (which have a higher-than-average share of food in their consumption basket) have been hit hard. Surprisingly, the popularity of the government has remained unchanged, partly thanks to its more or less successful channelling of popular anger against Ukraine ('we have war inflation') and the EU ('we have EU sanctions inflation') via the government owned or dominated media.

The government is planning substantial fiscal consolidation this year – of over 2 percentage points of GDP – to reduce the 6.1% of GDP deficit reported for last year. This will be tough: 2023 started with a very high fiscal deficit in the first three months. The costs of servicing the public debt are on the rise (from 2.3% relative to GDP in 2021 to an estimated 3.7% this year and 4.6% in 2024). The large FDI projects envisaged will require huge government subsidies. In line with its new strategic motivations, the government intends to turn Hungary into a 'great power' in the field of the production of batteries for electric cars. As well as those factories that are already operational or are under construction, other huge projects are in the pipeline. The largest, initiated by the Chinese CATL Co., is worth EUR 7.3bn. But battery production requires ample water resources, abundant energy and plenty of labour. All three are scarce in Hungary, and there is no comparative advantage that could be mentioned in support of this peculiar industrial policy. The environmental issues related to battery production that have already been reported (as well as further potential problems) have triggered popular protests even in cities and regions where the government's political support is strong. Of medium-term concern is the energy supply for this new industrial segment: Prime Minister Orbán has referred to the possible new construction of three large natural gas-based power stations – a trend-bucking notion at a time when other European states are making huge efforts to wean themselves off natural gas (and especially Russian deliveries of it).

The relationship between the European Commission and the Hungarian government has been steadily deteriorating, with anti-EU propaganda becoming ever shriller in the mainstream Hungarian media. Contested rule-of-law issues are being addressed half-heartedly by the government, and the mainly cosmetic changes do not satisfy the Commission (which seems to have learned from the earlier fiascos when it challenged the illiberal system of Prime Minister Orbán). However, any real adjustment in the critical areas of the judiciary, the treatment of NGOs, university endowments, gender issues and – most prominently – investigation of the numerous cases of suspected corruption would critically weaken the regime. The prospects of a green light being given to release the suspended EU transfers in the first half of the year are, therefore, dim; nor are they particularly promising in the second half of the year. However, transfers from the previous (2014-2020) Multiannual Financial Framework are still reaching Hungary, as are the EU's direct payments for farmers. Nevertheless, the continued suspension of a considerable part of the EU transfers places the government's fiscal targets in jeopardy, depresses aggregate demand and gets in the way of a more comfortable level of international currency reserves being attained. Ratings agencies are following developments closely, and downgrading may be triggered if there is no easing of the difficulties in this field.

With shrinking consumption and investment, the only support for economic growth in 2023 will come from net exports. The (most probably) lower prices for imported energy and the reduced demand for imported goods will, it is assumed, radically improve external balances. Fiscal restrictions and high interest rates are not growth friendly. All in all, a moderate (0.5%) decline in GDP is expected this year, with a recession in the first half year and a moderate recovery in the second. Inflation is expected to subside only slowly in the first six months, and then to drop in larger steps from the middle of the year. However, annual average inflation is still expected to amount to 18.5% – substantially higher than last year. While disinflation in the second half of the year would provide some grounds for a reduction in the 18% benchmark interest rate, the requirement to keep the HUF exchange rate stable will necessitate caution in this field. A green light to the lifting of the suspension of EU transfers (or indeed the absence of a green light) may influence growth prospects this year – in either direction – by up to 1 percentage point. Concerning the prospects for 2024 and 2025, there is huge uncertainty. The most likely scenario reckons with a moderate recovery, with slower disinflation than the targets set by the government and the central bank. A return to a fiscal deficit in the neighbourhood of 3% of GDP remains a major priority, putting a brake on growth.

Table 5.8 / Hungary: Selected economic indicators

	2019	2020	2021	2022 1)	2023	2024 Forecast	2025
Population, th pers., average	9,771	9,750	9,710	9,684	9,600	9,600	9,590
Gross domestic product, HUF bn, nom.	47,674	48,425	55,255	66,616	72,300	77,800	82,300
annual change in % (real)	4.9	-4.5	7.2	4.6	-0.5	1.5	1.7
GDP/capita (EUR at PPP)	22,860	22,380	24,380	27,380	.	.	.
Consumption of households, HUF bn, nom.	22,547	22,947	25,538	31,941	.	.	.
annual change in % (real)	5.1	-1.3	4.8	6.5	-1.5	1.0	1.5
Gross fixed capital form., HUF bn, nom.	12,873	12,841	15,139	18,909	.	.	.
annual change in % (real)	12.8	-7.1	6.5	1.2	-2.0	3.0	3.0
Gross industrial production							
annual change in % (real)	5.6	-6.0	9.6	5.7	1.5	5.0	5.0
Gross agricultural production							
annual change in % (real)	-0.1	-2.4	-0.7	-18.7	.	.	.
Construction industry							
annual change in % (real)	20.7	-9.8	11.9	3.3	.	.	.
Employed persons, LFS, th, average 2)	4,512	4,461	4,642	4,709	4,710	4,720	4,730
annual change in %	1.0	-1.1	0.7	1.4	0.0	0.3	0.2
Unemployed persons, LFS, th, average 2)	160	198	196	176	220	200	180
Unemployment rate, LFS, in %, average 2)	3.4	4.3	4.1	3.6	4.5	4.0	3.6
Reg. unemployment rate, in %, eop 3)	5.1	6.2	5.1	4.8	.	.	.
Average monthly gross wages, HUF 4)	367,833	403,616	438,814	515,766	602,000	656,700	703,300
annual change in % (real, gross)	7.7	6.2	3.4	2.5	-1.5	1.0	2.0
Average monthly net wages, HUF 4)	244,609	268,405	291,812	342,984	400,300	436,600	467,600
annual change in % (real, net)	7.7	6.2	3.4	2.6	-1.5	1.0	2.0
Consumer prices (HICP), % p.a.	3.4	3.4	5.2	15.3	18.5	8.0	5.0
Producer prices in industry, % p.a.	2.1	4.3	13.6	33.6	20.0	8.0	5.0
General governm. budget, EU def., % of GDP							
Revenues	44.0	43.5	41.2	43.9	44.5	44.0	44.0
Expenditures	46.0	51.1	48.3	50.0	49.0	48.0	47.3
Net lending (+) / net borrowing (-)	-2.0	-7.5	-7.1	-6.1	-4.5	-4.0	-3.3
General gov. gross debt, EU def., % of GDP	65.3	79.3	76.6	76.4	74.0	72.5	70.0
Stock of loans of non-fin. private sector, % p.a.	13.2	13.4	12.8	11.6	.	.	.
Non-performing loans (NPL), in %, eop 5)	4.1	3.6	3.2	3.2	.	.	.
Central bank policy rate, % p.a., eop 6)	0.90	0.60	2.40	13.00	12.50	8.00	4.00
Current account, EUR m 7)	-1,148	-1,570	-6,252	-13,725	-7,300	-5,200	-3,900
Current account, % of GDP 7)	-0.8	-1.1	-4.1	-8.1	-4.0	-2.8	-2.0
Exports of goods, BOP, EUR m 7)	92,525	88,655	100,885	124,340	132,500	141,800	150,300
annual change in %	4.5	-4.2	13.8	23.2	6.6	7.0	6.0
Imports of goods, BOP, EUR m 7)	96,212	89,990	105,311	139,246	146,900	156,400	165,000
annual change in %	5.9	-6.5	17.0	32.2	5.5	6.5	5.5
Exports of services, BOP, EUR m 7)	26,918	19,889	22,777	29,277	33,700	37,700	41,500
annual change in %	6.0	-26.1	14.5	28.5	15.0	12.0	10.0
Imports of services, BOP, EUR m 7)	19,828	15,885	17,863	21,221	23,600	25,700	28,300
annual change in %	14.5	-19.9	12.5	18.8	11.0	9.0	10.0
FDI liabilities, EUR m 7)	2,863	3,153	7,304	10,861	.	.	.
FDI assets, EUR m 7)	1,908	803	4,345	6,985	.	.	.
Gross reserves of CB excl. gold, EUR m	27,010	32,115	33,501	33,533	.	.	.
Gross external debt, EUR m 7)	107,104	111,754	130,525	149,755	143,000	144,000	145,000
Gross external debt, % of GDP 7)	73.1	81.1	84.7	88.0	79.1	76.8	75.8
Average exchange rate HUF/EUR	325.30	351.25	358.52	391.29	400	415	430

1) Preliminary and wiiw estimates - 2) From 2021 the new LFS methodology is applied in line with the Integrated European Social Statistics Regulation (IESS). - 3) In % of labour force (LFS). - 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.