HUNGARY

TARIFF HEADWINDS ARE MANAGEABLE

The unexpected decline in Hungarian GDP in Q1 2025 will probably be followed by modest growth over the next few quarters, with consumption as the main pillar. However, Hungary will not escape the negative consequences of the US tariff shock, as it is a very open economy. More intense competition from China is expected, particularly on medium and high-tech products. Nonetheless, China remains a major investor in Hungary, mainly in the automotive sector.

RESILIENCE OF THE ECONOMY DESPITE HEADWINDS

The Hungarian economy experienced a technical recession in Q2 and Q3 2024 but recorded a moderate GDP growth of 0.5% over the year as a whole. In Q1 2025, growth unexpectedly fell by 0.2% q/q (0.0% y/y).

Our growth forecast for this year has been revised downwards compared with last January (-0.9 point in 2025), mainly because of the tariff shock, which should result in a fall in exports and a postponement of investment projects in the short term. Despite this, growth is expected to improve modestly in 2025 compared with 2024. The resilience of the economy is expected to be underpinned primarily by household consumption, thanks to strong wages alongside with the gradual decline in inflation. Fiscal measures are likely to be generous in the run-up to the general election scheduled for 2026 and will provide support for consumption. For example, the Budget for 2025 provides for the continuation of the 13th month for pensioners, higher salaries for teachers and healthcare staff, an income tax exemption for mothers and generous family allowances. The budget for 2026 aims to support families even though the government's ability to significantly increase spending is limited. The country is already subject to an excessive deficit procedure and must therefore adjust its public accounts (Hungary has a four-year timeline) as part of its commitments towards the EU.

Hungarian economic growth is set to accelerate from 2026, but is likely to remain below its long-term trend (2010-2019: 2.9%) and its medium-term potential (estimated at 2.8% by the IMF). As far as exports are concerned, Hungary should benefit from a brighter outlook for demand from Germany over this period. The effects of the German recovery plan for defence and infrastructure (EUR 1,000 billion over 12 years) should be positive for Central European countries and should contribute to moving up the value chain. Certain sectors, such as armaments, machinery and electrical equipment, will undoubtedly see their activity grow over the next few years (they represented 29% of the added value of the Hungarian manufacturing sector in 2022), as will the construction sector. However, the implementation of the recovery plan will take time, and its effects will probably only be visible from 2027 onwards. The outlook for public investment remains conditional on the lifting of the suspension of European funds. At present, the blocked funds represent around EUR 19 bn (9% of GDP).

FORECASTS

	2022	2023	2024	2025e	2026e
Real GDP growth, %	4.3	-0.7	0.5	0.9	2.2
Inflation, CPI, year average, %	14.5	17.6	3.7	4.3	3.2
General gov. balance / GDP (%)	-6.2	-6.7	-4.9	-4.5	-4.5
General gov. debt / GDP (%)	73.9	73.0	73.5	74.3	75.0
Current account balance / GDP, %	-8.5	0.3	2.2	1.4	1.2
External debt / GDP, %	92.0	85.8	84.8	82.5	77.6
Forex reserves, EUR bn	38.7	41.4	44.6	47.5	49.8
Forex reserves, in months of imports	3.0	3.4	3.9	4.1	4.2

TABLE 1

e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

HUNGARY: INFLATION

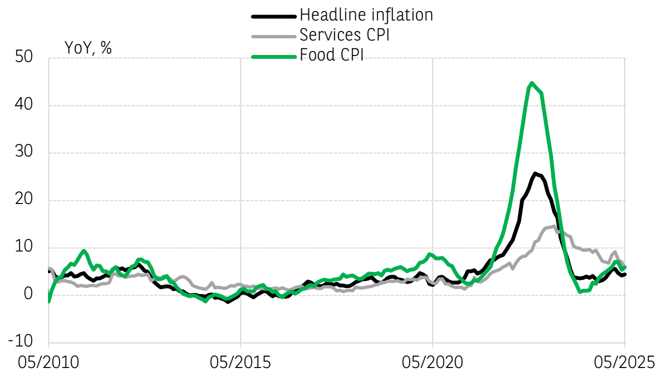

CHART 1

SOURCE: CENTRAL STATISTICAL OFFICE, BNP PARIBAS

GRADUAL EASING OF INFLATION

Inflation remains contained (4.4% y/y in May), following a temporary rise between October 2024 and February 2025 (5.6% y/y). The relief is due, in particular, to the temporary introduction of a cap on margins for companies in the agri-food sector between March and May 2025. In 2025, average inflation should be slightly higher than in 2024 due to high figures at the start of the year. A return to the 3% inflation target is expected in 2027.

Expectations of a fall in inflation, albeit gradual, may pave the way for monetary easing later this year. The Central Bank is likely to remain cautious in the short term. The risk of volatility in the Hungarian forint, in particular, is likely to weigh on the monetary authorities' decision, even though the Hungarian currency has appreciated against the dollar and its depreciation against the euro has been contained since the announcements on US tariffs. The key rate could therefore be cut to 5.75% at the end of 2025 and 4.50% at the end of 2026.

TRUMP 2.0: IMPACT ON TRADE FLOWS

The economies of Central Europe have not escaped the rise in US tariffs, even though their trade deficit with the United States is marginal.

In Hungary, the average effective rate of US customs duties rose from 1.4% at the end of March 2025 to 18.8% today. Exports of vehicles and spare parts to the United States are subject to a 25% tariff; the tariff on steel and aluminium rose to 50% on 4 June. The rest of the goods exported are subject to a rate of 10%. The effective rate could rise further to 25.8% if the reciprocal rate is increased to 20%. The pharmaceutical and electronics sectors may also be targeted by Donald Trump's administration. They account for 16% of Hungarian exports to the United States.

In Central Europe, Hungary is one of the countries most exposed to a trade shock, as it is a very open economy. Between 2022 and 2024, combined exports and imports of goods represented an average of 154.8% of GDP (77.1% for exports alone). Admittedly, the share of exports going to the United States is low (4.1% of total exports and 2.9% of GDP in 2024), but given the importance of its trade link with Germany (25.1% of exports in 2024 and 17.5% of GDP), Hungary will be affected indirectly and more markedly than other countries in the region.

The cumulative loss of activity linked to the negative effects on exports could represent between -1.4% and -2.3% of GDP. According to our calculations, which include tariff rates differentiated by sector, the direct impact would be -0.9% of total exports and -0.5% of GDP (with an elasticity of 1). On the other hand, assuming a 5-10% drop[1] in exports to Germany, Hungary would suffer a loss of around -0.9% and-1.8% of GDP respectively.

CHINA: BOTH COMPETITOR AND PARTNER

Against a backdrop of slowing global demand, and with all our trading partners affected by US customs measures, the ability to find new outlets for export products will be limited.

It cannot be ruled out that products from Asia, particularly China, will compete with locally manufactured goods intended for export, particularly in the medium and high-tech segments. Hungary specialises in the production of machinery and transport equipment, which accounted for an average of 55.5% of the country's total exports in 2024. Hungary's gains in market share in Germany in this segment since the 2000s (2000: 3.8% of German imports from Hungary, 2024: 4.9%) could be eroded somewhat in favour of China, which also has a revealed comparative advantage in these goods according to the UNCTAD indicator.

Meanwhile, China has also become one of Hungary's key partners in terms of foreign direct investment (FDI). Hungary has received the largest share of Chinese FDI in Central Europe, mainly in the automotive sector (USD 6.1 billion of Chinese FDI in stock in Q12025, 32.6% of Chinese investment). This is part of its strategy to become a key player in the production of electric batteries and electric vehicles. Hungary's strategy is to encourage foreign direct investment in the medium term.

HUNGARY'S EXPORTS TO THE UNITED STATES

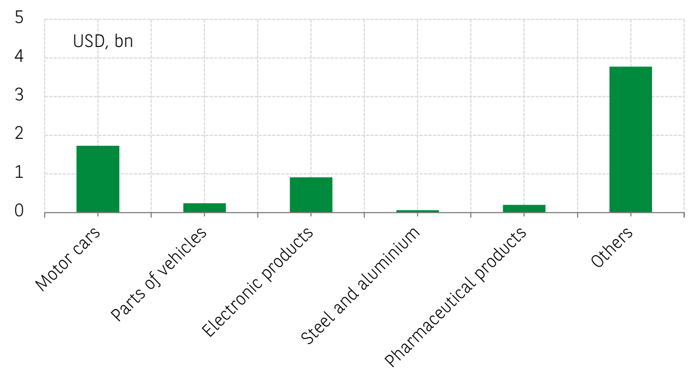

CHART 2 SOURCE: UNCTAD, BNP PARIBAS

Hungary remains an attractive destination for FDI and should continue to benefit from nearshoring in the short and medium term. FDI inflows rebounded strongly in 2021 and 2022 (5.6% and 8.4% of GDP respectively). These flows edged down in 2023 and 2024 (2.2% of GDP in 2023 and 2% in 2024) but remain well-oriented in the region.

SUPPORT FACTORS

In the short term, the negative impact of tariff measures should prevail. The scope for monetary and fiscal policy to offset these effects is relatively limited.

As part of the EU's defence plan, Hungary should benefit from a degree of budget flexibility in the medium term, should the need arise. The country, like other Member States, has activated the escape clause for defence, which allows defence spending to be excluded from the budget rules by up to 1.5% of GDP per year for 4 years. Moreover, a line entitled "defence reserve" has been included in the budget for 2026. For the time being, the Hungarian authorities plan to maintain defence spending at 2% of GDP in 2026, after 2.1% in 2024.

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1 We expect Hungarian exports to Germany to fall by around 5-10% in 2025. By way of comparison, exports fell by an average of 1.3% in 2019/2020, 11.3% in 2015 and 26.8% in 2009. Last year, exports to Germany fell by 7.3%.