HUNGARY

FISCAL CONSOLIDATION WILL CONSTRAIN GROWTH

Economic growth prospects are improving for 2024, but the recovery is likely to be limited by still sluggish domestic demand. On the foreign exchange market, the Hungarian forint has come under downward pressure recently. On public accounts, the fiscal consolidation that began in the summer of 2022 has not significantly reduced the deficit. For 2024, the deficit will probably be less pronounced than last year, but will remain high in any case (around 5% of GDP). As a result, Hungary will probably be subject to an excessive deficit procedure in 2024. On the international political scene, the focus will be on the Hungarian Presidency of the Council of the European Union, which will begin on 1st July 2024 (for a period of six months) against a backdrop of strong diplomatic tensions with the European institutions.

A MODERATE RECOVERY IN 2024

In the first quarter, Hungary returned to positive economic growth (0.8% q/q, 1.7% y/y), following a recession in 2023. The recovery is nevertheless unbalanced, driven mainly by the adjustment of inventories and net exports. Consumption is struggling to recover, with retail sales showing little growth and import volumes of consumer goods still declining. At the same time, investment has remained sluggish. The outlook for the coming quarters is slightly better, with moderate growth for both 2024 and 2025.

This year, private consumption should improve under the combined effect of falling inflation and persistent wage pressures (averaging around 14% y/y over the first four months of the year). This comes on top of renewed optimism amongst households as a result of supportive measures in their favour (mortgage rate cap extended till the end of 2024, pension and public sector salary increases, subsidies for energy renovations and first-time home buyers).

However, households are likely to adopt a cautious stance in the short term. Although the unemployment rate has fallen slightly, the labour market has recently shown some signs of slowdown. The number of job vacancies has fallen, particularly in the manufacturing sector. Similarly, the ratio of jobseekers to vacancies is deteriorating. It has risen slightly (3.34 in Q1 2024, 3.03 in Q4 2023 and 2.9% in Q3 2023). Employment is also growing more slowly in the services sector.

As far as investment is concerned, prospects for an improvement in its public component remain limited, given the postponement of government projects. European funds, which usually come as a support, will play a relatively small role in the short term, as Hungary has so far received only a tiny fraction of the amount in its favour under the recovery and resilience plan (EUR 0.14 billion out of EUR 6.5 billion, or 2.2% of the total). Finally, the much hoped-for revival in private investment is constrained by external demand, insofar as the eurozone will not see a more marked acceleration in its imports until 2025.

FORECASTS

	2021	2022	2023e	2024e	2025e
Real GDP growth, %	7.0	4.6	-0.7	3.3	3.2
Inflation, CPI, year average, %	5.1	14.5	17.6	3.8	3.6
General gov. balance / GDP (%)	-7.2	-6.2	-6.7	-5.0	-4.5
General gov. debt / GDP (%)	74.5	71.7	69.5	70.0	70.1
Current account balance / GDP, %	-4.1	-8.4	0.3	0.8	0.5
External debt / GDP, %	87.0	92.0	85.8	86.6	85.1
Forex reserves, EUR bn	38.4	38.7	41.4	48.5	49.8
Forex reserves, in months of imports	3.8	3.0	3.4	4.0	3.9

TABLE 1 e: ESTIMATES & FORECASTS SOURCE: BNP PARIBAS ECONOMIC RESEARCH

HUNGARY: INFLATION AND REAL WAGE GROWTH

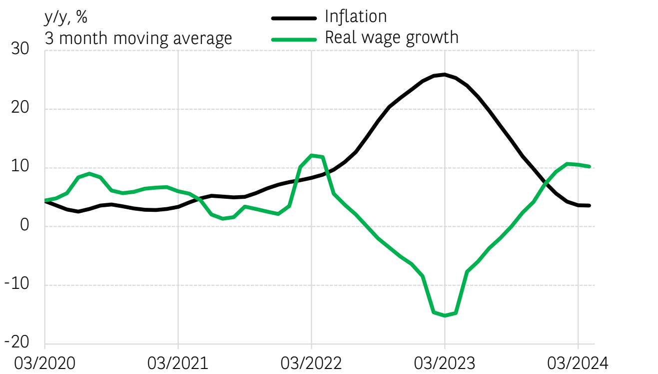

CHART 1 SOURCE: EUROSTAT, CENTRAL STATISTICAL OFFICE, BNP PARIBAS

DEPRECIATION OF THE HUNGARIAN FORINT

The Hungarian forint has come under depreciation pressure in recent months. It has lost 3.6% and 5.8% of its value against the euro and the dollar respectively since the start of the year, thus positioning it as one of the worst-performing currencies not only in Central Europe but also in the emerging countries. In the region, the Czech koruna fell by 1% against the euro and the Polish zloty appreciated by 1% over the same period.

The forint was trading at 396 units against the euro at the end of June, above its average value of 340 over the last 10 years. The forint's weak performance compared with neighbouring countries can be explained primarily by the divergence in monetary policy strategy. The Hungarian monetary authorities have opted for an aggressive monetary easing with a cumulative 600 basis point cut in the key rate since October 2023, while the other central banks in the region have either maintained a monetary *status quo* over the same period or reduced their key rates more modestly.

Concerns about public debt are also exerting downward pressure on the Hungarian currency. Uncertainty still looms over European funds, an important resource for financing the needs of the economy. The European Commission's decision on the release of funds at the end of 2023 has been questioned by the European Parliament and is still pending.

In the short term, the depreciation trend remains in place, with a probable breach of the 400 forint/euro mark by the end of December. However, a number of factors should help to mitigate the downward pressure. External accounts have improved significantly since 2023, with the current account back in surplus last year alongside with significant capital inflows. The current account continued to show a surplus, standing at of EUR 1.8 billion, or 4.4% of GDP in Q1 2024 (up from 0.3% of GDP in 2023), and it is likely to remain in surplus for the rest of the year. Similarly, net foreign direct investment flows averaged 1.8% of GDP between 2019-2023, despite the many shocks to the economy. The country could attract more FDI flows in the future as a result of the reorganisation of activities related to eurozone companies in the region, as well as the country's ambitions to become a global leader in battery production.

Portfolio flows will likely be supported by the positive short-term interest rate differential. The spread between Hungarian and German five-year government bond yields remains high at 430 basis points at the end of June. Finally, the Central Bank's recent recalibration towards a more cautious monetary policy through a smaller cut in the key rate would also support the Hungarian forint.

BUDGET EFFORTS TO CONTINUE

The consolidation efforts that begun in the summer of 2022, combined with a high nominal GDP, reduced the budget deficit by one point compared with the previous year, to 6.2% of GDP in 2022. However, this ratio worsened last year (to 6.7% of GDP) as a result of an increase in pensions, the extension of some of the government support measures introduced in 2022 and the rise in debt interest payments. The latter weighed heavily on the budget, mainly due to the increase in the debt servicing linked to inflation-indexed bonds. It should be noted that inflation reached 17.6% on average in 2023 (14.5% in 2022 and 5.1% in 2021). In 2023, interest payments as a percentage of government revenue almost doubled to 11.1% compared with 6.6% in 2022.

Despite the consolidation measures, the budget deficit will inevitably exceed the threshold of 3% of GDP set under EU's Stability and Growth Pact in 2024 and 2025. The authorities are expecting the budget deficit as a percentage of GDP to be less pronounced than last year but have revised it upwards to 4.5% of GDP in 2024, compared with the 2.9% initially forecast in the 2024 budget. The cumulative deficit for the first four months of the year has already reached 3.2% of GDP. The interest burden will continue to weigh on spending in the short term, even if the temporary halt to inflation-indexed bond issuance and the slight fall in bond yields should provide some respite. The government debt-to-GDP ratio could cross the 70% threshold as early as this year, and then rise until at least 2026.

HUNGARY: EXCHANGE RATE

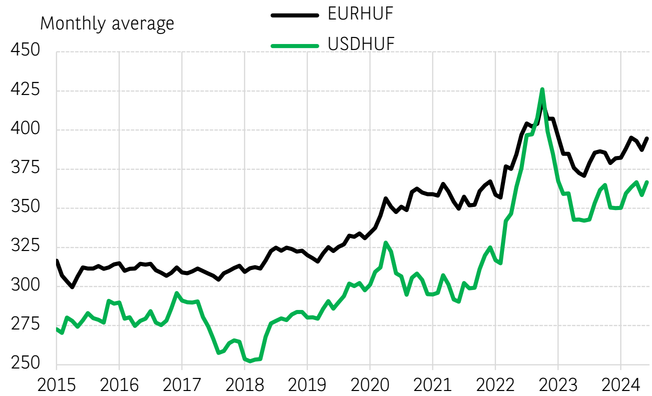

CHART 2 SOURCE: SOURCE: CENTRAL BANK OF HUNGARY, BNP PARIBAS

As a result of this situation, in its latest report in June, the Commission announced its intention to open an excessive deficit procedure as early as July. This situation may be a cause for concern. However, public debt remains sustainable in the short and medium term. The authorities are committed to tightening fiscal discipline, which suggests that new measures could be announced shortly. In the short term, the adjustment process is likely to be gradual, given the many challenges facing the country (the need to step up military spending in the face of geopolitical tensions, the presence of support measures, the gradual withdrawal of taxes on windfall profits in the short term). The parliamentary elections scheduled for 2026, which are generally accompanied by generous pre-election measures, will limit the country's ability to contain the budget deficit in the short term. Against this backdrop, a return to a primary surplus is unlikely before 2027.

As part of the reforms of the Stability and Growth Pact, an adjustment process over the next four years is planned in the event of an excessive deficit, in order to bring the budget deficit below 3% of GDP. Otherwise, the country would risk a suspension of European funds.

Cynthia Kalasopatan Antoine
cynthia.kalasopatanantoine@bnpparibas.com