Why Hungary's labour market remains strong despite a year-long recession

Hungary's labour market is in pretty good shape despite the country being in a technical recession for the past four quarters. So what's going on? Structural labour shortages are likely to be the main reason, and that's also keeping upward pressure on wage growth. But let's not discount the effects of 'greedflation'...

Commuters in Budapest

We've just had the latest set of labour market data on wages and unemployment from the Hungarian Central Statistical Office. And it shows that wage growth slowed in June compared to May but remains strong, while real wages fell for the tenth consecutive month. Although the unemployment rate's three-month moving average ticked up by 0.1ppt to 4%, this is hardly surprising given the record four-quarter technical recession. We believe that the economy's structural labour shortage is one of the main reasons we haven't seen widespread layoffs, giving workers leverage, thus keeping upward pressure on wages.

Wage outflows slowed but still remained strong in June

16.0%

Gross earnings growth

ING Forecast 17.7% / Previous 17.9%

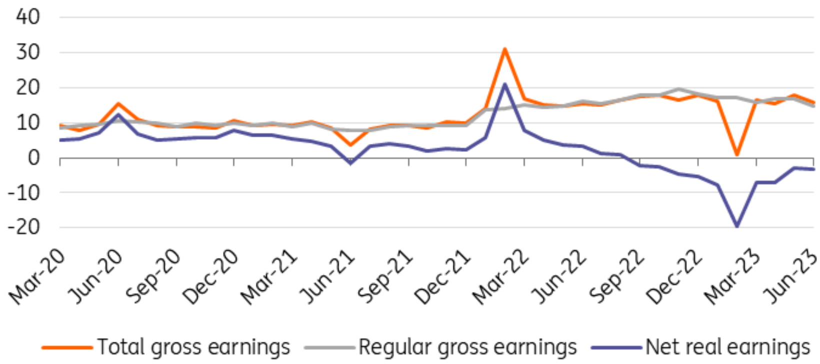
Lower than expected

Latest wage data shows that wage outflows remained quite strong in June – albeit lower than market consensus – with average gross wages rising by 16% Year-on-Year. As for regular gross earnings, the yearly based figure was 14.9% in June, declining by 2ppt compared to May.

Median wage growth was 15.6% in June, which is just slightly lower than the growth rate of average gross wages. Based on the combination of these data points, we believe that bonus payments may have been higher than last year, especially for those earning less.

Nominal and real wage growth

% YoY



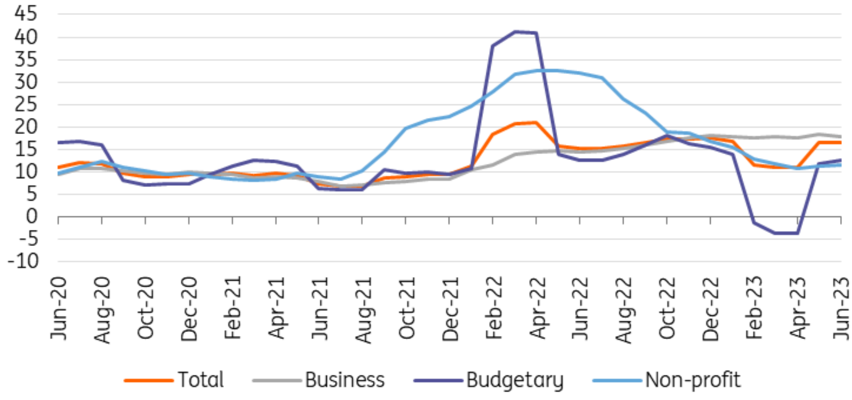
Source: HCSO, ING

Our view is supported by the slight convergence between private and public sector wage growth. While private sector wage growth slowed by 2.7ppt compared with the previous month, the average public sector salary increase accelerated by 0.5ppt. Nevertheless, the gap remains wide, with workers in the former sector receiving a 17.3% YoY pay rise, compared with a 12.6% YoY uptick in the latter. It is, therefore, likely that in June it was mainly one-off payments in the public sector that pushed up average and median total wages, while the increase in regular payments was more curbed.

The slowdown in private sector wage dynamics is also likely to be driven by the composition effect. The increase in the number of seasonal workers is pulling down the overall average wage in the economy. This can also be observed at the sectoral level as well, especially in agriculture and accommodation.

Wage dynamics

3-month moving average, % YoY



Source: HCSO, ING

Don't expect a rapid recovery in consumption

Although inflation slowed in June, real wages fell by more than in the previous month as a result of the slowdown in the growth rate of average wages. Real wages fell by 3.4% in June, extending the streak of negative real wage growth to 10 months. Despite real wage growth likely returning to positive territory by the end of the summer, or September at the latest, we would warn against any high hopes that this will result in a rapid recovery in consumption.

A large part of the population has used up much of their savings to withstand the current cost-of-living crisis, which has been ongoing for the past year and a half. Moreover, inflation remains well above desirable levels and the household confidence index is at a decade low. None of these suggests that households will start spending heavily just because one metric has turned negative to positive.

4.0%

Unemployment rate (May-July)

ING Forecast 3.9% / Previous 3.9%

Higher than expected

Minor uptick in the unemployment rate, but no need to worry

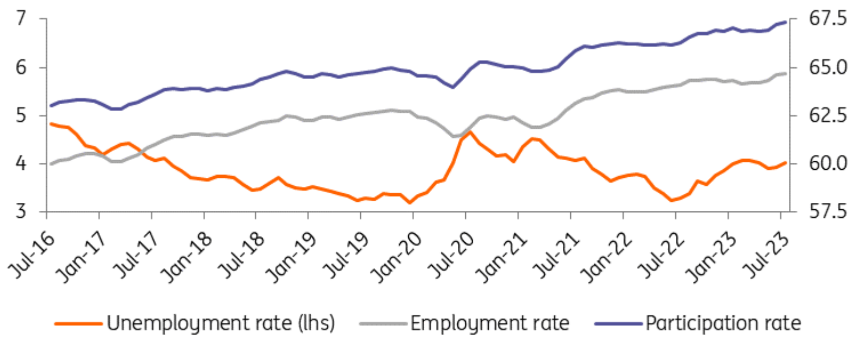
The latest unemployment figures published by the Statistical Office show no material change in the labour market in July. Both the model estimates for July (3.9%) and the survey-based official three-month moving average unemployment rate (4.0%) increased by 0.1ppt compared to the previous month's release. In this regard, the number of unemployed people remained below 200,000.

Even though the unemployment rate is higher than a year ago, these labour market statistics are pretty positive, given that the Hungarian economy has been in an unprecedented technical recession for four quarters.

Looking at the monthly data, perhaps the most important change is that the number of inactive persons increased significantly by around 13,500. Those leaving the labour market were mainly among the previously employed, as their number fell by 21,000, while the number of unemployed rose by only 6,300 in July. All this leads to the conclusion that the increase in the unemployment rate is, to a greater extent, due to the expansion of the inactive group. As the number of seasonal workers typically increases in the summer, we suspect that the main reason behind these figures is the increased number of pensioners.

Historical trends in the Hungarian labour market

%, 3-month moving average



Source: HCSO, ING

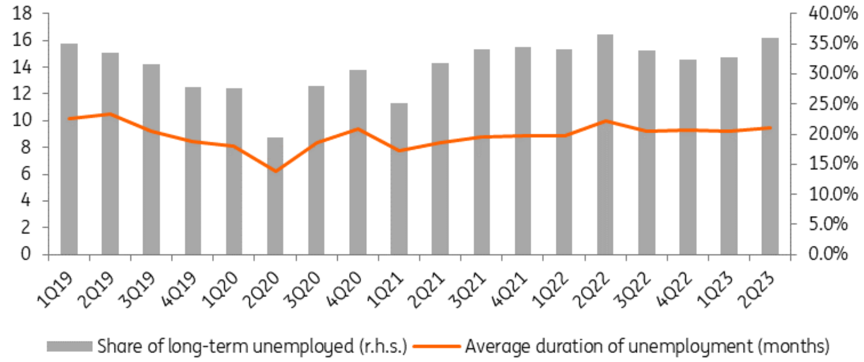
Expect some volatility but there's no serious problem

The slight increase in the unemployment rate does not appear to indicate a trend reversal or a phenomenon that would point to a more serious problem. We expect some volatility in the unemployment rate over the next couple of months due to seasonal effects, but even if we see a further rise in the indicator, the peak should remain close to 4%.

The supply side of the labour market may still be significantly affected by the high inflation environment, but as normalisation progresses, some of the labour force may be disintegrating. This suggests that employers may face further difficulties on top of the labour shortages they have been already experiencing.

For this reason, firms will continue to insist on retaining staff, having learned from the shocks of recent years that it is difficult to expand the workforce in a recovery phase in an economy with a structural shortage of labour. Therefore, the guiding principle is twofold: companies are optimistic about the rapid recovery of the Hungarian economy but also pessimistic about the labour market outlook.

Long-term unemployment in Hungary



Source: HCSO, ING

By long-term unemployment we mean those people who have been unemployed for at least 12 months

The tightness of the labour market can also be seen in the rising share of long-term unemployed (those who have been unemployed for at least 12 months). As the pool of easy-to-employ workers gets smaller, those who remain unemployed are more likely to have big skill gaps or are mismatched geographically. So, a higher share of long-term unemployed is generally leading to a lower-quality workforce.

We continue to see upside inflationary pressures as the main risk stemming from the tight labour market. The high level of inflation so far and the government's desire to achieve positive real wages could push companies towards higher wage increases. The question is whether, in the face of external inflationary shocks, companies can absorb these wage increases without further price increases.

There are grounds for optimism that the repricing of energy contracts at the end of this year promises to reduce costs, so companies may have more room to raise wages without being forced to raise prices. If consumption does not explode even if inflation falls sharply – we only expect a slow recovery – the slow growth in demand is also likely to prevent a renewed rapid rise in prices. The risk of a price-wage spiral remains, given the tight labour market, but right now, we see a good chance of it being avoided.

Our theory of a resilient labour market in a technical recession

Previously, we repeatedly stated that structural labour shortage is the biggest reason why we haven’t seen widespread layoffs. We still believe that this plays a crucial role in understanding recent labour market strength, but we’d like to raise awareness of another factor: companies' profit margins haven't really contracted.

As the National Bank of Hungary pointed out in its March 2023 inflation report, the gross operating income of Hungarian companies rose sharply following the reopening after Covid, outpacing its CEE peers. In addition, starting from the second half of 2022, Hungarian companies increased prices to a greater extent than could be explained by a rise in costs. Overall, this has led to an expansion of profit margins, and some might call that 'greedflation'. True, they have narrowed somewhat in the current technical recession, but not to the extent that would lead to widespread layoffs, which could materially weaken the labour market.

In addition, we believe that many companies do not have debt financing problems, which could be a further drag on profits. In recent years, many companies have been able to borrow at very low fixed interest rates and thus lock in favourable rates that have not risen in line with tighter monetary conditions, not to mention the debt moratorium and mortgage rate freeze measures coming from the government. Therefore, the problem of debt financing is much less of an issue in Hungary today than in previous recessions.

These factors, combined with a structurally tight labour market - where firms are reluctant to lay off workers for fear of finding it difficult to retain them in the recovery - may explain why we have seen such a resilient labour market compared with previous economic downturns.

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