

Monitoring Hungary: Dancing on thin ice

In our latest update, we reassess our Hungarian economic and market forecasts at a time when the economic recovery has come to an abrupt halt. We therefore lower our GDP forecast for this year.

Although inflation is likely to remain contained in the short run, we see two rounds of deflation later



Hungary: at a glance

- The economic recovery got a harsh reality check as GDP growth stagnated in 4Q23. As we entered the new year with a much less positive carry-over effect, we lower our GDP forecast for 2024.
- Although recent retail sales data look promising, industrial production data has

continuously disappointed, with risks accumulating regarding the export outlook.

- The very tight labour market has eased recently, which is likely to put downward pressure on wage growth. However, we still expect positive real wage growth this year.
- The year-end trade deficit was probably a one-off, but we are more pessimistic this year as we expect the manufacturing sector's performance to remain relatively subdued.
- Inflation is back in the central bank's tolerance band, however, it would be too early to declare victory as we expect two rounds of reflation this year.
- The central bank is front-loading rate cuts while the domestic environment and market stability allows. However, based on our inflation outlook, we still see a 6.5% terminal rate for 2024.
- In the budget, VAT dynamics remain disappointing, although January brought a monthly surplus. However, we are still waiting for an official update to this year's ESA-based deficit target, moving it to 4.5% of GDP.
- The speed of rate cuts undermines support for the forint, which remains on the weaker side, balancing between rate cuts and the central bank's efforts not to trigger a bigger sell-off.
- The last National Bank of Hungary meeting brought a wake-up call to the financial markets regarding the delivery of the terminal rate. However, a higher IRS curve may still be tempting for financial markets to be received again supported by further NBH rate cuts and a favorable inflation profile in the coming months.

Quarterly forecasts

	4Q23	1Q24F	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F
Real GDP (%YoY)	0.0	1.0	2.1	2.1	3.0	3.2	3.3	4.0
CPI (eop, %YoY)	5.5	3.4	4.5	4.2	6.0	5.0	4.3	3.7
Central bank key rate (eop, %)	10.75	8.00	6.50	6.50	6.50	6.50	5.75	5.50
3m interest rate (eop, %)	9.96	7.32	5.70	5.70	5.70	5.70	4.95	4.65
10yr yield (eop, %)	5.87	6.35	6.45	6.35	6.20	6.25	6.00	5.90
EUR/HUF exchange rate (eop)	382.78	390.0	395.0	385.0	390.0	387.0	385.0	385.0
USD/HUF exchange rate (eop)	346.44	361.1	359.1	343.8	339.1	336.5	337.7	340.7

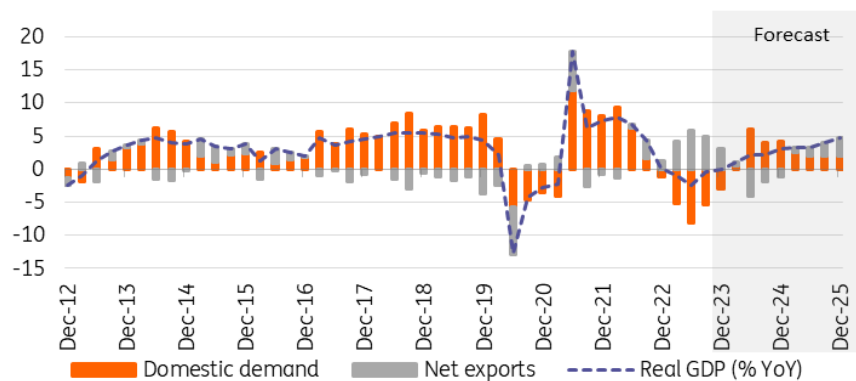
Source: National sources, ING estimates

We lower our 2024 GDP forecast, based on carry-over effects

2023 was a [recessionary year](#) in Hungary, as GDP fell by 0.9% for the year as a whole. What's even more disappointing is that although the economy emerged from a technical recession in the third quarter of last year, the economic recovery stalled as real GDP stagnated in the fourth quarter. Against this backdrop, we lower our full-year GDP forecast from 3.1% to 2.1%, mainly due to a much less positive carry-over effect.

Regarding the sectoral outlook for this year, we believe that agriculture is likely to be a drag on growth due to last year's high base, while the harvest season is likely to be average at best. As for industry, we remain rather pessimistic as the export outlook is bleak, while recovering domestic demand by itself is unlikely to be enough to keep industry afloat.

Real GDP (% YoY) and contributions (ppt)



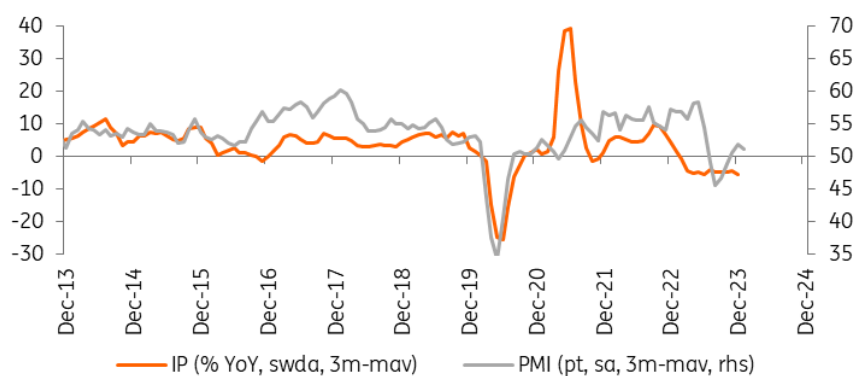
Source: HCSO, ING

Weaker external demand will likely hold back industry this year

Industrial production surprised on the downside in [December](#), as production volumes fell by 0.3% month-on-month (MoM), contributing to a sharp fall in output of 8.7% year-on-year (YoY) on a working-day basis. The fact that this was the third consecutive month in which output contracted on a monthly basis suggests that external demand must have been weak throughout the fourth quarter.

At the sectoral level, volumes are likely to have contracted in the two most important sub-sectors, namely electrical and transport equipment. Although there were some seasonal factory shutdowns in December, the poor performance cannot be explained by this alone, but rather by the fact that we are seeing external demand weaken while domestic demand is still not enough to keep industry afloat. For this year, we think that these contrasting dynamics will likely hold.

Industrial production (IP) and Purchasing Manager Index (PMI)



Source: HALPIM, HCSO, ING

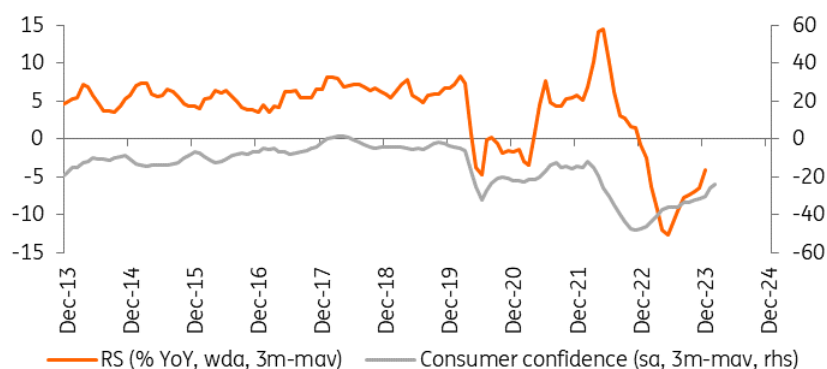
Retail sales have started to recover at a gradual pace

The retail sector performed well in the [fourth quarter](#) as real wages continued to improve. The volume of sales rose by 1.4% MoM in December, bringing the year-on-year figure to -0.2%. At the component level, each of the three components posted gains on a monthly basis, showing that

the recovery is broad-based. However, we believe that the 4% MoM increase in fuel retailing is unsustainable, as it was the result of the expected increase in fuel excise duty in January.

In this respect, fuel retailing is likely to be a drag in January, but in general, we expect retail sales to continue to recover in the coming months. Consumers will receive a significant income boost from retail bond coupon payments throughout the first quarter (approximately 2% of GDP), which if not reinvested will support consumer spending, while consumer confidence is trending higher.

Retail sales (RS) and consumer confidence



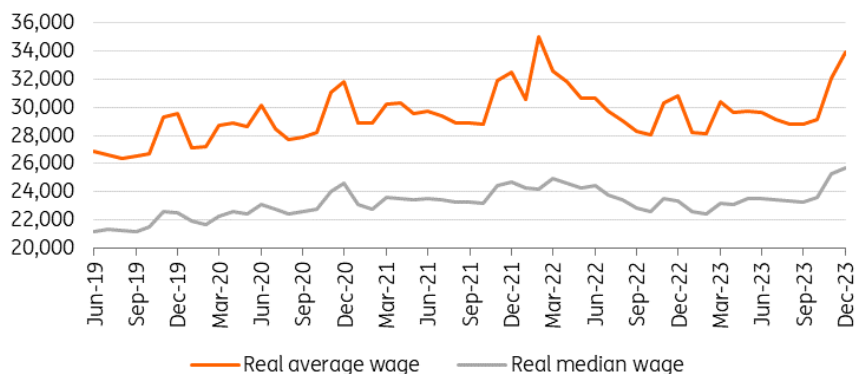
Source: Eurostat, HCSO, ING

The tightness of the labour market has eased somewhat

Average wage growth was particularly strong in [December](#) at 16.4% YoY, while real wages rose by a remarkable 10.3% YoY. However, this is hardly surprising as the combined effect of two minimum wage increases culminated in December's data. For this year, we expect real wages to improve gradually, which in turn will support consumption. Recently, we have seen a further deterioration in labour statistics, as the three-month (Nov-Jan) unemployment rate rose to 4.6%.

However, the latest employment data suggest that the marked tightness of the labour market has eased further, which in turn will put downward pressure on wage growth as it reduces the leverage of workers in wage negotiations. In our view, this will limit the chances of companies regaining strong pricing power as well, which in turn reduces the chances of consumption-led deflation.

The level of average and median real wages (1990 CPI adjusted HUF)



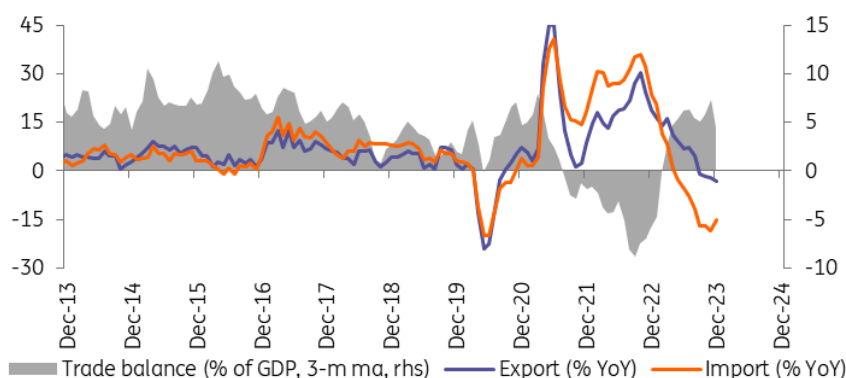
Source: HCSO, ING

Export prospects will be a headwind to trade balance surpluses

Throughout 2023, the trade balance improved markedly as domestic demand collapsed, reducing the need for imports. At the same time, export sales held up, which led to persistent trade surpluses between February and November. In December, however, the trade balance surprised to the downside with a deficit of HUF 188bn.

Without the exact details (due on 6 March) we don't know the main reasons, but we suspect that factory shutdowns and large energy imports may have played a role. Nevertheless, we believe that the export outlook will be more challenging this year, which in our view, will be a headwind for the trade and current account surpluses this year.

Trade balance (three-month moving average)



Source: HCSO, ING

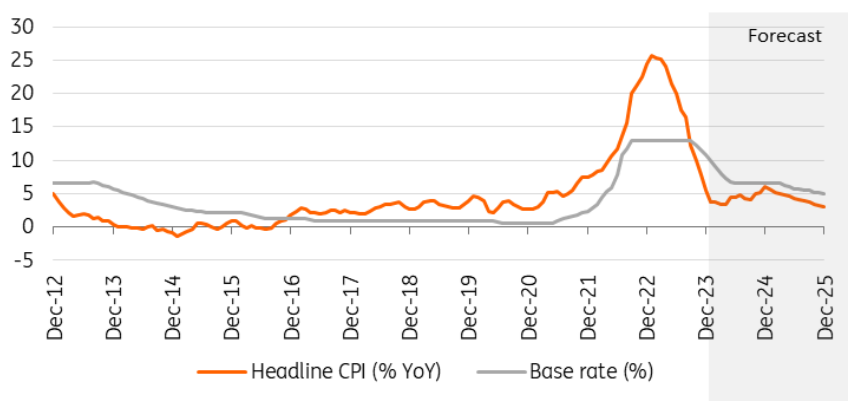
Disinflation will be strong in 1Q24, but reflation is inevitable

Headline inflation is back within the central bank's tolerance band, as the year-on-year rate fell to 3.8% in [January](#). The deceleration was mainly due to base effects, as the monthly inflation rate remains relatively high at 0.7%. At the component level, food, durable goods, and household energy prices rose on a monthly basis, while fuel prices fell. We will be closely monitoring the

repricing of services, as we expect strong repricing in March and April on the back of price increases by telecoms, banks, and insurance providers.

In the coming months we expect headline inflation to remain below the upper limit of the central bank's tolerance band, but from May we see a slight reflation driven by base effects. In this context, another round of reflation will emerge towards the end of the year, hence our call for year-end inflation in the range of 5.5-6.0%.

Inflation and policy rate



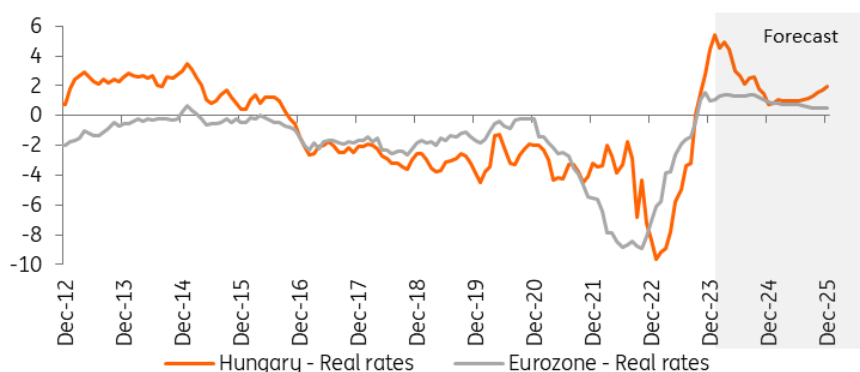
Source: NBH, ING

NBH is front-loading rate cuts, but mid-term view remains unchanged

At the [February](#) meeting, the National Bank of Hungary (NBH) accelerated the pace of rate cuts to 100bp, bringing the base rate to 9.00%, while maintaining the +/- 100bp symmetric interest rate corridor around the base rate. In our view, the central bank is only front-loading rate cuts on the back of favourable macro and market situation, while maintaining a data-dependent approach.

We think that the main takeaway from the last meeting is that the NBH is comfortable with the current pricing of the base rate in the 6-7% range until the end of the first half of 2024. We therefore maintain our call that the base rate will be cut to 6.50% at the June rate-setting meeting. However, we believe that this will also be the terminal rate for this year, as our year-end inflation forecast is in the range of 5.5-6.0%, and we see the NBH maintaining positive real rates.

Real rates (%)



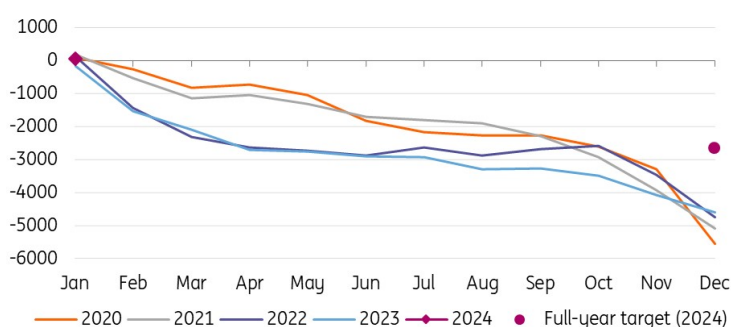
Source: ECB, NBH, ING

We are still waiting for an official update to the 2024 deficit target

The official ESA-based deficit target for 2024 remains at 2.9% of GDP, but we, like the market, don't really believe that this can be achieved. We have long argued that the 2024 deficit target needs to be revised, and we have said that 4.4% of GDP would be much closer to reality. In this context, the Minister of National Economy mentioned in an interview in early February that this year's budget deficit could be 4.5% of GDP. The reasoning is that this would maintain a primary balance of 0.0% of GDP, which in turn would maintain both the fiscal balance and economic growth.

As for the [January](#) data, the budget surplus was the result of EU inflows, while the dynamics of VAT revenues remain worrying. However, it is too early to judge as we are waiting for an official change in this year's ESA-based deficit target, which would also change the financing needs.

Budget performance (year-to-date, HUFbn)



Source: Ministry of Finance, ING

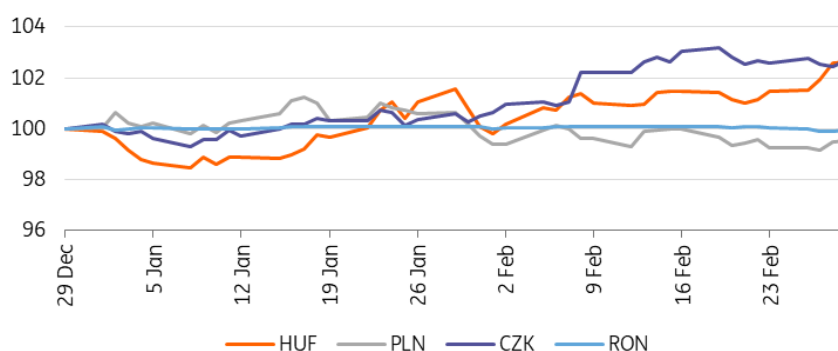
Hungarian forint stuck in range

We expected 2024 to be a good year for the forint, but things haven't exactly gone our way. The change in monetary policy tone in January and the increased unpredictability of economic policy have had a negative impact: markets are no longer cheered by the positive real interest rate

environment. Add to this a pro-growth fiscal policy, some red flags from the major rating agencies and the ongoing dispute with Brussels, and you have a challenging market environment. So we flip the switch: optimism off. We now see EUR/HUF hovering around 390 in the first quarter and 395 will be the gravity line in the second quarter. However, we still see some positive factors that will prevent the pair from breaking above 400.

The general view is therefore one of a range-bound movement, with problems in getting EUR/HUF lower in a cutting cycle. In the short term, we expect the HUF to balance between this NBH rate cut and the central bank's efforts to avoid a major sell-off. In case of a EUR/HUF move, we can expect a more cautious approach from the central bank to bring the currency pair back down. In terms of rates, the market is going through a catharsis after the last meeting and the pricing out of any rate cuts should keep EUR/HUF closer to 390. On the other hand, more political noise would mean more volatility and the still rather long market positioning together create more upside risks.

CEE FX performance vs EUR (29 December 2023 = 100%)

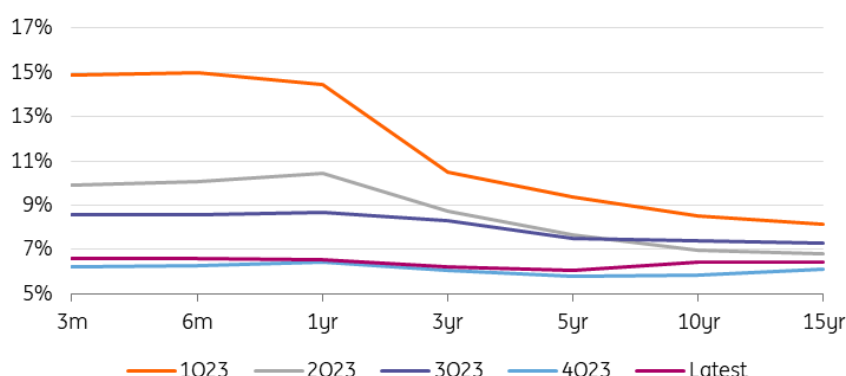


Source: NBH, ING

NBH wake up call for markets but still bullish on HUF rates

The last NBH meeting was a wake-up call for the financial markets, and despite the acceleration in the pace of rate cuts, the IRS curve moved significantly higher. Although we are seeing a smaller dose of rate cuts in the long run than the markets expect, the correction came a little earlier than we expected. With inflationary momentum and still a lot of NBH rate cuts ahead, this complicates the situation as to where to go next. Financial markets are currently pricing in two 75bp cuts and a subsequent slowdown, which is less than we expect at the next meeting but more in total, with the terminal rate just above 5%. Although the markets are much more aggressive than we are forecasting in terms of NBH rate cuts, the current very favourable inflation momentum is likely to keep rates low and some may see the current hike as an opportunity to get back into HUF rates. In our view, the long end of the curve could benefit the most if we see a simultaneous rise in core rates.

Hungarian sovereign yield curve (end of period)



Source: GDMA, ING

Hungarian government bonds (HGBs) followed the IRS curve and became slightly cheaper compared to CEE peers. On the supply side, we have seen significant frontloading by the debt agency in the first two months of this year, which in our view provides a significant buffer against potential problems on the fiscal side. At the same time, the auctions of HGBs have seen strong market demand. HGBs, together with CZGBs, have been our favourite picks in the CEE region since the beginning of the year, but we see the rally in both markets coming to an end given how much interest rate cuts are priced into the market. We still like the HGBs story, but we think the market may soon start looking around for other opportunities in the region (Poland as a potential candidate) and it will be time to switch more neutral.

Forecast summary

	4Q23	1Q24F	2Q24F	3Q24F	4Q24F	2023	2024F	2025F
Real GDP (%YoY)	0.0	1.0	2.1	2.1	3.0	-0.9	2.1	3.8
CPI (eop, %YoY)*	5.5	3.4	4.5	4.2	6.0	17.6	4.4	4.3
Central bank key rate (eop, %)	10.75	8.00	6.50	6.50	6.50	10.75	6.50	5.00
3m interest rate (%)*	9.96	7.32	5.70	5.70	5.70	13.98	6.88	5.03
10yr yield (%)*	5.87	6.35	6.45	6.35	6.20	7.56	6.24	6.03
EUR/HUF exchange rate*	382.8	390.0	395.0	385.0	390.0	385.3	388.6	386.4
USD/HUF exchange rate*	346.4	361.1	359.1	343.8	339.1	356.6	349.9	339.6

*Quarterly data is eop, annual is avg. Source: National sources, ING estimates

Authors

Peter Virovacz

Senior Economist, Hungary

peter.virovacz@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

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