Monitoring Hungary: Glimmering light at the end of the tunnel

In our latest update, we reassess our Hungarian economic and market forecasts, as we are waiting proof of a technical recession. Inflation and EU funds remain the key topics in the coming months, but we now see the light at the end of the tunnel in several aspects

Hungary's parliament building in Budapest

Hungary: At a glance

- As some hard and soft data suggest more resiliency in external demand, we see better prospects ahead for the Hungarian economy as well.
- The peak in inflation is still ahead of us and while the start of the new year could bring some ugly surprises, we see some signs of easing pipeline price pressures.
- The central bank has just turned up the volume regarding its hawkish tone and we see the dovish pivot only in the second quarter.
- The significantly reduced energy consumption of the country combined with lowering global commodity prices will bring an improvement in the external balance.
- We see the 3.9% deficit-to-GDP target as roughly realistic, where the key risk remains securing the planned 2.9% of GDP transfers from the European Union.
- Despite a rough start to 2023 in sovereign rating reviews, we think that agencies are a bit

behind the curve, and we are hopeful for a quick turnaround.

- The forint became the star of the region in the first few weeks of this year and as the market is shrugging off the negative rating actions, we remain bullish on HUF.
- We expect the steepening bias to continue in local rates, while liquidity conditions remain an obstacle to having a strong view here.

Quarterly forecasts

	3Q22	4Q22F	1Q23F	2Q23F	3Q23F	4Q23F	1Q24F	2Q24F
Real GDP (%YoY)	4.0	0.4	-0.4	-0.9	0.9	3.4	4.0	4.2
CPI (eop, %YoY)	20.1	24.5	25.0	21.0	13.2	8.6	5.9	5.3
Central bank key rate (eop, %)	13.00	13.00	13.00	12.75	12.00	11.25	10.25	8.75
3m interest rate (eop, %)	13.30	16.18	16.15	13.50	12.50	10.75	9.50	8.00
10yr yield (eop, %)	9.77	9.05	7.85	7.25	6.95	6.75	6.55	6.60
EUR/HUF exchange rate (eop)	421.4	400.3	385.0	375.0	383.0	375.0	370.0	365.0
USD/HUF exchange rate (eop)	428.6	375.7	356.5	326.1	342.0	334.8	321.7	317.4

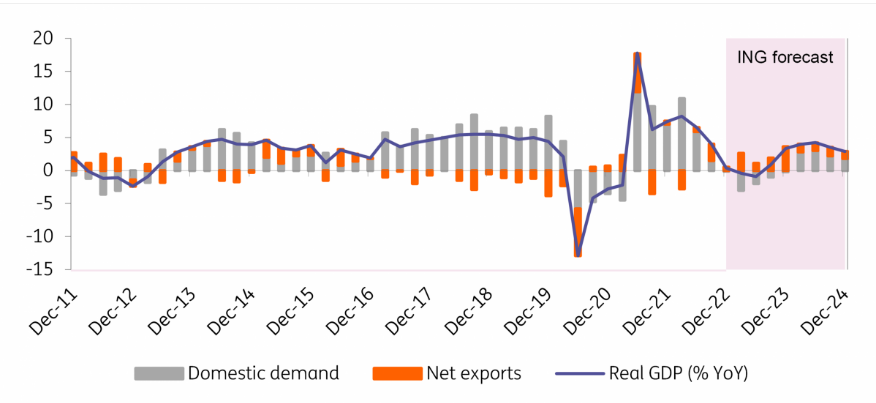
Source: National sources, ING estimates

First leg of technical recession is already in

Even though we haven't seen the fourth quarter GDP data, the 0.4% quarterly drop in the previous quarter confirms our view that Hungary slid into a technical recession in late 2022. A deteriorating industrial performance, along with weakening retail sales in the fourth quarter do not point to a rebound in activity, thus we forecast the economy to shrink by -1.2% quarter-on-quarter (QoQ). As financial conditions are tightening and households' purchasing power is deteriorating, we do not expect a rebound in the first quarter of 2023. We expect the Hungarian economy to recover only in the second half of 2023, resulting in a 0.7% GDP growth for the whole year. Nevertheless, an improving global growth outlook poses an upside risk to our forecast, limited by a possible next wave of energy price shock.

Hungarian GDP falls in the third quarter, confirming the deteriorating outlook

Real GDP (% YoY) and contributions (ppt)



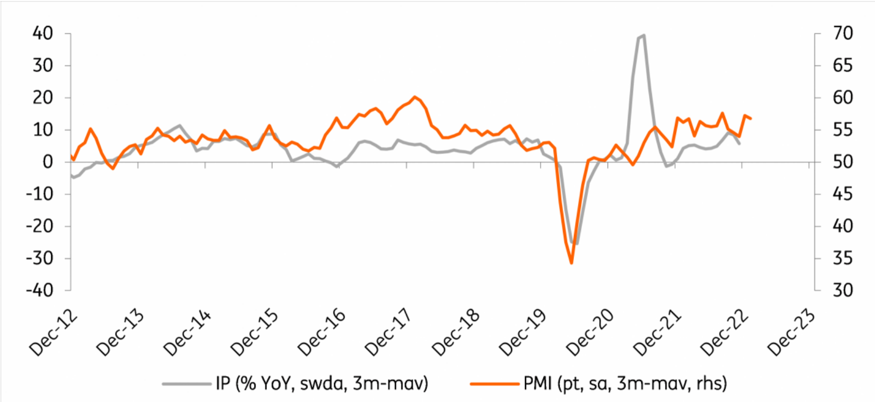
Source: HCSO, ING

Car manufacturing performance is not enough to save industry

Industrial production in November jumped by 0.8% year-on-year (YoY), adjusted for working days. At first glance, it might seem like industry is holding up against the backdrop of high energy prices, but the -0.7% performance on a monthly basis further increases the odds of a technical recession. Even though car manufacturing expanded significantly, the drop in food industry and electronics were much of a drag. The more conscious energy usage has impacted the energy production subsector, further worsening the overall performance. After months of PMI readings above 55+ and consequent negative industry performances, soft and hard data seems to be decoupling. The main reason could be the high level of stock of orders, coupled with capacity enhancing investments, which bode well for the longer-term outlook.

Hungarian industry runs into trouble again

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



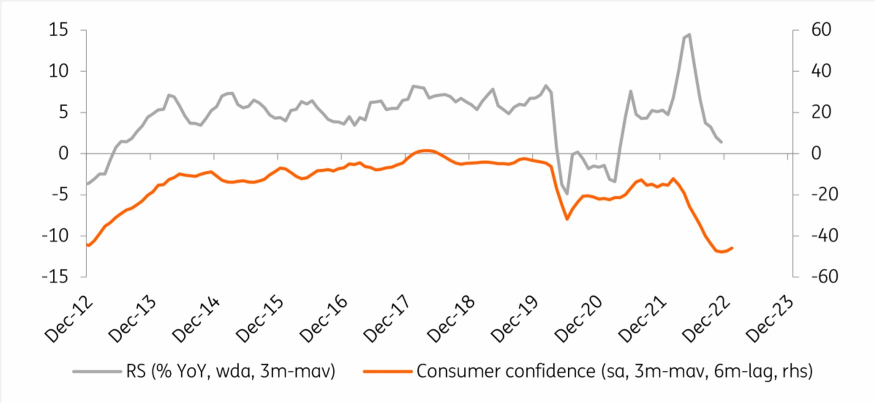
Source: HALPIM, HCSO, ING

Retail sales are weakening as real wage growth deteriorates

Retail sales rose by a mere 0.6% YoY in November, as the 0.15% monthly increase was just enough to put the performance above water for the time being. As food prices were increasing by more than 40% on a yearly basis, consumers are adapting to the new reality by cutting back on the volume of food purchases. What's even more, only fuel retailing could expand on a monthly basis, by posting a 2.9% growth, since consumers reduced demand for goods from non-food retailers likewise. As the government scrapped the fuel price cap on 7 December, we expect fuel consumption to fall significantly, dragging overall retail sales volume to negative territory going forward. Weakening overall consumption in all three sub-sectors will leave its mark on fourth quarter GDP, thus further increasing the chances of a technical recession.

Mediocre Hungarian retail sales continue to drag on growth

Retail sales (RS) and consumer confidence



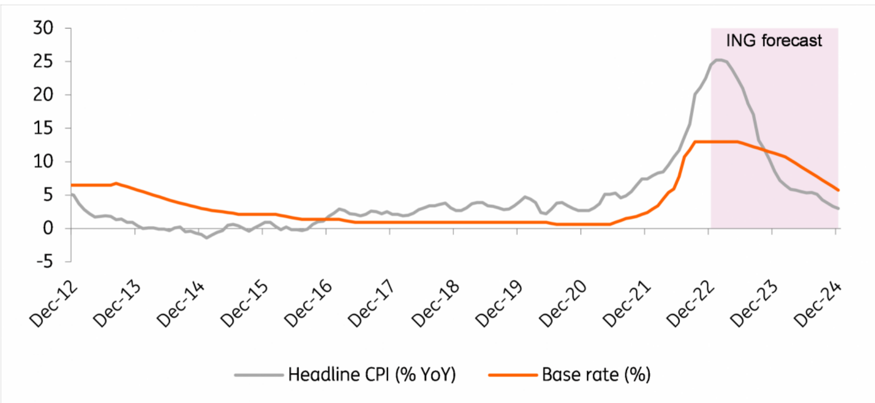
Source: Eurostat, HCSO, ING

Inflation peak is still ahead of us

Even though December's 24.5% YoY headline inflation surprised to the downside, the peak is still ahead of us. The lifting of fuel price caps pushed the headline reading higher by 2.1ppt in December, while underlying inflation strengthened too. Besides fuel, food and energy remains the main contributor to the extreme inflation. In January-February, we see further acceleration to above 25% as start-of-the-year repricing could be stronger than usual, especially in food and services. This might be the peak however, as pipeline price pressure has started to abate (see producer prices), global commodity prices have been dropping and more retailers are complaining about fading repricing power. The slow and gradual retreat of price pressure will translate into an 18.5% average CPI in 2023, but we see a single digit print by the year-end. Risks tilted to the upside are mainly due to the presence of the price-wage spiral, in our view.

[Hungary's inflation accelerates, but less than expected]

Inflation and policy rate



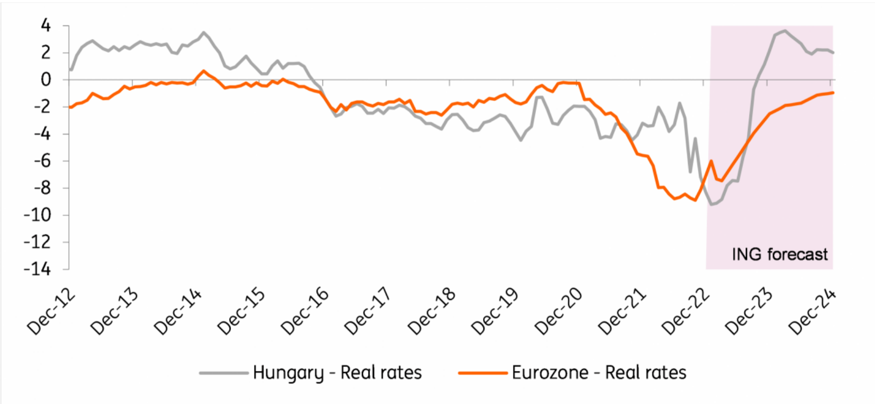
Source: NBH, ING

Monetary policy continues its tightening

The National Bank of Hungary (NBH) has left the interest rate complex unchanged since mid-October, leaving the base rate at 13.0% and the one-day quick tender as the effective marginal rate at 18%. However, by doubling the required reserve ratio (RRR) – effective from April – at the January meeting, the NBH continues the tightening cycle via liquidity-related measures. Draining excess forint liquidity via targeted and temporary tools, along with stricter RRR will help the central bank achieve price and market stability. As the NBH patiently waits for a material and permanent improvement in the general risk sentiment, we think the first signs of any potential pivot might come only at the March rate setting meeting. But after the January hawkish surprise, we are now skewed a bit more towards the idea that the central bank's hawkishness will reach well into the second quarter.

National Bank of Hungary review: Good things come to those who wait

Real rates (%)

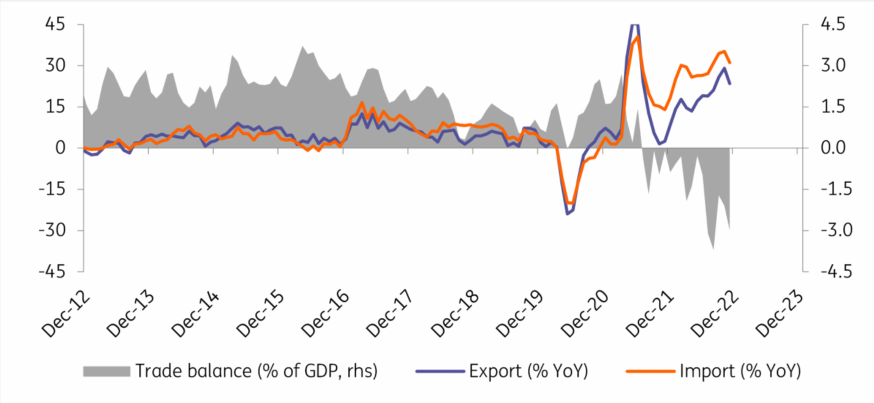


Source: ECB, NBH, ING

Trade balance will improve as energy prices moderate

The HUF1,415bn trade balance deficit in goods in November was the second highest on record. The main culprit was the energy import bill, which ballooned as energy prices stayed elevated throughout September. As energy import prices in Hungary follow the Dutch TTF gas prices by a two-month lag, the September 200 EUR/MWh average price put serious pressure on the overall trade balance. With gas prices falling off a cliff from the autumn highs we expect a significant improvement going forward, as October's average price for TTF was 81 EUR/MWh. For 2023, improvement in the global growth outlook could help the export side, along with a positive outlook for the export-driven industry. In the meantime, gas demand destruction and lower energy prices could help alleviate the pressure on the import side along with the retreating domestic demand.

Trade balance (3-month moving average)

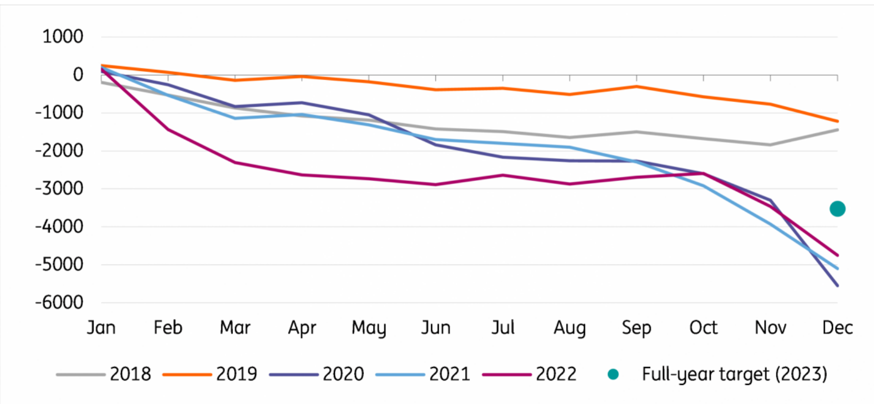


Source: HCSO, ING

Budget shows significant tightening compared to previous years

The Hungarian budget posted a HUF1,287bn deficit in December, thus having a HUF4,753bn cash flow-based deficit for the year of 2022, totaling to a Maastricht-based 4.9% of GDP deficit (6.1% with extraordinary gas stockpiling). High energy prices put serious pressure on the overhead reduction scheme embedded in the budget's expenditure side, which was attempted to be counterbalanced by new windfall taxes and austerity measures. This year, the government is calculating with a deficit totaling to 3.9% of GDP, with the Overheads Protection Fund (HUF2,610bn) and debt servicing (HUF2,074bn) being one of the costliest components. On the revenue side, EU transfers are planned at 2.9% of GDP, signaling confidence in a deal with the EU, however the planned 1.5% GDP growth is higher than our current 0.7% estimate, which poses some negative risk.

Budget performance (year-to-date, HUFbn)



Source: Ministry of Finance, ING

The fate of EU funds is the most important rating driver

After dodging an outright downgrade last year, this time S&P changed Hungary's credit rating from "BBB" to "BBB-" with a stable outlook in early 2023. Markets do not seem to be bothered by either S&P's downgrade, or Fitch's change in outlook from stable to negative in January, suggesting the markets' take that rating agencies look too much into the rear-view mirror. The factors that have the highest weight in rating decisions remained the same: the fate of the EU deal and economic policies. Regarding the former, we remain optimistic about a final deal being struck between the EU and the government, but in the coming months we see continued uncertainty in headline news. So, we expect Moody's to follow Fitch in changing Hungary's outlook from stable to negative at its March review. However, peaking CPI, a rebound in growth and improving external balances alongside EU funds flow might lead to a pivot in rating reviews.

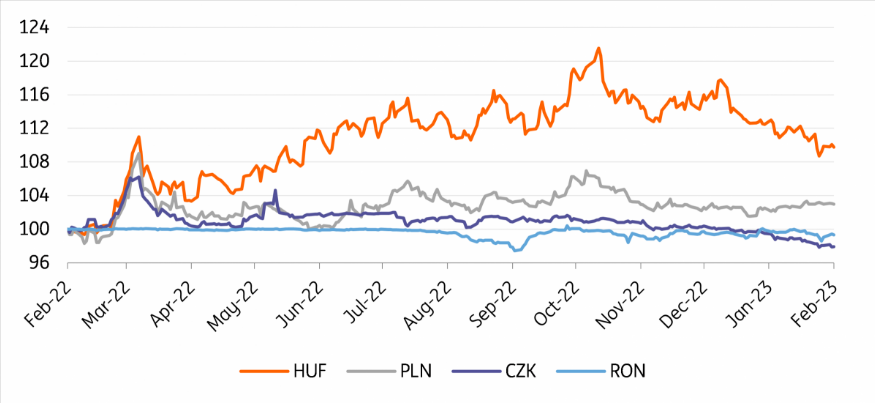
CDS and sovereign credit rating (S&P)

Source: S&P Global Ratings, ING

Forint starts 2023 with impressive outperformance

The forint has been the top currency in the EMEA region since the beginning of 2023 and number three in the EM space. Going forward, we believe that the forint still has a lot to offer and see it continuing on its current path. The NBH confirmed the hawkish intent, and we expect to see further progress in the EU story. Moreover, FX-implied yields are by far the highest in the region and the central bank has announced further steps to keep liquidity tight in the market. In addition, we also see favourable conditions for the forint at the global level. While EUR/USD is climbing higher, gas prices still have room to fall in the first quarter in our view, and it is the forint that may benefit the most within CEE. On the other hand, the biggest risk at the moment is the positioning, which is heavily tilted to the long side. Thus, we think further gains in the forint will be slower than what we have seen in the last two months, and moreover, the forint will be sensitive to the global story, with geopolitical escalation impacting gas prices or the EU story.

FX performance vs EUR (1 February 2022 = 100%)

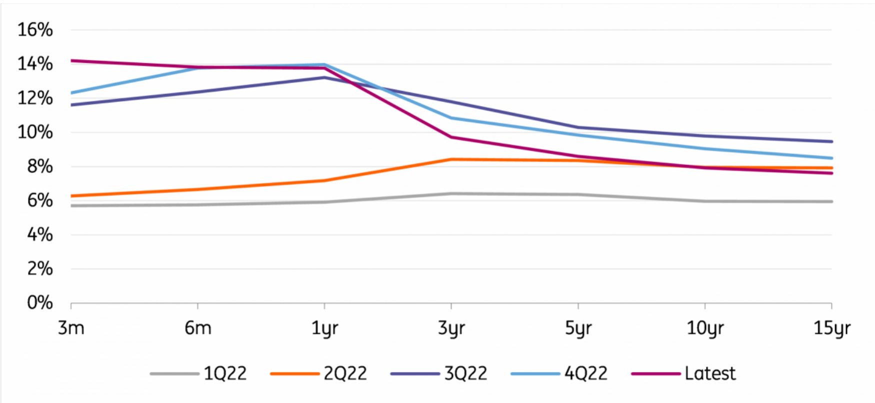


Source: NBH, ING

Short end of the curve to remain volatile in coming months

The NBH's decision in January has certainly calmed market speculation of an early central bank rate cut for a while. Also, higher inflation prints should keep the short end at higher levels until at least mid-March. On the other hand, we expect the market to start betting on early rate cuts again near the NBH meeting dates. So, the coming months at the short end of the IRS curve could be pretty volatile, bouncing around in a certain range. The long end of the curve on the other hand has dropped significantly in recent weeks and is not that far from CEE peers. We also don't expect it to have that much room to go lower yet. Overall, we maintain our view for the IRS curve to move lower and steeper. However, NBH and CPI pivoting may be volatile in the coming weeks, which continues to be supported by low liquidity, where we have seen only little improvement so far.

Hungarian sovereign yield curve



Source: GDMA, ING

On the bond side, Hungary's AKK, like CEE peers, took advantage of favourable market conditions and heavily frontloaded the issuance. According to our calculations, AKK issued 18.2% of its planned Hungarian government bonds (HGBs) and 86.7% of FX bonds. This, together with the cash buffer, gives AKK a very comfortable situation and the ability to stop the issuance if global conditions deteriorate in the coming months. This should limit the scope for a potential sell-off, however we see HGBs still bearing more risks compared to Czech or Romania government bonds and the recent rating and downgrade outlook from S&P and Fitch does not help much.

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