Monitoring Hungary: Looking for bright spots

In our latest update, we reassess our Hungarian economic and market forecasts at a time when incoming data and information tend to point to some downside risks. Nevertheless, we look for bright spots that give us hope for a more vibrant outlook beyond this year

Hungary's budget deficit improved at the end of 2024

Hungary: At a glance

- The details of the disappointing second quarter GDP data highlight some structural problems as well as some green shoots. We see economic activity at 1.5% and 3.6% in 2024 and 2025 respectively.
- The incoming high-frequency data on third-quarter economic performance have been rather disappointing and show no signs of a quick and significant turnaround.
- The labour market has been the bright spot of the Hungarian economy, although labour hoarding and high wage growth pose a wide range of risks.
- The country's external balances remain supportive for both real growth and financial market sentiment. We expect the current account to remain above 2% of GDP in the coming years.
- The recent downside surprise on inflation and its structure has triggered a significant

revision on our part. We see inflation remaining below 4% on average in 2024, although we expect some creep up to 4.2% in 2025 as a whole.
- The National Bank of Hungary cut rates by 25 basis points in September and we expect another cut later this year. Major central bank moves ahead could support an even more dovish outlook.
- The new Excessive Deficit Procedure report included the government's updated cash flow deficit target. Recent budgetary developments are in line with this. We don't see any financing problems ahead.
- The forint, like CEE peers, has come under pressure in recent days on global stories. However, a weaker HUF also means a more hawkish NBH, which should be a backstop for further weakness and time for a fade move in EUR/HUF.
- The global story is leading to some NBH rate cuts being priced out of the Interest Rate Swaps curve, but the fundamentals are more likely pointing to another drop in market rates later. The debt agency has covered this year's Hungarian Government Bonds issuance, opening a good story at the end of the current sell-off.

Quarterly forecasts

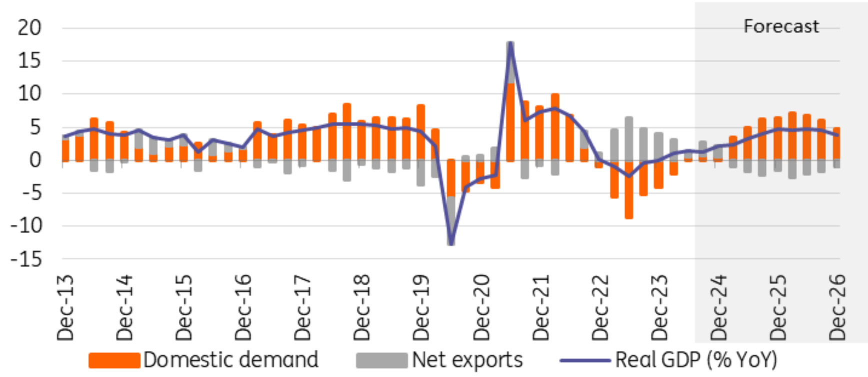
	2Q24	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F	1Q26F
Real GDP (%YoY)	1.5	1.3	2.2	2.4	3.3	4.0	4.8	4.6
CPI (eop, %YoY)	3.7	3.0	4.6	3.7	4.3	4.1	3.9	3.5
Central bank key rate (eop, %)	7.00	6.50	6.25	6.25	5.50	5.25	5.00	4.75
3m interest rate (eop, %)	6.89	6.32	6.05	5.95	5.30	5.05	4.75	4.50
10yr yield (eop, %)	6.82	6.16	6.25	6.45	6.65	6.80	6.95	6.95
EUR/HUF exchange rate (eop)	395.2	397.2	395.0	400.0	408.0	400.0	405.0	408.0
USD/HUF exchange rate (eop)	369.4	356.7	359.1	363.6	370.9	363.6	368.2	370.9

Source: National sources, ING estimates

Fragmented economic activity keeping a lid on growth this year

The Hungarian economy is once again experiencing some turbulence, as evidenced by the 0.2% quarterly contraction in the second quarter. The detailed data show that agriculture and industry were the main drags on the production side. Consumption grew, which is certainly a cause for optimism, but investment remains sluggish and this won't change without business confidence and sustained demand growth. The contribution of net exports has been positive, but it remains rather favourable for the wrong reasons: import demand is subdued, while exports are also weak, just not as much. We maintain our full-year GDP forecast at 1.5% for 2024 and around 3.6% for 2025 as we wait for consumer and business confidence to improve with the turn of the inventory cycle, pre-election government measures and a shift from saving to spending.

Real GDP (% YoY) and contributions (ppt)

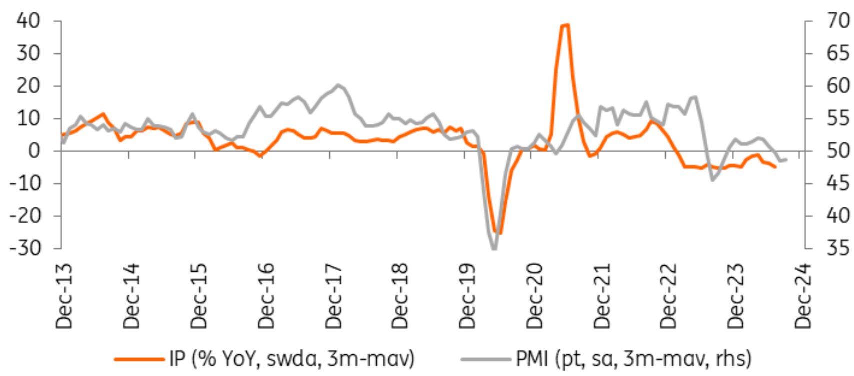


Source: HCSO, ING

Industry struggles as demand recovers slowly

Industrial production stagnated in July, contributing to a 6.4% year-on-year decline. Output volume is still 3.4% below the average monthly volume in 2021, and total order books at the end of July were 27% below last year's level. The recovery in external demand will be a slow and gradual process, as recent anecdotal evidence suggests that incoming FDI and manufacturers are downgrading production expectations for the coming years (to a third). Towards the end of this year, however, domestic demand may improve to the extent that at least some industrial sectors will be able to grow sustainably. But this will not be enough to save the year. Hungarian industry as a whole could be a significant drag on GDP growth in 2024.

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

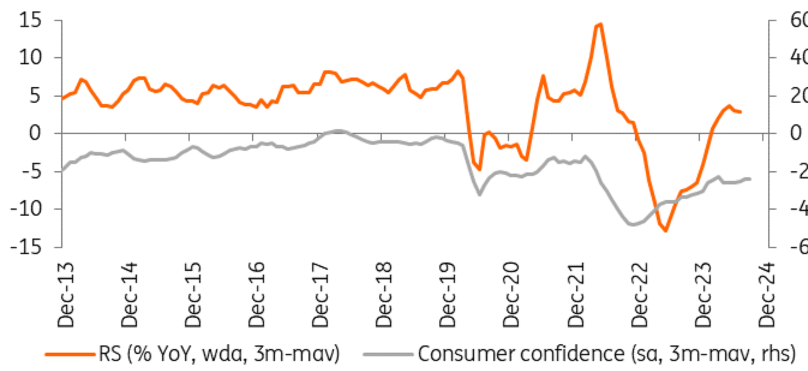


Source: HALPIM, HCSO, ING

High wage dynamics are not yet reflected in retail sales

The volume of retail sales was flat in July, bringing the adjusted figure to 2.5% year-on-year. Looking at the details, food retailing was again the main drag, with a decline of 0.7% on a monthly basis. The volume of non-food sales increased by 0.1% compared to the previous month. Within this, mail order, online and clothing store sales fell particularly sharply, while fuel sales rose by 0.4%. Continued high real wage growth and a generally strong labour market may provide some grounds for optimism. The service sector is expanding, but savings remain high. Foreign web shops also account for some of the consumption that does not show up in retail sales statistics. If inflation can be tamed further and brought back to 3-4% next year, this could help to further restore consumer confidence and thus improve the outlook for retail sales.

Retail sales (RS) and consumer confidence

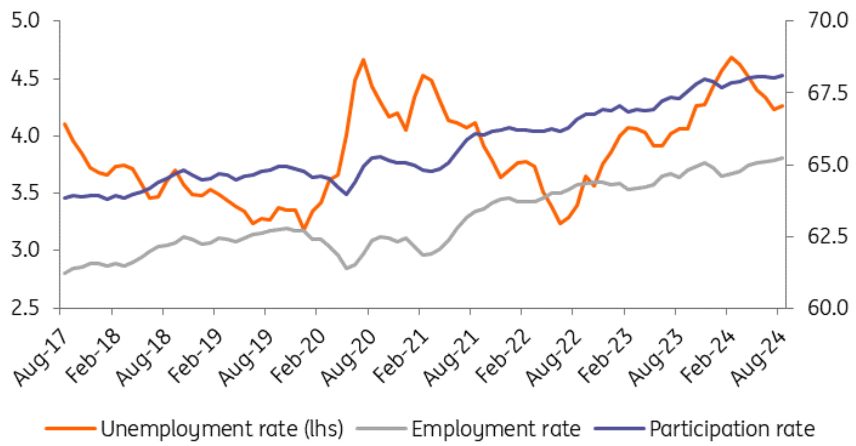


Source: Eurostat, HCSO, ING

Hidden unemployment keeps labour market tight

The unemployment rate remained stable at 4.2% in August, while the 3-month (June-August) unemployment rate rose to 4.3%. Details show that the layoffs are likely to be among the low-paid and low-skilled, who tend to rely on seasonal jobs. However, laid-off workers can quickly find new jobs, which keeps the unemployment rate stable. With the labour market still tight, firms are likely to retain staff beyond their planned capacity, creating 'hidden' unemployment, as shown by the data on labour hoarding. We expect the unemployment rate to remain close to 4.2% until the end of the year. With a sustained recovery in construction and services, redundant workers in the faltering manufacturing sector could be taken on, keeping the labour market outlook positive.

Historical trends in the Hungarian labour market (%)

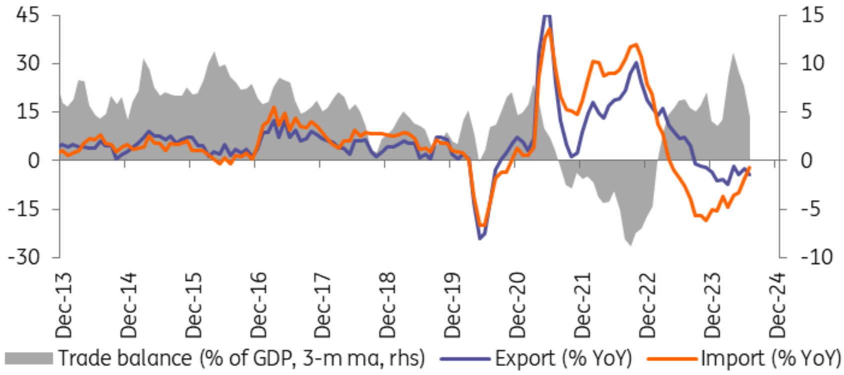


Source: HCSO, ING

Current account balance to move persistently above 2% of GDP

While the value of exports fell by 4.3% between January and July, the value of imports fell by a significant 8.4%, thus maintaining the trade surplus despite continued weakness in industrial export sales. In July there was still a trade surplus of EUR167m, but this is a significant reduction in the surplus compared with previous months. However, we see this as a seasonal phenomenon. In general, imports are faltering because domestic demand (especially investment) is weak, while exports are being constrained by the lack of external demand, just not as much in nominal terms. We believe that the general trend we've seen so far will continue in 2024, leaving the country's external balance intact. As a result, we maintain our forecast for the current account balance, which we expect to be at 2.2% of GDP in 2024, followed by a surplus of 2.4% next year.

Trade balance (3-month moving average)

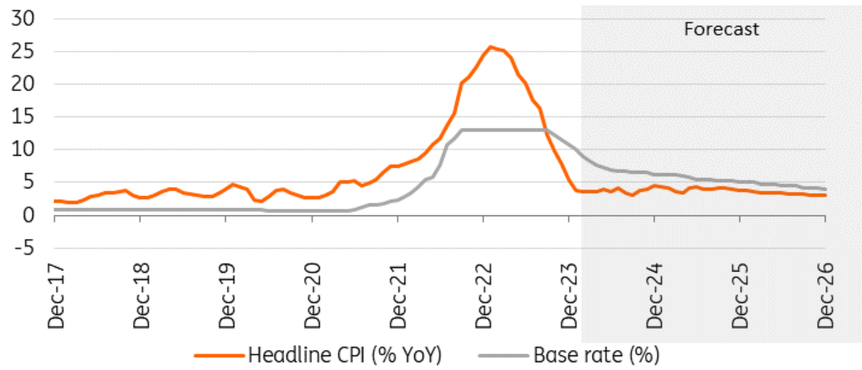


Source: HCSO, ING

We revise down the inflation path for 2024-2025

Due to the stagnation in the average price level on a monthly basis and the high base from last year, year-on-year inflation fell to 3.4% in August. The main components of core inflation also turned more favourable this month. Food prices stopped rising, fuel prices fell sharply and services inflation rose by 0.4%. Several indicators point to inflation stabilising, although there is still some way to go. We believe that the economy may perform even more weakly in the second half of the year than previously expected, limiting the ability of companies to meaningfully reprice, and we therefore revise down our end-2024 inflation forecast to 4.6%. Looking ahead, the expected pick-up in consumption, still strong wage growth and recent tax measures could lead to above-average monthly repricing by historical standards. As a result, we expect inflation to average 3.8% in 2024 and 4.0% in 2025.

Inflation and policy rate

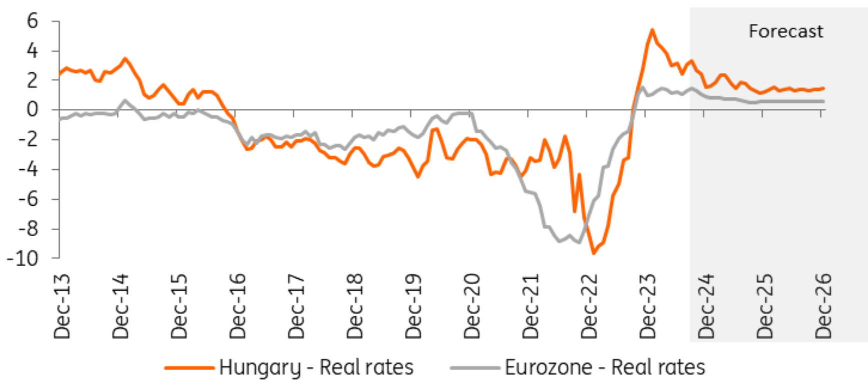


Source: NBH, ING

We expect one more rate cut from the NBH in 2024

At its September meeting, the National Bank of Hungary (NBH) lowered its key interest rate by 25bp to 6.50% and kept the interest rate corridor symmetrical (+/- 100 bp). The key factors for the upcoming October decision are the inflation outlook, Hungary's risk perception and financial market stability. The Monetary Council did not see any factors that would require a change in the telegraphed path of the key interest rate since its last meeting. Accordingly, it removed the reference to the possibility of further cautious rate cuts from the press statement. Against this backdrop, we see scope for one more 25bp easing in the fourth quarter. With so much uncertainty, both globally (geopolitics, major central banks' rate paths, etc.) and locally (changes in the Governing Council), it is hard to be very confident about the path of interest rates next year. We now expect at least as many cuts as the Fed/ECB deliver and see the local rate at the end of 2025 at 5.00%.

Real rates (%)



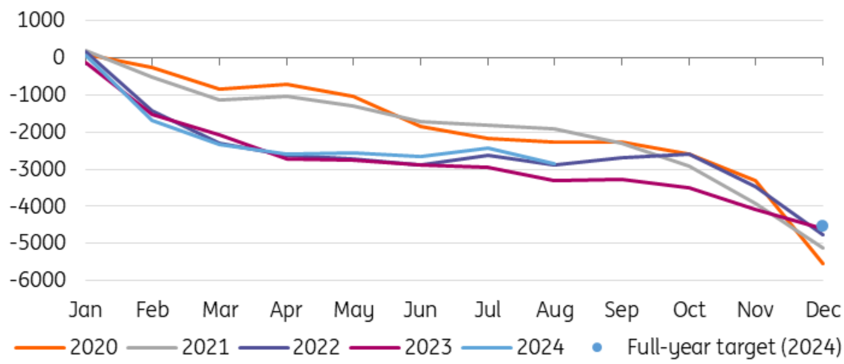
Source: ECB, NBH, ING

Government revises cash-flow deficit plan upwards

The monthly budget deficit in August was HUF 414bn, bringing the year-to-date central budget cash-flow deficit to HUF 2.86tr. This is 63% of the newly revealed cash-flow deficit plan for 2024. The latest Excessive Deficit Procedure (EDP) report of the Hungarian Central Statistical Office

(HCSO) sheds light on this new figure, which stands at HUF4.54tr or 5.55% of GDP. The roughly 1ppt European System of Accounts (ESA) gap between the unchanged 4.5% Maastricht deficit target and the local central government cash-flow plan is a result of EU funds accounting, the BUD airport purchase and may also be related to the inflation-linked retail bond coupon payments. While this new target is some HUF500bn higher than this year's officially planned financing needs, we don't see any change in the financing plan as the difference was already in the government's cash account due to last year's pre-financing.

Budget performance (year-to-date, HUFbn)

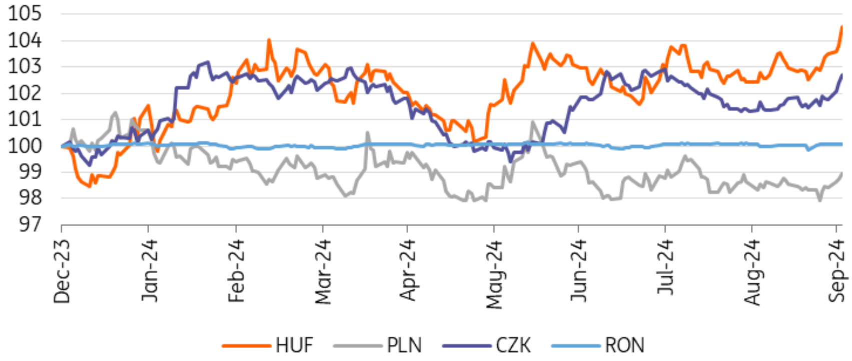


Source: Ministry of Finance, ING

We see a backstop for further HUF weakness

The forint, like CEE peers in the EM space, has come under pressure in recent days thanks to escalation in the Middle East and sliding EUR/USD. For now, we can see the strongest HUF sensitivity to global exposure within the CEE peers, which is usually the case in situations like this. The 400 EUR/HUF key level is back in sight after a long time with EUR/HUF touching the highest levels since early 2023. With a calming of the global situation not near at the moment, we may see continued pressure on FX. On the other hand, local fundamentals supporting the currency remain strong. IRS spread vs core markets widened during the current core rally to the highest levels since late June, which should fuel HUF appreciation later. Normally, we would say that the 392-400 EUR/HUF range remains the playing field until the end of the year, but the current geopolitical situation could easily take us above the key 400 level. However, a weaker HUF also means a more hawkish NBH, which should be a backstop for further weakness and time for a fade move in EUR/HUF.

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

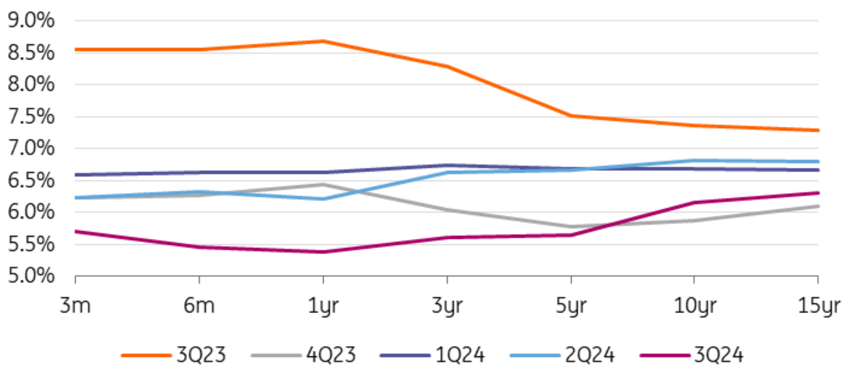


Source: NBH, ING

The sell-off to leave HGBs cheap and attractive

Although the rates and bond markets were able to resist global pressures late September, the escalation in early October has pushed the Hungarian market to some repricing and eliminated about half of one NBH rate cut across the curve for now and we can expect more volatility in the days ahead. Still, we believe the entire IRS curve should be lower based on fundamentals, but risk-off moods usually affect HUF assets significantly and a sell-off is the first reaction at the moment.

Hungarian sovereign yield curve (end of period)



Source: GDMA, ING

In the universe of Hungarian government bonds (HGBs), even taking into account the fiscal risk for this year, the borrowing needs are basically covered. The debt agency indicates 77% coverage of all needs and 96% of HGBs issuance in the third quarter report, matching our calculations. The last of this year's maturing HGBs (HUF773bn) is due at the end of October, which could allow the debt agency to reduce supply in the last two months, similar to last year, which could lead to a tightening of ASWs, but they are already rather expensive. Nevertheless, the overall picture continues to look favourable due to steady high demand in auctions and secured financing. In addition, next year would not indicate any problems on the supply side and thus the debt agency does not need to front-load issuance significantly. Once the global situation calms down, we believe HGBs can thus offer the best risk-reward in the CEE region.

Forecast summary

	2Q24	3Q24F	4Q24F	1Q25F	2Q25F	2023	2024F	2025F
Real GDP (%YoY)	1.5	1.3	2.2	2.4	3.3	-0.9	1.5	3.6
CPI (eop, %YoY)*	3.7	3.0	4.6	3.7	4.3	17.6	3.8	4.0
Central bank key rate (eop, %)	7.00	6.50	6.25	6.25	5.50	10.75	6.25	5.00
3m interest rate (%)*	6.89	6.32	6.05	5.95	5.30	13.98	7.41	5.42
10yr yield (%)*	6.82	6.16	6.25	6.45	6.65	7.56	6.36	6.62
EUR/HUF exchange rate*	395.2	397.2	395.0	400.0	408.0	382.0	393.2	401.6
USD/HUF exchange rate*	369.4	356.7	359.1	363.6	370.9	353.3	359.8	365.1

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

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