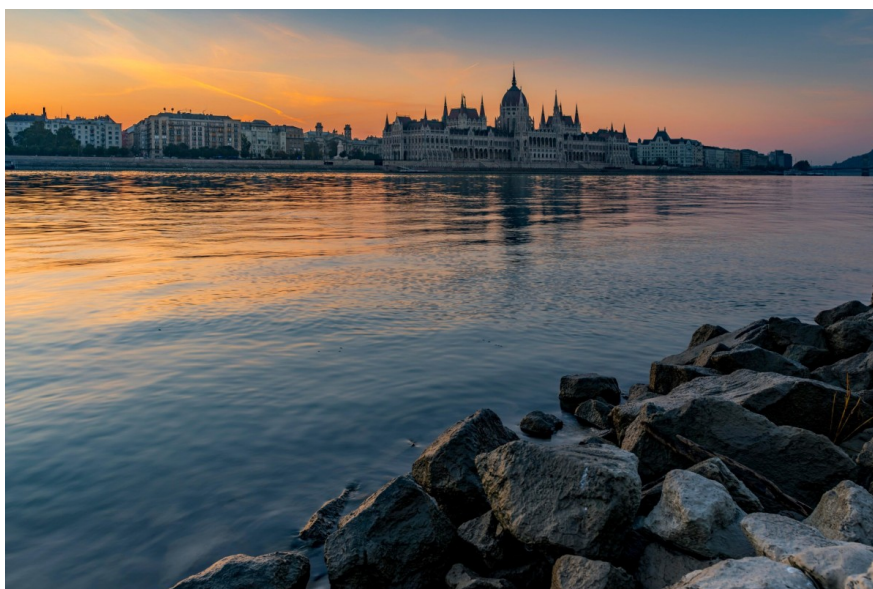


Monitoring Hungary: Moving in the wrong direction

In our latest update, we reassess our Hungarian economic and market forecasts at a time when a plethora of indicators and moves in market consensus suggest that things won't improve quickly. The situation is far from dramatic, but we had hoped for a better start



Hungary is facing another challenging year after two years full of negative surprises, but the third could be a charm

Hungary: At a glance

- The dull **GDP growth** seen in the fourth quarter of 2024 means that the carry-over effect will be virtually zero in 2025. With all the local and global headwinds, we see 2% GDP growth as the base case for Hungary.
- There are **plenty of headwinds**. Consumer and business confidence are both moving in the wrong direction, reducing the potential for a quick and strong turnaround in the economy.
- The main **labour market indicators** show a positive change, but this is due to a fall in labour supply rather than any real development. The risk of a negative feedback loop for further weakness in consumer and business confidence is on the rise.
- A slow deterioration has started in the **external balances**, though we currently don't see anything that wasn't already expected. Trade balances should remain in surplus in 2025, but with a narrowing trend.

- **Underlying inflation indicators** ticked up in December. Price expectations and perceived inflation are galloping higher. We revise our average inflation forecast for 2025 up to 4.5%.
- Our new base case contains a total of **75bp easing in 2025** with a more back-loaded profile – though the probability of this happening is sharply dropping, and the likelihood of a flat policy rate of 6.50% during this year is increasing.
- With 2026 being an election year, a series of negative surprises in economic activity and the labour market will put the **3.7% of GDP deficit target** at risk.
- We see little point in chasing a **rally for the Hungarian forint** here as EUR/USD is likely to correct in the near future, which in turn should put some pressure back on EM currencies in general. We see **EUR/HUF** peaking at around 420 this year.
- The belly and long-end of the yield curve are mispriced at current levels and we should be pricing **more cuts in the medium-term horizon** than the very short term.

Quarterly forecasts

	4Q24	1Q25F	2Q25F	3Q25F	4Q25F	1Q26F	2Q26F	3Q26F
Real GDP (%YoY)	0.4	0.4	0.6	2.7	4.2	4.8	5.1	4.3
CPI (eop, %YoY)	4.6	3.9	4.7	4.6	4.4	3.8	3.5	3.3
Central bank key rate (eop, %)	6.50	6.50	6.50	6.25	5.75	5.50	5.25	5.00
3m interest rate (eop, %)	6.50	6.50	6.50	6.10	5.60	5.35	5.10	4.85
10yr yield (eop, %)	6.56	6.60	6.75	7.00	7.15	7.35	7.25	7.15
EUR/HUF exchange rate (eop)	410.1	415.0	415.0	418.0	420.0	424.0	420.0	422.0
USD/HUF exchange rate (eop)	393.6	406.9	415.0	418.0	411.8	415.7	411.8	409.7

Source: National sources, ING estimates

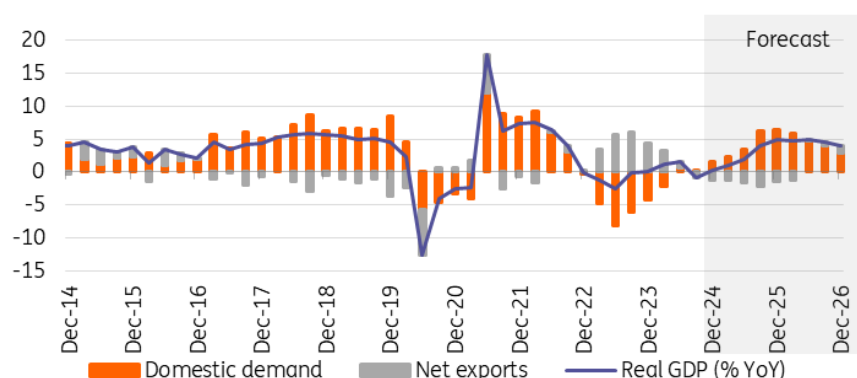
We maintain our 2025 GDP forecast

Hungary's 0.5% quarter-on-quarter GDP growth in the fourth quarter of 2024 brought the country out of technical recession, but annual growth for the year as a whole was only 0.5%.

Agriculture, industry and construction were the main drags, while services offset this negative performance. On the expenditure side, consumption seemed to be the driving force, with investment somewhat better, but net exports were a drag. With zero carry-over effect into 2025, Hungary needs an average quarterly growth rate of 1.325% this year to meet the government's GDP forecast of 3.4%. This is not impossible, but we would describe it as challenging in the current environment.

We see GDP growth of around 2.0% in 2025, driven by consumption and investment. Without a change in external demand, net exports could continue to be a drag as we see import activity picking up.

Real GDP (% YoY) and contributions (ppt)



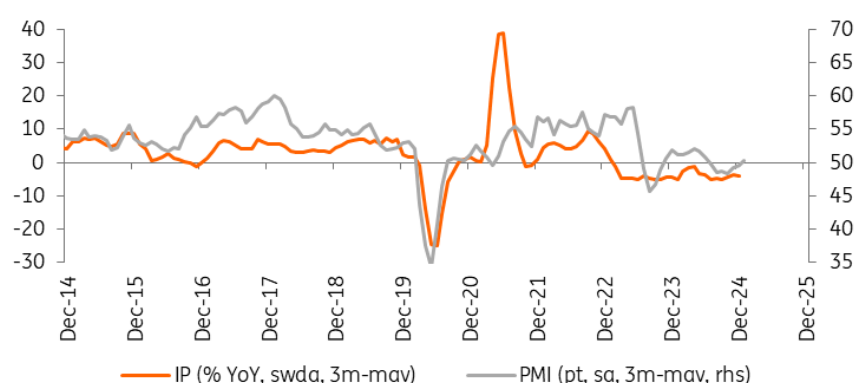
Source: HCSO, ING

Industry brings another negative surprise

Industry was unable to maintain its positive momentum in November and December, and production is now 6.4% below last year's level. Industrial production is also more than 6% below the average monthly performance in 2021, so industry has wasted another year and continues to slump.

In December, the two main sub-sectors (cars and electric vehicle batteries) were in decline, but were accompanied by some positive developments in electronics and food. Looking ahead, structural problems in external demand and moderate recovery expectations remain. Industry is unlikely to turn around in the short term. While new capacity will come on stream later this year, a further deterioration in the global environment may dampen the impact. Domestic business confidence indices are also on a downward trend. At present, industry is unlikely to be a major contributor to GDP growth in 2025.

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



Source: HCSO, ING

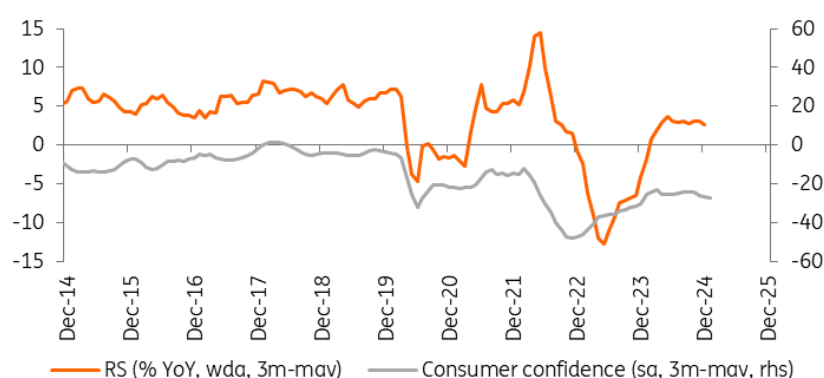
Retail sales close 2024 with a poor performance

After positive surprises in October and November, retail sales ended the year with a poor performance. On an annual basis, retail sales rose by only 0.1% in December. The average sales

volume in 2024 was 0.5% lower than the average performance in 2021, so the overall picture remains bleak.

Looking at the details for December alone, this time around there was more of an overall deterioration in the sector, with broadly similar declines across the sub-sectors. The biggest decline was in fuel sales, which fell by 3% on the month as a result of rising prices. The weak year-end performance of the retail sector as a whole holds back hopes of a strong rebound in 2025. Nevertheless, real wage growth is expected to remain strong and, together with large retail bond payments, this could boost consumption. However, FX volatility and rising perceived inflation are putting consumer confidence back on a downward trajectory, which is a warning sign.

Retail sales (RS) and consumer confidence



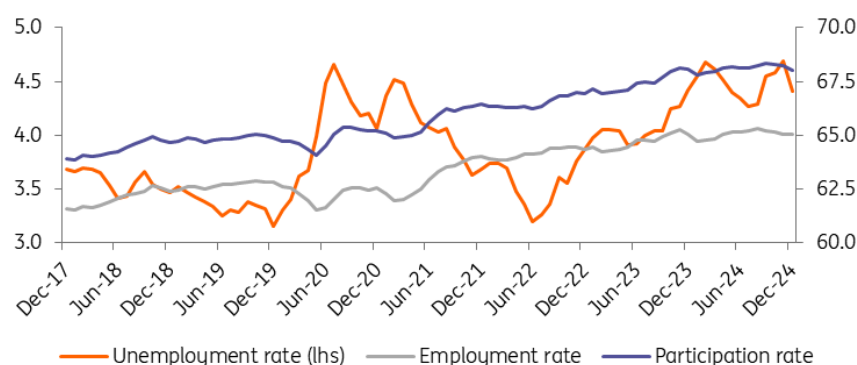
Source: HCSO, ING

Brighter labour market data should be taken with a pinch of salt

The official three-month unemployment rate fell to 4.4% in October-December, which was a positive surprise. However, this was due to a fall in labour supply rather than an increase in labour demand. Looking at the year as a whole, however, we can see a worsening trend, with both supply and demand falling. The same can be seen in the labour hoarding statistics, which also showed a decline at the end of the year, mainly due to ongoing layoffs.

Nevertheless, the labour market is still tight and this could be exacerbated by new production capacity in the manufacturing sector. In 2025, companies may have to rationalise their workforces further, as suggested by falling confidence indicators. However, we see a slight improvement this year, with an average unemployment rate of around 4%, as supply-side problems increase.

Historical trends in the Hungarian labour market (%)

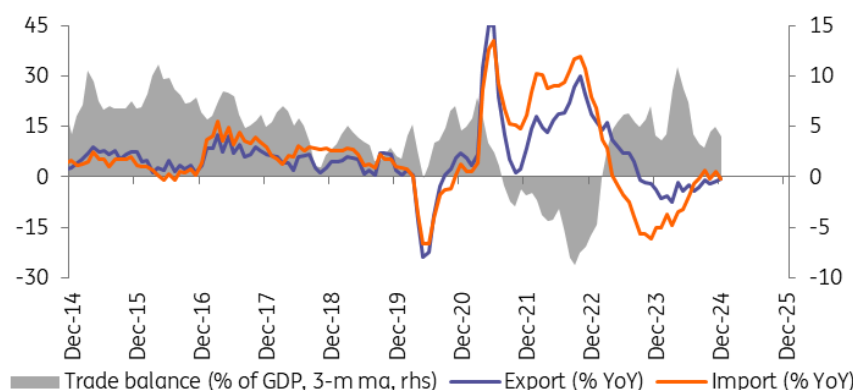


Source: HCSO, ING

Current account surplus to narrow this year

While the value of exports in euro terms fell by 3.6% in 2024 compared with the previous year, the value of imports fell by 5.7%. The surplus in the trade balance therefore came in at EUR 11.6bn, roughly EUR 2.5bn higher than a year ago. And this is despite the continued weakness in industrial export sales. In our view, domestic demand will drive GDP growth in 2025, leading to a significant increase in import needs. While new manufacturing capacity will help exports, it will also boost import activity. As a result, without a significant turnaround in the external environment, we forecast a negative impact of net exports on economic activity. Against this backdrop, we also expect the current account and trade balances to narrow, but remain in clear surplus territory.

Trade balance (3-month moving average)



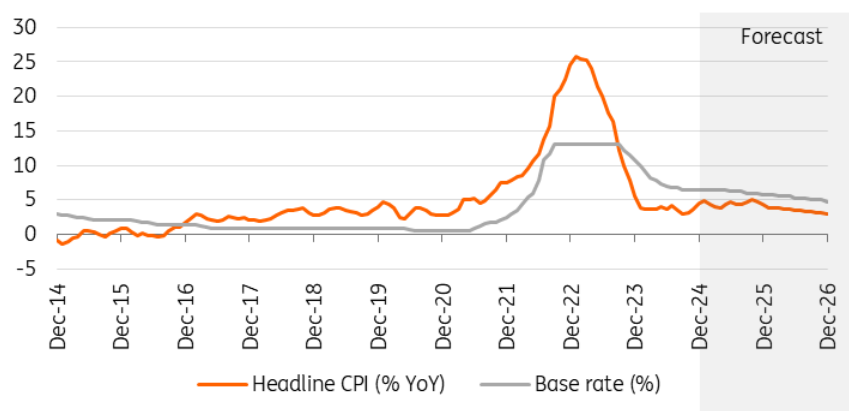
Source: HCSO, ING

We raise our inflation forecast for 2025

Inflation rose to 4.6% YoY in December, with both headline and core inflation accelerating, probably in part due to the weaker forint. Rises in fuel prices, processed food and consumer durables were the significant contributors. The bigger issue is that these items are also affecting perceived inflation. In turn, household confidence is being impacted not only by the official statistical data but also by the increasing perceived inflation, which is exacerbating negative sentiment and makes price expectations less anchored.

The 2024 average inflation of 3.7% is better than forecast at the beginning of 2024, but this is overshadowed by the weak economic performance. Looking ahead to 2025, we see the average at 4.5%, with the acceleration coming from tax changes, wage pressures, global commodity prices and a weaker HUF.

Inflation and policy rate



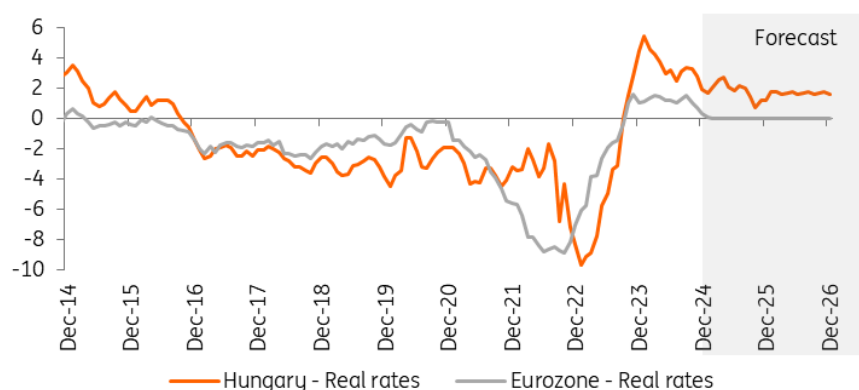
Source: NBH, ING

Rising inflation keeps the base rate unchanged for a while

The National Bank of Hungary (NBH) kept its base rate unchanged at 6.50% in January. The main message was the rising inflation risk, driven by risk aversion, geopolitical tensions and rising inflation expectations. The expected divergence between the Federal Reserve and the European Central Bank in 2025 could further increase risk aversion in emerging markets, which is a hawkish message.

The careful, patient and stability-oriented approach remains, and a rate cut is off the table for the foreseeable future, based on the new forward guidance. While we stick to our call of a total of 75bp (heavily back-loaded) easing in 2025, we admit that the probability of this happening decreases sharply and the likelihood of a flat policy rate of 6.50% increases – especially if inflation prints surprising on the upside and inflation expectations become less anchored.

Real rates (%)



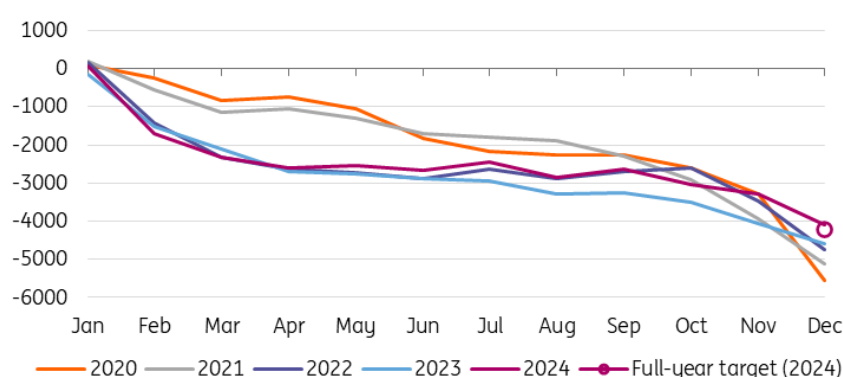
Source: ECB, NBH, ING

The 2025 budget outlook remains a black box

The monthly budget deficit of HUF 811bn in December 2024 was lower than usual, bringing the cash deficit for the year to HUF 4,096bn. This positive surprise is probably due to the tight control of the expenditure side. While the cash-flow deficit outperformed the plan, the accrual-based deficit was 4.8% of the GDP, which is above the 4.5% planned target. The official accrual deficit target valid at the beginning of 2025 is 3.7% of GDP, but we think there is a non-negligible chance of slippage.

Due to the different macroeconomic outlook, our deficit forecast is 4% of GDP and we think it is more likely that the deficit will be even higher than that, especially if negative growth risks materialise in the run-up to the general election in spring 2026.

Budget performance (year-to-date, HUFbn)



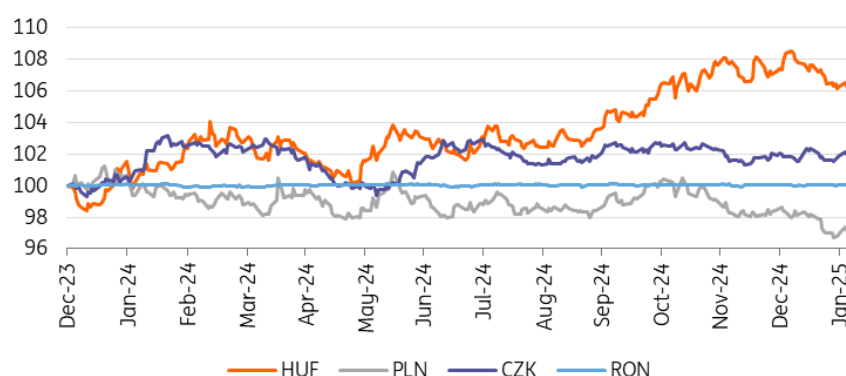
Source: MinEco, ING

Forint remains vulnerable despite the encouraging start of the year

The upgraded hawkish message from the NBH after its January meeting has proved to be an effective positive signal for FX. EUR/HUF has been grinding lower since early January, so the relief on the global side is a major factor here, but the steady and cautious NBH tone helps as well.

In our view, EUR/HUF has a chance to hold lower levels for longer and potentially test new lows, however there is little point chasing a long-lasting HUF rally here given the likely rebound in EUR/USD lower as sooner or later the tariff-optimist will fade. As soon as it happens, this should put some pressure back on EM currencies in general.

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



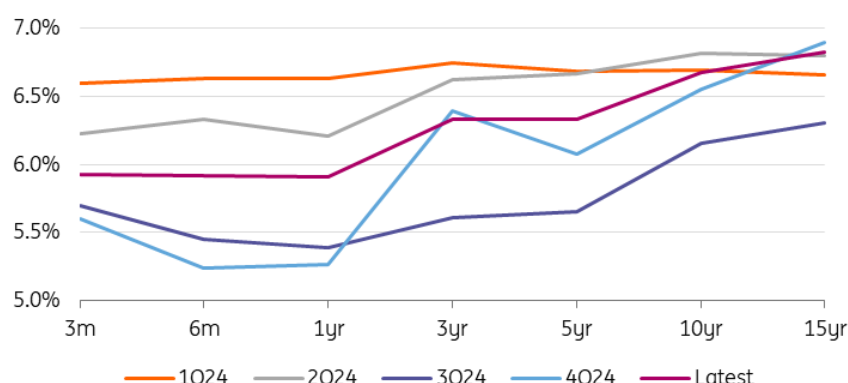
Source: NBH, ING

At the moment on the local side we see that the relationship between the interest rate differential and FX has reversed since the US election, and lower market rates indicate a stronger HUF. This may be typical for temporarily stressed markets. However, as the HUF market normalises and at the same time pressure on EM currencies returns, we believe EUR/HUF will head higher again heading into the 410-415 range in the medium term with the prospect of future rate cuts, which for now we don't have much timing conviction on – but markets are increasingly pricing in that they will come one day.

The market should return to dovish pricing, while bond supply increases

The rates market in Hungary, like the FX market, has been following the developments in the core market. The IRS curve keeps inching lower, with some flattening bias since the last NBH rate setting meeting. This confirms our view that although NBH rate cuts seem unclear in the short term, the belly and long-end of the curve are mispriced at current levels and we should be pricing more cuts in the medium-term horizon than the very short term. The FRA curve in the annual horizon is pricing two 25bp rate cuts. Still, most of the IRS curve is trading very close to BUBOR rates, which we think will continue to be at attractive levels for the market as long as EUR/HUF stays in check. We should therefore see further compression in the elevated premium vs core rates in our view.

Hungarian sovereign yield curve (end of period)



Source: GDMA, ING

In the bond market, Hungarian government bonds (HGBs) continue to enjoy the highest demand in primary auctions in the CEE region. The debt agency has published a funding plan for next year that indicates a shift in focus towards local currency bonds and a lower weighting of retail and FX issuance. Overall, gross issuance of HGBs is expected to increase by around 33% next year. The debt agency expects the tax incentive for local banks and insurers to be the main buyers, while some of the retail bond redemptions should go to the local market. On the other hand, the fiscal risk points to a larger supply than the debt agency is currently indicating. HGB issuance should be directed to the long end of the curve. Combined with the NBH story, we see a re-steepening of a curve that flattened significantly during the November sell-off, offering interesting levels.

In the bond market, Hungarian government bonds (HGBs) continue to enjoy the high demand in primary auctions and the start of the year confirmed that the positive sentiment continues. Despite a significant increase in the issuance plan this year, January suggests smooth coverage for now. By our calculations, the debt agency has covered roughly 13% of this year's issuance of HGBs. At the same time, most FX issuance has been placed in the market and we also see strong demand for retail bonds coming from heavy redemptions. After the first month of this year, Hungary therefore seems to be the best positioned within the CEE region in terms of supply. Valuations also seem attractive in our view, looking at the spreads versus CEE peers. Similar to rates, we see room for a rally in the belly and long end of the curve. Given the increase in issuance especially at the long end, the belly of the curve therefore seems to us the best place to be at the moment.

Forecast summary

	4Q24	1Q25F	2Q25F	3Q25F	4Q25F	2024	2025F	2026F
Real GDP (%YoY)	0.4	0.4	0.6	2.7	4.2	0.5	2.0	4.4
CPI (eop, %YoY)*	4.6	3.9	4.7	4.6	4.4	3.7	4.5	3.5
Central bank key rate (eop, %)	6.50	6.50	6.50	6.25	5.75	6.50	5.75	4.75
3m interest rate (%)*	6.50	6.50	6.50	6.10	5.60	7.50	6.24	5.10
10yr yield (%)*	6.56	6.60	6.75	7.00	7.15	6.42	6.81	7.18
EUR/HUF exchange rate*	410.1	415.0	415.0	418.0	420.0	396.3	415.6	422.0
USD/HUF exchange rate*	393.6	406.9	415.0	418.0	411.8	366.3	409.0	411.5

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

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