Monitoring Hungary: Peaks and troughs

In our latest update, we reassess our economic and market forecasts for Hungary, as the economy navigates through a three-quarter technical recession. Sky-high inflation is suffocating economic activity, but inflation is turning, and the labour market is defying the trough, so we expect the economy to soon be back on track

For the time being, we continue to see inflation as the biggest risk to Hungary's labour market

Hungary: At a glance

- Even though the economy is currently in a technical recession, we believe that it will be short-lived, and a marked rebound can take place in the third quarter of 2023.
- Household purchasing power has been deteriorating for five months now, but we expect positive real wage growth in the second half of 2023, which in turn can fuel economic activity.
- With the inflation peak behind us, we see a gradual decline in the near term, followed by speedy disinflation. We forecast a single-digit inflation print in December.

- The central bank is patiently waiting for a number of risks to alleviate; thus, we believe that a dovish pivot can happen in June at the earliest.

- Lower energy prices will continuously improve the country's external balances in the coming months as reflected in the latest trade balance data.

- We still see the 2023 deficit-to-GDP target as roughly realistic, where the key risk remains to secure the planned 2.9% of GDP transfers from the European Union.

- The labour market has been gradually weakening, but it is nowhere near a crisis scenario, and we see a turnaround in late summer.

- After two weeks of heightened volatility, the forint has recovered to pre-SVB collapse levels and posted the best year-to-date performance in the CEE region.

- We consider Hungarian Government Bonds to be cheap based on their spread against CEE peers, with high potential for a rally if risks do not materialise.

Quarterly forecasts

	4Q22	1Q23F	2Q23F	3Q23F	4Q23F	1Q24F	2Q24F	3Q24F
Real GDP (%YoY)	0.4	-0.6	-0.9	1.3	2.9	3.9	4.2	3.4
CPI (eop, %YoY)	24.5	24.8	20.8	14.0	9.0	6.1	5.7	3.7
Central bank key rate (eop, %)	13.00	13.00	13.00	13.00	11.50	8.00	6.75	6.00
3m interest rate (eop, %)	16.18	16.30	16.00	14.00	11.25	7.75	6.50	5.75
10yr yield (eop, %)	9.05	8.40	7.75	7.25	7.05	7.05	7.00	6.80
EUR/HUF exchange rate (eop)	400.3	380.0	370.0	383.0	375.0	370.0	365.0	365.0
USD/HUF exchange rate (eop)	375.7	349.0	336.4	342.0	326.1	321.7	317.4	317.4

Source: National sources, ING estimates

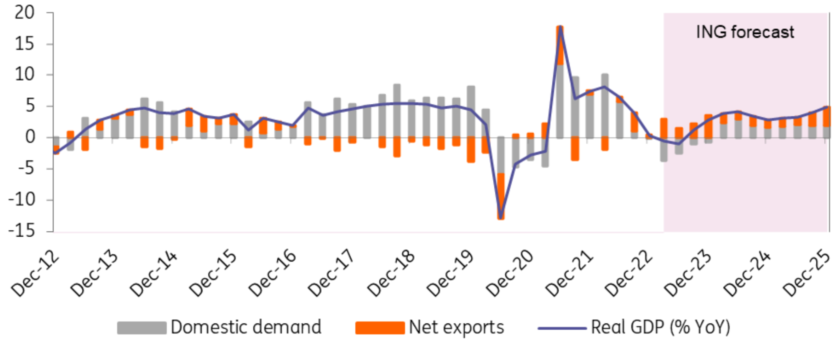
Technical recession will be short-lived

Hungary has been in a technical recession for three quarters (3Q22-1Q23) as sky-high inflation suffocated economic activity. The latest GDP data show a 0.4% quarter-on-quarter (QoQ) contraction in the fourth quarter, and only the 0.5ppt contribution of net exports was able to keep the annual figure (0.4% YoY) above water. Wholesale and retail trade contracted on an annual basis. Growth rates of industry, construction and services have all slowed down.

The economy has largely managed to pull through the gradual decline of household purchasing power in the fourth quarter of last year. We don't believe that this resilience has continued into 2023 as real wages are dropping at their fastest pace since 2008-09, so we see another drop in the real GDP in the first quarter. The economy will likely emerge from the technical recession in the second quarter, followed by a marked rebound from the third quarter, which will help bring full-year GDP growth to 0.7%.

Hungarian GDP falls in the fourth quarter, officially confirming the technical recession

Real GDP (% YoY) and contributions (ppt)



Source: HCSO, ING

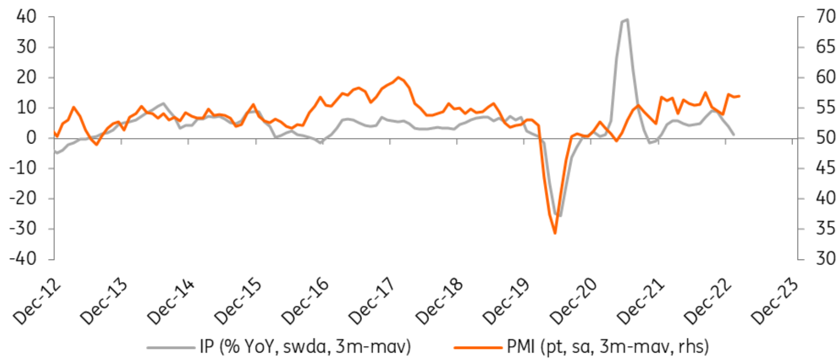
Industry is having a tough time

Industry started 2023 off on the wrong foot as production in January shrank by 3.2% year-on-year, after adjusting for calendar effects. The monthly dynamics paint an even bleaker picture with a 5.1% month-on-month drop. The largest positive contributors to industrial performance were electrical and transport equipment manufacturing (e.g. electric vehicle batteries and cars). The food industry seems to still be struggling as it posted a yearly contraction in the volume of production.

Going forward, uncertainty concerning future industrial performance remains elevated with PMI releases offering little clues. Nevertheless, with easing external demand for manufactured goods, we believe that the underperformance of the Hungarian industry will likely continue in the short run.

[No one saw this big drop coming in Hungarian industry]

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



Source: HALPIM, HCSO, ING

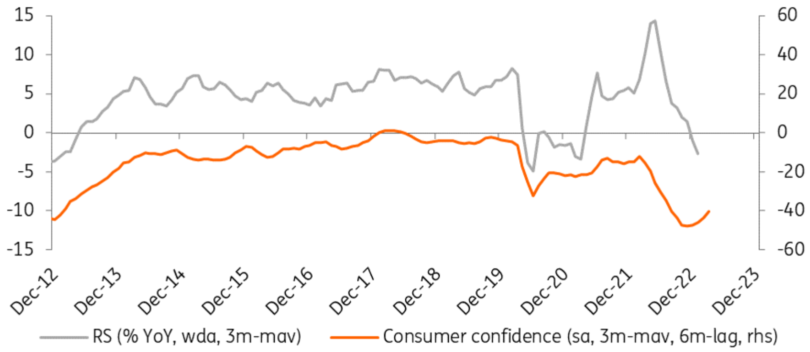
Retail sales will continue to fall as real wage growth deteriorates

After December's poor performance, retail sales registered a 4.5% YoY decline in January, because of a 0.6% MoM contraction. The loss in households' purchasing power continues to constrain overall consumption, as food retailing dropped nearly 5.0% YoY, while non-food retailing fell by 1.5% YoY. With the removal of the fuel price cap, fuel retailing declined too.

Despite sky-high inflation, household consumption did not collapse entirely, which is likely due to consumption smoothing, as consumers tapped into their savings to maintain nearly the same standard of living. We don't think this can continue for long. As the deterioration of real wages will likely exacerbate, the volume of retail sales will continue to drop, which in turn will have a marked drag on the first quarter's economic performance, contributing to the ongoing technical recession.

Hungarian retail sales deteriorate further

Retail sales (RS) and consumer confidence



Source: Eurostat, HCSO, ING

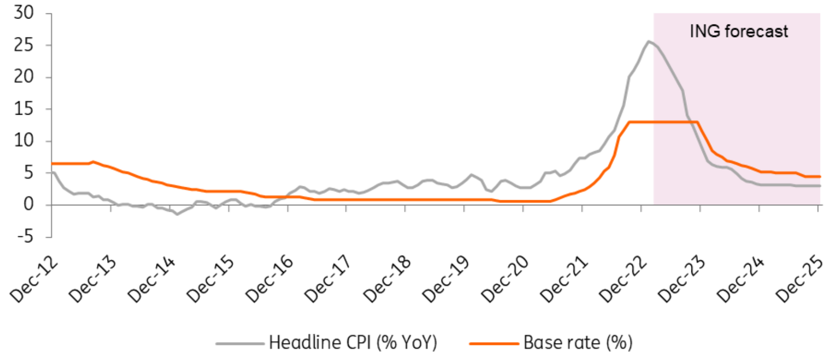
Inflation will markedly slow down from April

January's 25.7% YoY inflation print marked the peak as February's reading came in slightly below that (25.4%). Food inflation continued to moderate for a second month in a row in February, while both fuel and household energy prices retreated. On the other hand, prices of alcoholic beverages and tobacco have picked up, along with a rise in services prices.

We believe that the prices of food, durable goods and energy could decelerate due to falling energy prices, recent forint strength and stronger retail competition on dropping aggregate demand. So, we expect a slow deceleration in the coming months both in headline and core inflation. On top of this, base effects will contribute to a substantial decline in the year-on-year headline inflation starting from April.

We continue to expect full-year average inflation of around 19% in 2023, with December's figure dipping into a high single-digit area. In our view, a key risk for inflation is the expected positive real wage growth in the second half of this year.

Inflation and policy rate



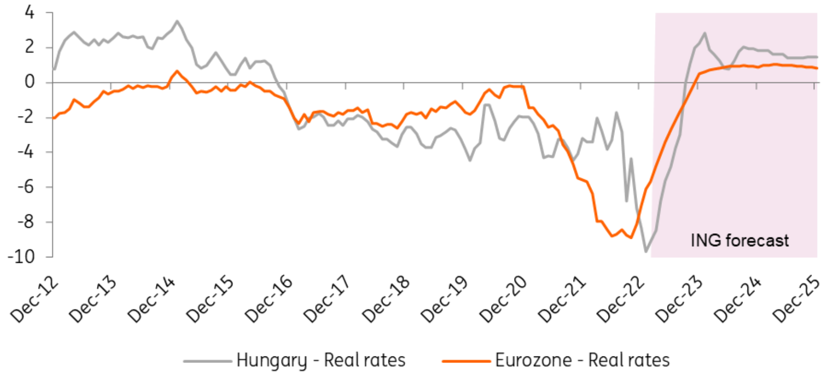
Source: NBH, ING

No pivot is expected by the central bank at least until June

The National Bank of Hungary (NBH) has left the interest rate complex unchanged since mid-October, leaving the base rate at 13% and the one-day quick tender as the effective marginal rate at 18%. At the latest Monetary Council meeting in March there was no signal, nor any hint of a potential pivot as the NBH remains cautious and patient in monitoring local and global developments. The lack of evidence confirming any permanent improvement in both external and internal imbalances makes the NBH cautious about a potential policy shift. Overall, the last meeting strengthened our view that we won't see any change in the monetary policy setup at least until June. If easing starts, it will come in 50bp or 100bp monthly steps and we see the year-end effective (and base) rate at 11.5%.

Hungary's central bank ain't got no room for change

Real rates (%)



Source: ECB, NBH, ING

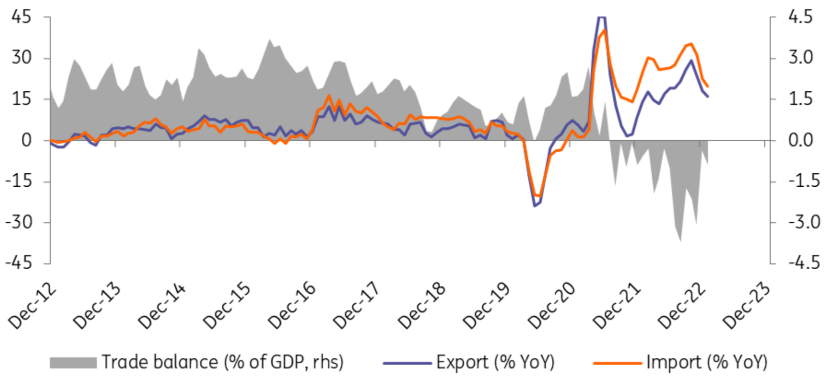
Trade balance is on track to improve amid lower energy prices

After extreme trade balance deficits throughout the second half of 2022, the toll on the trade balance has markedly diminished as energy prices have fallen. The latest €413m trade balance data from January roughly halved compared to fourth-quarter levels, equating to a deficit of

€824m; thus, we see material progress on this front.

Our Head of Commodities Strategy forecasts the TTF natural gas price for this year to be in the range of €52-62MWh on average, which can keep the energy-related trade balance in a significantly more favourable position compared to last year's third (€171MWh average price) and fourth (€151MWh average price) quarters. As energy import prices in Hungary follow the Dutch TTF gas prices largely by a two-month lag, we expect the trade balance to gradually improve throughout the year.

Trade balance (3-month moving average)



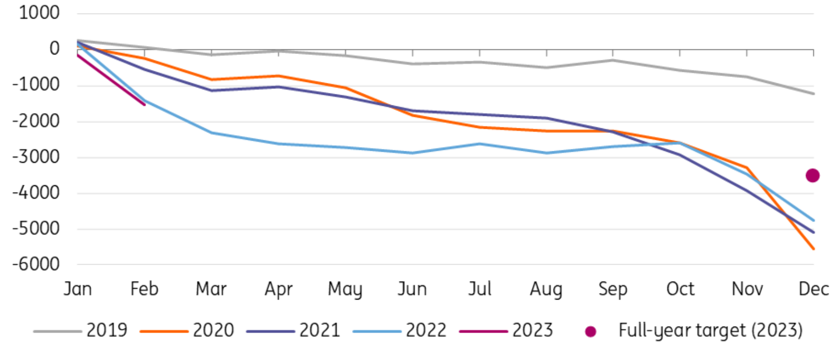
Source: HCSO, ING

Despite a bumpy start, we still expect the budget deficit target to be met

The Hungarian budget posted a HUF 1,381.5bn deficit in February, pushing the year-to-date shortfall to above HUF 1,500bn. The main culprits behind this astonishing deficit were pension expenditures (supplemented by the so-called "13th-month one-off payment"), debt servicing, and financing the Overhead Reduction Scheme (ORS). The special pension payments can be discounted from March onwards, while the retreat of global energy prices helps to alleviate the financing cost of the ORS. Thus, we expect a moderation regarding the upcoming deficits.

This year, the government is calculating a shortfall totalling 3.9% of GDP, with the Overheads Protection Fund (HUF 2,610bn) and debt servicing (HUF 2,074bn) being one of the costliest components. Even though 48% of the full-year target has been met in February, we believe that fiscal consolidation will take place in 2023, which is crucial to keep negative rating decisions at bay.

Budget performance (year-to-date, HUFbn)



Source: Ministry of Finance, ING

Real wages drop at the fastest pace since 2008

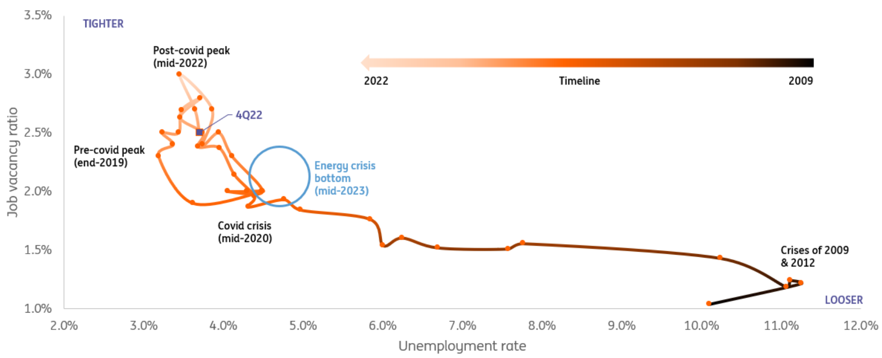
The Hungarian labour market appears resilient amid the technical recession, although it is gradually weakening. The three-month unemployment rate inched up to 4.1% in the December-February window. The number of unemployed is on the rise, as some workers that have been made redundant cannot find new jobs immediately, while roughly half of firms have enacted a hiring freeze in the current economic climate. We expect the unemployment rate to rise further, albeit at a slow pace, peaking around 4.5% in the summer.

The secularly tight labour market clearly impacts workers' compensation as gross wages in January rose by 16.1% YoY. However, after adjusting for inflation, real wages dropped by 7.6% YoY. January is the fifth consecutive month in which real wage growth has been negative, and we believe that this trend will continue at least until the end of this summer. In our view, the pace of wage growth will be around 16-17% in 2023. Though a turnaround in real wages is likely in the second half of the year.

Hungarian unemployment edges up

Hungarian real wages drop amid sky-high inflation

Tightness of the Hungarian labour market with ING's forecast

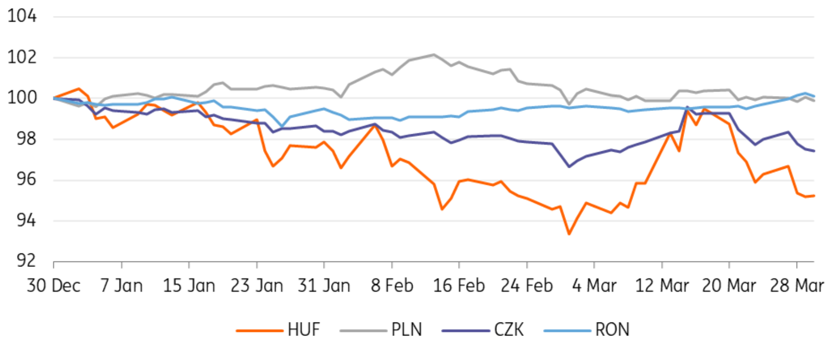


Source: HCSO, ING

Local and global factors make case for a renewed forint rally

The Hungarian forint has maintained the highest beta against the global story, which, assuming favourable global conditions, creates room for a significant recovery. Together with the Czech koruna, the Hungarian forint remains our favourite CEE currency in the current market conditions. The NBH has made it clear that priced-in rate cuts are not on the table at the moment, which should keep FX carry by far the highest in the region. In addition, the decline in risk aversion, higher EUR/USD rates and lower energy prices provide perfect conditions for a forint recovery in the coming weeks.

FX performance vs EUR (30 December 2022 = 100%)

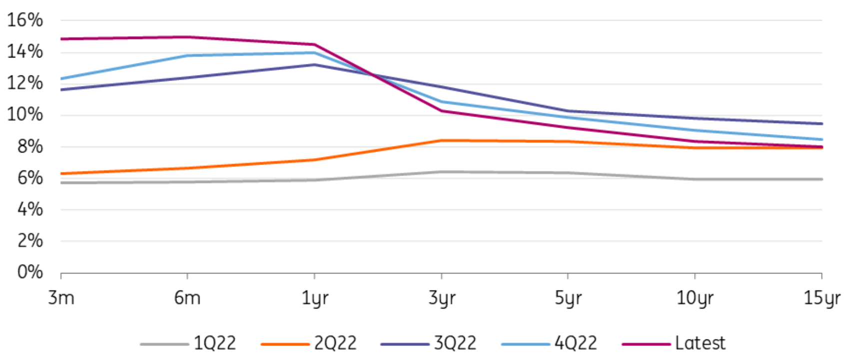


Source: NBH, ING

We see high potential for Hungarian Government Bonds

On the bond side, funding appears fully under control for the first quarter. On 7 March the Debt Management Agency (AKK) made a private placement of $450m regarding two USD-denominated bonds. Moreover, CEO Zoltan Kurali didn't rule out further FX debt issuance during the second half of the year, even though Hungary has pretty much met this year's Eurobond issuance targets. As the AKK sees this as a possible pre-financing step for 2024, this could be a sign that on the one hand the government expects further delay in EU transfers, but on the other hand, naming it "pre-financing" means that any issuance will ease the burden on next year's FX debt issuance, suggesting the EU funds will eventually flow.

Hungarian sovereign yield curve



Source: GDMA, ING

AKK has covered about 25.3% of all planned Hungarian government bonds (HGBs) for this year since the beginning of the year, according to our calculations, lagging a bit behind CEE peers. On the other hand, FX (87.5%) and retail issuance (36.4%) remain funding strengths. On the fiscal side, February's state budget numbers show risks of a higher deficit, but for now we believe the government will manage to keep the deficit under control. Thus, as with the forint, the main risk remains the government's dispute with the European Commission and weaker bond market liquidity compared to CEE peers. On the other hand, looking at the HGBs spread against CEE peers, we consider HGBs to be cheap with a high potential for a rally if risks do not materialise.

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