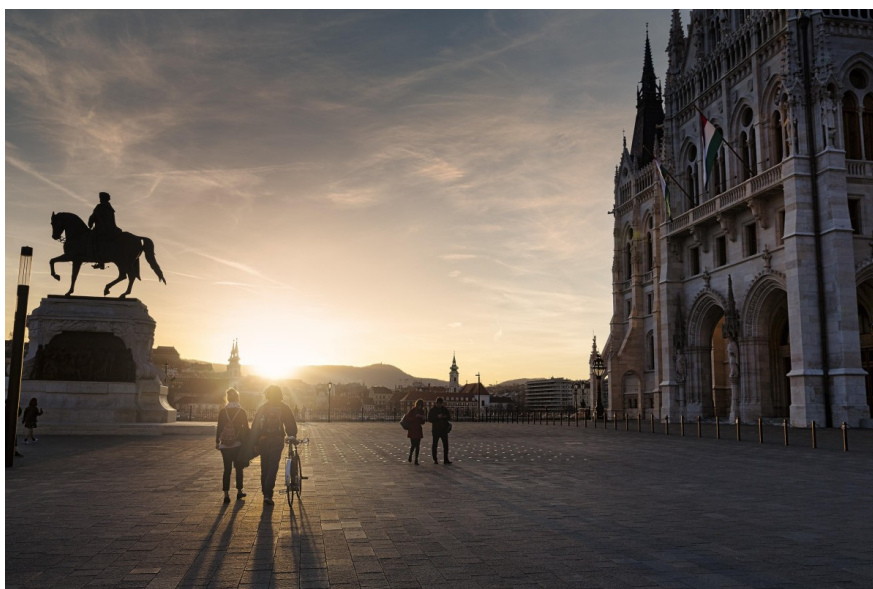


## Monitoring Hungary: Sensing some optimism

In our latest update, we reassess our Hungarian economic and market forecasts at a time when a number of economic data releases have surprised to the upside. Against this backdrop, we sense some optimism in the air when looking at the bigger picture



While Hungary's outlook remains clouded, we see some rays of light breaking through

### Hungary: At a glance

- We are still waiting for the detailed first-quarter GDP release (due on 4 June), but based on the current set of information, we see upside risk to our full-year GDP forecast of 2.2%.
- There is still a clear divergence between the retail and industrial sectors, with the former showing some signs of life while the latter is clearly struggling.
- The labour market remains resilient, with the unemployment rate roughly stable while wage outflows remained very strong throughout the first quarter of 2024.
- We believe that the surprisingly wide surplus in the trade balance is only temporary, supported by a lower import bill on very slowly improving domestic demand.
- Disinflation came to an end in Hungary, with the first wave of strong reflation (due in May) being a well-flagged upswing due to base effects. However, the drop in fuel prices has done much to reduce the pace of acceleration.

- The central bank is paying attention to the changing inflation landscape, and we therefore believe that the patient and cautious approach is justified and will remain in place.
- The latest budgetary data indicates that the expenditure side is under tight control, so we see a maximum risk of 0.5ppt to the updated 4.5% of GDP deficit target – an improved picture compared to our previous calculation.
- There are two rounds of credit rating decisions ahead of us, where we think that the risk of an outlook downgrade by Moody's is moderate. For Fitch, the chance for an outright downgrade is rather substantial.
- We see the current EUR/HUF levels as this year's lows, with a bounce in the domestic story returning to the markets' attention in the coming months and heading down again with 385 at the end of this year.
- Rates and bonds face uncertain conditions domestically and globally in the coming weeks that will show the next direction. This leaves us with a preference to be neutral here.

## Quarterly forecasts

	1Q24	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F
Real GDP (%YoY)	1.1	2.3	2.2	3.1	3.2	3.3	3.9	4.8
CPI (eop, %YoY)	3.6	4.3	3.9	5.7	4.4	4.3	3.7	3.0
Central bank key rate (eop, %)	8.25	7.00	7.00	7.00	6.75	6.00	5.75	5.25
3m interest rate (eop, %)	7.83	7.00	7.00	7.00	6.65	5.95	5.75	5.25
10yr yield (eop, %)	6.69	7.35	6.95	6.85	7.00	7.10	7.20	7.20
EUR/HUF exchange rate (eop)	395.8	395.0	388.0	385.0	395.0	405.0	400.0	405.0
USD/HUF exchange rate (eop)	367.3	365.7	352.7	350.0	359.1	368.2	363.6	368.2

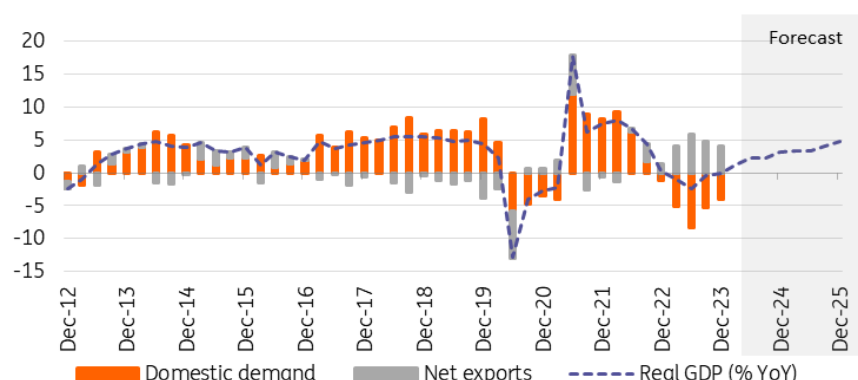
Source: National sources, ING estimates

## We are slightly more optimistic about the medium-term outlook

The Hungarian economy has once again emerged from stagnation, as evidenced by the flash GDP data for the [first quarter](#) of 2024. The growth rate of 0.8% quarter-on-quarter, adjusted for seasonal and calendar effects, resulted in a 1.1% year-on-year economic activity. However, we are still waiting for the detailed GDP report due on 4 June to see the exact structure of growth.

The Hungarian Central Statistical Office (HCSO) has adopted a new methodology, meaning that the margin of error for revisions compared to the flash estimate could be around +/- 0.2ppt. In our view – based on the latest high-frequency indicators for construction, industry, and fiscal developments – we see a minor downside risk to this year's first quarter GDP review. However, the recent flow of labour market data points to a better growth outlook for the rest of the year, so we see the risks tilted to the upside when it comes to our current 2024 GDP growth forecast of 2.2%.

## Real GDP (% YoY) and contributions (ppt)



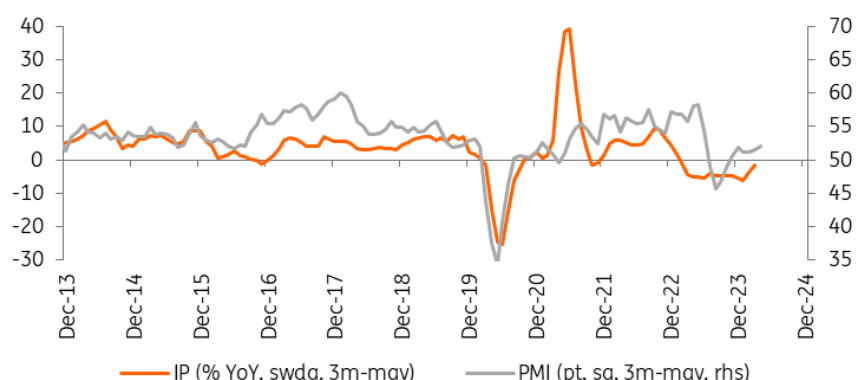
Source: HCSO, ING

## Industrial production is in freefall as export activity deteriorates

Industrial production surprised to the downside in [March](#) as production volumes fell by 3% month-on-month, contributing to a 2.8% YoY decline in output on a working-day basis. This follows a surprisingly strong February report – which [at the time](#) we cautioned was overly optimistic.

The detailed breakdown shows that output fell in all sectors on an annual basis, showing a double-digit fall in the major sectors. What's more is that capacity utilisation is only 70% in the second quarter, lower than during the pandemic. The total order books continued to deteriorate, falling 20.7% YoY. The outlook, therefore, isn't too bright. With external demand still subdued, we maintain our view that industry will make a negative contribution to GDP growth this year.

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



Source: HALPIM, HCSO, ING

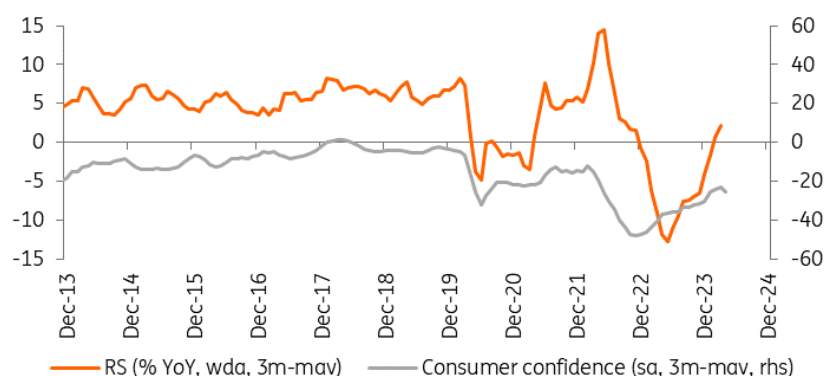
## Retail sales ends the first quarter on a surprisingly strong note

Retail sales volumes rose by 2% MoM in [March](#), bringing the YoY figure to 4.2% on a calendar-adjusted basis. This remarkable performance was reflected across the board as retail volumes expanded in all sectors. However, the March report raises a number of questions as the performance of the retail sector in the first two months of this year has been quite sluggish.

Against this backdrop, we believe that the March data should be taken with a pinch of salt, as this exceptional outperformance is not reflected in other economic indicators.

In this respect, VAT revenues (which are closely linked to sales volumes) didn't perform as well, improving by only 2.8% YoY. Nevertheless, the strong dynamics of wage outflows may have boosted savings rather than consumption. Apart from that, we suspect that the disconnect between retail sales and VAT revenues could also be due to lower tax collection efficiency and/or shopping tourism abroad.

## Retail sales (RS) and consumer confidence



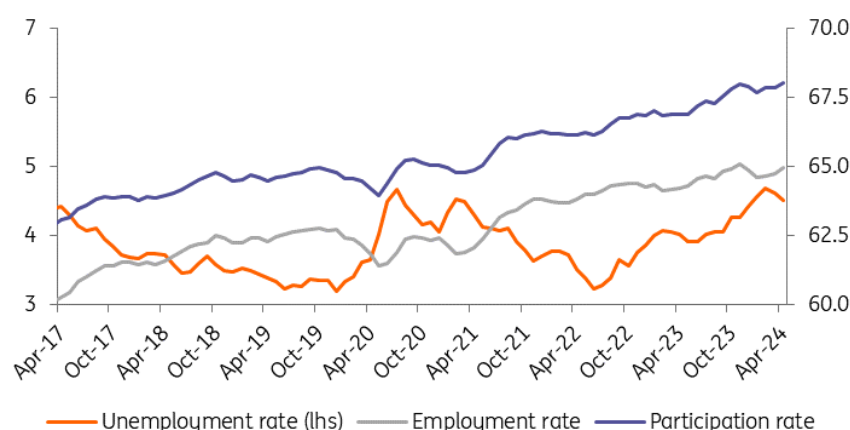
Source: Eurostat, HCSO, ING

## Recent stream of labour market data points to stabilisation

The recent stabilisation in [labour market statistics](#) continued in April, with the three-month (February-April) unemployment rate improving to 4.5%. We expect a marginal improvement in the coming months as seasonal hiring picks up, followed by a significant improvement in the second half of this year as the country's growth engines shift into higher gear.

Stability was reflected not only in the latest unemployment rate statistics but also in the latest wage data, as wage outflows remained quite strong at 13.9% YoY in March. This came as a surprise to us, as various surveys had indicated that employers were looking to raise wages by 5-10% this year and so we had expected the pace of wage growth to slow by March. Overall, we maintain our call for average wage growth of around 10% for 2024 as a whole, with a strong upside risk.

## Historical trends in the Hungarian labour market (%)



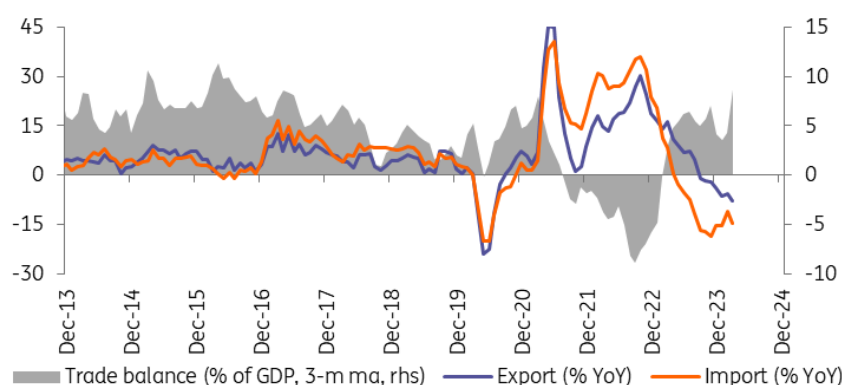
Source: HCSO, ING

## We believe the recent strength in the trade balance data is temporary

March brought another large trade surplus of EUR1.5bn, despite a sharp contraction in export sales of industry. Against this backdrop, we see a rather large disconnection between current industrial performance and trade balance developments. Therefore, on the export side, we believe that the large trade surplus continues to be driven by existing agricultural inventory sales. On the import side, however, there has been a notable decline of 20% YoY. This is likely the result of a reduction in energy bills as well as more subdued domestic demand, which is improving more slowly than expected.

Given that the industrial export order book has been deteriorating since August 2023 (currently -21.6% YoY), this clearly doesn't bode well for the export outlook. Considering all of these factors, we think that the recent strength in the trade balance will be temporary.

## Trade balance (3-month moving average)



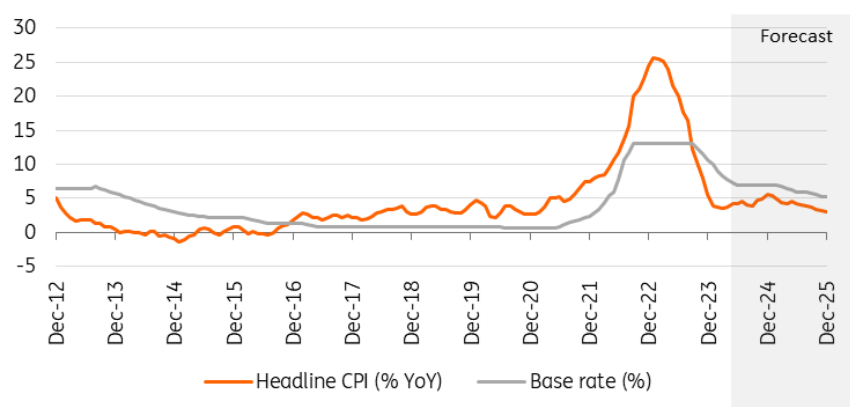
Source: HCSO, ING

## We revise our full-year inflation forecast on lower fuel prices

Headline inflation increased slightly, with the year-on-year rate rising to 3.7% in [April](#), while the monthly repricing slowed to 0.7%. At the component level, the retrospective nature of the services sector's repricing has been rebuked by the central bank, which justifies its cautious and patient approach in our view. April marked the end of disinflation, and we expect another jump in headline inflation next month due to base effects.

However, the monthly repricing in May will be smaller (0.1-0.2%) than seen previously (0.7-0.8%), as the recent sharp drop in fuel prices has changed the inflation profile. As a result, we lower our full-year average inflation forecast for 2024 to 4.25%. While we still expect headline inflation to settle in the 5.5-6.0% range in December, we now see the lower end of the range as the more likely outcome based on incoming data.

## Inflation and policy rate



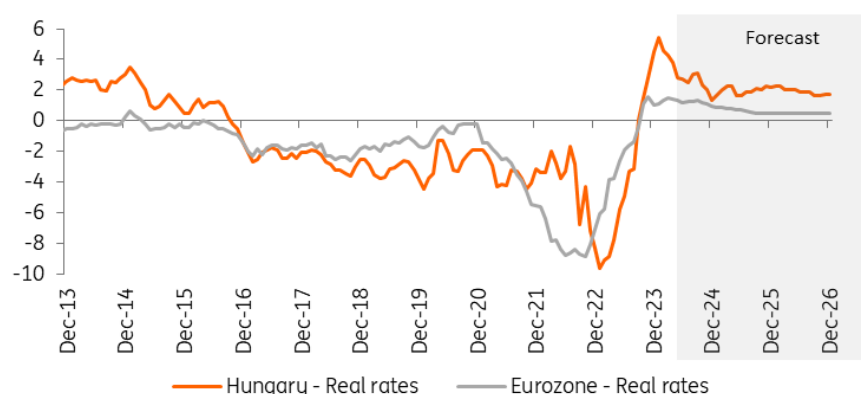
Source: NBH, ING

## We slightly favour a 25bp rate cut in June

At its [April](#) meeting, the National Bank of Hungary (NBH) maintained the previous pace of rate cuts at 50bp, bringing the base rate to 7.25%, while maintaining the +/- 100bp symmetric interest rate corridor around the base rate. The upcoming June decision is well telegraphed, leaving only two options on the table: either a 25bp or a 50bp cut. With three weeks to go before the meeting (18 June), we believe that the odds of either outcome are currently evenly split.

However, the divergence between rate paths for both the Federal Reserve and the European Central Bank, combined with stubborn services inflation and ongoing geopolitical risks warrant a cautious approach, in our view. Not to mention that we may see increased HUF volatility in the coming weeks due to a possible negative rating decision by Fitch and the outcome of the 9 June elections. Taking all these factors into account, if we need to pick sides, we slightly favour a 25bp rate cut at the June meeting.

## Real rates (%)



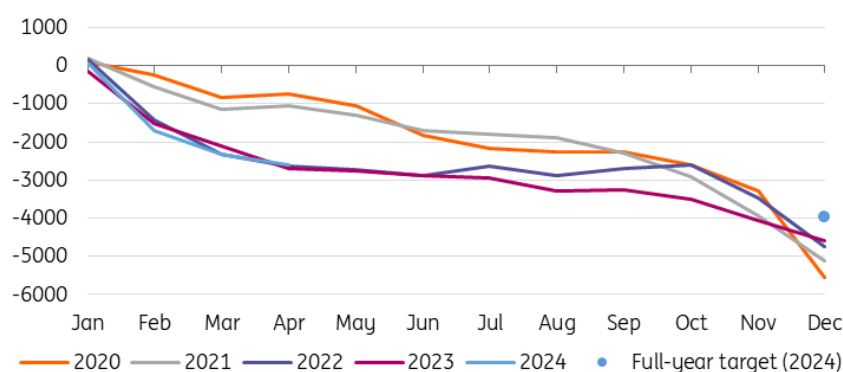
Source: ECB, NBH, ING

## Reduced risk of fiscal slippage through tightly controlled expenditures

The ESA-based deficit target for 2024 has been raised to 4.5% of GDP, but based on our technical projection we still see a slippage risk. The good news, however, is that in light of the [April](#) detailed budget report, we now see a lower gap at a maximum of 0.5% of GDP. Looking at the latest developments, what stands out is the fact that the expenditure side is under tight control as central government spending in April fell on a year-on-year basis – which is remarkably rare in Hungary.

On the revenue side, the strong wage outflow is clearly reflected in higher personal income tax revenues (+14.8% YoY), but VAT revenues (+3.7% YoY) remain sluggish. Overall, we see room for further improvement in terms of reducing the risk of slippage. But for this to happen, the recovery in consumption needs to shift into a higher gear, while the government should continue to keep the expenditure side under tight control.

## Budget performance (year-to-date, HUFbn)



Source: Ministry of Finance, ING

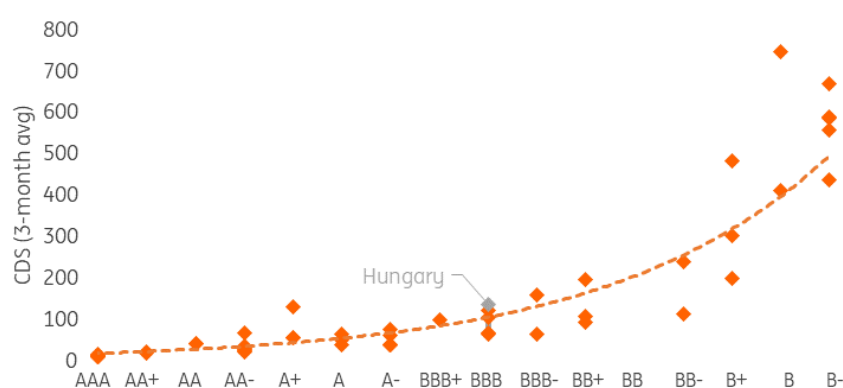
## We see substantial risk of a downgrade by Fitch

At its April review, S&P Ratings affirmed Hungary's 'BBB-' credit rating with a stable outlook.

However, the country's credit rating is one notch higher at both Moody's and Fitch, the latter of which has been quite critical of the country's fiscal path. In addition to the more critical tone, Fitch's 'BBB' rating has come with a negative outlook (since January 2023), leaving room for a potential outright downgrade. In this regard, it highlighted in its latest December report that it expects this year's deficit to reach 4.2% of GDP, which the government has already raised from that level.

Not to mention the fact that the risk of a rising debt-to-GDP ratio in 2024 is absolutely realistic, while the prospects of EU funds inflow are rather bleak. Overall, we believe that Moody's (31 May) will be more reluctant to change the country's rating complex at the upcoming decision, while Fitch (14 June) will adopt a more critical tone, possibly leading to a credit rating downgrade to 'BBB-'.

## CDS and sovereign credit ratings of Fitch Ratings



Source: Bloomberg, Fitch Ratings

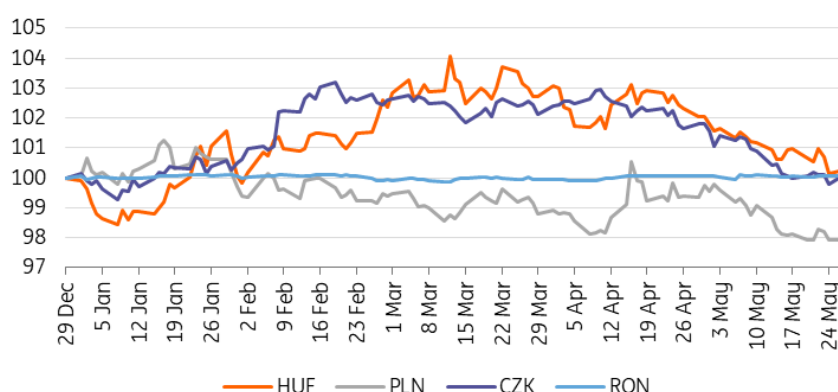
## The forint – supported by the global story – ignores the clouded domestic outlook

The forint has traded surprisingly well since mid-April and EUR/HUF has returned to its lowest levels since early February. We see this driven rather by global factors led by risk-on sentiment and a relatively weak US dollar (DXY is hovering around its lowest level in the second quarter). This has helped the entire emerging markets space regain some ground, however the HUF – like the entire emerging market – is still in losses this year to add context. Moreover, amongst its CEE peers, the forint is the biggest underperformer. We continue to see HUF as the most overvalued currency within the CEE region at the moment.

The main reason is the FX disconnect from rates and the narrowing interest rate differential coming out of the cutting cycle. Overall in the short term, on the one hand the forint can continue to benefit from favourable global conditions, while on the other, it is exposed to fiscal risk and the ongoing cutting cycle in the coming weeks. Looking ahead, however, we believe it is only a matter of time before the relationship between rates and FX returns to normal and the local story gets the spotlight. However, despite the revision of our HUF forecast, we remain more on the negative side with 395 EUR/HUF at mid-year and 385 at year-end in our forecast.



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



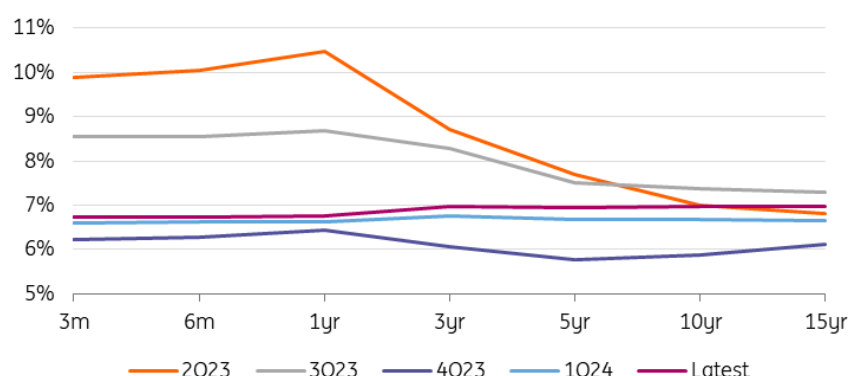
Source: NBH, ING

## Market still underestimates cuts next year, but risks block the road

Short-term market pricing shows that markets have been shifting expectations closer to a 25bp rate cut rather than a 50bp move since the May meeting, which is also our preference. However, despite significant BUBOR normalisation, 3M is still 23bps below the central bank's key rate hiding some rate cuts here. On the other hand, for the second half of the year, the market is only pricing in around a 10-20% chance for rate cuts in each meeting – roughly matching our thinking. However, looking further out, the terminal rate is stuck above 6.00% at the 18 month horizon, where our forecasts and market pricing start to diverge.

While we see a continuation of the cutting cycle over the next year of a decent size, the market is starting to once again price in rate hikes well above 6.50% and the 5y5y IRS at 7.05%. Therefore, we continue to see the most mispricing on the curve in the belly and long end, which should favour flatteners given the coming end of – or pause in – the cutting cycle. At the same time, the Hungarian curve is by far the steepest one in the CEE region at the moment. On the other hand, elevated core rates, rising inflation in the coming months and fiscal risk are going against this, putting HUF assets at risk. As a result, it's easier to remain neutral for a while until the situation becomes clearer regarding the rebound in inflation, a possible rating downgrade and the likelihood of rate cuts in the second half of the year.

## Hungarian sovereign yield curve (end of period)



Source: GDMA, ING

In the Hungarian government bonds (HGBs) space on the supply side, we estimate that the debt agency has covered about 60% of the planned issuance after the revision of the funding plan, confirming a comfortable situation despite unfavourable fiscal developments. So even another increase in the deficit this year should not bring HGBs under pressure due to higher supply. On the demand side, high yields of HGBs boosted market demand in auctions to the highest level within the CEE region in May (in the bid-to-cover metric). On the one hand, this shows that the markets like Hungary and in turn the financing should be smooth. On the other hand, if there are problems, we could see a very unpleasant sell-off supported by low market liquidity. Overall, however, the same uncertainty for the coming weeks applies here as in the case of the IRS market coming from both domestic and foreign markets. Moreover, since the last Monitoring, ASWs haven't been looking too attractive, which leaves us rather neutral here.

## Forecast summary

	1Q24	2Q24F	3Q24F	4Q24F	1Q25F	2023	2024F	2025F
Real GDP (%YoY)	1.1	2.3	2.2	3.1	3.2	-0.9	2.2	3.8
CPI (eop, %YoY)*	3.6	4.3	3.9	5.7	4.4	17.6	4.2	4.1
Central bank key rate (eop, %)	8.25	7.00	7.00	7.00	6.75	10.75	7.00	5.25
3m interest rate (%)*	7.83	7.00	7.00	7.00	6.65	13.98	7.76	6.12
10yr yield (%)*	6.69	7.35	6.95	6.85	7.00	7.56	6.74	7.07
EUR/HUF exchange rate*	395.8	395.0	388.0	385.0	395.0	382.0	389.3	398.0
USD/HUF exchange rate*	367.3	365.7	352.7	350.0	359.1	353.3	356.4	361.8

Source: Source: National Sources, ING estimates

\*Quarterly data is eop, annual is avg.

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