

Monitoring Hungary: The moment of truth approaches

In our latest update, we reassess our Hungarian economic and market forecasts. We think that over the coming weeks, it will become clear whether the risks to our base case scenario have materialised. We remain positive but cautious as we await the new data



The release of third-quarter GDP figures on 14 November will be the moment of truth for revealing whether or not Hungary's year-long technical recession could finally be over

Hungary: at a glance

- The Hungarian government responded to the nine questions from the European Commission, and our sources indicate that the net 90-day review period has recommenced. There are just under 10 days remaining until the final decision.
- The technical recession probably ended in the third quarter of this year, and the next GDP figure will therefore bring a moment of truth. Nevertheless, a full-year recession cannot be avoided.
- Recent retail sales and industrial production data have disappointed, and the question remains whether we can expect a turnaround in the short term.
- Real wages will flip back to positive by September, but we doubt that the impact on consumption will be significant and we expect the labour market to remain tight.
- Energy price-related consequences of geopolitical risks will be a crucial factor in determining

whether the current account will have a slight surplus by the year-end.

- Recent inflation dynamics have shown more promise than we or the market expected, giving the National Bank of Hungary (NBH) ammunition to argue for larger rate cuts.
- On the other hand, the biggest question remains whether the risk environment will allow the central bank to continue the rate-cutting cycle at the same pace.
- While the government revised the 2023 ESA-based deficit target to 5.2% of GDP, we need more evidence to assess whether the updated target can be met or not.
- The forint survived the first rate cut in the base rate without major damage. After some short-lived weakness and volatility, the forint should continue to strengthen.
- In the rates space, we can expect further steepening of the IRS curve again, while in bonds we need to see progress in the EU money story and a clearer fiscal policy picture for a significant rally.

Quarterly forecasts

	3Q23	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F
Real GDP (%YoY)	-0.2*	1.7	2.8	4.2	3.5	3.0	3.2	3.3
CPI (eop, %YoY)	12.2	6.8	4.6	5.5	4.8	5.1	4.2	3.8
Central bank key rate (eop, %)	13.00	10.75	8.75	7.50	7.00	7.00	6.50	5.75
3m interest rate (eop, %)	12.27	9.95	8.30	7.20	6.75	6.75	6.00	5.35
10yr yield (eop, %)	7.37	7.30	6.80	6.70	6.65	6.75	6.70	6.70
EUR/HUF exchange rate (eop)	389.6	375.0	368.0	365.0	365.0	370.0	370.0	370.0
USD/HUF exchange rate (eop)	368.5	353.8	340.7	331.8	325.9	321.7	321.7	324.6

Source: National sources, ING estimates

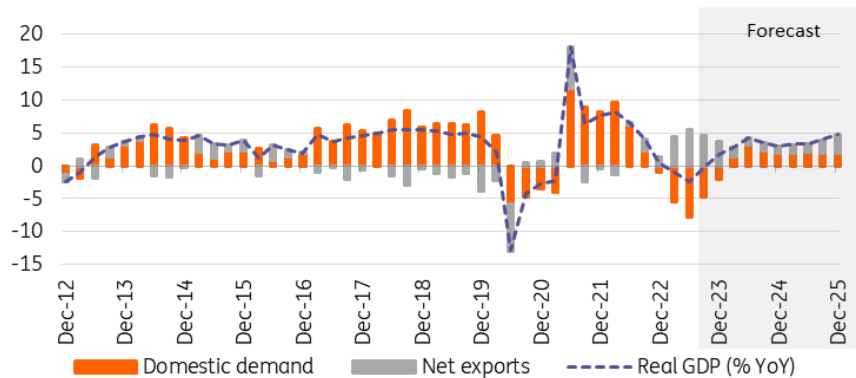
*ING forecast

Will the longest technical recession end in the third quarter?

Hungary has been in a technical recession for [a year now](#), with economic activity contracting in all sectors except agriculture in the first half of 2023. The positive contribution from agriculture in the second quarter was not enough to pull the economy out of a technical recession, as the collapse in domestic demand weighed on all sectors. This time around, we expect the technical recession to end in the third quarter on the back of the agricultural outperformance. Favourable weather conditions combined with a good harvest season support our view.

14 November will be the moment of truth – when the third quarter GDP data is due. Nonetheless, agriculture alone will prove insufficient in generating a positive balance in the entire economy this year. In our view, a 0.5% recession awaits us in 2023.

Real GDP (% YoY) and contributions (ppt)



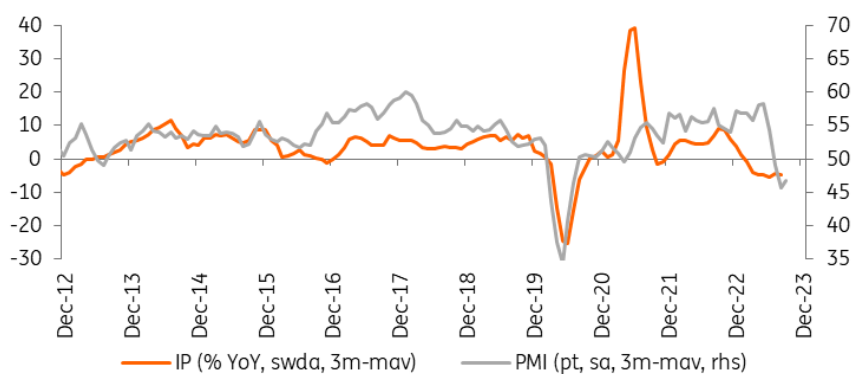
Source: HCSO, ING

Is the deterioration in export sales a turning point for industry?

Industrial production surprised on the downside in [August](#), as production volumes declined by 2.4% month-on-month, contributing to a sharp fall in output of 6.1% year-on-year. At a sectoral level, the picture remains unchanged from recent months, with volumes expanding only in the electrical and transport equipment sub-sectors. However, in contrast to the dynamics of recent months, this time export sales deteriorated in line with domestic sales – which may explain the large drawdown in overall output.

We suspect that export sales may pick up as the dismal August figure was more the result of factory shutdowns, but subdued global demand limits the export outlook. Nevertheless, barring an ugly surprise in September, the expected industrial performance in the third quarter should be better than in the second quarter. This should help the economy to emerge from its technical recession.

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



Source: HALPIM, HCSO, ING

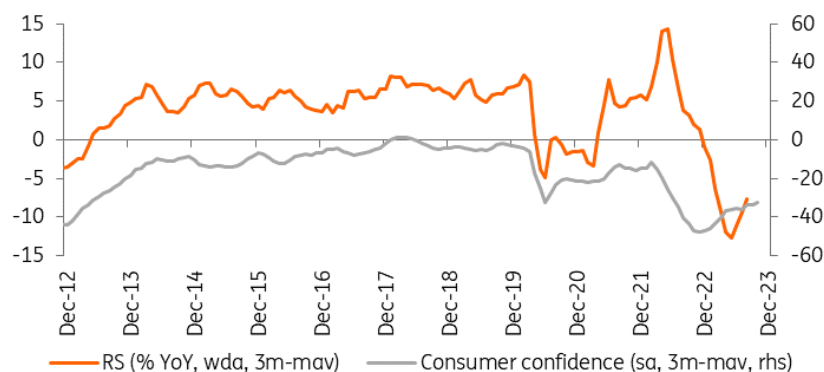
Will the turnaround in real wages boost retail sales?

The retail sector is suffering from the cost of living crisis. The volume of sales in [August](#) fell by 7.1% YoY, while on a monthly basis, the overall volume declined by 0.5%. At the component level, food and fuel sales both contracted, while non-food retailing stagnated compared to last month. These

dynamics are broadly in line with those seen in previous months, but the main question now is whether the turnaround in real wages will lead to a pick-up in consumption.

We suspect that the answer is no, as we believe that households will mainly deleverage and/or rebuild their savings before consumption picks up. In this regard, the 10-year low in households' consumer confidence index supports our view. We therefore believe that the impact of the turnaround in real wages will not markedly boost consumption until 2024, leaving the rest of this year's retail sales figures in the red.

Retail sales (RS) and consumer confidence



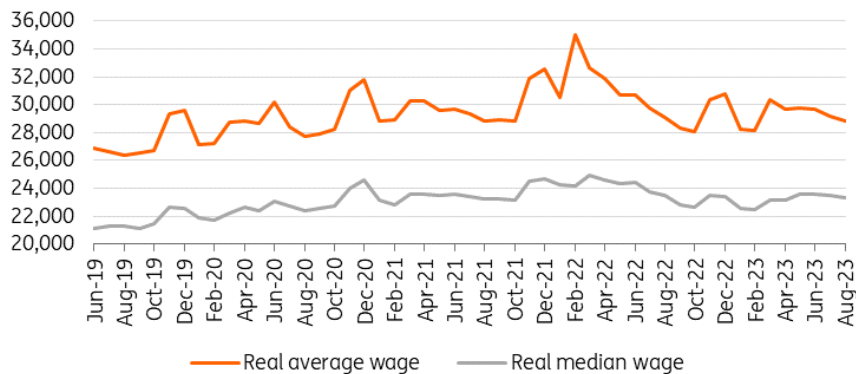
Source: Eurostat, HCSO, ING

Could the tight labour market trigger a price-wage spiral?

Average wage growth remained strong at 15.2% YoY in [August](#), but after adjusting for inflation, real wages still fell by 1% YoY. This is the 12th consecutive month of negative real wage growth. The good news is that it may have been the last of this cycle. We see real wage growth flipping back to positive by September, but as discussed before, the impact on consumption throughout 2023 may be limited. Households' purchasing power is still equivalent to 2021 levels.

At the same time, the resilience of the labour market is quite impressive, as the three-month unemployment rate was at 4.1% in the [July-September](#) period. The tight labour market poses upside risks to inflation, with the expected 10-15% increase in minimum wages next year leading to a significant rise in real wages. In our view, the biggest question remains how fast domestic demand will recover in 2024; if we were to see a slow and gradual recovery, then a price-wage spiral might be avoided.

The level of average and median real wages (1990 CPI adjusted HUF)



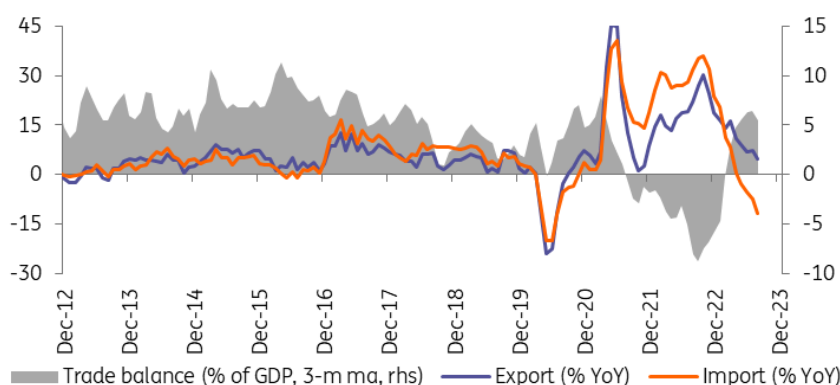
Source: HCSO, ING

How will geopolitical risks affect the trade balance?

The collapse in domestic demand led to a slowdown in economic activity in the first half of the year, which rapidly reduced the need for imports. In addition, as energy prices were significantly lower than a year earlier, the pressure on the trade balance from the import side continued to ease. These factors have led to persistent trade surpluses, while the current account was also in surplus in August. We see two downside risks to our call for a small current account surplus by the end of 2023.

The first is the start of the heating season, which will lead to an increase in gas imports. However, gas storage is in particularly good shape, with levels above 90%. The second is the risk of a renewed rally in commodity prices on geopolitics. Nevertheless, we are maintaining our call and highlighting the risks as we continue to monitor market developments.

Trade balance (3-month moving average)



Source: HCSO, ING

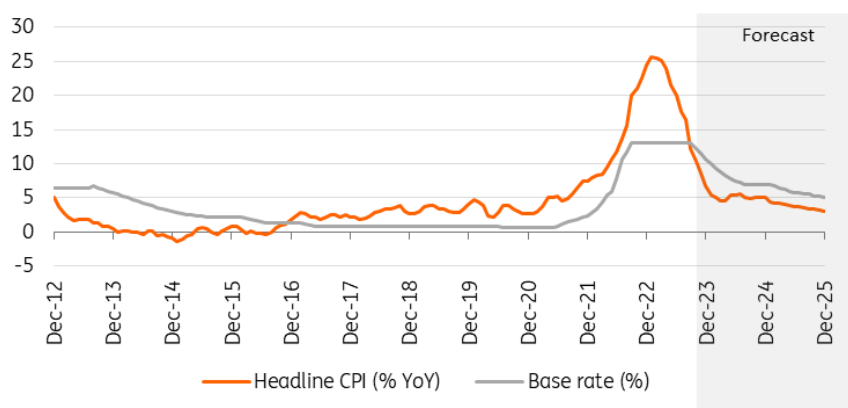
How fast will disinflation unfold over the rest of the year?

Headline inflation sunk to 12.2% YoY in [September](#), mainly on significant base effects, while prices rose by 0.4% compared to August. The vast majority of the deceleration is attributed to the

household energy component; last year's base was enormous due to the administrative price change. Apart from this, food prices fell on a monthly basis, while fuel prices jumped on the back of higher oil prices and the stronger USD. Another positive development was that core inflation fell by 0.2% MoM, raising hopes that underlying price pressures are dissipating.

Going forward, we expect disinflation to continue swiftly supported by both base effects and constrained spending. In our view, the easier task is to bring inflation down to 7%, which is our forecast for the end of 2023. The central bank will have a much harder task in the form of bringing inflation down further to 3%, especially in light of various upside risks.

Inflation and policy rate



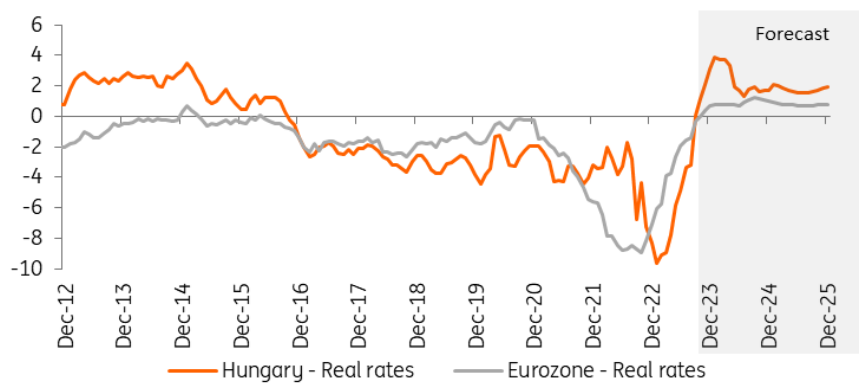
Source: NBH, ING

What is needed for the NBH to sustain the present pace of easing?

At its **October** meeting, the National Bank of Hungary cut the base rate by 75bp to 12.25%, while maintaining the +/- 100bp symmetric interest rate corridor around the base rate. Strong disinflation and an improvement in the country's external balances supported the case for a larger rate cut, while the looming risk environment warranted a cautious approach by the Monetary Council. In the end, the result was a careful compromise that represents a slowdown from the previous pace of easing.

Going forward, we expect the NBH to stick to the same 75bp of cuts for the rest of the year, bringing the policy rate to 10.75% at the end of the year. However, given the central bank's data-dependent approach, any significant deterioration in the risk environment could lead to smaller cuts or even to a pause in order to maintain FX stability.

Real rates (%)



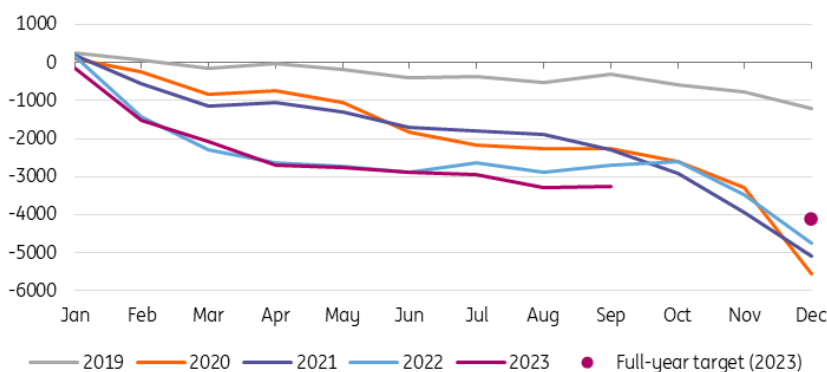
Source: ECB, NBH, ING

How realistic is this year's revised deficit target?

At the beginning of [October](#), the government revised up the 2023 Maastricht-based deficit target by 1.3ppt to 5.2% of GDP. It was only a matter of time before we saw this kind of revision, as in early September, the Government Debt Management Agency raised this year's financing needs to HUF 4,133bn. Part of the change is due to a downward revision of the government's nominal GDP forecast (0.2ppt) and the rest reflects the budgetary slippage. The latter is the result of underperforming indirect tax revenues, higher pensions, and higher debt service costs, which are the main budgetary issues.

Despite the updated deficit target, we are not sure that this will be enough judging by the deficit dynamics in the fourth quarters of the last four years. Barring a miracle increase in revenues and a freeze in expenditures, we remain sceptical that even the updated target can be met.

Budget performance (year-to-date, HUFbn)



Source: Ministry of Finance, ING

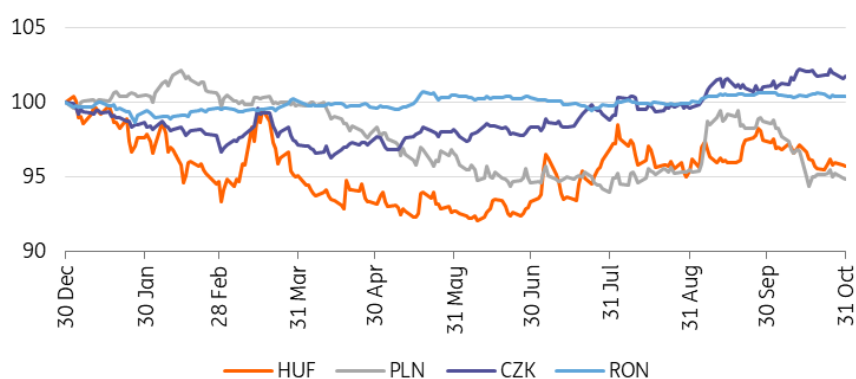
*The 2023 full-year target is based on the Debt Management Agency's updated financing plan in 2023.

Why we're maintaining our call for a stronger forint in the longer term

The forint survived the first rate cut in the base rate without major damage, but we believe it should still see some short-term weakness – especially until the EU deal remains in limbo. Market expectations have still not fully adjusted to the new interest rate path indicated by the NBH, which may keep the forint at weaker readings in the coming weeks. Moreover, the US dollar still maintains stronger values which are generally not supportive to the EM universe (including the HUF).

In the medium and long term, not much has changed after the last NBH meeting, and the forint should continue to strengthen depending on the success of the NBH delivering rate cuts and the EU money story. We expect 375 EUR/HUF at year-end and 365 EUR/HUF in the middle of next year, supported by the highest positive real rate and carry in the region.

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



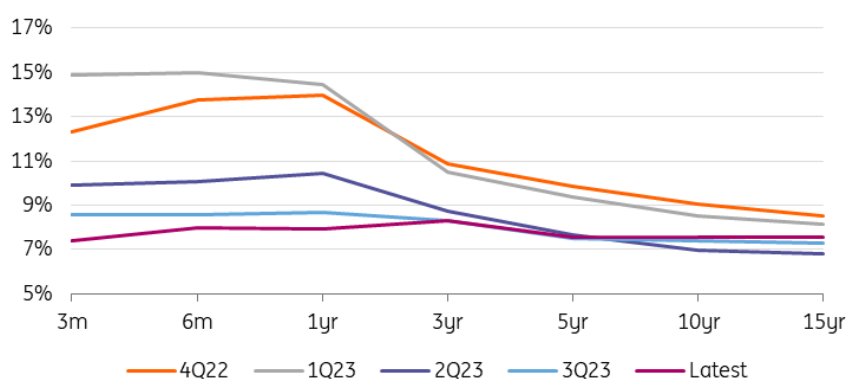
Source: NBH, ING

How much do core rates affect the Hungarian interest rate space?

In the rates space, if we consider the baseline to be a 75bp pace of cutting for the coming months, the FRA curve and front-end of the IRS curve still have room to move down in our view. At the moment, the market is pricing in an almost 75bp move for the next meeting but only 50bp or less for the coming months. If core rates remain elevated – which seems to be the baseline at the moment – we can expect further steepening of the IRS curve again.

However, 2s10s HUF has already approached the CZK curve within CEE peers, and it is clear that the vast majority of the curve normalization is behind us. On the other hand, the biggest potential for repricing remains at the long end of the curve, which still basically ignores NBH rate normalisation and pricing base rates above 7% in long-term. However, this will only be unlocked later in this cycle when we need to see core rates falling as well.

Hungarian sovereign yield curve (end of period)



Source: GDMA, ING

Hungarian government bonds (HGBs) provide the biggest beta to core rates at the moment, which has led to a strong sell-off in recent weeks, and so far we have seen only a cautious recovery. The supply side of HGBs, despite the unclear fiscal policy picture, is rather positive. The debt agency (AKK) has covered about 85% of all planned issuance and should remain under control this year as a result. In the case of additional needs stemming from a higher deficit this year, we expect to focus on retail bond issuance, avoiding pressure on HGBs.

The picture for next year still remains cloudy, but our preliminary indications point to significantly lower gross redemption needs and roughly the same supply of HGBs as this year – which is already significantly lower than previous years given the focus on retail issuance. On the demand side, we believe that the highest yields within the CEE region should attract sufficient demand, but we need to see progress in the EU money story and a clearer fiscal policy picture for a significant rally first.

Forecast summary

	3Q23	4Q23F	1Q24F	2Q24F	3Q24F	2023F	2024F	2025F
Real GDP (%YoY)	-0.2*	1.7	2.8	4.2	3.5	-0.5	3.4	3.8
CPI (eop, %YoY)**	12.2	6.8	4.6	5.5	4.8	17.8	5.1	3.7
Central bank key rate (eop, %)	13.00	10.75	8.75	7.50	7.00	10.75	7.00	5.00
3m interest rate (%)**	12.27	9.95	8.30	7.20	6.75	13.97	7.79	5.62
10yr yield (%)**	7.37	7.30	6.80	6.70	6.65	7.84	6.84	6.74
EUR/HUF exchange rate**	389.6	375.0	368.0	365.0	365.0	383.8	368.6	370.0
USD/HUF exchange rate**	368.5	353.8	340.7	331.8	325.9	357.9	334.8	325.2

Source: National sources, ING estimates

*ING forecast **Quarterly data is eop, annual is avg

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