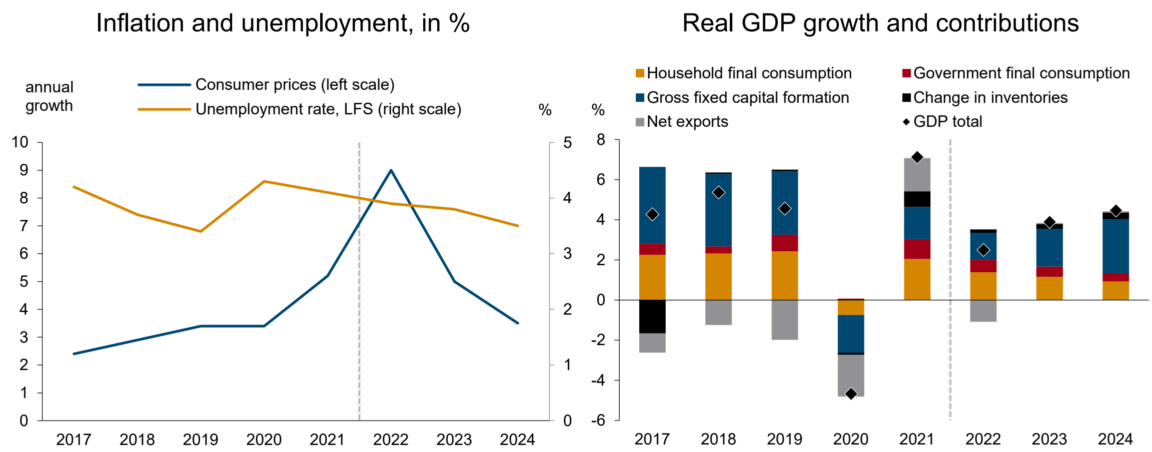
HUNGARY: The party is over

SÁNDOR RICHTER

Since mid-2021, the Hungarian economy has undergone a period of overheating that was intimately bound up with the extended campaign leading up to the parliamentary elections on 3 April. The excessive deployment of 'election goodies' by the government has resulted in large current account and fiscal deficits, rising inflation and a weak forint. Now that the election has been won, Prime Minister Orbán will have to deal with the unpopular task of economic consolidation. A relatively soft landing would require the country to gain access to the EU transfers from the Recovery and Resilience Facility, but the ongoing conflict with the EU over the 'rule of law' (primarily corruption related) renders this doubtful. Economic growth is expected to slow this year, to the range of 2-3%.

Figure 4.8 / Hungary: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

The COVID-related recession has been overcome, with GDP growth amounting to 7.1% last year. That said, by the end of 2021 GDP was only 2.1% higher than in the last pre-COVID year of 2019. The two halves of last year showed very different characteristics: while the first half of 2021 was still shaped by the bounce-back from the COVID recession, the second half – and indeed especially Q1 2022 – witnessed some determined actions by the government to secure victory for Orbán's Fidesz party in the 3 April general election.

Domestic demand was boosted by some excessive central government spending on 'election goodies'. The list included the reintroduction of the 'thirteenth-month pension', the repayment of 2021 personal income tax to families with children, exemption from personal income tax for those aged below 25, a 20% rise in the minimum wage, extension of the moratorium on credit repayments, a centrally fixed price cap on various commodities, etc. In addition, net real wages increased by close to 10% in 2020-2021. The consequences of all this started to be clearly felt from summer 2021. The current account deteriorated sharply in the last two quarters of 2021, with a deficit that reached 3.1% of GDP by the end of the year, due primarily to a large deficit in the trade in goods. This represents a nearly threefold increase over the previous year. Inflation started to accelerate well before Putin's war in Ukraine began. The subsequent increases in the price of imported energy will fuel inflation. Elevated government spending increased the budget deficit in the second half of 2021 – a process that carried on into Q1 2022, when close to 75% of the planned annual fiscal deficit had already been attained.

Price caps on household energy are adding to the burdens of the budget. Keeping household energy prices decoupled from market prices has been a central element of Orbán's policy for several years. Nevertheless, since the start of the war the subsidies have become quite absurd: households currently pay (early April) only about a sixth of the actual market price for natural gas. Meanwhile, Hungary's reliance on energy imports is extremely high: 80% of the gas consumed comes from Russia. There is a somewhat smaller (yet still heavy) dependence on Russian crude oil deliveries, as well as a 100% exposure in imports of fuel for the nuclear power plant at Paks. The possible substitution with non-Russian sources would be logistically difficult and expensive, as well as acutely politically embarrassing for Putin loyalist Orbán.

The 3 April election will most probably count as a watershed for the Hungarian economy. Prime Minister Orbán, enjoying overwhelming support from the public and most of the privately owned media in an unfair election campaign – again managed to obtain more than two thirds of the seats in parliament, giving him a supermajority. With the election victory in his pocket, the leader of the Fidesz government has no time to lose: urgent steps are required to tackle the macroeconomic imbalances. The number one issue is how to curb inflation. The central bank has already engaged in a cycle of policy rate rises. This seems to have helped arrest the plummeting HUF exchange rate, albeit at a relatively low level. A weak HUF fuels imported inflation. Higher interest rates will pose a problem to the wide circles of the population that are locked into variable-interest mortgage loans. High inflation does have one positive side effect, however, insofar as the 'election goodies' distributed before April will lose a substantial part of their purchasing power and will thus help curtail excess demand. This also applies to the rapid increase in nominal wages.

Another crucial issue this year will be how to move towards a sustainable level of fiscal deficit. Unlike last year, the revenue side will receive no help in the shape of abundant tax receipts due to strong economic growth. If expenditure is to be cut, lifting the caps on household energy and petrol prices would seem to be unavoidable – even if keeping household spending down was a central plank of the Fidesz election campaign. The thirteenth-month pension may also turn out to be unsustainable. Consolidation of the budget will thus necessitate unpopular measures; later this year Fidesz supporters will be confronted with the harsh and bitter truth.

Gaining access to EU transfers from the Recovery and Resilience Facility (RRF), worth around 3-4% of Hungary's annual GDP, would seem to be essential if a soft landing is to be ensured. Disbursement of these EU resources would ease the burden of budget consolidation, substantially improve the external equilibrium of the economy and help stabilise the exchange rate. However, the re-election of Orbán renders that extremely problematic, unless he is prepared to make concessions over the disputed 'rule of law' issues. Positions may change, but on the anti-corruption issue it is hard to imagine Hungary making concessions. If the country were to join the European Public Prosecutor's Office (EPPO), that would present an existential threat to the prime minister, his family and key Fidesz-loyal magnates. However, the need for concerted action in the current tense international situation may incline the EU to be indulgent, in order to secure Orbán's assent to motions that require unanimity on the part of the member states.

Given the unfavourable international environment and the unavoidable consolidation measures to restore macroeconomic equilibrium, we forecast a substantial slowdown in economic growth in 2022. The current account will be affected negatively by the deteriorating terms of trade, but positively by the sharply reduced pace of economic growth. All in all, it is expected to remain nearly as high as last year. Investment will be influenced by whether or not the government gains access to the EU transfers, and also by the uncertainties surrounding large government projects like Paks 2, the Belgrade-Budapest railway line and the campus of the Chinese Fudan University. Summarized, GDP growth in 2022 is expected to be in the range of 2-3%, with large and hitherto unprecedented downside risks.

Table 4.8 / Hungary: Selected economic indicators

	2018	2019	2020	2021 1)	2022	2023 Forecast	2024
Population, th pers., average	9,776	9,771	9,750	9,710	9,700	9,650	9,650
Gross domestic product, HUF bn, nom.	43,392	47,531	47,988	55,046	62,100	68,400	74,300
annual change in % (real)	5.4	4.6	-4.7	7.1	2.5	3.9	4.5
GDP/capita (EUR at PPP)	21,640	22,800	22,100	24,420	.	.	.
Consumption of households, HUF bn, nom.	20,513	22,553	22,889	25,485	.	.	.
annual change in % (real)	4.8	5.1	-1.6	4.3	3.0	2.5	2.0
Gross fixed capital form., HUF bn, nom.	10,730	12,873	12,857	14,787	.	.	.
annual change in % (real)	16.3	12.8	-6.9	6.0	5.0	7.0	10.0
Gross industrial production							
annual change in % (real)	3.5	5.6	-6.0	9.7	6.0	5.0	7.0
Gross agricultural production							
annual change in % (real)	2.6	-0.1	-2.4	-2.1	.	.	.
Construction industry							
annual change in % (real)	21.2	20.7	-9.8	13.1	.	.	.
Employed persons, LFS, th, average 2)	4,470	4,512	4,461	4,642	4,690	4,690	4,690
annual change in %	1.1	1.0	-1.1	0.7	1.0	0.0	0.0
Unemployed persons, LFS, th, average 2)	172	160	198	196	190	190	170
Unemployment rate, LFS, in %, average 2)	3.7	3.4	4.3	4.1	3.9	3.8	3.5
Reg. unemployment rate, in %, eop 3)	5.2	5.1	6.2	5.1	.	.	.
Average monthly gross wages, HUF 4)	329,943	367,833	403,616	438,814	490,300	525,100	562,500
annual change in % (real, gross)	8.3	7.7	6.2	3.4	2.5	2.0	3.5
Average monthly net wages, HUF 4)	219,412	244,609	268,405	291,812	326,000	349,100	374,000
annual change in % (real, net)	8.3	7.7	6.2	3.4	2.5	2.0	3.5
Consumer prices (HICP), % p.a.	2.9	3.4	3.4	5.2	9.0	5.0	3.5
Producer prices in industry, % p.a.	5.6	2.1	4.3	13.6	15.0	5.0	4.0
General governm. budget, EU def., % of GDP							
Revenues	44.0	43.6	43.6	45.0	45.0	45.0	45.0
Expenditures	46.1	45.7	51.6	52.5	50.5	48.5	48.0
Net lending (+) / net borrowing (-)	-2.1	-2.1	-8.0	-7.5	-5.5	-3.5	-3.0
General gov. gross debt, EU def., % of GDP	69.1	65.5	80.1	78.0	77.5	77.0	76.0
Stock of loans of non-fin. private sector, % p.a.	10.5	13.2	13.4	12.8	.	.	.
Non-performing loans (NPL), in %, eop 5)	5.4	4.1	3.6	3.3	.	.	.
Central bank policy rate, % p.a., eop 6)	0.90	0.90	0.60	2.40	6.50	4.00	3.00
Current account, EUR m 7)	216	-1,018	-1,558	-4,736	-5,000	-3,000	-300
Current account, % of GDP 7)	0.2	-0.7	-1.1	-3.1	-2.9	-1.6	-0.1
Exports of goods, BOP, EUR m 7)	88,544	92,525	88,710	103,245	110,500	116,600	124,800
annual change in %	3.8	4.5	-4.1	16.4	7.0	5.5	7.0
Imports of goods, BOP, EUR m 7)	90,824	96,212	89,908	107,056	118,000	124,500	132,000
annual change in %	8.7	5.9	-6.6	19.1	10.2	5.5	6.0
Exports of services, BOP, EUR m 7)	25,396	26,917	19,916	22,069	25,200	28,200	31,600
annual change in %	6.6	6.0	-26.0	10.8	14.0	12.0	12.0
Imports of services, BOP, EUR m 7)	17,316	19,828	15,849	17,088	18,600	20,300	22,100
annual change in %	2.6	14.5	-20.1	7.8	9.0	9.0	9.0
FDI liabilities, EUR m 7)	6,671	2,882	2,879	5,067	.	.	.
FDI assets, EUR m 7)	4,059	1,888	568	2,925	.	.	.
Gross reserves of CB excl. gold, EUR m	26,273	27,010	32,115	33,501	.	.	.
Gross external debt, EUR m 7)	107,696	106,051	109,928	126,850	128,000	128,000	127,000
Gross external debt, % of GDP 7)	79.1	72.6	80.5	82.6	75.2	67.4	61.5
Average exchange rate HUF/EUR	318.89	325.30	351.25	358.52	365	360	360

1) Preliminary and wiiw estimates - 2) From 2021 the new LFS methodology is applied in line with the Integrated European Social Statistics Regulation (IESS). - 3) Unemployed in % of LFS labour force. - 4) Enterprises with 5 and more employees. From 2019 based on tax administration data, survey data before. - 5) Loans more than 90 days overdue and those unlikely to be paid. - 6) Base rate. - 7) Excluding SPE.

Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.