Macroeconomic and fiscal developments in 2021 and the first half of 2022

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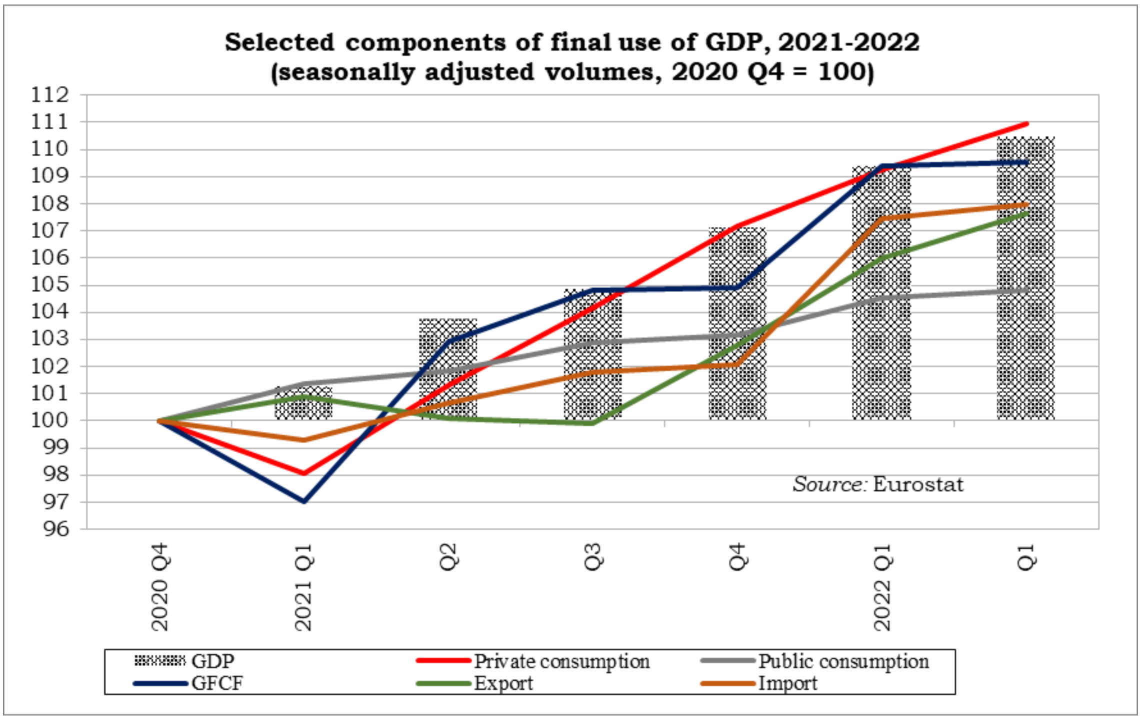
The economy and its future prospects

The Hungarian economy has grown at a considerably fast pace over the past 18 months. The year 2021 was mainly about recovering from the COVID-19 crisis, but already in the third quarter seasonally adjusted GDP exceeded its pre-COVID peak in the fourth quarter of 2019. Lockdowns prevalent in the second wave of the pandemic had still had an impact in the first quarter of 2021, thus private consumption declined in volume compared with the previous quarter, which, together with the accumulation of fixed assets, had put reins on economic growth. However, after this period the economy grew steadily at a good pace (at least by 1% from the previous quarter), mainly owing to domestic consumption. As illustrated in the figure with seasonally adjusted data, the driver of growth was private consumption, at least beginning from the second half of last year. The rising trend of the accumulation of fixed assets supported by first state, then, temporarily, corporate investments taking momentum was by far more hectic.



In the meantime, net exports contributed to economic growth now positively, now negatively, and over an average of the past six quarters only minimally. One reason for this is to do with the stubborn bottlenecks on the supply side, running through a good length of the period examined and leaving exports marking time. A pickup in exports as seen on the figure below is to a good part due to the export of services from the fourth quarter of 2021. In contrast, imports supported by domestic demand continued to expand starting from the second quarter of 2021 and made a big leap in the first quarter of 2022.

All in all, the recovery had come to pass by the second half of last year. GDP growth continued at a good pace in the first half of this year.

A weighted average of GDP growth rates in Q1-Q2 of 2021 and 2022 (%)

Czechia	Hungary	Poland	Romania	Slovakia
3.7	7.2	6.2	5.9	2.8

Source: Based on Eurostat data

Thus, economic output over the past 18 months has surpassed those of the other Visegrad countries and that of Romania. This can be said both about 2021 and also about the first half of 2022. At the same time a low base also contributed: only in Czechia was economic decline stronger than in Hungary in 2020. Still in Czechia even the low base did not help: its economic growth pace was one of the slowest in the region in 2021.

As we have mentioned before, from the second quarter of last year the dynamic growth was mainly due to domestic demand, more specifically to a rise in household spending, which was on the one hand supported by a recovery-related employment growth, and on the other, a strong increase in real wages, underpinned by a returning critical labor shortage.

In the first quarter of this year, the rise in consumption went stratospheric by a one-off shock effect, the government's demand-boosting intervention package timed for February. This - with the help of still strong corporate investments - led to an unforeseen 11.5% rise in domestic consumption, and in turn to a robust 8.2% GDP growth in the first quarter, which is very strong even with the slackening effects of jumping imports and net exports. In view of this, it is not a slowdown that is worthy of attention in the second quarter, but the fact that the slowdown was relatively modest.

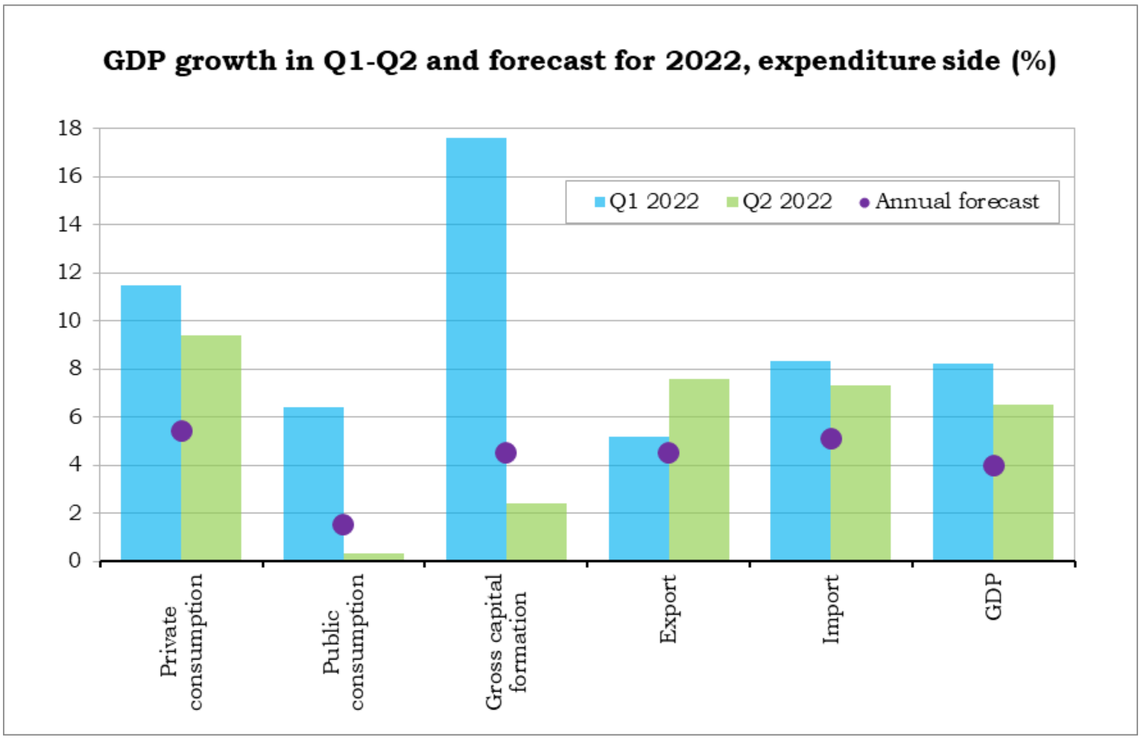
Still, in the second quarter the storm clouds were already gathering. In wake of the war, the possibility of a future energy crisis was emerging. In addition, this year's summer has given the world, and within it, Hungary, a glimpse of what kind of weather will become customary in one or two decades, and to what average produce yields that will lead.

All that said, in Hungary real wages rose at a medium pace on a quarterly basis, and the impact of the one-off income boost of February still lingered on in the better part of the second quarter, while a reduction in the utility bill support scheme was only announced by the government in July. Thus consumer spending still rose by around 10% in the second quarter, which kept GDP growth above 6% in the second quarter. On the manufacturing side, these trends primarily manifested in a strong growth in services - around 10% both in the first and second quarter - in a modest output of industry and a hectic and volatile output by the construction sector, as well as by a spectacular fall of agricultural yield in the second quarter.

But it is precisely personal consumption that the expected negative eventualities would affect most severely. In the third quarter the consumer price index is expected to rise above 15%, through which the real-wage-rise trends seen so far would come to a halt and turn into a decline towards the end of the year. From September the reduction in the government's utility bill support scheme will start to show up in bills, making a serious dent in households' disposable incomes and cutting down their consumption drastically.

In parallel a drastic slowdown of the growth pace of services can be expected to be seen on the production side, if not for other reasons, merely due to demand-side effects. Further, many companies have been feeling for some time the pain from the ever-greater increases in energy prices, while others will start to feel it from October, facing a manifold increase in prices compared to their earlier bills.

Severe consequences are expected for industry, too. Although industrial output showed a rising trend still in July, by autumn, news of difficulties experienced by many businesses had started to trickle in. All in all, for now we expect that – despite a significant slowdown in industry – its growth pace in the second half of 2022 and in 2023 will be more favorable than that of services. In sum, in light of the robust growth seen in the first half and, in contrast, the approaching negative turn, we keep our earlier projection of 4% growth level. However, for next year, we foresee a strong downturn and economic growth of around a mere 0.5%, with considerable downside risk added.



Budgetary and fiscal developments and outlook

2021 was a year of mild fiscal consolidation in the EU: the public deficit for the EU27 fell from an annual 6.7% of GDP to 4.7% (it was 0.6% in 2019, pre-COVID). In the first quarter of 2022 positive fiscal trends continued and the deficit fell to 3.1%.

Over the past year and a half Hungary's public deficit has also diminished, although to a lesser extent: in 2020 it fell from an annual 7.8% to 6.8% in 2021, and then to 5.4% in the first quarter of 2022. With these results Hungary had the fifth to seventh largest deficit among EU27 countries.

Hungary's cashflow-based budget deficit came to HUF 2,890 billion, reaching 92% of the deficit target for the full year (HUF 3,150 billion). The Budget Act of 2022 passed in June 2021 had in the meantime lost its relevance, therefore it is not useful to use it for comparing factual data. The Budget Act of 2022 calculates with a CPI of 3% and a GDP deflator of 3.8%, projecting a GDP of HUF 56,361 billion. But in reality, we are lucky if the year goes out with a CPI of 14% and a GDP deflator of around 10%. As a result, nominal GDP could exceed HUF 60,000 billion. These are the figures to consider when taking stock of the budget deficit and public debt.

The record high public deficit of the first half was caused by the government's pre-election "feel-good" measures, which added about HUF 1,700 billion worth of expenditures (income tax refund for families, 13th month pensions, one-off bonus for law enforcement workers and other spending items).

After the elections the government began the fiscal adjustment: it introduced extraordinary taxes dubbed as "extra-profit tax" on certain sectors, significantly raised excise taxes, and dramatically increased energy prices for a group of residential consumers.

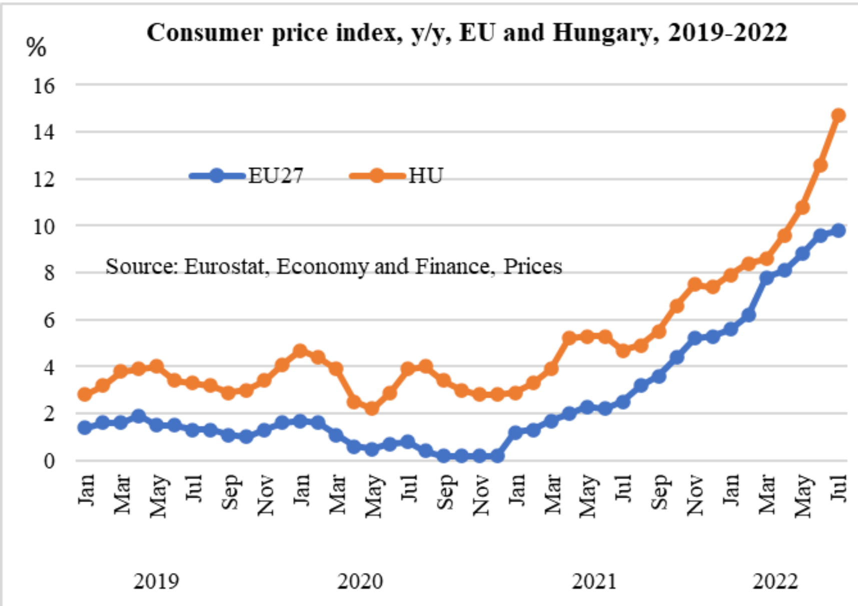
Fiscal consolidation is helped by inflation, insofar as inflation considerably increases revenues at current prices. Due to a high consumer price index in the first seven months of 2022 almost every item on the revenue side of the budget was up significantly on the previous year (and even more so on the targets). Revenues from consumer taxes were up by 25% in 2022 compared with the first seven months of 2021, while revenues from payments of households rose by 10.6%, if we count the 2021 income tax payments, later paid back to families, as revenues. Tax revenues from companies also rose considerably and are expected to do so even more during the year, when extra-profit taxes are levied.

In the short term – still this year – high inflation is still beneficial for the budget, as it can increase the nominal value of revenues. This is especially true considering that on the spending side only pension payments have to be adjusted to inflation. However, a high CPI will inflate away household incomes, resulting in household spending slowing down, perhaps even turning negative, which can reduce tax revenues already in the short to medium term. In addition, interest on a rising public debt will increase significantly, too.

Public debt rose by HUF 4,000 billion in 2021 and by another HUF 4,000 in the first half of 2022 (in six months alone), to HUF 46,000 billion or 77.5% of GDP. This is especially alarming, as yields on state securities rose above 10% on almost all denominations in September 2022, and the interest rate boosts of the National Bank of Hungary, seen as necessary in this environment, are foreshadowing the likelihood of further yield rises.

The forint's weakening is now a trend, the Hungarian currency is performing bottom-of-the-field not only against the EU currency but also against regional currencies, which is fueled in part by an increased mistrust of the government's economic policies as well as rising insecurities surrounding sealing a pact with the EU on funding from the seven-year Partnership Agreement and, more acutely, the Recovery and Resilience Facility (RRF). Yet by the end of August 2022 the government has already spent from its own sources and at its own risk HUF 186 billion on projects at the expense of RRF funds and has committed HUF 430 billion forints in contracts. Should Hungary be deprived of that funding, all these commitments are to put a toll on Hungary's public finances.

At the same time implicit inflation in Hungary is record high in the EU. While the Harmonized Index of Consumer Prices (HICP) only stood in sixth or seventh place in the inflation rankings in July 2022, this was artificially kept down by the price caps on energy and fuel prices. From August 2022 energy prices will rise dramatically. This considered, the implicit part of Hungarian CPI is to become explicit and as a result, the annual price level could put the country in the lead among EU countries in 2022.



Among the EU member states, food price rises were among the highest in Hungary (together with Lithuania) in July 2022, and *the* highest in the case of certain core items (bread and cereals and meat). Hungary's price increase was among the highest for vegetables and fruit, too. Notably high food prices show the impact of the "extra-profit tax" payable by foreign retail chains, pushing up prices.

The Hungarian CPI is expected to continue to rise in the last third of the year, it is set to surpass 20% in December, despite the government's extension of price caps on seven food items and fuel until 31 December.

Inflation is sure to continue growing in 2023, partly due to the low base, as the first eight months will still be compared with the relatively low (10.7%) base figure of 2022. On top of this it is plausible that other price caps will be removed, which could result in a significant increase in the price of those select seven food items (although they have a small weight in the consumer basket), as food prices continue to show a rising trend. Fuel prices can go either way in 2023, as it is not to be ruled out that global oil prices would decline. By December 2023 the overall price index could fall back to 5-6%.

In the meantime, the trade and current account deficits are also remarkably worsening, which is a factor behind the forint's weakening. Further, a fast-rising interest rate puts reins on both corporate and household borrowing, which in turn has a cool-down effect on investments and economic growth.

Macroeconomic data and KOPINT-Tárki projections

(Annual change, percent)

	Data				Projection	
	2021	2022				
		Q1	Q2	July-August	2022	2023
GDP aggregates, real growth						
GDP Total	7.1	8.2	6.5		**4.0**	**0.5**
Domestic demand	5.8	11.5	6.2		**4.5**	**-0.9**
Private consumption	4.4	11.5	9.4		**5.4**	**-1.5**
Public consumption	3.9	6.4	0.3		**1.5**	**0.0**
Gross fixed capital formation	5.9	13.2	6.1		**4.8**	**0.0**
Gross capital formation	9.6	17.6	2.4		**4.5**	**0.0**
Export	10.3	5.2	7.6		**4.5**	**1.7**
Import	8.7	8.3	7.3		**5.1**	**0.0**
Industrial production	9.5	5.6	4.6	4.0	**4.5**	**2.5**
Consumer Price Index	5.1	8.2	10.6	14.7	**14.0**	**16.5**
Employment, earnings						
Number of employed, growth [a]	0.7	2.3	1.6	1.1 [f]	**1.0**	**-0.5**
Employment rate [a]	63.0	63.7	64.0	64.1	**64.0**	**63.6**
Unemployment rate [a]	4.1	3.7	3.2	3.3 [f]	**3.6**	**3.8**
Unit labour cost [b]	-1.4	9.3	5.7		**2.0**	**7.5**
Gross nominal wages [c]	8.7	21.0	15.2		**17.0**	**12.0**
Net real wages	3.4	11.8	5.1		**2.6**	**-3.9**
Savings rate, % of GDP [d]	6.5	5.7	5.2		**6.0**	**5.5**
Current and capital accounts balance, % of GDP	-0.4	-2.4 [h]			**-4.0**	**-2.5**
General government						
Fiscal balance, ESA-2010, % of GDP	-6.8	-4.8			**-6.5**	**-4.0**
Gross government debt, % of GDP	76.6	77.3	77.5		**77.0**	**75.0**
Short-term government yields (3M), eop	2.16	5.7	6.3	8.0 [g]	**11.0**	**9.0**
Long-term government yields (10Y), eop	4.51	5.9	8.0	8.8 [g]	**10.5**	**9.5**
External assumptions						
International trade in goods and services	9.3				**5.0**	**4.4**
Brent oil price ($/bbl, p. avg.)	70.8	100.3	100.9	106.2	**107.0**	**100.0**
GDP real growth, eurozone, %	5.4	5.5	4.1		**2.6**	**1.3**
GDP real growth new EU Members, %	-3.8	7.1	4.7		**3.1**	**-2.7**
EUR-HUF, period average	359	364	386	403	**389**	**400**
EUR-USD, period average	1.18	1.12	1.06	1.02	**1.05**	**1.00**

a ILO methodology, period averages, aged 15-74, public workers are counted as employed
b Manufacturing, based on gross value added and the monthly average compensation of employees in euro, cumulated from the beginning of the year
c Enterprises with at least 5 employees, all budgetary institutions, and major non-profit institutions
d Net lending of households according to the financial accounts statistics, percentage of GDP, four-quarter cumulative data
e July
f May-July
g August