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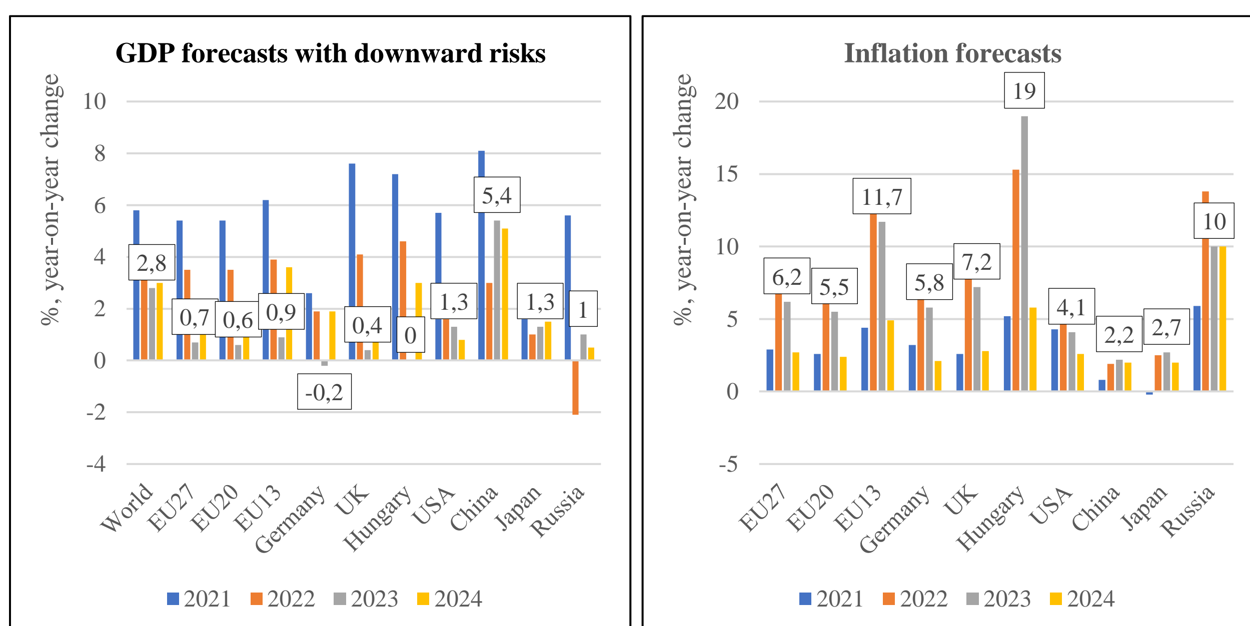
1. The world economy

The state of the global economy

The **global economy** may grow, according to the latest OECD forecast, by about 2.7%, with only a modest improvement to 2.9% in the next year. The pace of the growth acceleration primarily depends on the degree of disinflation and, as a corollary, the pace of real income growth. The interregional differences are still substantial: GDP may expand dynamically (by 5-6%) in the emerging economies, including India and China, the US and Japan may achieve growth rates above 1%, while the EU GDP is likely to stagnate. While GDP expanded considerably in the first months of the year, it is uncertain for how long the good pace can continue. The inflation outlook is still dim, with inflation forecasts still way above central bank targets everywhere except for China. Despite the easing of commodity prices, there are still strong inflationary drivers, and the downward impact of lower commodity prices will only gradually become noticeable. Disinflation is likely to continue the next year, but this prospect is not without negative risks either, especially because core inflation rates seem to be stuck at high levels. Further energy supply disturbances cannot be ruled out, and this poses another inflationary risk, although the experience so far suggests that the markets can quickly adapt to the changes. The continuing strict monetary policy stance restrains growth and the high interest rate levels seriously constrain the range of options for fiscal policy.

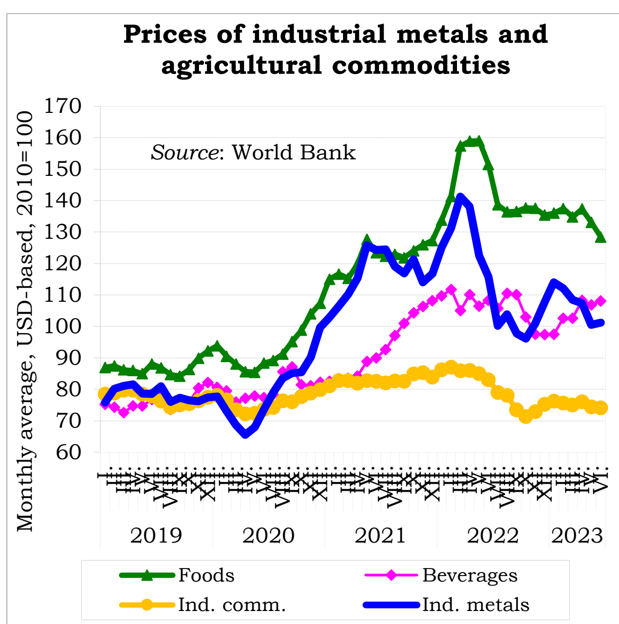


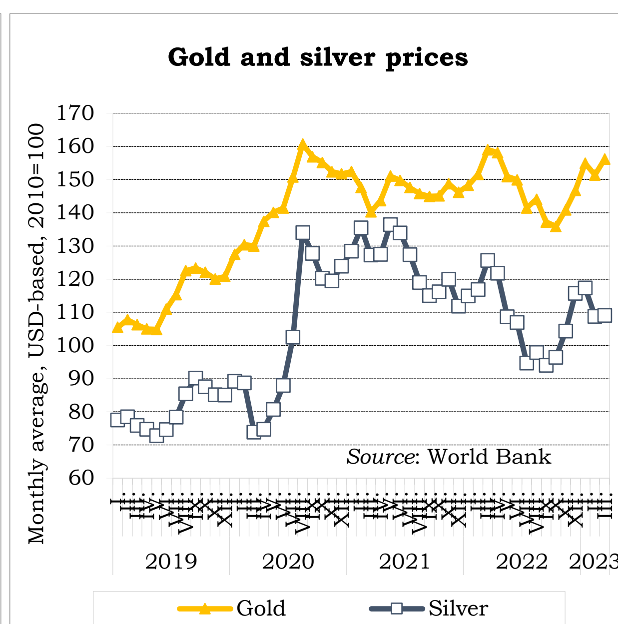
World trade

In the first quarter of 2023, the volume of **world trade** stagnated or even slightly contracted. The latter is the result of the global economic slowdown. The high inflation in developed countries led to shifts in the structure of consumption, reducing demand for the products that are produced through global value chains. International shipping companies report such levels of capacity underutilization that severely hurt their bottom lines. External trade prices are still high, following global inflationary trends, and no significant decrease is likely even if a significant further rise seems unlikely too. We continue to expect modest growth in world trade, and the pace of growth is likely to remain below its pre-pandemic average in 2024 as well.

Commodity markets

Brent crude oil price has been hovering around 80 USD/barrel in much of the first half of this year, followed by some rise in July-August. For the year as a whole, we expect an average price of nearly 80 USD/barrel and no significant rise is likely in 2024 either, even though the OPEC countries plan to extend their output cut to the next year and they revised upward their expectations regarding global oil demand. The alter is warranted by the coming rise in Chines, Indian and South American oil demand. While the economic upturn in China and India may indeed push oil prices upward, we expect this effect to be moderate. On the **European gas market** prices continued to decrease in April-May, followed by a slight rise in June. Still, the June price level was only 28% of the level seen in December 2022, which means that gas prices basically returned to their pre-crisis level. In some countries, including Germany, gas providers started to reduce their prices. In Asia, the price of liquid gas dropped back to its early 2021 level as well. Still, an upturn in China and the potential bottlenecks may push gas prices upward again.



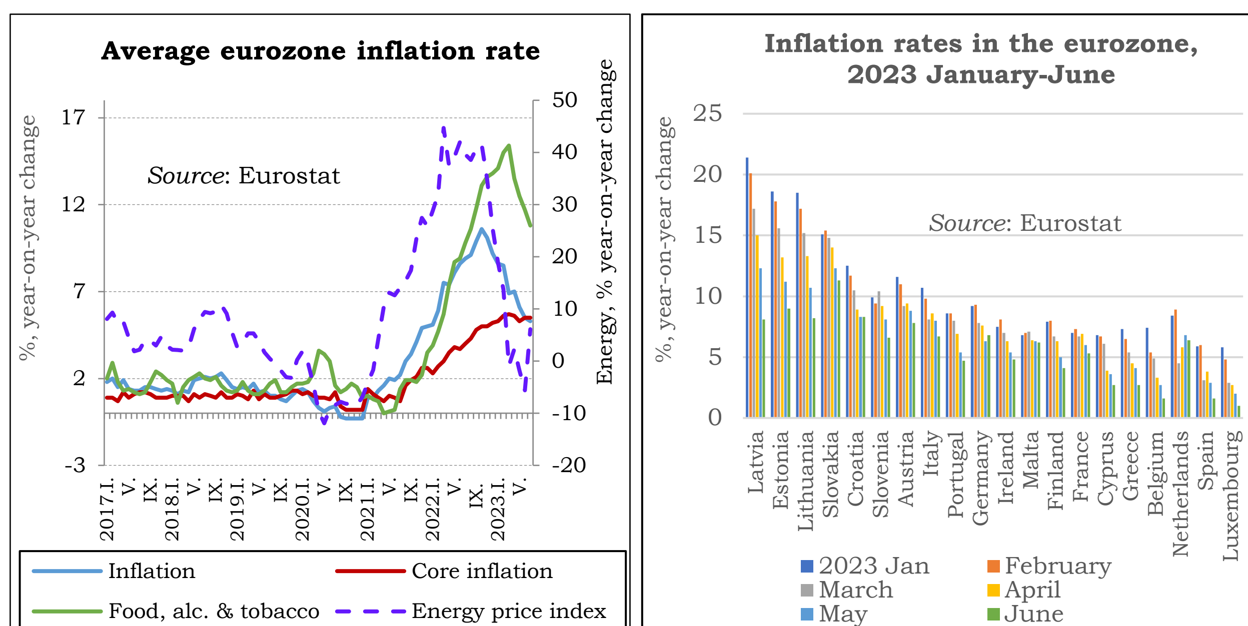


The global price of energy decreased for two consecutive months in May and June. Coal prices dropped the most, followed by oil prices, partially offset by a mild rise in gas prices in Europe and the US. By June, global energy prices dipped by almost 50% on an annual basis.

Non-energy commodity prices have also continued to decrease but no significant further drop is likely for the rest of the year. On the one hand, production costs, especially for labor intensive commodities, grew considerably. On the other hand, summer droughts are expected to jeopardize agricultural yields worldwide. Industrial metal prices will probably remain subdued, due to the weak global economic activity, but they are expected to rise in 2024, even if at a lesser pace than in the past year. The recessionary fears push the prices of precious metals upward – the price of gold has reached record highs, with an all-time record of 2000 UDS/ounce in April. No significant decrease is likely until a significant easing of global inflation and an upturn in global economic growth.

Monetary policy

The latest **inflation** data show a moderation of price indices, but **core inflation** remains sticky everywhere. In June, core inflation stood at 4.8% in the US, 6.4% in the UK, 6.1% in Germany, 4.9% in Italy, and 2.8% in Japan. The headline inflation rate was 5.7% in June, 5 percentage points down from its peak in October 2022. Despite receding energy prices food prices keep rising, and the past increases are already built into consumer prices, which is reflected in core inflation trends. Under such conditions, any significant **monetary easing** is unlikely. The communication on the part of the FED is not unequivocal, either: the reference rate has been raised by 1 percentage point so far this year, and further raises are not ruled out, although the communication suggests that the rate hike cycle is nearing the end. While the reference rate is 5.3% at present, the July inflation rate was 3.2%, still above the 2% target but not very far from it. On the other hand, the economy remains robust, despite the adverse short-term prospects. As a result, several FED representatives indicated the willingness to continue raising the FED rate.



The *ECB* has raised the policy rates by 50 basis points two times and by 25 basis points three times so far in 2023. Inflation in the euro area dropped from 8.6% in January to 5.3% in July but core inflation has not started decreasing so far. The ECB at present concentrates on spillover risks, for example labor cost trends. The high core inflation level indicates that inflationary pressures are still substantial in the EU economies, which raises the possibility of further rate hikes by the ECB.

In the *United Kingdom*, the central bank continued to raise the reference rate (to 5.25%) in August. The inflation stood at 8.7% in June. In *Switzerland*, after two rate hikes in 2023 until July,

By contrast, monetary policy is becoming more accommodative, especially after a record fall in producer prices in June. After 2% in the 2022, the inflation target for this year is 3% and encouraging household consumption has become a priority. The *Japanese central bank* maintains its extremely loose monetary policy stance and keeps the policy rates unchanged. The BOJ expects an upturn of economic activity in the second half of the year, but the state of the global economy poses some negative risks in this respect.

Economic trends outside the EU

In the **US**, economic growth seems to lose momentum. This is corroborated by the Beige Book, published by the FED in mid-July. According to recent data, a record number of businesses went bust in the first half of this year, which indicates that the harsh interest rate conditions and high inflation imposes a growing burden on US firms. The decrease in disposable income and the drying up of savings accumulated during the pandemics put a break on household consumption. The high inflation and interest rates will continue to obstruct economic growth, especially private consumption and housing construction, during the rest of the year. High financing costs and the uncertain demand prospects, in turn, weaken investment demand. No further fiscal stimulus can be expected. GDP may climb 1.3% in 2023 as a whole, but in the second half of the year, even an economic contraction cannot be ruled out. In 2024, GDP growth is likely to decelerate further, along with some worsening in the labor market situation. Disinflation will continue but the overall inflation level may keep exceeding the target set by the FED in the next year.

In ***Japan***, economic growth is seemingly gains momentum. The annual growth rate may accelerate to 1.5% in 2024 from the 1.3% expected this year. The external demand conditions constitute the primary obstacle to growth while the domestic demand is buttressed by the very loose monetary policy. Wage growth tends to surpass inflation, which leads to an acceleration of consumption growth. Inflation is fluctuating around 2%, which is much higher than during the Covid crisis, but the central bank keeps interest rates low. As a result, financing costs rose much more moderately than in the other developed countries.

In the **UK**, a modest growth of about 0.4% is expected this year, with only a slight acceleration in 2024. Growth will be supported by public consumption and investments while private consumption remains muted, and companies keep their stocks at a low level. Due to the sluggish external demand and the aftereffects of Brexit, export may decrease by 3-4% this year. At the same time, import will fall as well amid weak domestic demand, leading to a positive growth contribution of net export. Inflation will remain high (7.2%), thus monetary tightening continues. Gross public debt is still above 100% of GDP, the fiscal policy stance will remain restrictive during the forecast period.

According to the OECD experts, the **Chinese economy** may achieve a growth rate of 5.4% in 2023, roughly twice the global growth rate. They expect the pent-up consumer demand, accumulated during the Covid-related lockdowns, to be the main driver of growth, especially the surge in demand for services related to recreation, entertainment, food services and the related consumer goods, equipment and vehicles. China is relatively protected from the global food and energy market shocks: while food products are very prominent in the Chinese consumer basket, food import is limited. As a result, the inflationary effect of a global food price surge is mild in China. In addition, much of the country's energy import demand is covered by Russian import, conducted under various preferential schemes. After the massive surge during the Covid years and the subsequent drop in 2022, export is unlikely to grow substantially in 2023. On the one hand, the effective demand in many major export destinations for traditional Chinese export goods took a hit. On the other hand, the increasingly widespread rumors regarding the risks of Chinese high-tech products to national security and institutional, business and personal data protection also have a major impact among customers.

Outlook for the euro area

In the first quarter of 2023, the eurozone GDP stagnated compared to the previous quarter. Both private and government consumption contracted while investments expanded, and net export contributed positively to economic growth. After the annual growth of 3.5% in the last year, the euro area GDP is expected to expand only by 0.6% this year, followed by some modest acceleration in 2024. The continuing high level of employment supports private consumption, but the uncertain demand prospects and the tightening financing conditions put a brake to private investments. Hence private consumption may grow at a symbolic pace of 0.5% while investments and government consumption are likely to contract. Export growth will decelerate substantially while import stagnates – as a result, net export will contribute only minimally to GDP growth. After a relatively good start of the year, the business sector outlook soured during the spring, and the worsening external demand conditions add to the existing uncertainties. In some areas, the labor shortage pushes wages upward. Inflation is moderating due to decreasing energy prices, but the continuation of the Russo-Ukrainian conflict can trigger new energy supply disturbances – and energy price hikes – at any moment. The monetary policy stance remains restrictive for now: the evolution of inflation, especially core inflation, will be the decisive factor regarding when the tightening cycle ends. Expansive fiscal policy, while tolerated during the Covid years and the energy crisis, is now tightening as well, and the earlier stimulus measures are being discontinued everywhere.

The **EU27** GDP was up 0.2% in the first quarter on a quarter-on-quarter basis. We expect the annual GDP to grow by 0.7% this year, with an acceleration in 2024 to 1.9%. In the next year, the EU13 region will boast higher growth rates than the eurozone. Inflation will remain high in the EU27 (6.2%) this year, primarily because the relatively high rates in the Eastern European member states. But even here, disinflation is seen everywhere, even in countries where inflation reached very high levels (e.g. Poland and Hungary). The Hungarian inflation is still the highest among the EU countries.

In the first quarter of this year, the quarter-on-quarter growth rate was negative in ***Germany***, primarily due to the fiscal expenditure cuts. The level of industrial orders is still high, business-to-consumer services benefit from rising wages. While annual GDP is expected to slightly contract this year due to the weak first half of the year, the second half will probably see an upturn in economic activity. According the expectations, the German economy will grow by nearly 2% in 2024. Both private consumption and investments will decrease this year, along with government consumption, with only export expanding at a modest pace. Since sluggish domestic demand keeps a lid on import, net export will contribute positively to GDP growth. Accordingly, business sentiment is subdued. Since April the IFO business climate index has been falling: the companies are becoming pessimistic regarding both their current situation and the future prospects. The inflationary pressures are steadily decreasing and the annual inflation rate is expected to sink to about 2% in the next year. The decline of labor supply, generated by demographical changes, cause increasing tensions in several economic sectors.

Central Eastern Europe

In the first quarter of 2023, the average annual GDP growth rate was merely 0.5% in the **EU13**. Five countries posted negative growth: Estonia (-3.2%), Lithuania (2.4%), Hungary (-0.9%), Czechia (-0.2%) and Poland (-0.1%). In the second quarter, however, further countries are likely to experience negative growth, primarily due to reduced private consumption levels. In the coming one or two quarters, the whole region may face economic contraction. The dramatic rise in energy prices in the last year caused oppressive inflation rates in every country, even though the differences between the member states remained substantial. The price indices have already peaked everywhere but even so, the regional average inflation rate will exceed 10% this year. The next year will see substantial disinflation but some of it will only a result of technical base effect. While the average rate expected for 2024, 5%, is a significant improvement compared to this year, the annual rates will remain way above the central bank targets in the new member states. This will slightly hinder the economic upturn in the next year. In 2023, the average growth rate is likely to reach 1% at most, with significant negative risks, especially in Poland, while in 2024 we expect the average growth rate to rise to about 3.5% in the region. This prediction, apart from the statistical base effect, is based on several assumption, namely: economic growth will be supported by a sensible use of the funding coming from the cohesion and recovery funds, interest rates decrease to a level which does not hinder investments and consumption, and there will be no further energy price shock.

Table 1/1.

Economic Growth in the EU Member States

(Percentage change of real GDP over the previous year)

	Weight	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023***	**2024***
Germany	25.0	2.7	1.0	1.1	-3.7	2.6	1.8	-0.2	1.9
France	17.3	2.3	1.9	1.8	-7.8	6.8	2.6	0.7	1.4
Italy	12.4	1.7	0.9	0.5	-9.0	7.0	3.7	1.1	0.8
Netherlands	6.0	2.9	2.4	2.0	-3.9	4.9	4.5	0.3	1.6
Belgium	3.4	1.6	1.8	2.2	-5.4	6.1	3.1	1.0	1.3
Luxembourg	0.5	1.3	1.2	2.3	-0.8	5.1	1.5	0.5	2.0
Ireland	2.7	9.0	8.5	5.4	6.2	13.6	12.0	-0.8	4.3
Greece	1.2	1.1	1.7	1.9	-9.0	8.4	5.9	1.7	2.7
Spain	8.4	3.0	2.3	2.0	-11.3	5.5	5.5	2.1	2.1
Portugal	1.5	3.5	2.8	2.7	-8.3	5.5	6.7	2.5	1.9
Austria	2.8	2.3	2.4	1.5	-6.5	4.6	5.0	0.7	1.2
Finland	1.8	3.2	1.1	1.2	-2.4	3.0	2.1	0.0	1.2
Estonia	0.2	5.8	3.8	3.7	-0.6	8.0	-1.3	-0.3	3.1
Slovakia	0.7	2.9	4.0	2.5	-3.4	3.0	1.7	1.0	2.1
Slovenia	0.3	4.8	4.5	3.5	-4.3	8.2	5.4	1.2	2.5
Cyprus	0.2	5.7	5.6	5.5	-4.4	6.6	5.6	2.3	2.4
Malta	0.1	10.9	6.2	7.0	-8.6	11.8	6.9	4.2	4.1
Latvia	0.2	3.3	4.0	2.6	-2.2	4.1	2.0	0.3	2.3
Lithuania	0.4	4.3	4.0	4.6	0.0	6.0	1.9	0.0	2.5
Croatia	0.4	3.4	2.8	3.4	-8.6	13.1	6.3	1.7	2.5
Euro Area	**85.2**	**2.6**	**1.8**	**1.6**	**-6.1**	**5.4**	**3.5**	**0.6**	**1.7**
Denmark	2.3	2.8	2.0	1.5	-2.0	4.9	3.8	1.5	1.6
Sweden	3.6	2.6	2.0	2.0	-2.2	5.4	2.6	0.9	1.6
Hungary	1.0	**4.3**	**5.4**	**4.9**	**-4.5**	**7.2**	**4.6**	**-0.5**	**2.5**
Czech Republic	1.6	5.2	3.2	3.0	-5.5	3.6	2.5	0.0	2.4
Poland	3.9	5.1	5.9	4.5	-2.0	6.8	4.9	0.8	3.6
Romania	1.6	8.2	6.0	3.9	-3.7	5.8	4.8	2.5	3.5
Bulgaria	0.5	2.8	2.7	4.0	-4.0	7.6	3.4	1.5	2.5
EU14	***88.7***	**1.8**	**1.6**	**-5.8**	**5.3**	**3.5**	**1.8**	**0.6**	**1.6**
New EU13	**11.3**	**5.0**	**4.9**	**4.0**	**-3.5**	**6.3**	**4.1**	**0.9**	**3.6**
EU27	**100**	**2.8**	**2.1**	**1.8**	**-5.6**	**5.4**	**3.5**	**0.7**	**1.9**
Memorandum items									
USA		1.6	3.0	2.3	-3.4	5.7	2.1	1.3	0.8
Japan		1.0	1.9	0.7	-4.7	2.3	1.0	1.3	1.5
United Kingdom		1.7	1.3	1.6	-11.0	7.6	4.1	0.4	1.2
China		6.7	6.8	6.0	2.2	8.1	3.0	5.4	5.1
Russia		-0.2	2.2	1.3	-2.7	5.6	-2.1	1.0	0.5
South-Eastern Europe									
Serbia		2.1	4.5	4.3	-0.9	6.7	3.0	1.9	3.0
Turkey		7.4	3.0	0.9	1.8	9.0	5.6	3.5	4.0

* Kopint-Tárki forecast

EU14 = Countries that joined the European Union before 2004

New EU13 = Countries that joined the European Union in 2004, 2007 and 2013

Source: Eurostat, national statistical offices, OECD

Table ½.

Inflation in the EU Member States

(Harmonized consumer price indices, percentage change over the previous year)

	Weight	2017	2018	2019	2020	2021	2022	2023*	2024*
Germany	24.6	1.7	1.9	1.4	0.4	3.2	8.7	5.8	2.1
France	17.4	1.2	2.1	1.3	0.5	2.1	5.9	5.0	2.3
Italy	14.1	1.3	1.2	0.6	-0.1	1.9	8.7	5.7	2.2
Netherlands	4.9	1.3	1.6	2.7	1.1	2.8	11.6	5.0	2.7
Belgium	3.3	2.2	2.3	1.2	0.4	3.2	10.3	4.5	2.5
Luxembourg	0.2	2.1	2.0	1.6	0.0	3.5	8.2	3.2	2.1
Ireland	1.4	0.3	0.7	0.9	-0.5	2.4	8.1	4.9	2.1
Greece	1.7	1.1	0.8	0.5	-1.3	0.6	9.3	5.3	2.8
Spain	9.1	2.0	1.7	0.8	-0.3	3.0	8.3	4.3	2.7
Portugal	1.9	1.6	1.2	0.3	-0.1	0.9	8.1	6.9	3.2
Austria	2.7	2.2	2.1	1.5	1.4	2.8	8.6	6.6	2.7
Finland	1.7	0.8	1.2	1.1	0.4	2.1	7.2	4.9	2.4
Estonia	0.2	3.7	3.4	2.3	-0.6	4.5	19.4	10.0	3.5
Slovakia	0.8	1.3	2.5	2.8	2.0	2.8	12.1	11.0	5.0
Slovenia	0.3	1.6	1.9	1.7	-0.3	2.0	9.3	7.5	4.0
Cyprus	0.2	0.7	0.8	0.5	-1.1	2.3	8.1	3.9	2.6
Malta	0.1	1.3	1.7	1.5	0.8	0.7	6.1	5.4	2.8
Latvia	0.2	2.9	2.6	2.7	0.1	3.2	17.2	10.0	2.5
Lithuania	0.4	3.7	2.5	2.2	1.1	4.6	18.9	10.0	3.0
Croatia	0.4	1.3	1.6	0.8	0.0	2.7	10.7	7.7	3.3
Euro Area	**85.7**	**1.5**	**1.8**	**1.2**	**0.3**	**2.6**	**8.4**	**5.5**	**2.4**
Denmark	2.0	1.1	0.7	0.7	0.3	1.9	8.5	4.4	2.2
Sweden	3.0	1.9	2.0	1.7	0.7	2.7	8.1	6.4	2.6
Hungary	1.0	**2.4**	**2.9**	**3.4**	**3.4**	**5.2**	**15.3**	**19.0**	**5.8**
Czech Republic	1.5	2.4	2.0	2.6	3.3	3.3	14.8	11.0	3.0
Poland	4.3	1.6	1.2	2.1	3.7	5.2	13.2	13.0	6.0
Romania	1.9	1.1	4.1	3.9	2.3	4.1	12.0	10.5	5.5
Bulgaria	0.5	1.2	2.6	2.5	1.2	2.8	13.0	10.0	4.0
EU14	**88.1**	**1.7**	**1.9**	**1.3**	**0.4**	**2.6**	**7.8**	**5.4**	**2.3**
New EU13	**11.9**	**1.7**	**2.3**	**2.7**	**2.7**	**4.4**	**13.9**	**11.7**	**4.9**
EU27	**100.0**	**1.6**	**1.8**	**1.4**	**0.7**	**2.9**	**9.2**	**6.2**	**2.7**
Memorandum items [a]									
USA		0.1	1.3	1.5	1.2	4.3	6.3	4.1	2.6
Japan		0.8	0.5	0.5	0.0	-0.2	2.5	2.7	2.0
United Kingdom		2.7	2.5	1.8	0.8	2.6	9.1	7.2	2.8
China		1.4	2.0	2.9	2.5	0.8	1.9	2.2	2.0
Russia [b]		7.0	2.9	4.5	2.6	5.9	14.0	10.0	10.0
South-Eastern Europe									
Serbia		3.1	2.0	1.9	1.7	3.6	8.5	12.4	5.9
Turkey		11.0	16.4	15.2	12.3	17.8	72.3	45.0	30.3

a Non-harmonized price indexes
b December/December
* Kopint-Tárki forecast
EU-14 = Countries that joined the European Union before 2004
EU-13 = Countries that joined the European Union in 2004, 2007 and 2013
Source: Eurostat, national statistical offices, OECD

Table 1/3.

Harmonized Unemployment rates in the EU Member States

(Unemployed as a percentage of the labor force aged 15-74, ILO-Eurostat)

	Weight	2017	2018	2019	2020	2021	2022	2023*	2024*
Germany	20.3	3.8	3.4	3.1	3.6	3.6	2.7	2.9	2.8
France	14.0	9.4	9.0	8.4	8.0	7.9	7.3	7.0	7.0
Italy	12.1	11.2	10.6	10.0	9.6	9.6	8.2	7.9	7.7
Netherlands	4.3	4.9	3.8	3.4	3.3	4.2	3.4	3.5	3.2
Belgium	2.4	7.1	6.0	5.4	6.4	6.3	5.6	5.5	5.5
Luxembourg	0.1	5.5	5.6	5.6	5.8	5.5	4.7	4.9	4.7
Ireland	1.1	6.7	5.8	5.0	6.7	6.3	4.8	3.9	3.7
Greece	2.2	21.5	19.3	17.3	15.3	14.8	12.5	12.0	11.9
Spain	10.9	17.2	15.3	14.1	15.2	14.8	13.1	12.7	12.0
Portugal	2.4	9.0	7.1	6.5	6.7	6.6	5.9	6.8	6.6
Austria	2.1	5.5	4.9	4.5	6.4	6.2	4.6	5.0	4.9
Finland	1.3	8.6	7.4	6.4	7.7	7.7	6.7	6.8	6.7
Estonia	0.3	5.8	5.4	4.4	6.8	6.2	6.1	6.2	6.1
Slovakia	1.3	8.1	6.5	5.8	6.8	6.8	6.3	5.8	5.4
Slovenia	0.5	6.6	5.1	4.5	4.6	4.8	4.1	3.9	3.8
Cyprus	0.2	11.1	8.4	7.1	7.5	7.5	7.2	6.9	6.4
Malta	0.1	4.0	3.7	3.6	4.0	3.5	3.2	2.9	2.9
Latvia	0.4	8.7	7.4	6.3	7.3	7.6	7.1	6.8	6.5
Lithuania	0.7	7.1	6.2	6.3	7.1	7.1	6.0	6.6	6.5
Croatia	0.8	11.2	8.5	6.6	6.7	7.7	6.3	6.6	6.1
Euro Area	**76.8**	**9.1**	**8.2**	**7.6**	**8.0**	**7.7**	**6.7**	***6.6***	***6.4***
Denmark	1.4	5.8	5.1	5.0	5.3	5.1	4.2	4.8	4.7
Sweden	2.5	6.7	6.4	6.8	8.9	8.8	7.4	7.4	7.2
Hungary	2.2	**4.0**	**3.6**	**3.3**	**4.1**	**4.1**	**3.7**	4.1	3.8
Czech Republic	2.5	2.9	2.2	2.0	2.7	2.8	2.7	2.8	2.6
Poland	8.0	4.9	3.9	3.3	3.3	3.4	2.7	3.3	3.2
Romania	4.2	4.9	4.2	3.9	5.0	5.6	5.4	5.4	5.1
Bulgaria	1.6	6.2	5.2	4.2	5.1	5.3	5.2	4.3	4.0
EU14	**77.2**	**8.4**	**7.5**	**7.1**	**7.9**	**7.8**	**6.7**	***6.6***	***6.4***
New EU13	**22.8**	**5.5**	**4.5**	**4.1**	**4.4**	**4.6**	**4.1**	***4.3***	***4.1***
EU27	**100.0**	**8.3**	**7.4**	**6.8**	**7.2**	**7.1**	**6.1**	***6.1***	***5.9***
Memorandum items [a]									
USA		4.9	3.9	3.7	8.1	5.4	3.6	3.7	4.2
Japan		3.1	2.8	2.4	2.8	2.8	2.7	2.6	2.5
United Kingdom		4.4	4.1	3.8	4.5	4.6	3.7	4.4	4.5
China[b]		4.0	4.0	3.8	3.6	4.0	4.2	4.2	4.2
Russia[c]		5.7	5.4	4.6	6.0	5.9	3.9	4.5	3.0
South-Eastern Europe									
Serbia[d]		13.5	12.7	10.4	9.0	10.7	9.2	8.6	8.3
Turkey		10.9	10.9	13.7	13.2	12.8	12.9	10.2	10.2

a Nonharmonized unemployment rates
b Urban unemployment
c OECD statistics, unemployment rates for the age group 15-64
d National statistics, unemployment rates for the age group 15-64
* Kopint-Tárki forecast

EU-14 = Countries that joined the European Union before 2004
EU-13 = Countries that joined the European Union in 2004, 2007 and 2013
Source: Eurostat, national statistical offices, ILO, OECD

Macroeconomic indicators for Hungary and Kopint-Tárki forecast

(year-on-year change, percentage)

	Data				Forecast		
	2021	2022	2023		2023		2024
			Q1	Q2	2023 May	2023 Aug.	2023 Aug.
GDP aggregates, real growth							
GDP total	7.2	4.6	*-0.9*	*-2.4*	-0.5	**-0.5**	**2.5**
Domestic Demand	6.3	3.9	*-4.9*		-2.5	**-3.0**	**2.4**
Private Consumption	4.0	5.8	*-2.5*		-2.0	**-2.0**	**2.2**
Public Consumption	2.5	-1.3	*-4.6*		-1.0	**-2.0**	**0.5**
Gross Fixed Capital Formation	6.5	1.2	*-6.0*		-4.0	**-4.0**	**3.5**
Gross Capital Formation	13.0	2.2	*-8.1*		-4.0	**-4.3**	**3.5**
Export	8.8	11.8	*6.6*		2.3	**3.5**	**3.6**
Import	7.7	11.1	*1.9*		0.0	**0.6**	**3.5**
Industrial production	9.0	6.2	*-3.4*	*-6.2*	2.0	**-3.0**	**4.0**
Consumer Price Index	5.1	14.5	*25.4*	*21.8*	18.5	**18.0**	**5.8**
Employment, earnings							
Number of Employed, growth [a]	0.7	1.3	*0.5*	*0.7*	-0.3	**0.1**	**1.0**
Unemployment Rate [a]	4.1	3.6	*4.1*	*3.9*	4.2	**4.1**	**3.8**
Unit Labor Costs, in EUR [b]	0.1	1.3	*16.3*		9.3	**17.6**	**3.4**
Gross Nominal Wages [c]	8.9	17.4	*10.8*	*16.7* [e]	15.0	**15.0**	**8.0**
Net Real Wages [c]	3.6	2.5	*-11.6*	*-4.9* [e]	-3.0	**-2.5**	**2.1**
Savings Rate, % of GDP [d]	6.5	4.0	*4.6*		4.5	**6.5**	**6.5**
Current and Capital Accounts Balance, % of GDP	-1.3	-6.1	*-2.5* [f]		-3.5	**-0.5**	**1.0**
General government Fiscal Balance, ESA-2010, % of GDP	-7.1	-6.2	*-9.8*		-4.0	**-4.9**	**-3.9**
Gross Government Debt, % of GDP	76.6	73.3	*74.9*		69.3	**71.4**	**69.9**
Short-term Government Yields (3M), eop	2.2	12.3	*14.5*	*10.0*	10.0	**8.5**	**5.5**
Long-term Government Yields (10Y), eop	4.5	9.0	*8.4*	*7.0*	7.5	**6.5**	**5.5**
External assumptions							
Internat. Trade in Goods and Services [d]	10.4	5.4			2.4	**2.4**	**3.4**
Brent Oil Price ($/bbl, p. avg.)	70.8	101.0	*81.1*		86.0	**86.0**	**80.0**
GDP Real Growth, Eurozone	5.3	3.5	*1.2*		0.9	**0.9**	**1.6**
GDP Real Growth, New EU Members	6.3	4.0			0.9	**0.9**	**2.7**
EUR-HUF, period average	359	391	*389*	*373*	395	**390**	**390**
EUR-USD, period average	1.18	1.05	*1.07*	*1.09*	1.05	**1.05**	**1.08**

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 All employers
d Net lending of households according to the financial accounts statistics, percentage of GDP, four-quarter cumulative data
e April-May
f Seasonally adjusted data by the MNB

2. The Hungarian economy

Macroeconomic situation and outlook

In the first quarter of 2023, the Hungarian GDP **decreased** in real terms on an annual basis, for the first time since early 2021. Compared to the previous quarter, on the other hand, this was the third consecutive quarter of contraction. The year-on-year growth rate was among the worst within the EU, exceeded only by Estonia and Lithuania.

In itself, the 0.9% fall in the unadjusted volume (and the 1.1% drop in the seasonally and calendar adjusted GDP) is moderate. The quarter-on-quarter decrease decelerated to 0.3% in the first quarter.

The rate of household consumption decrease remained relatively moderate in Q1

Although the world economy has many problems and tensions, the primary cause of the GDP fall in Hungary, namely the fact that inflation peaked at record levels in the first months of this year, has in large part domestic causes. The high inflation led to a decrease in household incomes and, consequently, a contraction of domestic demand. In fact, this contraction could have been more severe, considering that in the first quarter, ***real net wage disbursements*** dropped by 10.3% on an annual basis. Despite this steep fall, the CSO reported only a 3.9% decrease in *household consumption expenditures*, even though the 9.1% decrease in real retail trade turnover at the same time suggested a steeper consumption crunch.

In earlier cases, such a relatively mild decrease could be explained by a smoothing of consumption, by letting their savings slip somewhat. This time, however, this explanation is problematic because households *sharply increased their current financial savings* in the first quarter, amid the seemingly massive fall in household incomes, with real net household lending growing by nearly 25% on an annual basis. The net savings-to-GDP ratio jumped to 9.4% (the four-quarter cumulative savings rate was 4.6%).

Another possible explanation is that households, instead of cutting their financial savings, rather cut their *investments*. This is supported by the data that show a steep fall in new housing loans, the contraction of demand for new dwellings and the dearth of housing purchases for investment purposes. On the other hand, the data from the investment statistics suggest that the combined investments of households, micro- and small enterprises and nonprofits slightly *increase* in the first quarter, so there are some doubts regarding this hypothesis, too.

Based on the above considerations, it is possible that later on the CSO will retroactively revise its first-quarter consumption index downward. Another possibility is, however, that the decrease in *overall household incomes* was less pronounced in the first quarter than what the plunge in real wages (and real pensions) suggests, because *mixed incomes* might have increased at the same time. This version is tentatively supported by the fact that the economy-wide *gross operating surplus* – which is, roughly speaking, the value added less labor compensation – *grew* in the first quarter, despite all the turbulence, exploding costs and uncertainties.

Finally, it should be noted that the economic contraction has not generated a decrease in employment levels (on an annual basis), and the available data suggests that a marked

worsening of the labor market situation is unlikely for the rest of the year. This could have a moderating impact on consumption fall.

Due to a sudden surge in *individual government consumption*, overall private consumption fell only by 2.5%, at a milder rate than private consumption expenditures.

Falling investments, improving net export

Gross fixed capital formation value added was down 6% in the first quarter on an annual basis. According to the investment statistics by the CSO, the decrease in *business* investments was the culprit behind the fall, while state investments – after two-quarters of a steep fall – moderately increased. This, however, may be in part the result of an institutional change: several state-owned companies operating in the transport, water, tourism and sports infrastructure field were liquidated and transferred to budgetary institutions. This has a downward effect on business sector investments and an upward effect on state investments. The fact that investments drastically dropped in "traditional" public sector areas like public administration, education and the health-social work sectors suggests that the impact of this institutional reshuffle on the statistical data was indeed significant. At the same time, investments kept expanding in the largest sector, manufacturing, and some increase was registered in real estate, another important sector. More generally, the investment activity in the more export oriented economic fields remained favorable while the majority of largely domestic-oriented sectors saw a decrease in investments. In the largest state-dependent sector, transport & storage, the ongoing investment fall continued, albeit at a lesser pace. The drastic cuts in public investments were reflected by the fall in *construction* investments, while the volume of investments in machinery grew in the first quarter.

At this point, it is worth mentioning again that in the majority of economic sectors, the real *gross operating surplus* kept growing in the first quarter of this year. This implies that rather than current profitability problems, gloomy demand outlook and rising financing costs could hold back firms from investments. The question is, whether the situation changed in the second quarter, when the further contraction of domestic demand led to more substantial disinflation, and hence a reduced capacity to incorporate rising costs into output prices. Overall, domestic demand fell by 4.9% in the first quarter, but without the strong negative change in inventories the decrease would have been much milder.

By contrast, the *net export of goods and services* had a positive, and unusually strong, contribution to GDP growth. This time, most of the positive impact was due to the external trade of *goods*: according to the GDP statistics, the goods export growth rate (7%) was higher than the import growth rate (1.7%) by more than 5 percentage points. This surplus was exclusively due to the external trade of machinery and transport vehicles, while in the other product groups, the volume of export uniformly *decreased*. The fall in food export is especially striking because it was accompanied by a strong expansion of food import.

Although the pace of the export of services also surpassed the pace of services import, the difference was much less pronounced now than in the past two years.

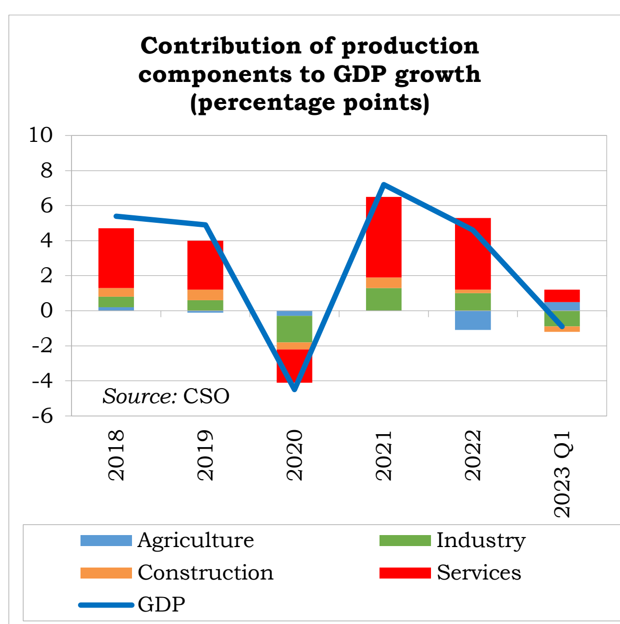
As opposed to the severe terms-of-trade deterioration in the last year, the terms of trade are improving this year. As a result, the *merchandise trade* balance has turned into a surplus.

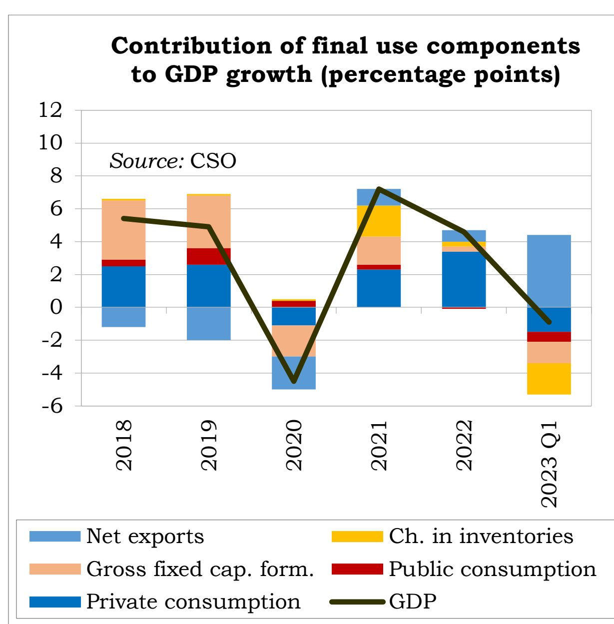
To sum up, on the ***expenditure side*** of GDP, consumption expenditures and inventory change pulled down the growth rate (in the case of the former, the impact was mostly due to the component's large weight, rather than the less-than-drastic pace of decrease). The main upward effect came from net export – that in large part offset the negative effect of domestic components – that is how the overall GDP fall was milder than 1%.

On the ***production side***, agricultural value added jumped as expected while construction value added fell largely as expected (not least because of the public investment cuts). Services, on the other hand, were up 1.1%, which is remarkable amid the worsening domestic demand conditions. But this growth is mostly due to a drastic jump in the output of the health & social work sector. There is no information available about the background of this jump. The volume of *market services* decreased by 0.5%, but some growth was registered in the financial, info-communication and tourism sectors and real estate.

The negative surprise came from industry: manufacturing value added was down 1.5% while the overall industry (which includes the energy sector) fell by 3.2% in the first quarter. According to the data from industrial statistics, the decline is due to plummeting domestic sales but export sales also almost stagnated, in stark contrast to the external trade data and the GDP statistics that show overall export growing at a healthy rate.

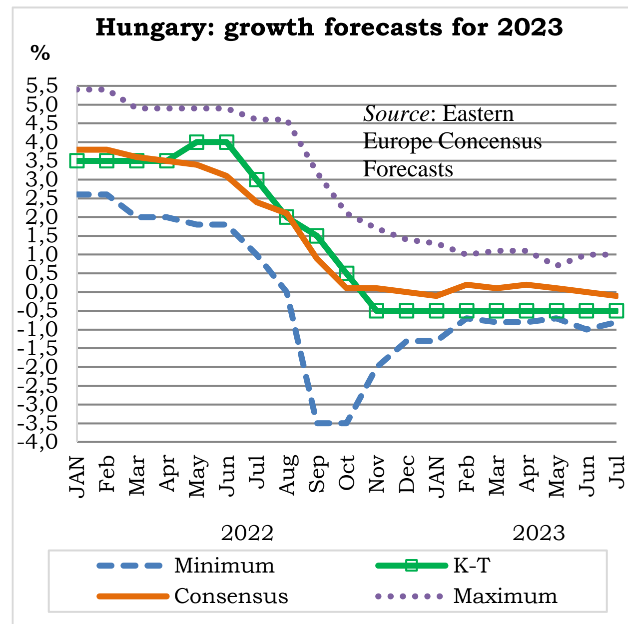
In our spring report, we predicted modest industrial growth but by now, it has become virtually impossible. Even if industrial activity improves in the second half of the year, the annual average growth rate will be negative. This is underlined by the unfavorable external conditions – the difficulties in German manufacturing and the underwhelming post-Covid recovery in China – and the sharp worsening of the manufacturing PMI from July.





Outlook for 2023

Based on the considerations above, we **maintain our growth forecast** and expect an annual **decrease of 0.5%** for 2023. This is still somewhat below the consensus.



On the ***production side***, contrary to our earlier expectations, now we predict a decline in industrial output. On the other hand, we expect a stagnation or even a slight growth in services, even though the continuation of sharp growth in public services (health & social work sector) is unlikely and market services will contract this year.

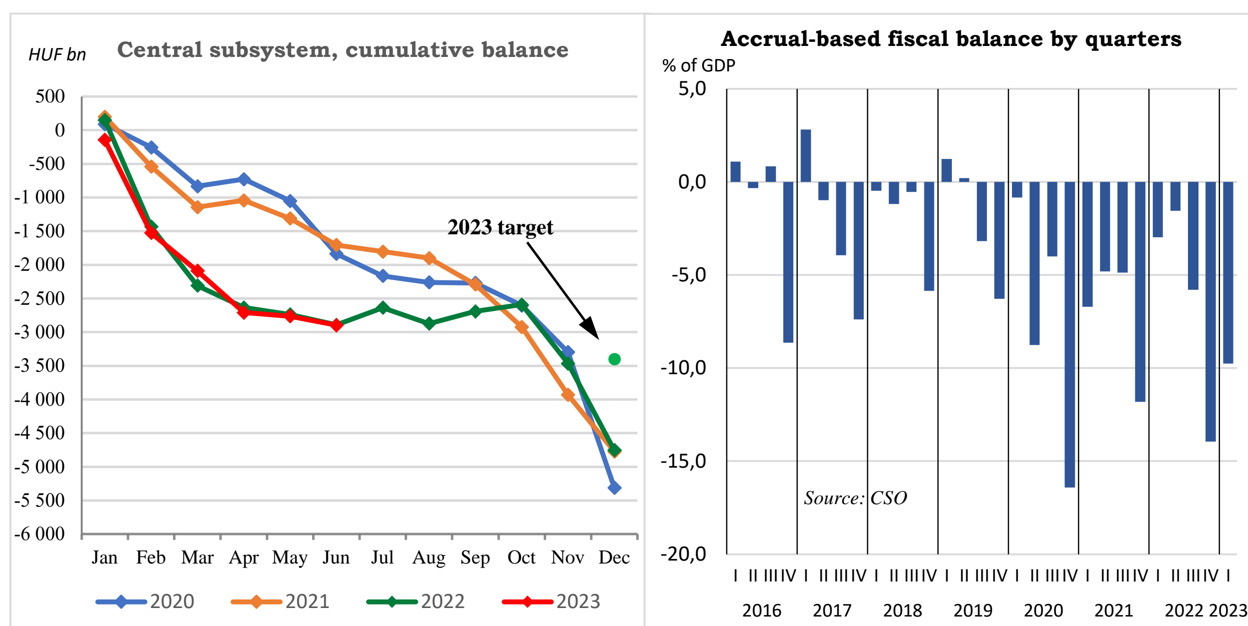
On the ***expenditure side***, we still predict a 2% fall in public consumption in 2023. There are significant upside risks to this prediction. Our consumption forecast is based on two assumptions: *first*, the second quarter will see a steeper decrease in consumption than the first quarter, despite the moderation of real wage decline. The second-quarter retail trade data clearly supports this assumption. *Second*, we assume that private consumption will approximately stagnate even in the fourth quarter even if by then real wages will grow on an annual basis. We expect *fixed capital investments* to decline by 4%.

In the second half of the year, the positive difference between export and import growth rates is likely to shrink, due to the slowdown in the fall of domestic demand. As a result, the positive growth contribution of net export will weaken toward the end of the year.

The negative growth expectation is corroborated by the preliminary report on **second-quarter** GDP growth: according to the report, the pace of GDP fall accelerated to 2.4% (unadjusted) in the second quarter.

Fiscal developments

We have revised our **fiscal forecast for 2023** substantially since our May report: now we expect the yearly **ESA deficit** to reach **4.9% of GDP** – amid negative risks – which is 1 percentage point worse than the official fiscal target.



Although the pace of rise in the *central subsystem deficit* was already slowing down in May-June, the cumulative cash flow deficit in the first six months almost reached HUF 2,900 billion, which is more than 85% of the annual target. On the other hand, the *accrual-based public sector deficit* amounted to 9.8% of GDP in the first quarter – the highest first-quarter deficit ratio since 2007. The deficit surge at the start of the year is partially due to one-off and seasonal effects. The utility cost support expenditures, which have a "nose-heavy" temporal distribution due to the heating season, reached two-thirds of the yearly appropriation, while the revenues from the sectoral windfall taxes (which are supposed to cover the utility price support costs) largely arrive only during the second half of the year, due to the legally set deadlines. But apart from these factors, the data show a severe shortfall in tax revenues as well, especially in the case of *taxes on consumption*. *VAT* revenues grew only by 2.2% in the first six months while the budget envisaged a yearly growth of more than 16%. This shortfall reflects not just the decline in retail trade turnover but also the unusually high level of VAT refunds. The overall annual shortfall of tax and contribution revenues may increase the deficit-to-GDP ratio by 0.65 percentage point, but the impact can be even higher if consumption growth fails to improve during the rest of the year. On the *expenditure side*, the deficit-enlarging effect of the spending overshoots is likely to be smaller, amounting to about 0.35 percentage point. These overshoots are due to the additional *pension raise*, due to the higher-than-expected inflation rate, and an overshoot in *housing subsidies*.

In the **2024 budget act**, adopted in early July, the ESA deficit target is 2.9% of GDP, somewhat higher than the originally planned 2.5% but still below the 3% of Maastricht threshold. This is important because from 2024 the *general escape clause* – which suspended the excessive deficit procedure – will be deactivated. Without further fiscal consolidation steps, however, the deficit may reach **3.9% of GDP** in the next year.

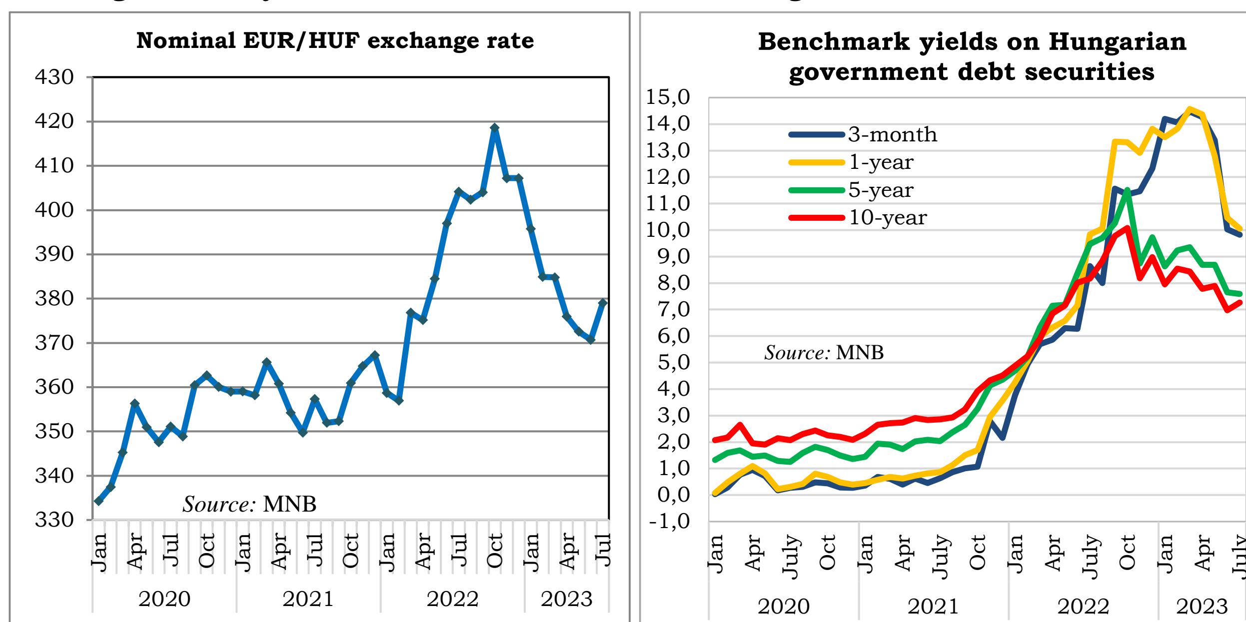
In the next year, the budgetary outcome will be improved by the decision that the abolishment of the windfall taxes will be only partial. At the same time, the appropriation to the Utility Price Protection Fund, while still substantial, will be halved (from 3.3% to 1.6% of GDP). If calculated without the utility price subsidies, the GDP ratio of the primary expenditures of the central subsystem will moderate, even if nominally they will rise roughly per the envisaged 6% inflation rate. Within those expenditures, the appropriation to the *National Defense Fund* (which was created to help modernize the Hungarian army) will rise by more than 50%. This rise, however, is offset by the decrease in state property-related expenditures and the reduction of housing subsidies. We expect that the *tax and contribution revenues* as a percentage of GDP will fall short of the target by about 0.6% percentage point. This prediction partly partially reflects the revenue shortfall in the basis year (2023), which is partially considered in the budgetary targets, but partly comes from the fact that our macroeconomic forecast for 2024 is less optimistic than the government projections. Also, the *recapitalization of the central bank after losses* may increase the deficit by 0.4-0.5 percentage point. Based on the current rules, we built this loss into our fiscal prediction, but it should be noted that the government plans to change the central bank act to get rid of this cost item.

Along with our deficit expectations, we also revised upward our **state debt** forecast. But even so, the debt-to-GDP trajectory remains on a decreasing trajectory, due to the high nominal GDP and (in 2024) the improving fiscal deficit. The debt ratio may decrease to 71.4% by the end of 2023 (from 73.3% in end-2022) and dip marginally below 70% by the end of the next year. We have taken into account that – according to a calculation by the Ministry of Finance – the components within the *government sector* but outside the central subsystem will increase the debt-to-GDP ratio by 3 percentage points in 2023.

Financial and capital market developments

The central bank started the **rate-cut cycle** in April, by reducing the upper end of the interest rate corridor. This was followed by a reduction of the *one-day deposit rate* – which currently serves as the main interest rate – for three consecutive months by 100-100 basis points. We expect the one-day deposit rate to reach 13% – the current level of the reference rate – during the summer. From that time, the reference rate, while serving again as the main interest rate, is likely to be gradually reduced to the end of the year.

Despite the rate cuts, the Hungarian main interest rate still stands out as very high, which contributed, along with the improving investor sentiment, to the **strengthening of the forint** against the euro during the second quarter of the year. In June, the monthly average EUR/HUF exchange rate was stronger by 3.8% than in March and 9.1% stronger than last December. The substantial weakening in July, however, demonstrated a persisting vulnerability of the forint. Since the high interest rates attracted substantial amounts of "hot money" into the market of the forint, the exchange rate may become more sensitive to the changes in the interest rate levels as



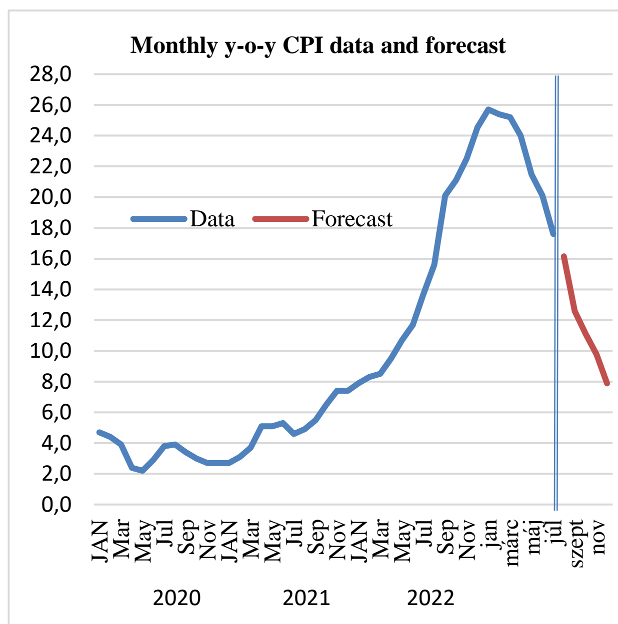
the rate cut cycle progresses. At the same time, the *real appreciation of the forint* affects exporter firms unfavorably, which may weaken the commitment to a strong forint and have a weakening effect.

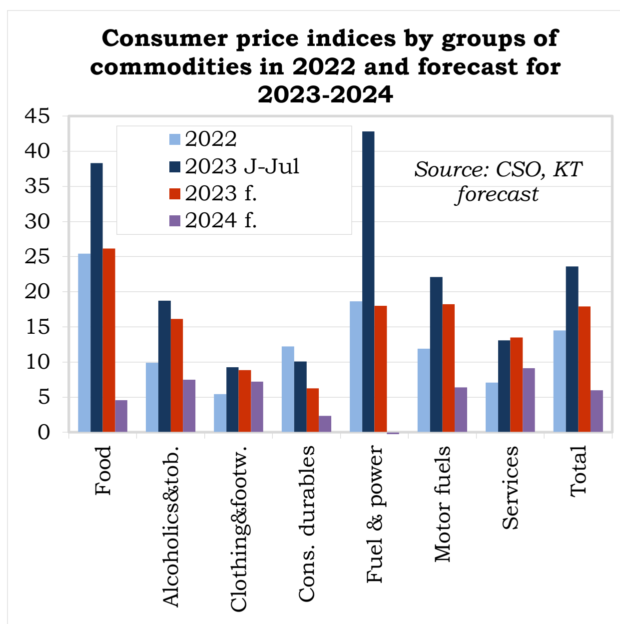
In the second quarter, **government bonds** were decreasing at every maturity. The biggest fall – nearly 450 basis points – was produced by the 3-month yield which dipped below 10%, a level last seen during the last fall. The 10-year yield dropped below 7% by the end of June. The pace of decrease accelerated in June, due to a demand-boosting *government intervention*. First, the government ordered the investment funds to keep at least 20% of their liquid assets in discount treasury notes. Second, from July 1, interest rate incomes are subject to the social contribution tax while government papers are exempt from it. Due to the ongoing reduction of the main central bank interest rate and the disinflationary trend, however, a further decrease in government yields is expected in the coming quarters.

Inflation

The rate of Hungarian inflation is by far the highest among the EU member states both in the first half of 2023 and in July. The half-year average rate was 24% (as opposed to the 8.3% in the EU27); within that, the harmonized June rate was 19.9%. There is no harmonized data for July, but the non-harmonized rate was 17.6%. The Hungarian inflation outpaces by 7-8 percentage points even the Visegrad countries, Romania and Estonia, where the June inflation rate was within the 9-12% range.

The first half year was characterized by outstanding food and energy price inflation. In the case of *foods*, the annual rates have been steadily decreasing, from 44% in January to 23.1% in July, and the downward trend is likely to continue during the rest of the year. The food price index may reach 8% by December. The impact of the abolition of price cap on food prices (from August 1) is uncertain. We posited in our earlier reports that the moderating effect of the price caps was at best minimal, and the overall impact was likely negative, due to the steep rise in the prices of goods not covered by the caps. As a result, the abolition of the price caps will not result in a significant food price hike. The degree of a possible secondary price-raising effect of the newly introduced mandatory discounts (the prices of the discounted goods decrease by x while the prices of the other goods rise by x+y) is still unknown.





The average annual growth rate of *household energy* prices in the first half year was above 40%, with a gradual decrease in the monthly rates. A significant part of this decrease can be attributed to the fact that the CSO takes into account the steady decrease in the higher-priced segment of energy consumption. This accounting method may cause quite a surprise in September because that is when the consumption trajectory of those consumers who do not report their consumption every month will become known.

We **revise our 2023 inflation forecast to 18%** from the earlier 19%. The possible future interventions into the food price setting pose an upward risk while the possible revision of the energy price index in September poses a downward risk. We maintain our 5.8% prediction for 2024, which can be deemed optimistic in light of the raised excise tax on fuel, effective from the start of the year.