Forecast for 2022

Summary of the 2022/2 forecast of GKI Economic Research Co. closed on 23 June 2022

GKI has revised its growth forecast. For 2022, it raised its GDP forecast to 3.5-4 per cent from 2.5-3 per cent previously, and lowered its GDP forecast for 2023 to between 2.5-3 per cent from 3.5-4 per cent. The change is a consequence of faster-than-expected growth in the first quarter and stronger-than-expected austerity and inflation, a deteriorating global political situation, and strained relations with the EU.

The Hungarian economy is expected to enter **recession** at the turn of 2022-2023. Hungary's GDP growth rate in the first quarter of 2022 is likely to peak this year, at 8.2 per cent year-on-year. This is the **third** fastest in the region (after Poland and Slovenia). Growth was driven by domestic consumption, with both household consumption and fixed capital formation growing at double-digit rates. Thus, final consumption and gross capital formation contributed 7.7 and 3.0 percentage points respectively to first-quarter growth, while the trade balance restrained economic performance by 2.6 percentage points. On the production side, all sectors except agriculture increased their GDP output. **However, some of the data for March and April already point to a slowdown in output, and the deterioration in economic expectations for the rest of the year suggests that this is likely.** There may have been a slowdown in the second quarter and only a very modest growth rate is expected in the third and fourth quarters; a decline is likely at the end of the year compared to the previous quarters.

The rapid growth in the last four quarters has clearly been driven by the low base due to the Covid crisis and the **recovery**. (For example, in the first quarter of last year, Hungarian GDP fell by 1.4 per cent.) But it was also the result of the **excessively stimulating electoral economic policy**, which, with the money injected in February (e.g., 13th month pension, tax rebate for families), specifically aimed to maximise especially consumption, but also investments, before the April elections. All this led to a predictable dangerous **deterioration** of the **equilibrium**, such as accelerating **inflation**, a **weakening forint**, and a surge in internal and external **deficits**. As a result, the government announced **measures to improve the balance**, raising tax revenues and cutting spending, which it explained as necessary due to the Russian-Ukrainian war and EU sanctions. Although the war obviously worsened the operating conditions of the Hungarian economy, the recent rise in energy prices, the deterioration in exchange rates, the growing insecurity of energy supply and supply chains in general, and the riskier nature of the region have only **exacerbated** the imbalances that have been building for years. The crisis-generating setting of the EU's role is false and one-sided, since, on the one hand, EU sanctions are only a response to Russian aggression and, on the other, the EU's recovery fund would offer resources for crisis management if the Hungarian government were willing to commit to the rule of law and market economy standards.

In the end, the Hungarian adjustment package will certainly reduce the huge deficit that is emerging. Given the high inflation, the government's original target of a deficit of **5.9 per cent of GDP** seems possible. However, reaching the deficit target of 4.9 per cent is conditional on an **agreement** on EU transfers.

The **employment** situation in Hungary has improved considerably recently, and it can be considered as moderate in the EU. With a seasonally adjusted unemployment rate of 3.4 per cent in April, Hungary appears to be in 6th place out of 27 countries. However, if we take into account public work scheme employees, who are in the category of social employment in other member states, the unemployment rate would be 5.1 per cent, which would give Hungary the good enough 12th place, **in the middle rank**. Employment rose by 2 per cent in the first four months of the year, mainly due to the expansion of the primary labour market. The **number of public workers** continued to fall (below 80,000), while foreign employment increased slightly. In view of the economic austerity measures and the minimum labour reserve, the GKI expects employment to **rise by** no more than **0.5 per cent** in 2022, and the unemployment rate to **fall** slightly from 4.1 per cent last year **to 3.9-4 per cent** on average over the year.

Hungarian inflation was the **ninth highest** in the EU in May. However, the inflation situation in Hungary is **much worse, as household energy prices in Hungary are hardly rising because of the "overhead reduction"**, while this explains about 40 per cent of the price increase in the EU. As a result, core inflation in Hungary is higher than inflation (12.2 per cent in May), while in the EU it is less than half. This implies a further increase in the rate of price increases. **A particular problem in Hungary is that the impact of high imported inflation is amplified by the almost continuous weakening of the forint.**

As **Hungary' reputation deteriorated** in a fluctuating but noticeable way in the last year due to the worsening of relations with the EU and thus uncertain access to EU transfers, as well as the proximity of the Russian-Ukrainian war, the electoral spending, and then the unfavourable adjustment and the insufficiently tightening monetary policy, the forint has continuously weakened. In 2022, after the outbreak of the Russian-Ukrainian war, the exchange rate of the euro temporarily approached HUF400, then it exceeded it in mid-June. In May 2022, compared to January 2022, **the forint depreciated by 9-10 per cent not only against the euro but also against regional currencies**. (It only grew stronger compared to the Turkish lira in crisis.) At the same time, this means that the devaluation was basically the **result of Hungarian economic policy**, not of the Russian-Ukrainian war. The GKI expects the **average annual euro exchange rate in 2022 to be around HUF385** (after HUF373 in the first five months, it will be around HUF395 in the second half of the year). A settlement with the EU could bring a meaningful strengthening, but in the absence of a settlement or if it is delayed, the chances of an even weaker forint are increasing. The **benchmark interest rate** (the interest rate on one-week central bank deposits) could be around 8.5 per cent by the end of the year.

The political and professional **challenge** for the government in the fight against inflation is to break with the radical minimum wage increases (to contain the price-wage spiral) and to ensure that the sectoral levies (known as the extra profit tax) have an inflationary effect, albeit disguised and prolonged. There is also the question of when and how the administrative restrictions (price caps), which have been extended again, will be lifted. Overall, inflation will **average around 10 per cent per year, or it is likely to be slightly higher**. Although inflation may fall slightly in the final months of the year due to the base effects, it is expected to remain high in 2023, averaging around 8 per cent per year.

The fiscal adjustment is also sharply curbing public and subsidised business investments, which are constrained by rising interest rates and general uncertainty about the war. Thus, **expansion of investments** is expected to be much slower than in the first quarter, at only **around 2 per cent**. Household **consumption** is slowing down to an annual average of 5.5 per cent, compared with the first quarter, as individual income-increasing measures expire, and inflation is still accelerating. Slowing domestic consumption is **holding back external trade and current account deficits**. At the same time, a delay, or even a complete failure, to reach an agreement with the EU will increase the cash deficit, the current and capital account deficit and Hungary's external debt, because of the substitution of EU transfers by borrowing. This trend, combined with the country's deteriorating international financial standing, is increasing the financial burden on the Hungarian economy, limiting the scope for future growth. Some credit rating agencies have already expressed reservations about Hungary's adjustment and the importance of reaching an agreement with the EU, raising the prospect of a reconsideration of Hungary's rating.

GKI Economic Research Co.
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The forecast of GKI for 2022

	2018	2019	2020	2021	2022			
	(fact)				September	December	March	June
GDP	105.4	104.6	95.0	107.1	105	104.7	102.7	**103.7**
• Agriculture	105.2	98.0	91.3	97.8	100	100	100	**100**
• Industry	102.6	103.0	93.0	109.8	107	107	102.5	**104**
• Construction	115.2	113.1	89.1	115.8	106	104	100	**102**
• Trade	110.6	105.8	100.9	106.8	105	107	105	**105**
• Commercial lodgings and catering	107.5	104.8	57.5	114.1	115	115	108	**120**
• Transport and storage	107.0	105.2	89.5	109.5	104	104	102	**104**
• Information and communication	110.5	110.3	105.0	113.9	106	106	106	**106**
• Financial services	105.2	113.7	104.1	104.9	103	103	101	**100**
• Real estate activities	104.5	102.9	100.9	102.6	102	102	102	**102**
• Professional, scientific, technical activities	109.1	106.3	95.1	107.2	102	102	102	**105**
• Public administration, education, healthcare	100.9	100.6	96.7	103.9	103	103	103	**103**
• Arts, entertainment	107.3	108.8	86.0	106.3	105	105	105	**105**
• Core growth	107.1	106.8	97.3	108.6	105	104	102.7	**104**
GDP domestic demand	107.1	106.6	97.3	105.6	103.5	104	102.2	**104**
• Private consumption	104.2	104.5	98.0	104.3	104.5	104.5	104	**105.5**
• Gross fixed capital formation	116.3	112.8	93.1	106	105	104	100	**102**
Exports (goods and services)	105.0	105.4	94.1	110.1	110	110	106	**105**
Imports (goods and services)	107.0	108.2	96.5	108.2	109	109	105.5	**105.5**
Consumer price index (preceding year = 100)	102.8	103.4	103.3	105.1	104	105	109	**110.2**
Unemployment rate (annual average)	3.7	3.4	4.1	4.1	4	3.9	4	**3.9**
General government balance in per cent of GDP (ESA)	-2.1	-2.1	-8.0	-7.3	-6	-6	-6	**-5.5**
Balance of the current and capital accounts								
• EUR billion	3.4	1.7	0.6	-0.9	3	0.5	-2	**-2.5**
• In per cent of GDP	2.5	1.2	0.4	-0.6	1.8	0.3	-1.3	**-1.5**

Source: HCSO, MNB, MoF, **GKI**

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