GKI Economic Research Co.
We analyse and forecast. You decide.

The forecast of GKI Economic Research Co. for 2022-2023 (4/2022)

(An update of GKI's forecast published in September 2022. Closed: 9 December 2022)

1. Summary—recession, accelerating inflation, continuing indebtedness

Hungary's GDP fell by 0.4 per cent in the third quarter of 2022 compared with the previous quarter, bringing the Hungarian economy close to a technical recession. GDP is still growing at an annual average rate of 5.2 per cent, but the rate is falling by around 2 percentage points per quarter, with a decline of 1-1.5 per cent expected in 2023. The main reason for this is that a serious deterioration in the external and internal equilibria can only be halted by curbing domestic demand. Real earnings will decline by around 3.5 per cent in the fourth quarter after rising by almost 12 per cent in the first quarter of 2022. Household consumption is expected to decrease by 3 per cent next year after its 6.5 per cent increase in 2022, and investments are expected to fall by 5 per cent after their 6 per cent increase this year. Hungarian inflation and policy interest rates are by far the highest in the EU, and the forint's weakening in 2022 is also extreme. After 14.6 per cent in 2022, inflation will rise to 18 per cent next year, with a peak of around 26 per cent in the spring. Achieving single-digit inflation by the end of 2023 is highly unlikely. The fundamental problem with economic policy is that the measures to improve economic disequilibria are repeatedly overridden by politics. The lack of a strategy is illustrated by the fact that in the first decade of December 2022, Hungary does not even have a valid budget, let alone the macroeconomic forecast on which it is based. According to GKI, there will be some kind of agreement with the EU this year, that is, there will be no permanent loss of funds, but no significant fresh money will arrive in the country for at least half a year, and it is almost certain that the disputes will continue. The massive current and capital account deficits (4.5 per cent of GDP in 2022 and 2 per cent in 2023) will require a significant increase in foreign borrowing even in the event of an agreement with the EU. Failure to reach an agreement would lead to a very serious economic crisis.

2. World economy—recession, slowly falling inflation

The **IMF** forecasts that the **global economy** could expand by 3.2 per cent in 2022 and only by 2.7 per cent in 2023, after 6 per cent in 2021. In particular, growth is expected to be 0.5 per cent in the euro area next year, 1 per cent in the United States and 4.4 per cent in China. According to the forecast, 2023 will therefore be the year of a widespread slowdown. The economies of countries representing one-third of the world economy are expected to shrink as early as the end of this year or next year. With the three largest economies, the United States, China and the eurozone, coming to a standstill, a recession is likely in many countries as the global economy continues to face serious challenges. The three most important challenges are Russia's aggression against **Ukraine**, the subsistence crisis caused by persistent and widening **inflationary pressures** (the highest inflation in advanced economies in forty years, caused by the uncertainty of the energy situation, changes in the market for agricultural products, a contraction in supply) and a slowdown in economic growth in **China**.

The European Commission forecasts that growth **in the EU** of 3.3 per cent in 2022 will be followed by 0.3 per cent in 2023 (3.2 per cent and 0.3 per cent in the euro area, respectively). The **EU is forecast to enter a technical recession at the turn of 2022-2023**, meaning that GDP in the last quarter of this year and the first quarter of next year will be below the previous quarter. Although growth is forecast to resume in the spring, mainly due to some deceleration in inflation, it will be modest due to weak demand. **Inflation** in the EU will be 7 per cent in 2023 after 9.3 per cent in 2022 (8.5 per cent and 6.1 per cent in the euro area, respectively). The real value of households' real income, savings and housing assets will fall sharply, so that the **growth of household consumption** will slow from 3.7 per cent in 2022 to 0.1 per cent in 2023. The expansion of **investments** also decreases, from 3 per cent to 0.5 per cent in the EU. The projection assumes a continued decline in EU energy demand due to the surge in energy prices, further diversification of supply sources, and a slight improvement in the **terms of trade** (0.3 per cent) next year after a 5.8 per cent deterioration in 2022. **Unemployment** will rise only slightly, and the EU's **general government deficit** as a share of GDP will increase by around 0.2 percentage points to 3.6 per cent of GDP in 2023, after falling by more than 1 percentage point this year, due to high energy prices.

3. Economic expectations—sharp deterioration in business and consumer confidence indices, with a correction in November

After almost a year of declines, the European economic sentiment index almost fully compensated for the October fall in November, essentially **returning to its September level**. Business sector expectations were only within the statistical margin of error, but consumer outlook improved markedly. The **German industrial** confidence index, which is of particular importance for the Hungarian economy, has fallen steadily since the outbreak of the Russian-Ukrainian war. This did not continue in November, with this indicator stagnating.

In November 2022, after half a year of falls, the decline of the **GKI economic sentiment index** slowed down. The business confidence index declined slightly further in November after a huge fall in October, with the index being similarly negative during the covid period at the beginning of 2021. Consumer sentiment, on the other hand, improved slightly, although it remained more pessimistic than it was during the panic caused by the lockdowns in September, which followed the onset of the Covid pandemic. On the other hand, it is positive that the business sector's willingness to employ slightly strengthened, its intentions to raise prices weakened, while consumers' fear of unemployment and inflationary expectations also changed in a favourable direction.

4. Economic policy—steps to improve economic disequilibria are repeatedly overridden by politics

Hungarian economic policy reached an **impasse** by the spring of 2022. The forced economic policy in the 2010s, which considered the balance of payments as secondary, may have been effective in the short term in a favourable global economic and political situation for Hungary (low energy prices and interest rates, soft EU policy on rule of law issues). Meanwhile, the future was being eaten up (cuts in rationing, nationalisation of private pension funds, evisceration of the health and education systems). However, the imbalances caused by the electoral stimulus in spring 2022, the Russian-Ukrainian war, the surge in energy prices and the threat to EU transfers have made the previous economic growth path and the promises made in this regard **unsustainable**.

The government's approach to the problems is essentially **power-technical and PR-based, not economic**. For example, it clings to pro-people "achievements" until the last possible moment. In principle, we are still living in a period of overhead reductions, with the removal of the petrol price cap, despite supply disruptions, the introduction of the EU's oil price cap was waited, even though the two had nothing to do with each other only at the level of propaganda.

Today's Hungarian crisis-management economic policy does not even have a name, let alone a well-thought-out strategy. In fact, the government did not announce that the rebalancing and anti-inflationary economic policy would **mean a break** with the forced growth of recent years. The government did not announce it, because to admit this would be contrary to its power-technology goals based on continuity and “infallibility”. That is why it represents them only half-heartedly. This often leads to ill-considered haste and **political overriding of economically sound decisions** (for example, in the case of wrangling over price caps and interest rate hikes), which overall results in much greater losses than inevitable (for example, in the form of a weak forint and high policy rates).

The **lack of a strategy** is illustrated by the fact that in December 2022, Hungary does not even have a valid budget (though the revision of the budget law adopted in the summer has already been announced), let alone the macroeconomic forecast on which it is based. It does not have inflation and income forecasts, which would be essential for a wage agreement. The government is using almost its only remaining foreign policy tool, its **blackmail potential**, to drag out the agreement with the EU until the last possible moment, to make as few “concessions” as possible, in fact, to accept the rules and regulations that are normal in European market economies. It is not known **when and how much EU transfers** may arrive in the country. While there is an agenda to extend the role of the state (for example in air transport, telecommunications, or insurance), the lack of resources limits the realisation of these objectives.

The **clash of power politics and economic policy objectives** has led to disputes coming to light, for example between the government and the MNB. The government is trying to loosen the monetary policy tightening with more and more anti-recessionary tools (such as a HUF100bn working capital loan programme for SMEs at zero interest rate, and a HUF1,500bn low-cost loan programme for medium and large enterprises). Under these circumstances, there is little chance of a consistent economic policy. Meeting the demands of the EU, and at the same time the demands of the European market economy, requires a change in Hungarian economic policy and economic model that is far from certain, and indeed highly doubtful. It is feared that Hungary’s maverick policy will lead the country towards **permanent isolation and economic stagnation**, and further regional backwardness.

5. Consumption and investments—falling real income, uncertain EU transfers

In 2022, **real household earnings** will rise by around 2.7 per cent, driven by a 17.7 per cent wage increase and a 14.6 per cent price rise. The growth rate in the first quarter was 11.8 per cent, but this is expected to turn into a decline of around 3.5 per cent in the fourth quarter. Household **consumption** will rise by 6.5 per cent in 2022, after 4.2 per cent in 2021. However, there is a significant slowdown within the year, mainly due to the extra incomes in the first quarter, the downward trend in real earnings, including the acceleration in inflation. Following growth of 10.6 per cent in the first quarter and 4.2 per cent in the third quarter, consumption is expected to expand by around 2 per cent in the final quarter. The slowdown is expected to turn into a **downturn** in 2023, with an annual average decline of around 3 per cent. The decline will be sharp in the first quarter, partly due to the high base and partly due to still rising inflation. The content of the wage agreement, the rate of the minimum wage increase, is uncertain in the absence of a realistic budget, but the government believes that a minimum wage increase of around 15 per cent could be agreed. If that were to happen, GKI’s 18 per cent inflation forecast suggests an average 14 per cent rise in gross earnings, which would imply a real earnings decline of around 3.5 per cent. The smaller decrease in consumption is explained by the consumption of those with higher incomes at the expense of their savings. As borrowing by people with lower incomes is greatly restricted by high interest rates and general uncertainty, **the differentiation of society is increasing**, and some strata are in a particularly dire situation.

As with consumption, the expansion in **fixed capital formation** will accelerate in 2022 compared with 2021, although the rise from 5.2 per cent to 6 per cent is less impressive. Here too, there is an **annual**

slowdown, with 10.6 per cent in the first quarter of 2022 followed by 6.2 per cent and then 4.1 per cent, with a rate of around 3 per cent in the final quarter. The fall in investments is smaller than expected. In 2022, the investment rate, already the second highest in the EU, will even rise slightly (to 27.4 per cent). The developments in 2023 are highly uncertain. Regarding EU transfers, the only thing that is almost certain is that **Hungary will not receive money** from the reconstruction fund and cohesion funds **before the second half of the year**, and pre-financing will also face financial constraints. It is questionable **how business investments will be affected** by the proximity of war, the unpredictability of Hungarian economic policy, the reduction of corporate funds available for development, deteriorating borrowing conditions, the limited fiscal capacity, and the brutal rise in energy prices, as well as uncertain domestic and foreign demand due to the restrictive market situation. The government is expected to continue to support large investments mainly in vehicle and battery production, as well as to provide preferential funding to loyal ownership groups. Ultimately, GKI anticipates a decline in fixed capital formation of around 5 per cent in 2023, without ruling out extreme divergences, for example in the event of a failure to reach a genuine EU agreement.

6. Real economic trends—export growth in 2023 may partially offset the decline in domestic demand

Hungary's GDP fell by 0.4 per cent in the third quarter of 2022 compared with the previous quarter, putting the Hungarian economy into a **technical recession**. However, the year-on-year figures are still favourable. Hungary's GDP already exceeded the 2019 level in 2021 (which only happened this year for the EU as a whole), and in the first three quarters of 2022 it grew by 6.1 per cent, the **third fastest** in the region. This was almost entirely due to a 6 per cent rise in domestic consumption. However, as the **terms of trade** have deteriorated dramatically in the meantime (by 6.9 per cent in the first eight months), GDP generated has not covered this, or only through foreign borrowing. This is reflected in the deterioration of the trade balance: In the first three quarters of 2022, the deficit was EUR5.7bn, while one year earlier it was EUR2.4bn in assets. In terms of current account, this year's first three quarters of foreign trade deficit was EUR3.4bn compared with last year's EUR1.6bn in assets. GKI estimates that domestic consumption growth in 2022 could be slightly below the GDP growth rate (5.1 per cent and 5.2 per cent, respectively).

In 2023, to improve economic disequilibria, reduce imports and increase exports, it will become essential to **curb domestic consumption**, the 3 per cent decrease of which is expected to far exceed the 1-1.5 per cent drop in GDP. This could be offset by a 2 percentage point faster growth in exports than imports. However, the carry-over effects of the terms of trade deterioration and income developments will lead to a relatively modest improvement in the external disequilibria. For this reason, external funding will be indispensable.

On the production side, in 2022, all sectors will increase their GDP output, except **agriculture**, which will see a dramatic fall in output (around 30 per cent in GDP terms). The sectors with the **strongest growth** are **tourism and catering and transport**, whose performance was still down a year earlier due to Covid. However, within the year, most sectors experienced a slowdown in line with GDP and falling domestic demand. The main exception is **industry**, its export-oriented part, helped by the low base.

Only **agriculture** is expected to expand strongly **in 2023**, with rapid growth expected even in the event of worse-than-average weather, following this year's downturn. However, this will be limited by fertiliser shortages and agricultural inefficiencies, from ownership structure to irrigation and subsidy policy. Growth is expected in the **transport** and **telecoms** sectors, while the others are likely to stagnate or decline to some extent. The **near-stagnation in industry** is the result of a rise in exports and a fall in domestic sales, while the decline of around 5 per cent in **construction** is explained by a fall in investments and the fact that the level of contracts has been lower than in the previous year for months. The downturn will be more pronounced in civil engineering. The fall in consumption is causing a downturn in the **trade** sector and **consumer services**, while in the tourism sector, foreign guest turnover, boosted by the weak forint, could result in an overall stagnation. The transport sector will also be able to offset the fall in domestic demand outside agriculture through its exports.

7. General government—unclear budgetary processes

The budgetary developments in 2022 **bear no relation** to the appropriations in the Finance Act. This is because it did not include the impact on revenues and expenditures of the election spending at the beginning of the year, the tax increase and utility costs increase measures taken to reduce the explosively rising deficit, and the impact of inflation, which is almost five times higher than planned (14.6 per cent instead of 3 per cent). In early 2022, presumably to mitigate the negative impact of big spending on investor perceptions, the statutory deficit target of 5.9 per cent of GDP was announced to be lowered to 4.9 per cent, and then raised to 6.1 per cent in September, citing additional gas purchases. The European Commission's forecast is almost the same at 6.2 per cent. This is also possible, according to the GKI, as the denominator, **nominal GDP, is much higher than previously assumed due to high inflation**, thus providing room for a high deficit. But it is a very high deficit, the **third largest** in the EU (the EU average is only 1.5 per cent), and it is prohibitively expensive to finance. The **government debt** relative to GDP ratio is noticeably reduced from 76.8 per cent in 2021 to around 72 per cent, also due to high nominal GDP.

The **2023 budget**, adopted at the beginning of summer 2022 and based on already completely outdated assumptions, was formally withdrawn in the autumn, but the new one, which will be decided by decree on the grounds of the emergency, has not yet been born. The deficit target for 2023 as a share of GDP was 3.5 per cent in the summer, while the European Commission forecast was 4.4 per cent, which would be the seventh highest in the EU (the EU average is 3.6 per cent). GKI **expects a deficit of around 4.5-5 per cent**, given the increasing debt service burden, the negative impact of the economic downturn on the budget, affecting both the revenue and expenditure sides, and on the other hand, the impact of inflation increasing income and inflating nominal GDP. However, the validity of this is weak without knowing the budget. The **government debt** relative to GDP ratio will further decrease to around 70 per cent.

8. Inflation, interest rates, exchange rates—all the worst in the EU

Hungarian **inflation** was 22.5 per cent in November 2022, the highest in the EU. The removal of the price cap on petrol in December is expected to lead to a price increase of around 25 per cent in December, averaging 14.6 per cent over the year. Following the MNB's announcement at the end of September that it had ended its interest rate hike cycle, the overnight deposit rate (still 18 per cent) replaced the **reference rate** in mid-October to stem the resulting weakening of the forint. This is by far the highest in the EU, with base rates in the Czech Republic and Poland, for example, at around 6.5-7 per cent. Compared with the end of last year, the **forint** depreciated by around 12.5 per cent by the first decade of December, while the Polish zloty depreciated by only 2.2 per cent and the Czech koruna even strengthened by almost 4.5 per cent. In other words, even against the zloty, which is considered the basis of comparison, the forint's devaluation is more than 10 per cent, while the international effects (Russian-Ukrainian war, rising energy prices) similarly affect the currencies of the region. Thus, the **responsibility of the unorthodox Hungarian economic policy**, the gradual loss of its credibility, and the descent of its international prestige into a mere blackmail potential are decisive in the exceptionally bad financial data.

According to GKI, there will be **some kind of agreement with the EU this year**, that is, there will be no permanent loss of funds, but no significant fresh money will arrive in the country for at least half a year. This means that the forint exchange rate is unlikely to strengthen or weaken significantly, with the **euro exchange rate** expected to average around HUF392 in 2022 and HUF420 in 2023, with very significant fluctuations. **Inflation** will accelerate further in the first months of 2023, peaking at around 26 per cent, with an annual average of 18 per cent likely. By the end of 2023, **the single-digit increase expected by the prime minister is unlikely** to be reached, but is likely to be around 2 percentage points higher. Depending on the path of inflation and the strength of the forint, the policy rate could start to be cut in the second half of 2023, bringing it closer to the base rate.

9. External equilibria—indebtedness continues even as EU transfers come in

The external disequilibria of the Hungarian economy is **deteriorating at an accelerated rate** from the second half of 2019 due to economic policies that stimulate domestic demand, and then due to the huge deterioration in the terms of trade. The **current account** deficit already reached EU9.6bn in the first three quarters of 2022, after EUR6.4bn in 2021. For the year, a deficit of EUR12bn is expected, equivalent to 7 per cent of GDP. In 2021, the **external financing capacity** (including EU transfers) already turned negative (-EUR0.9bn), due to a widening current account deficit and the non-availability of part of EU transfers. In the first three quarters of 2022, a deficit of EUR6.1bn was recorded. And with only the sums due from the previous EU budget cycle due to be received by the end of the year, the annual deficit could be around EUR8bn, or 4.5 per cent of GDP, which is very high. This deficit could be reduced to EUR4bn (2 per cent of GDP) in 2023, if an agreement is reached with the EU by the end of the year, thanks to transfers that are only slowly starting to flow. This also means that a **significant amount of foreign currency borrowing** will still be needed this year and next year. Borrowing due to delayed or even doubtful access to EU transfers started as early as autumn 2021. This is ongoing and must continue, if only because Hungary's **foreign exchange reserves** are declining despite increasing financing needs. The reserve of EUR38.4bn, considered acceptable at the end of 2021, fell to EUR36.5bn in August 2022, and then it was EUR36.8bn at the end of October. At the same time, reserves will be reduced by the fact that the MNB will provide the foreign currency needed for the country's energy imports from mid-October until the end of the year. As the cheapest source is EU transfers and credit, non-agreement would have very serious consequences.

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The forecast of GKI for 2022-2023

	2018	2019	2020	2021	2022	2023
	(fact)				forecast	
GDP	105.4	104.6	95.0	107.1	**105.2**	**98.7**
• Agriculture	105.2	98.1	92.2	98.1	**70**	**120**
• Industry	102.6	103.0	92.3	106.2	**105**	**99**
• Construction	115.2	113.1	91.4	109.2	**104**	**95**
• Trade	110.6	105.9	101.7	107.0	**106**	**97.5**
• Commercial lodgings and catering	107.5	104.8	55.5	143.2	**130**	**100**
• Transport and storage	107.0	106.2	90.2	103.6	**115**	**103**
• Information and communication	110.5	110.4	106.5	121.7	**108**	**102**
• Financial services	105.2	113.6	104.4	110.4	**105**	**95**
• Real estate activities	104.5	102.8	100.3	104.0	**105**	**99**
• Professional, scientific, technical activities	109.0	106.3	96.5	115.6	**110**	**95**
• Public administration, education, healthcare	100.9	100.5	95.7	102.1	**103**	**99**
• Arts, entertainment	107.3	108.9	88.4	112.7	**110**	**93**
• Core growth	106.6	105.7	93.6	111.5	**108**	**90**
GDP domestic demand	107.1	107.1	97.4	104.2	**105.1**	**97**
• Private consumption	104.2	104.5	98.1	104.3	**106.5**	**97**
• Gross fixed capital formation	116.3	112.8	92.9	105.2	**106**	**95**
Exports (goods and services)	105.0	105.4	93.9	110.3	**108.7**	**101**
Imports (goods and services)	107.0	108.2	96.1	109.1	**108.5**	**99**
Consumer price index (preceding year = 100)	102.8	103.4	103.3	105.1	**114.6**	**118**
Unemployment rate (annual average)	3.7	3.4	4.1	4.1	**3.5**	**4.2**
General government balance in per cent of GDP (ESA)	-2.1	-2.1	-7.8	-6.8	**-6.1**	**-4.7**
Balance of the current and capital accounts						
• EUR billion	3.3	1.5	1.2	-2.5	**-8**	**-4**
• In per cent of GDP	2.5	1.1	0.9	-1.6	**-4.5**	**-2**

Source: HCSO, MNB, MoF, GKI