The forecast of GKI Economic Research Co. for 2023 (3/2023)

(Closed: 21 September 2023)

The Hungarian economy was already in its **fourth quarter of recession** in the second quarter of this year, such a recession only occurred in Estonia outside Hungary in the EU. In the second quarter, the Hungarian decline was the third largest in the EU (after Estonia and Sweden). GKI expects that this year's third quarter may see an end to the decline compared to the previous quarter, but growth compared to the same period last year is only likely in the fourth quarter.

GKI **predicted a decline of 0.5 per cent this year** from the beginning of 2023, and this did not change in September, although GKI considers that there is a slightly higher chance of a greater decline than a smaller one. The -0.5 per cent **decline was previously a very pessimistic forecast**, but now more and more analysts are saying that a fall in GDP this year is likely, and even the government has now admitted that the 1.5 per cent growth target is unrealistic, and that a positive zero would be a good result. GKI reduced its **growth forecast for 2024** to 2.2 per cent (2-2.5 per cent) from 2.5 per cent previously. The **reason** for this is that no substantial **EU transfers** are expected this year, and they are also questionable for next year; in addition, the government **decided to reduce investments again** in September and then envisaged more; furthermore, this year's and next year's **budgets will also need to be adjusted**, and European, including German and Hungarian, **economic activity seems worse** than previously expected. True, the 2 per cent rise in **consumption** next year (after a 1.5 per cent fall this year) and the potential for growth in Hungarian **exports**, thanks to a good agricultural harvest and the start of production in some battery plant investments, among other things, are relatively favourable. However, these **can only dampen the impact of the continuing decline in investments** (-2 per cent after -10 per cent this year). At the same time, especially if the inflow of EU transfers does not start, there is a significant chance of **lower growth**. The Hungarian economic path will be **export oriented** both this year and next year, due to the weakness of domestic demand. The average annual **unemployment** after 3.6 per cent last year will be 3.9 per cent this year and 3.8 per cent next year.

Real earnings are expected to fall by 1.5-2 per cent in 2023. However, this rate will decrease during the year as inflation decreases, with an average of 8 per cent in the first half of the year and 3.4 per cent in June. By the end of 2023, real earnings in the competitive sector could already be growing substantially (by 6 per cent in December), and the decline in the public sector could end. The **three major dilemmas of the 2024 wage agreement** are expected to be the treatment of the 2023 real earnings decline, the credibility of the government's 2024 inflation forecast, and the acceptability to workers (and the ambivalent government) of a modest real earnings increase on average across the economy that does not threaten to restart the wage-price spiral. The 2024 budget assumes 6 per cent inflation, while the prime minister considered even 5 per cent realistic in August. If the government were to advocate 6 per cent in wage negotiations, it is possible that the minimum wage increase would be close to 10 per cent, even in the face of employer opposition. (The 2024 budget assumes a 10.3 per cent increase in average gross earnings.) The big question is whether the productivity of the Hungarian economy will allow this. In this case, GKI expects an average price increase of around 7 per cent, falling to only 6 per cent by the end of the year. This would mean a **2.5-3 per cent increase in the real value of the minimum wage**, and the average increase in real wages would probably be similar. Real income and **consumption are expected to grow by around 2 per cent**.

Hungarian **inflation** has been **falling** slowly but steadily since its peak in January 2023 (25.7 per cent), reaching 16.4 per cent in August. The main reasons for the moderation are the **base effect** and a marked contraction in **purchasing power**. Compared with the previous month, however, only in May did the price level fall, for example in August it rose by 0.7 per cent compared to July.

The government's goal of a **single-digit** price increase by the end of the year is certainly **achievable**. However, government hopes at the end of the summer that this could happen as early as October seem too optimistic. Due to the weakening of the forint and the rise in oil prices, among other factors, this is more likely to happen in December, and presumably the price increase will not be much below 10 per cent. **For the year as a whole, prices are expected to rise by around 18 per cent** (slightly lower than GKI's previous forecast of 19 per cent). The budgeted target of 15 per cent average annual inflation was abandoned by the government months ago. The **2024** budget assumes an average annual price increase of 6 per cent. GKI expects a higher **rate of around 7 per cent**, partly due to the already announced increases in excise duty and motorway tolls, the economy-wide impact of the drastic increase in waste disposal charges, the expected increase in earnings of around 10 per cent and the expected weakening of the forint. In addition, the government's anti-inflationary commitment is likely to weaken. This is also indicated by the **new government slogan**, according to which "2023 was the year of breaking inflation, 2024 will be the year of restarting economic growth".

GKI expects an annual average **exchange rate** of the forint to the euro of HUF386, after an average of HUF381 in the first eight months, and HUF390-395 forints in the fourth quarter. The weakening could be caused by a cut in the policy rate and increasing uncertainty about EU transfers. It is likely that in September **the benchmark and base rates will be unified at 13 per cent**, and the base rate will once again be the benchmark. Thereafter, the extent of the rate cut, and possibly its temporary halt, will be heavily influenced by the perception of the Hungarian economy and the exchange rate that reflects it. According to the Monetary Council's communication, it will make its decisions cautiously, in a "data-driven" way. **By the end of the year, the base rate is expected to be 11-12 per cent**, which would imply a real interest rate of around 2 per cent if inflation in December is around 9 per cent. **In 2024**, GKI expects the forint to weaken somewhat (to around HUF400 per euro) and, assuming inflation of around 6 per cent by the end of the year, the base rate to be around 8 per cent.

The **general government** deficit in cash flow terms already almost reached the **annual appropriation** at the end of August 2023 (97 per cent of it). In September, the finance minister already raised the need to revise the 3.9 per cent of GDP deficit target and take deficit-cutting measures. Although **inflation will help reduce the debt-to-GDP ratio** in 2023, the cash deficit would increase so much if Budapest Airport were acquired that **it would be unlikely to reach the government's target of 69.7 per cent**. (The transaction does not affect the accrual deficit.) Although the government still considers it essential in its rhetoric to achieve a **deficit below 3 per cent in 2024**, based on the situation and the government's behaviour so far, GKI expects a **higher than planned deficit of around 3.9 per cent in 2024, after 4.7 per cent in 2023**.

The **external equilibria** improved clearly and visibly in the first seven months of the year. After a current account deficit of EUR13.6bn last year, the first seven months of this year brought a **surplus of about EUR0.2bn**. That is, **the asset of the goods and services balance could offset the deficit in the income balance**. This is mainly due to the improving energy balance due to the fall in energy prices, lower import demand due to curbing domestic demand, and the rapid increase in Hungarian exports until the slowdown in July. In 2023 as a whole, an asset of around EUR0.5bn is expected, or 0.2 per cent of GDP. It is worrying that the inflow of **EU transfers** is still minimal (EUR1bn in the first seven months) and no turnaround can be expected this year. The **current and capital account balance for the year as a whole could be around EUR2.5bn**, or 1.2 per cent of GDP. **In 2024**, the current account balance could rise to EUR3bn and the current and capital account to EUR7bn, or 1.4 per cent and 3.3 per cent of GDP, respectively. The latter, however, **presupposes significant progress in the deal with**

the EU, which is highly uncertain, and though economic pressure is strong, the Hungarian government's decisions are driven more by **power politics**.

Hungary's **credit rating** is the worst among the EU's regional countries, along with Romania. Further downgrading could result above all from a lack of **EU reconciliation**, both because of the loss of access to a large share of transfers and because of a failure to respect market economy principles. The patience of credit rating agencies is expected to last **until the December reviews**.

GKI forecast for 2023-2024

	2019	2020	2021	2022	2023	2024
	(fact)				forecast	
GDP	104.6	95.0	107.1	104.6	99.5	102.2
• Agriculture	98.1	92.2	98.1	68.8	140	100
• Industry	103.0	92.3	106.2	105.4	96.5	105
• Construction	113.1	91.4	109.2	103.0	92	98
• Trade	105.9	101.7	107.0	104.6	96	102
• Commercial lodgings and catering	104.8	55.5	143.2	127.5	99	102
• Transport and storage	106.2	90.2	103.6	114.3	98	103
• Information and communication	110.4	106.5	121.7	107.5	102	103
• Financial services	113.6	104.4	110.4	105.9	102	100
• Real estate activities	102.8	100.3	104.0	105.7	100	100
• Professional, scientific, technical activities	106.3	96.5	115.6	109.9	99	102
• Public administration, education, healthcare	100.5	95.7	102.1	103.7	102	101
• Arts, entertainment	108.9	88.4	112.7	109.6	99	101
• Core growth	105.7	93.6	111.5	107.6	95.3	100
GDP domestic demand	107.1	97.4	104.2	103.9	96.5	101
• Private consumption	104.5	98.1	104.3	106	98.5	102
• Gross fixed capital formation	112.8	92.9	105.2	102.2	90	98

Exports (goods and services)	105.4	93.9	110.3	110.3	**102**	**103.5**
Imports (goods and services)	108.2	96.1	109.1	109.5	**98.5**	**102**
Consumer price index (preceding year = 100)	103.4	103.3	105.1	114.5	**118**	**107**
Unemployment rate (annual average)	3.4	4.1	4.1	3.6	**3.9**	**3.8**
General government balance in per cent of GDP (ESA)	-2.1	-7.8	-6.8	-6.1	**-4.7**	**-3.9**
Balance of the current and capital accounts						
• EUR billion	1.5	1.2	-2.5	-9.1	**2.5**	**7**
• In per cent of GDP	1.1	0.9	-1.6	-5.4	**1.2**	**3.3**

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

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