Hungary | Macro Outlook

Clouds gathering over short-term growth outlook
Tightening to continue via liquidity measures from the fall
Bond yields to remain high for some time
Gas crisis and rule of law issues weakened forint

Economy (%)	2022e	2023e	2024e
GDP (real, y/y)	5.0	0.9	4.2
Unempl. Rate	3.5	3.7	3.4
CPI (y/y)	14.3	13.3	4.2
Retail Sales (y/y)	5.9	2.8	3.5
Ind. Prod. (y/y)	3.3	4.1	5.5
Public Debt/GDP	73.8	71.4	69.5

Source: Erste Group Research

Market	Spot	22Q4	23Q1	23Q2
EUR/HUF	397.31	390.00	385.00	380.00
USD/HUF	392.65	371.43	350.00	336.28
Target Rate (%)	11.75	13.75	13.75	10.75
3M Rate (%)	12.85	13.95	13.95	10.95
5Y Bond (%)*	10.11	9.19	9.09	7.88
10Y Bond (%)*	9.10	8.18	8.08	7.35

Source: FactSet, Erste Group Research

Rating	Current	Outlook
Moodys	Baa2	stable
S&P	BBB	neg
Fitch	BBB	stable

Source: Erste Group Research

General	2022
Population mn	9.7
GDP/Capita EUR	17,264

Source: Erste Group Research

Spot Rates as of:
12th Sep. 2022

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Note:
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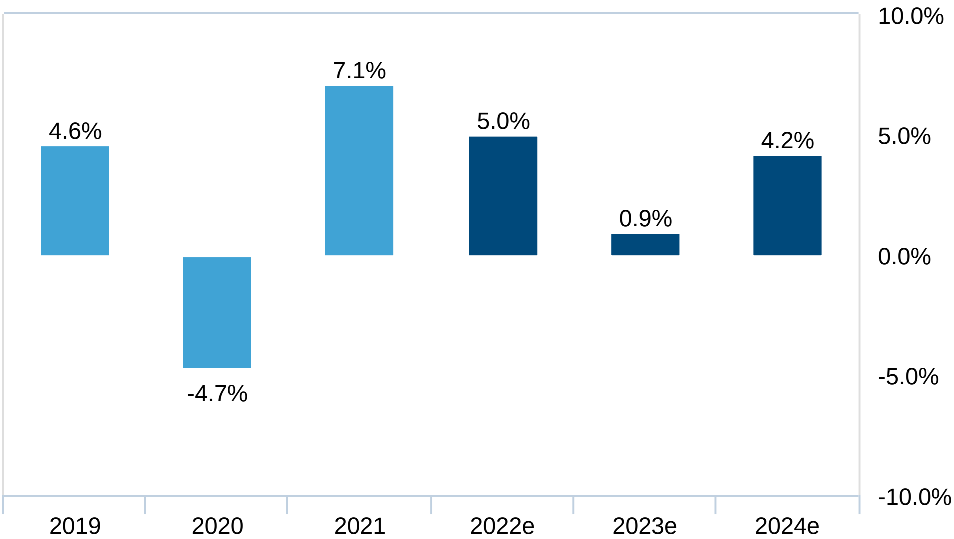
GDP growth was strong in the first half of the year, driven mainly by improving domestic demand. A considerable slowdown is underway, however, as both external and internal growth drivers are losing their momentum. The energy crisis, coupled with high interest rates and fiscal consolidation measures, should hit both households and companies, especially in the last quarter. Although this year's annual GDP growth is set to reach 5% (based on the strong first half's performance), we expect the economy to slow to 0.9% annually in 2023. The mid-term outlook is more favorable, however, thanks to already built-up capacities, supporting a revival of exports.

Inflation remains on an increasing path and reaching the peak is still ahead. The headline rate will likely reach 20% in September and would remain above this level until 2Q23. The ultra-high core inflation print indicates strong second-round price pressure, justifying the hawkishness of monetary policy. Rate hikes, coupled with new liquidity withdrawing measures, should continue and short-term rates might increase to 14% by year-end. Thanks to strict monetary policy, we expect the forint to manage to stabilize at stronger levels, but this is conditional on reaching an agreement with the EU and an easing of energy market tensions.

GDP (real,y/y)



Source: Erste Group Research

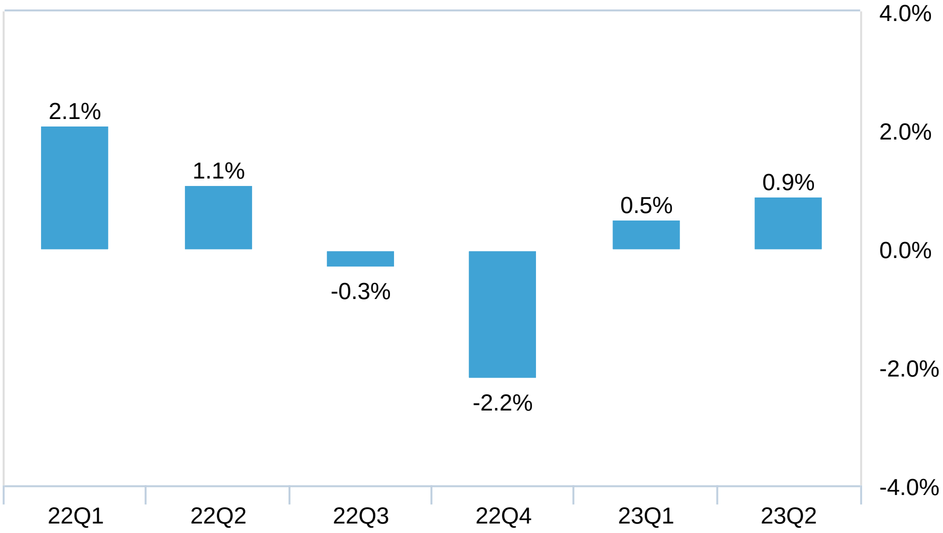
GDP

Clouds gathering over short-term growth outlook

Economic performance remained fairly good in 1H22: GDP expanded by 7.3% y/y. On the final use side, growth was primarily driven by internal demand. Actual consumption of households increased by 10.4% y/y, thanks to surging wages and huge fiscal expansion, while investments also performed well, rising by 8.8% y/y in January-June 2022. Looking ahead, however, short-term growth prospects have considerably deteriorated during the summer. The negative effects of the war have started to bite, global recession fears, looming energy crisis, and slightly easing but still existing supply chain bottlenecks, all worsen the prospects of exports.

Meanwhile, domestic demand – which so far has been the main growth driver – is set to slow down from the fall. Lower business and consumer confidence, a bunch of special taxes on companies, ongoing fiscal adjustment, and extremely high energy bills coupled with a high and still rising interest rate environment imply a slowdown of internal demand. We think that FY annual GDP growth could hardly reach 1% next year. The economy may regain slow momentum in 2024. The previously built-up capacities imply a higher pace of growth of exports, while inflows of EU funds and mid-term moderation of inflation could support internal demand.

GDP (real, s.a., q/q)



Source: Erste Group Research

Annual	2020	2021	2022e	2023e	2024e
GDP real	-4.7%	7.1%	5.0%	0.9%	4.2%
CPI (y/y)	3.3%	5.1%	14.3%	13.3%	4.2%
Private Consumption	-1.9%	4.4%	6.2%	0.5%	3.8%

Source: Erste Group Research

Inflation

Headline rate to increase above 20% y/y in near future

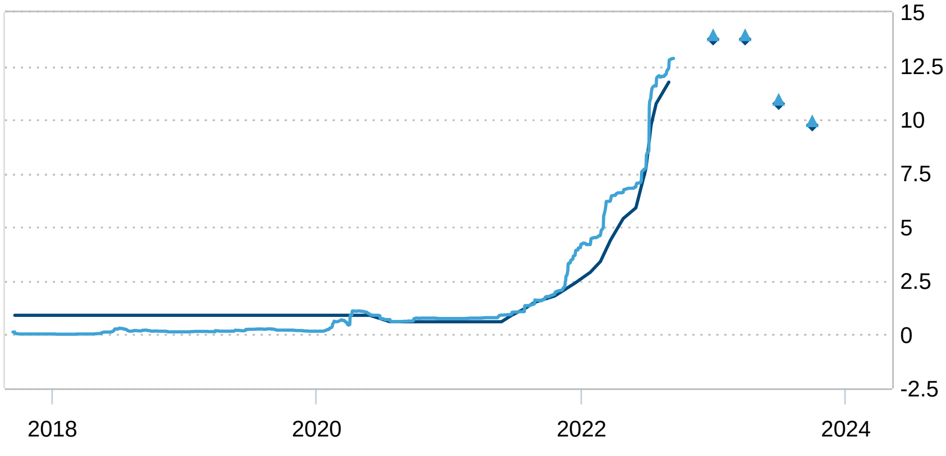
The yearly headline CPI rate was 15.6% in August, while the core rate stood at the extremely high level of 19% y/y. This shows that, despite a bulk of the price caps affecting mainly energy, underlying inflation pressure is rather strong in the economy. The main CPI drivers are foods, durables and services. The inflation outlook has remained rather unfavorable. The phasing out of different price caps is already scheduled, while extra taxes on companies, drought damage and permanent volatility of the forint would cause additional price increases. The 12-month rate should also remain in double-digit territory for the majority of 2023.

Monetary Policy

Tightening to continue via liquidity measures from the fall

In June, the MNB merged the policy rate and the 1-week deposit rate at 7.75%, eliminating the duality of its interest rate system. Then, rates were further increased, with the key rate reaching 11.75% by the end of summer. According to forward guidance, the Monetary Council will continue its rate hiking cycle as long as the inflation outlook is stabilized around the central bank's target and inflation risks become balanced over the monetary policy horizon. Apart from interest rate increases, the Monetary Council decided to introduce additional measures in order to reduce interbank liquidity and increase the effectiveness of the transmission mechanism.

Short Term Yields



Source: FactSet, Erste Group Research

Market (%)	**Spot**	**22Q4**	**23Q1**	**23Q2**	**23Q3**
Target Rate	11.75	13.75	13.75	10.75	9.75
3M Rate	12.85	13.95	13.95	10.95	9.95

Source: FactSet, Erste Group Research

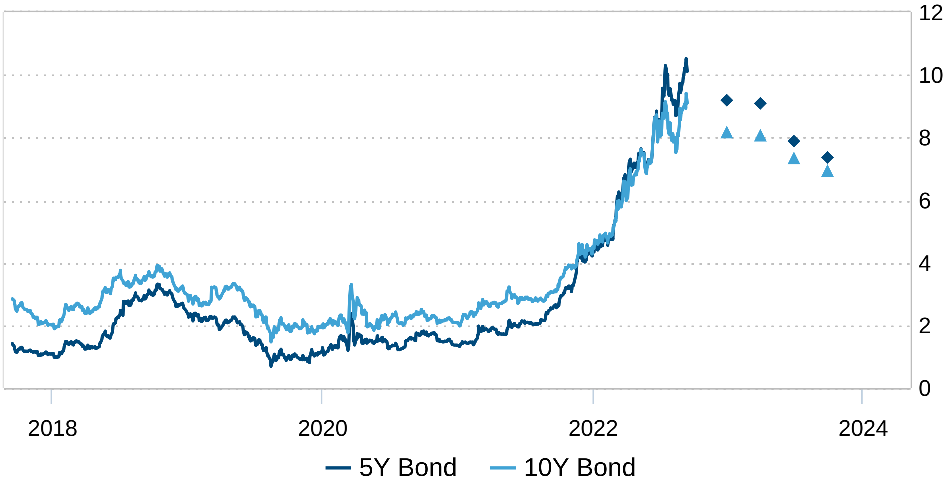
Bond Yields

Bond yields to remain high for some time

Both external and internal risks burden the bond market, leading to exploding risk premiums. Despite the government's ongoing efforts, the unblocking of EU funds should not be expected before year-end. In the summer, Hungary's rating outlook remained stable at Fitch, but was changed to negative at S&P. Volatility on the bond market should remain elevated in the coming period, but the MNB's strong commitment to curb inflation and progress in fiscal consolidation should help long-term yields stabilize at somewhat lower levels later.

Meanwhile, the central bank's increased efforts to strengthen the monetary transmission mechanism have led to increases at the short end of the yield curve since the end of August. The ÁKK's announcement regarding the suspension of the switch auction program could also imply higher yields in the case of short-term papers. The effects of the MNB's rate hikes could to a greater extent be visible in short-term yields from now on. As a result, the steepness of the domestic yield curve would further increase.

Generic Bond Yields (%)



Source: FactSet, Erste Group Research

Market	Spot	22Q4	23Q1	23Q2	23Q3
5Y Bond*	10.11	9.19	9.09	7.88	7.36
10Y Bond*	9.10	8.18	8.08	7.35	6.94

Source: FactSet, Erste Group Research

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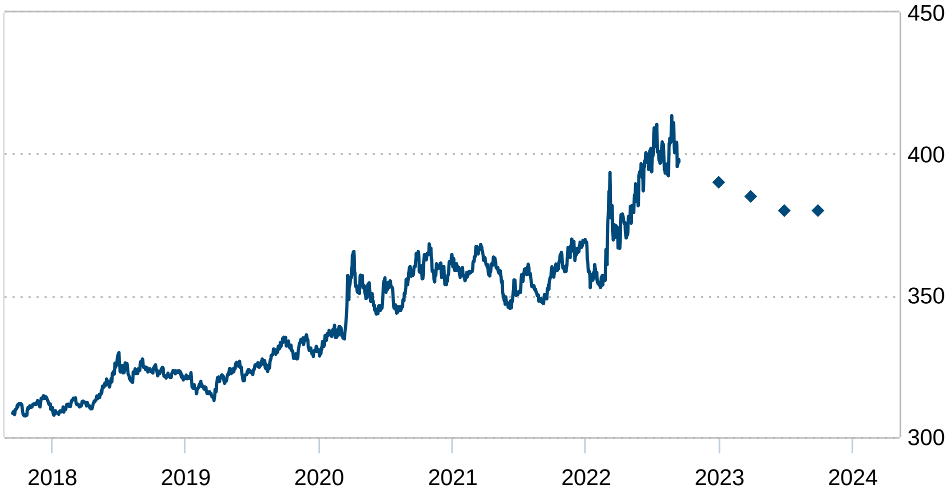
Forint

Gas crisis and rule of law issues weakened forint

The disciplinary procedure that may deprive Hungary of EU funds has been weighing on the forint since this spring. In addition, surging energy prices have put an extra burden on the trade balance and created additional demand for FX on the market. Skyrocketing gas prices have led to a monthly trade deficit amounting to more than EUR 1bn in July vs. a deficit of just EUR 175mn in July 2021. The deteriorating trade balance could have been a key reason for the historic lows of the forint seen this summer.

Hungary's strong exposure to Russian energy and looming energy crisis fears have been the most relevant forint weakening factors. Meanwhile, the MNB has been continuing its aggressive monetary tightening, but the EURHUF has remained extremely volatile. Further rate hikes, coupled with liquidity withdrawing measures, should help stabilization in the last quarter. However, clearer positive signs from the talks with the EC and the easing of tensions on energy markets would be needed to mitigate the pressure on the currency.

EUR/HUF



Source: FactSet, Erste Group Research

	Spot	22Q4	23Q1	23Q2	23Q3
EUR/HUF	397.31	390.00	385.00	380.00	380.00
vs. Spot		*-1.8%*	*-3.1%*	*-4.4%*	*-4.4%*
USD/HUF	392.65	371.43	350.00	336.28	339.29
vs. Spot		*-5.4%*	*-10.9%*	*-14.4%*	*-13.6%*

Source: FactSet, Erste Group Research

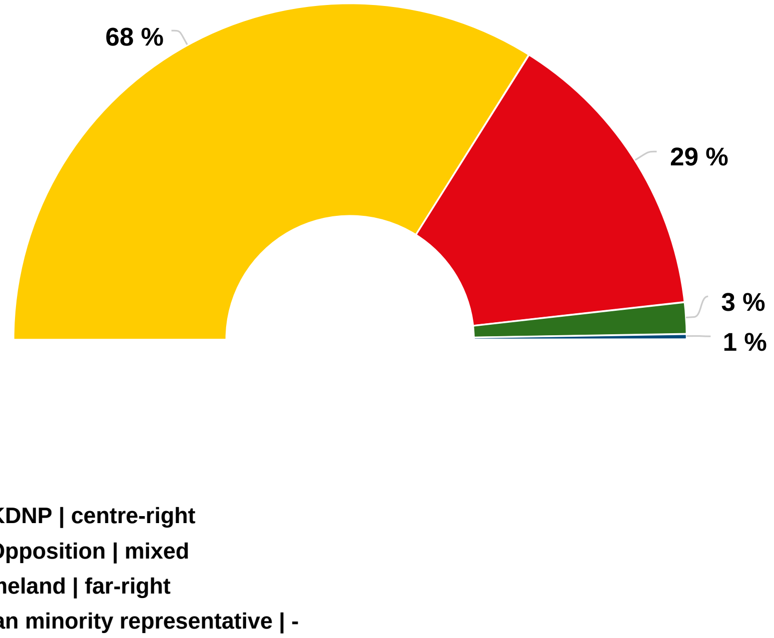
Politics

Debates with EU not yet resolved

The disciplinary procedure that started in spring and may deprive Hungary of EU funds has remained a key topic on the market. The European Commission is expected to decide in September whether to recommend funding cuts against Hungary or close its rule-of-law probe. Due to the possibility of serious financial sanctions, the government decided to establish an anti-corruption agency that will be tasked with intervening in critical cases.

The Hungarian authorities are optimistic about the positive outcome of the rule-of-law debate. Meanwhile, the YTD budget deficit amounted to HUF 2,873bn in August, 91% of the FY cash flow based target. The ESA-based deficit goals are 4.9% of GDP and 3.5% of GDP in 2022 and 2023, respectively, which can be seen as quite ambitious amid the current serious energy crisis. Since the April election, a number of consolidation measures to curb the deficit have been announced, including a change in the utility bill support system for households.

Parliament Seats



Source: Erste Group Research

Last Election:
2022 Q2

Next Election:
2026 Q2

Forecasts

Annual	2016	2017	2018	2019	2020	2021	2022e	2023e	2024e
Real GDP growth	2.2	4.3	5.4	4.6	-4.7	7.1	5.0	0.9	4.2
Inflation (CPI, avg)	0.4	2.4	2.8	3.4	3.3	5.1	14.3	13.3	4.2
Unemployment rate (avg)	5.0	4.0	3.6	3.3	4.1	4.1	3.5	3.7	3.4
Retail sales growth	4.9	5.7	6.7	6.0	-0.2	3.5	5.9	2.8	3.5
Industrial output growth	0.9	4.6	3.6	5.4	-6.1	9.6	3.3	4.1	5.5
Private consumption growth	4.1	4.5	4.2	4.5	-1.9	4.4	6.2	0.5	3.8
Fixed capital formation growth	-10.6	19.7	16.3	12.8	-7.0	5.9	4.5	2.0	5.5
Percent of GDP									
Trade balance	3.4	1.3	-1.7	-2.5	-0.9	-2.5	-8.7	-5.1	-4.6
Current account balance	4.5	2.0	0.2	-0.7	-1.1	-3.2	-8.4	-4.9	-3.9
Foreign direct investment	-0.7	6.6	3.5	3.9	1.7	-0.4	0.9	1.2	1.2
Budget balance	-1.8	-2.5	-2.1	-2.1	-7.8	-6.8	-4.9	-3.5	-3.2
Public debt	74.8	72.1	69.1	65.5	79.6	76.8	73.8	71.4	69.5
External debt, gross	97.4	85.1	79.1	72.6	80.0	82.8	81.2	74.6	69.6
FX, money market									
USDLCY average	281.44	274.27	270.25	290.65	307.93	303.29	366.14	341.16	326.09
EURLCY average	311.46	309.21	318.87	325.35	351.17	358.52	387.84	381.25	375.00
EURLCY eop	311.02	310.14	321.51	330.52	365.13	369.00	390.00	380.00	375.00
(percent)									
CB policy rate (avg.)	1.04	0.90	0.90	0.90	0.76	1.11	8.09	11.38	7.00
3m interbank offer rate (avg.)	0.99	0.15	0.12	0.19	0.69	1.39	9.40	11.58	7.20
2Y Yield (average)*	1.52	0.87	1.26	0.82	1.04	2.04	8.60	9.16	6.35
5Y Yield (average)*	2.12	1.72	2.16	1.58	1.51	2.38	7.00	7.85	5.92
10Y Yield (average)*	3.14	2.97	3.06	2.47	2.23	3.07	7.30	7.20	5.73

Source: Erste Group Research

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