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Weekly Briefing

Hungary economy briefing:
Hungarian policy responses to worsening external environment

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Hungarian policy responses to worsening external environment

As a direct result of the war in Ukraine and the ongoing impact of the global pandemic, the state of the world economy has deteriorated rapidly in recent months. The World Bank forecasts GDP growth of 2.9 percent in 2022, down from 5.7 percent in 2021, and the negative impact of the war has been felt more acutely in countries close to the war and in poor developing countries whose finances tend to be fragile; see the recent crisis in Sri Lanka. It is obvious that an economic crisis of this magnitude will also affect Hungary, which is a neighboring country of Ukraine. Therefore, the Hungarian government has taken steps to mitigate the impact of the crisis and prepare for the worst. This briefing looks at those steps.

Introduction

If we look back at the economic development of the last three decades and even before, we can see that the Hungarian economy either grew rapidly or reached external equilibrium, but these two positive trends did not usually coincide. This vicious circle seemed to be broken after 2012, when the Hungarian economy was able to grow in a balanced way. Now the Hungarian economy is growing rapidly and domestic demand is strong, but to maintain this status, policies must be adjusted to restore balance. The most worrisome element of the balance is always the current account, which shows whether the country is borrowing or lending more from the world. This briefing looks at what the Hungarian government and central bank have done in recent months to maintain this position.

External balance of the economy

In the next part, we look at the external balance of the economy and examine four basic indicators: (1) the current account balance, (2) the flow of foreign direct investment, (3) government debt, and (4) the government budget. And we also explore the question of what precautionary measures the Hungarian government took last week.

(1) Current account balance - net lending/borrowing. Over the past year, the current account has been characterized by two opposing trends. In the first half of the year, the current account balance approached zero, because lockdowns were lifted and the economy began to recover, with output in the services sector in particular surging. At the same time, the balance

deteriorated in the second half of the year, with the current account deficit reaching 3.1 percent of GDP and the net lending turning into a net borrowing. The deterioration can be explained by the global shortage of semiconductors and higher energy and raw material prices. The trend continued in the first quarter of 2022 and the country's net borrowing was 999 million euros, equivalent to 2.4 percent of Q1 GDP. It should be added that the relatively low net borrowing may deteriorate if the country fails to reach an agreement on EU transfers with the European Commission. The balance of the current account was 2,530 million euros, while the balance of the income account was 1780 million euros. A look at the details shows that the deterioration in the current account balance was due to higher-than-expected imports. Imports increased by 31 percent between 1Q 2021 and 1Q 2022. The growth can be explained mainly by higher energy and commodity prices.

There are several explanations for the current volatility of the Hungarian forint exchange rate, one of which is the deterioration of the current account. At the same time, Hungarian central bank forecast an improvement in the balance for the following reasons: First, exports are always supported by a weaker currency; second, the high investment ratio will improve from Q3 onward.

(2) The flow of foreign direct investment. During 2021, foreign direct investment worth 3.8 billion euros flowed into the country. The net flow of foreign direct investment was over 2 billion euros, which is a significant volume, but the outflows were also significant during this period. National foreign The national external debt grew by 4.6 billion euros in 2021, which was due to the issuance of foreign currency-denominated bonds by the Hungarian government. The expansion of total foreign sources amounted to 12.4 billion euros, while the stock of foreign assets owned by residents increased by 7.8 billion euros. In 2021, outward direct investments doubled in value by 1.7 billion euros.

Of course, we do not have data for 2022, but we can conclude that Asian investors continue to consider Hungary an attractive country for investment. In particular, Chinese investors showed interest in the country. Some examples of major investments. PEX Automotive announced it would invest another 15 million euros to produce auto parts. Semcorp, Lenovo and Chervon Auto also chose Hungary as a production location. According to the Hungarian Investment Promotion Agency (HIPA), 17 Chinese investment projects worth 0.7

billion euros were handled by HIPA in 2020-2021, and these companies created around 2,300 new jobs.1

(3) debt. At the end of 2021, government debt as a percentage of GDP in Hungary was 76.8 percent, while the EU average in the same year was 90.3 percent. In four years, the government debt ratio will fall to 63.1 percent in Hungary and 84.1 percent in the EU. Hungary's nominal debt was 38,408 billion forints in the last quarter of 2020 and increased to 42,088 in the last quarter of 2021. The change is 9.6 percent within one year, but we should also not forget the impact of currency depreciation and GDP growth. For this reason, Hungary's government debt to GDP ratio fell by 2.8 percentage points, while the EU average of the decline in government debt between Q4 2020 and Q4 2021 was only 1.9 percent.

Although Hungarian government debt is below the EU average, its level is higher than the regional average. At the same time, the structure of Hungarian government debt is sound, as 79 percent of government bonds are denominated in HUF and residents make up the bulk of government bond holders. (The data refer to the end of May 2022).

Table 1. Public debt in term of GDP in Central and Eastern European Countries (%)

1 https://bbj.hu/politics/domestic/government/china-continues-to-show-interest-in-hungary-with-more-opportunities-on-the-horizon

	2020Q4	2021Q4
Bulgaria	24.7	25.1
Czechia	37.7	41.9
Estonia	19.1	18.0
Croatia	87.3	79.8
Latvia	43.3	44.8
Lithuania	46.6	43.3
Hungary	79.6	76.8
Poland	57.1	53.8
Romania	47.2	48.8
Slovenia	79.8	74.7
Slovakia	69.0	65.8
Source: Eurostat data retrieved from: https://ec.europa.eu/eurostat/documents/2995521/14497745/2-22042022-BP-EN.pdf/90896015-2ac1-081a-2eef-ad8d5f2c0da1		

(4) Government budget. At the end of June 2022, the deficit of the government budget was HUF 2.892 billion. The amount is in line with the targets. The revenues of the government budget were 13.5 percent higher than in the corresponding period last year. For this reason, we can assume that the target of a budget deficit of 4.9 percent can be achieved at the end of this year. At the same time, the Hungarian government has taken precautionary measures due to the global uncertainty and made adjustments to the ministries' budgets last week. As a result of these austerity measures, the Hungarian government will spend 415 billion forints less this year than originally planned. In addition to these plans, public investments worth HUF 152 billion will be postponed. The total amount of savings is HUF 568 billion, while the originally planned total government budget deficit is HUF 3.152 billion, i.e. the total amount of savings is equal to 18 percent of the annual government budget deficit.

The Hungarian government has also declared a state of emergency over energy shortage. The 6-measure package also includes an element that will significantly reduce public budget spending. The policy of maintaining utility prices low will be maintained, but favorable prices for natural gas, electricity and water will be capped at average consumption, and consumption above average will be charged without government subsidies.

Summary

Hungary, which is close to the war, feels the effects of the war more than many other countries. At the same time, the solid foundation of public finances allows it to cope with the crisis. Looking at the different elements of the external balance of the economy, the most worrying element seems to be the weak currency. However, we should not forget that the domestic currency is a tool for adjusting the economy, it boosts exports and also improves the country's trade balance and current account. The steady inflow of foreign direct investment is evidence of a solid economic foundation and business confidence. This investor confidence will continue to improve due to the Hungarian government's recent austerity measures and the precautionary measures that will help achieve the public deficit and public debt targets.