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Weekly Briefing

Hungary economy briefing:
The development of the Hungarian economy during the war in Ukraine

Csaba Moldicz

China-CEE Institute

Kiadó: Kína-KKE Intézet Nonprofit Kft.
Szerkesztésért felelős személy: Chen Xin
Kiadásért felelős személy: : Feng Zhongping

1052 Budapest Petőfi Sándor utca 11.
+36 1 5858 690
office@china-cee.eu
china-cee.eu

The development of the Hungarian economy during the war in Ukraine

In 2022, the global economy slumped more than expected across the board, and inflation rose to levels not seen in several decades. The cost of living rose in all regions. Not surprisingly, several analysts concluded that the global economy is facing stagflation, a period of economic stagnation with galloping inflation. According to the IMF's October forecast, the eurozone is expected to see full-year GDP growth of 3.1 percent, compared with 3.1 percent for China and 1.6 percent for the United States. In view of the sluggish growth, Hungary is one of the top performers among the EU members with GDP growth of 5.7 percent.

Table 1. GDP growth in 2022 (percent)

Ireland	7.9	EU	3.3
Portugal	6.6	Bulgaria	3.1
Slovenia	6.2	Denmark	3.0
Greece	6.0	Sweden	2.9
Croatia	6.0	Belgium	2.8
Romania	5.8	France	2.6
Malta	5.7	Lithuania	2.5
Cyprus	5.6	Czechia	2.5
Hungary	5.5	Finland	2.3
Austria	4.6	Latvia	1.9
Netherlands	4.6	Slovakia	1.9
Spain	4.5	Germany	1.6
Poland	4.0	Luxembourg	1.5
Italy	3.8	Estonia	-0.1

Source: European Commission: Autumn 2022 Economic Forecast, The EU economy at a turning point, retrieved from: https://economy-finance.ec.europa.eu/economic-forecast-and-surveys/economic-forecasts/autumn-2022-economic-forecast-eu-economy-turning-point_en#executive-summary

Introduction

The reason for the relatively high GDP growth figures in the EU is the robust growth in the EU member states in the first half of the year. However, the adjustment process to the new commodity prices and higher inflation rates started in the second half of the year, and we expect the adjustment process to be completed by the end of next year

While the EU economy is still struggling with the consequences of the global pandemic, the impact of the war in Ukraine is hitting the EU economy. The EU is the region in the global economy most affected by the impact of the war. There are two reasons for this: one is the proximity to the war, the other is the heavy dependence on external energy sources. The first two quarters were still strong in terms of growth, even the third quarter of the year could be characterized by economic growth, but in the last quarter the downturn was very clear. The same trend applies to the Hungarian economy, where GDP growth was 8.2 percent in the first quarter, 6.5 percent in the second quarter, and 4.0 percent in the third quarter. This briefing takes a closer look at the development of the Hungarian economy in 2022 - based on basic economic indicators such as GDP growth, inflation and employment.

Growth

Looking at the production side of GDP growth, we find that agriculture experienced the largest decline in output, as the sector's output in the third quarter was 39.3 percent lower than in the corresponding period last year. This decline can be attributed to the severe drought in the summer. At the same time, industrial production grew by 9.6 percent and manufacturing by 10.6 percent in the same period. The services sector outperformed as its output increased by 5.6 percent in the third quarter of 2022 compared to the third quarter of 2021. Services contributed 3.4 percentage points to the 4.0 percent of GDP, while industry contributed 1.7 percentage points and construction 0.1 percentage points. At the same time, the decline in agricultural production reduced GDP by 1.8 percentage points in Q3 2022.[1]

Inflation and interest rates

Inflation has risen over the past 11 months, with November's inflation rate reaching a new high of 22.5 percent. The biggest push came from rising commodity and energy prices on the international market. However, we should not forget that the inflation rate had already increased in 2021. If we take a closer look at the inflation data, we see that energy prices increased by 65.9 percent between November 2022 and November 2021. The second largest jump was in

[1] https://www.ksh.hu/gyorstajekoztatok#/hu/document/gdp2209

food prices, where the increase was 43.8 percent, while price increases were moderate for consumer durables (14.4 percent), spirits and tobacco (13.8 percent), services (9.0 percent), and clothing and textiles (8.0 percent)

Central banks in Central Europe responded to galloping inflation by raising key interest rates significantly. Hungary's rate is now (Dec. 18, 2022) 13 percent, up from 2.4 percent in January 2021. Over the last 11 and half months, the MNB has raised the key interest rates ten times. Although the MNB has signaled the end of the monetary tightening cycle - when it raised the interest rate to 13 percent at the end of September - it cannot be ruled out that there will be further key rate hikes in the near future given the latest inflation reports

In a Central European comparison, the Hungarian interest rate is the highest - not counting countries such as Moldova (20 percent) and Ukraine (25 percent). The real interest rate (difference between inflation and interest rates) is negative everywhere; however, the second smallest negative interest rate is found in Hungary (the smallest is found in the Czech Republic). This monetary policy may seem aggressive, but it also helps to maintain external financing of public debt.

Table 2. Inflation, interest rate and real interest rates in Central Europe

	Interest rate	Inflation	
Slovakia	2.5	15.4	-12.9
Estonia	2.5	21.3	-18.8
Latvia	2.5	21.8	-19.3
Lithuania	2.5	22.9	-20.4
Poland	6.75	17.5	-10.75
Romania	6.75	16.76	-10.01
Czechia	7	16.2	-9.2
Hungary	13	22.5	-9.5

Source: https://tradingeconomics,com/country-list/interest-rate?continent=europe and https://tradingeconomics.com/country-list/inflation-rate?continent=europe

Labor market: salaries and unemployment

Despite galloping inflation, the Hungarian labor market has performed extremely well in recent months, as Hungary was the only economy in the European Union to record an increase in real wages in 2022. A look at the figures for January-November shows that inflation rose by 13.6 percent, while wages increased by 15.4 percent.[2]

Public finances and public debt

According to the European Commission, the government deficit will be about 6.2 percent of GDP at the end of this year. This figure seems high, but we should consider two factors. First, government debt is down at 6.2 percent compared to 7.1 percent in 2021. Second, it can be explained by the expansionary measures that were necessary to avoid a recession after the outbreak of war in Ukraine. The European Commission forecasts a slight decline in public debt from 76.8 percent of GDP in 2021 to 76.4 percent in 2022.[3]

Trade and current account balance

In October 2022, export volumes (measured in euros) were 21 percent higher than in the same month a year earlier, while imports were 26 percent higher. The trade balance began to deteriorate before the end of the war in 2021, and a deficit could be reported since mid-2021, but in July (1.3 billion euros) and August 2022 (1.58 billion euros), a significant deficit appeared in the balance due to energy prices that reached new highs in the summer. Since these prices have since fallen slightly, the trade balance has also improved. We must also add that in 2021 and 2022 there was significant foreign direct investment, and in the first phase of investment it is quite typical that imports dominate until the factory starts production and only then export volume exceeds imports

In this context, we must mention that the largest foreign direct investment ever made in Hungary was decided this year by a Chinese company. The investment case we are looking at is the investment of the Chinese CATL (Contemporary Amperex Technology Co.), which is one of the largest battery producers in the world and decided to invest in Eastern Hungary. (In the first two months of 2022, CATL has a 34.5 percent share of the global market)[4] According

[2] https://www.napi.hu/magyar-gazdasag/minimalber-fizetesek-inflacio-realber-atlagber-keresetek.764773.html

[3] https://economy-finance.ec.europa.eu/economic-surveillance-eu-economies/hungary/economic-forecast-hungary_en

[4] The second largest company in this sector is the Korean LG Energy Solution with 15.9 percent, followed by the Chinese BYD (11.1 percent), the Japanese Panasonic (9.9 percent), the Korean SK ON Innovation with 6.6 percent, the Chinese CALB (4.4 percent), and the Korean Samsung SDI (3.8 percent). https://www.statista.com/statistics/235323/lithium-batteries-top-manufacturers/

to the plans, the company will invest in a 7.3 billion euro battery factory in Hungary, the largest in Europe to date. After obtaining the necessary permits, the construction of the 100 GWh plant will take no longer than 64 months. Once built, the factory will be able to produce batteries for Mercedes, BMW and Volkswagen.

Summary

The year 2022 was one of the most challenging years since the early 1990s. The challenge came from several directions: high inflation, long-term impact of the global pandemic, geopolitical uncertainty, deterioration of the terms of trade, weak demand in global, especially European, markets. Despite the deteriorating external conditions, the growth of the Hungarian economy is expected to be around 5 percent in 2022. The labor market remains in excellent shape, as the unemployment rate is low, employment levels are high, and wages could rise faster than inflation. However, there are still challenges that need to be addressed: High inflation seems to be stubborn, which is why interest rates cannot be lowered, and the terms of trade also need to be improved. The main problem remains that the above-mentioned problems mainly originate from the global economy and the positive trends of the Hungarian economy are not sufficient to compensate for the negative external elements.