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Hungary economy briefing:

Grappling with inflation: the Hungarian economy in autumn 2023

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Grappling with inflation: the Hungarian economy in autumn 2023

The first and foremost challenge of Hungary's economic policy is to curb inflation at the moment, the finance minister stressed at the 61st Meeting of Hungarian Economists. He added that lower inflation rates and restored balance can lead to further economic growth in Hungary next year. This briefing looks at what the main trends in the Hungarian economy will be this fall and what the government and central bank's responses will be to control inflation and spur economic growth. It also discusses the economy policy dilemmas Hungary is facing now.

Introduction

In addressing the complex factors underlying the recent surge in inflation, the Minister of Finance pointed to a multi-layered landscape in his speech at the 61st Meeting of Hungarian Economists. He said that a confluence of events has contributed to Hungary's current inflationary challenges: (1) the negative impact of the war, (2) the energy crisis, (3) Hungary's dependence on external energy sources, (4) a historic drought,(5) the tight labor market, and (6) the mismatch between fiscal and monetary policy in recent years have all been important factors that have contributed significantly to high inflation in Hungary. The political debate among monetary and fiscal policy leaders now appears to be dying down, however, the challenge of keeping inflation in check remains a task for policymakers in the months to come. While we see negative factors such as high inflation and the public deficit, we can also clearly observe that the balance of the economy is being gradually restored. The best indicators in this regard are the improvement of the trade balance and the current account in Hungary. In the next part of the briefing, we will take a brief look at the key macroeconomic figures of the Hungarian economy, and then try to interpret the emerging political debate in the next part.

Hungarian economy in figures

In the second quarter of the year, the gross domestic product (GDP) decreased by 2.3 percent compared to the corresponding period of the previous year. Compared to the previous quarter, the GDP of Hungary decreased by 0.3 percent. Only agriculture grew significantly in the second quarter of 2023, by 6.9 percent compared to the corresponding quarter of 2022. At the same time, industrial and construction output fell by 5.7 and 6.0 percent, respectively, in the same period. The decline was less pronounced in the services sector (2.4 percent), but this sector also suffered from weak demand in the second quarter of 2023.

Weak domestic demand can easily be seen in the consumption side of GDP. Actual household consumption fell by 1.6 percent in the second quarter of 2023, while public consumption and the volume of social transfers increased by 2.3 and 6.2 percent, respectively. Despite these latter factors, total consumption fell by 1.0 percent in Q2 2023 compared to the corresponding quarter of 2022. However, the main cause of the decline in GDP was not private consumption, but investment. Fixed investment declined 15.6 percent in Hungary, and gross investment contracted 21.3 percent in the quarter compared to the second quarter of 2022.

The growing trade surplus was not able to fully compensate for the negative trends in investment and consumption. While consumption and investment contributed 0.7 and 7.2 percentage points to GDP, net exports increased GDP by only 5.4 percent.[1]

In August 2023, the consumer price index was 16.4 percent over prices in the corresponding month in 2022. This is a significant drop in annual inflation rate compared to previous months. If we take a look at the details, we find that energy and food prices have exploded over the last 12 months. Energy prices increased by 34.7 percent and food and fuel prices increased by 19 and 19 percent, respectively.

At its last meeting, the central bank left the key interest rate at 13 percent, while it cut the central bank deposit rate by 50 percentage points (from 12.50 to 12.00) and the interest rate on secured loans from 16.50 to 14.00 percent. The decline in lending to businesses and individuals was an inevitable side effect of war- and sanctions-induced inflation and the resulting rise in interest rates in Hungary. For this reason, the government put pressure on banks to provide incentives for lending. Annual lending to households in the first part of 2023 was 98 billion forints higher than a year ago.

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[1] https://www.ksh.hu/gyorstajekoztatok#/hu/document/gdp2306

[2] https://www.penzcentrum.hu/hitel/20230906/tul-vagyunk-a-nehezen-elenkulo-keresletre-szamitanak-a-bankok-1140934#

Table 1. Prices indices in August 2023		
	Previous month = 100 percent	August 2022 = 100
Consumer prices index	100.7	116.4
Harmonized consumer price index	100.8	114.2
Core inflation rate (seasonally adjusted)	100.2	115.2
Pensioner prices index*	100.5	117.2
Source: https://www.ksh.hu/gyorstajekoztatok#/hu/document/far2308		

The labor market remains a strong demand market, which is why the unemployment rate was a low 3.9 percent in August 2023. At the same time, the long-term trend continues to point upward. This can be seen in the changes in the 3-month average. In the May-June period, the unemployment rate in the 15-74 age cohort increased from 3.3 percent to 4.0 percent. The unemployment rate by age cohorts shows great differentiation. Table 2 shows that it is much more difficult for young people aged 15-24 to find a job than for older people.

Table 2. Unemployment rates according to age cohorts		
Age cohorts	%	Change in percentage
15-24 years	13.2	3.2
25-54 years	3.5	0.7
55-75 years	3.2	0.0
Total	4.0	0.7
Source: https://www.ksh.hu/gyorstajekoztatok#/hu/document/mun2307		

The balance of the Hungarian economy has improved significantly in recent months. The trade balance now shows a surplus of 920 million euros, in sharp contrast to last year's deficit of 2970 million euros. The improvement is due to two factors: weak domestic demand for imported goods and an improvement in the terms of trade, reflecting lower energy prices on world markets. The balance of trade in services also became more favorable, as the surplus increased from 2057 to 2400 million euros. These positive trends were partially offset by the deterioration of the income balance. The balance of the current account improved significantly in the second quarter. In the three months between April and June, a surplus of 690 million euros was recorded, an improvement of 3.3 billion euros year-on-year.[3]

[3] https://piacesprofit.hu/cikkek/gazdasag/javult-magyarorszag-folyo-fizetesi-merlege.html

Policy dilemmas

In recent months, different approaches to fighting inflation have dominated the Hungarian discourse; in particular, the gap between monetary and fiscal policy has become apparent, but the difference has since narrowed. Finance Minister Varga said in an interview that the differences were significant in the past, but the Ministry of Finance and the Central Bank are now working together. He added that the central bank's fight against inflation coincided with the central bank's corporate bond program, which significantly increased inflationary pressures. The minister said that high inflation with the economic recession has led to high public budget deficits. He argued that this situation could lead to a new bank tax. At the same time, it later turned out that this was more of a communicative ploy to put pressure on the banking sector. The government notes that lending has been cut back because the current situation has led to additional profits in the banking sector, while banks are not lending to the corporate sector and households.

According to the Minister of Economic Development, the government believes that rapidly falling inflation will be accompanied by real wage growth and GDP growth of 4 percent next year. He also added that we have overcome the most important part of the price shock, but many companies are still paying double the market price based on fixed-price contracts that were signed earlier. This problem will disappear when these contracts expire.[4]

According to several analysts, the central bank wants to cool the economy, while the government is aiming for growth starting next year. The Hungarian Prime Minister recently responded to this problem, saying that the government has taken on the task and responsibility of fighting inflation, as the central bank is not up to the severity of the problem.

[4] https://www.economx.hu/magyar-gazdasag/kozgazdasz-vandorgyules-nagy-marton-inflacio.777801.html

Summary

As we can see from the above analysis, inflation is currently too high and the economy is in recession. At the same time, we have observed positive trends in terms of the balance sheet, as the current account and the trade balance have improved significantly in recent months, so that the Hungarian economy does not have to deal with the so-called “twin deficit”. (“Twin deficit” is used for economies that have both a budget deficit and a current account deficit, and it is assumed that the high budget deficit causes the current account) Another element worth mentioning is that the labor market is still tight, i.e. it is a demand market where it is difficult to find qualified labor.