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# Hungary political briefing:
# Trade, investment and balance in the Hungarian Economy: early 2024

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# Trade, investment and balance in the Hungarian Economy: early 2024

*The Hungarian economy suffered a slight decline in 2023. According to forecasts, GDP is likely to have fallen by around 0.4-0.5 percent in 2023. The international economic environment was extremely unfavorable for the Hungarian economy, as geopolitical uncertainties accompanied us throughout the year, and other factors such as high interest rates, high inflation and weaker global demand were also prevalent and did not support the development of the Hungarian economy. This briefing focuses on the development of foreign trade and balance of payments data. At the same time, we also look at the development of foreign direct investment, as this has a strong influence on balance of payments and trade figures in Hungary. The fiscal and monetary policy measures taken in Hungary are also examined in the analyzes.*

## Introduction

In 2022, when energy prices skyrocketed due to the war in Ukraine, the Hungarian economy was characterized by increasing foreign trade deficit and deteriorating terms of trade, a phenomenon that has long existed in Hungary before 2010. Deteriorating term of trade simply means that we have to work and export more to get the same amount of energy for our products and services. Global and European energy prices are still much higher now than before the war in Ukraine, but the price increase is tending to level off, which leads us to the conclusion that the Hungarian economy will have to adjust to a higher energy price level in the long-term, but sudden price increases are less likely in the future. ("Average household electricity prices in the first half of 2023 were €28.9 per 100 kilowatt-hour (kWh) – up from €25.3 per 100kWh for the same period in 2022. Average gas prices also rose to €11.9 per 100kWh from €8.6 per 100kWh in 2022." an analysis of Victora Masterson concluded [1])

Part of the adjustment in 2023 was lower domestic demand in Hungary or companies exporting more than before. We should add that the increasing battery production in Hungary, which is a result of the successful "Eastern Opening Policy", also contributes to a better balance

1 https://www.weforum.org/agenda/2023/11/gas-electricity-prices-europe/

of the Hungarian economy. It is obvious that when the crisis is over – and the latest Q3 figures indicate this – domestic demand will increase, which will also have an impact on the foreign trade balance.

**Most recent foreign trade data**

The latest data on Hungary's foreign trade comes from the Hungarian Central Statistical Office. In October 2023, the trade surplus amounted to 1 billion euros, indicating that the months of deficits are over and net exports are contributing to GDP growth again. In October, the export volume was 3 percent higher than in the corresponding month of 2022, while imports fell by 2.5 percent in the same period. In October 2022, the trade deficit in Hungary was 0.9 billion euros, the improvement is significant.

If we look at these figures from a regional perspective, we see that exports to the EU 27 improved by 0.1 percent, while imports fell by 5.6 percent. As a result of these trends, the trade balance improved by 611 million euros and grew to a surplus of 1.6 billion euros. The EU-27 countries accounted for 77 percent of exports and 70 percent of imports. At the same time, trade with the rest of the world still showed a deficit in October, despite an improvement of 1.3 billion euros from October 2022 to October 2023. In this relation, exports increased by 13 percent and imports by 4.7 percent in the same period.[2]

In November 2023, the volume of exports was 3.8 percent lower than in the corresponding month of 2022, while imports fell by 25 percent in the same period, improving the trade balance by 3.2 billion euros.[3] The trends are still positive, as the volume of exports increased by 1 percent this month, while imports fell from October to November. The current data shows a huge surplus compared to the energy price explosion in 2022, which ultimately affects the forint. When these figures were published by the Hungarian Central Statistical Office on January 4, 2024, the Hungarian currency reacted with an appreciation and 1 euro cost only 380 forints, which is a record in the period of the last three months.

2 https://www.ksh.hu/gyorstajekoztatok#/hu/document/kul2310
3 https://www.ksh.hu/gyorstajekoztatok/kue/kue2311.html

## Foreign direct investments

The change in trade dynamics can be attributed to lower domestic consumption, but another factor is the recent massive inflow of foreign direct investment (FDI). It is obvious that the focus of Hungarian economic development has recently been on attracting foreign direct investment. Márton Nagy, the Minister of Economic Development, spoke at a conference in February 2023 about a financial structural change in the Hungarian economy. He emphasized how important it is to keep the GDP investment rate at around 30 percent, while the share of foreign direct investment in overall investments is more than 20 percent. From this we can conclude that the annual investment volume must be between 5-10 percent of GDP.[4] Obviously, the low corporate tax rate, lowering taxes on labor and the favorable framework conditions for companies have contributed to this success.

As a result of the efficient FDI policy in Hungary and the changing structure of global FDI flows, the league of main investor countries has also changed significantly. While Germany was still the dominant investor in Hungary 10 years ago, its share of Hungarian FDI has fallen from 26 percent to 17 percent. In general, Europe's share fell slightly from 58 percent to 56 percent in the period from 2013 to 2023. America's role decreased from 19.4 percent to 8.9 percent and the United States' share fell from 19 percent to 7 percent. Meanwhile, Asia's share rose from 18.8 percent to 34 percent, but within this development, the change in the weight of individual countries is particularly interesting. While Israel accounted for 12 percent of all foreign direct investment, this share has now fallen to 3 percent, while China's weight has risen from 1 percent to 9 percent. The real change took place in the case of South Korea, where South Korea's share of Hungary's FDI stock rose from 1 percent to 14 percent![5]

According to preliminary figures, the inflow of foreign direct investment in Hungary will reach a new record in 2023. According to estimates, the FDI volume amounted to EUR 13 billion last year, twice as high as in the previous year (FDI inflow in 2022 amounted to EUR 6.5 billion). In addition, the global FDI volume fell by 20 percent in 2022 and by 30 percent in the first half of 2023. Considering these global trends, Hungary performed very well. These

4 https://www.portfolio.hu/gazdasag/20230302/a-kormany-tobb-ezer-milliard-forintos-terve-egy-szereplon-bukhat-el-600368

5 https://www.economx.hu/magyar-gazdasag/befektetes-izrael-korea-nemetorszag.778993.html

foreign direct investments created 19 thousand new jobs and the government added 2 billion euros to this FDI volume in the form of state subsidies.

In terms of invested capital, China invested the most in Hungary last year, while most of the investments in terms of the number of companies came from domestic companies, which shows that Hungarian companies can successfully compete with foreign companies. The Hungarian Foreign Minister said that most of the investments were aimed at the production of electric car batteries and electric cars. It is obvious that the biggest investment was announced at the end of the year. The Chinese company BYD will build an electric vehicle production plant in Szeged. The company's plan is to sell around 10 percent of electric cars on the European market in seven years. For this investment, Hungary had to compete with Germany, France, Spain and Poland and emerged victorious from this competition.

As a result of these investments, Hungary plays a leading role in the European production of environmentally friendly electric vehicles and batteries. According to forecasts, Hungary will soon be number two in the global production of electric car batteries due to recent investments in this area.[6] An article in the Figyelő summarized the development of the sector thus: "The domestic battery production has been increasingly important not only in the context of global trade in recent years but also within Hungarian exports. While in 1995, battery trade accounted for only 0.16 percent of the total national export, by 2021, it had surpassed 3.04 percent. With the realization of future investments, it is presumed that the sector will further strengthen and could become one of the most crucial Hungarian export commodities in just a few years. The question remains: to what extent does this significant growth make the Hungarian economy vulnerable and to what degree does it create dependence, particularly in relation to the automotive industry, potentially making the domestic economy even more fragile?"[7] The question of dependency is relevant, but we should look at it from a different angle. The automotive industry has recently undergone a significant transformation, the most important element of which is the spread of electric cars. If Hungary is unable to attract investment in the field of batteries, which are technologically at the heart of the electric car,

6 https://www.vg.hu/vilaggazdasag-magyar-gazdasag/2024/01/rekordosszegu-beruhazas-erkezett-magyarorszagra-tavaly

7 https://figyelo.hu/hirek/akkumulator-gyarto-nagyhatalom-lesz-e-magyarorszag-182636/

Hungary will lose its competitiveness and may not be able to maintain existing investment in the automotive industry, let alone attract new investment. In other words, Hungary finds itself in what in chess is called a forced move.

**Domestic Investment**

Foreign direct investment is crucial for maintaining a sufficient level of investment in the Hungarian economy, especially in bad times, when investment by domestic companies declines or falls due to an external economic crisis. This is the case in Hungary, as domestic investments decreased last year (2023). According to the Hungarian Central Statistical Office, the investment volume fell by 12.1 percent in the third quarter of 2023 compared to the same period of the previous year (2022). Comparing the figures for the third quarter of 2022 with those of the previous quarter, the decline amounted to 2.2 percent. There were only two major economic sectors in which investment increased during this period: manufacturing and public administration.

During this period (from Q3 2022 to Q3 2023), investment declined in nineteen sectors of the Hungarian economy, including thirteen sectors. Manufacturing, which holds the largest share and accounts for almost a third of domestic investment, has seen a slowdown in growth in recent quarters, with a 6.3 percent increase in the current quarter. This slowdown is mainly due to single-digit growth in the production of electrical equipment, the sector with the largest share, which expanded more slowly than in previous periods due to the gradual implementation of major long-term projects.

At the same time, investment in the manufacture of transportation equipment, the second most important sector, grew rapidly. This growth is due to the dynamic developments in various domestic production and supply companies for transportation equipment. Some of these projects focused on capacity expansion and contributed significantly to this positive trend. From the above trends and data, it is clear why Hungary's foreign policy aims to attract more foreign direct investment and offset the effects of the unfavorable international environment. According to experts, the Hungarian economy already has the worst of the crisis behind it and economic growth will have a healthy structure in 2024.

**Forecasts from Hungarian experts**

The chief economist of Makronóm Intézet said that the most important challenge now is to restore consumer confidence. He pointed out that real wages have risen since September, but domestic demand is still weak, which is a problem for investment and consumption. This trend can be observed in both production ( in manufacturing, construction and retail) and consumption ( of services and investment). The agreement on the minimum wage for 2024 (15 percent increase) and the guaranteed minimum wage (10 percent increase) will result in a double-digit increase in wages. Raiffeisenbank's chief economist agreed with this point and said: "To kickstart the economy, it's crucial for consumer spending to pick up, which we haven't witnessed yet. A breakthrough is needed here."[8]

The chief economist of K&H Bank emphasized the importance of the healthy growth structure that will most likely shape the year 2024. He said that investment and consumption will contribute significantly to GDP growth in 2024, while the actual contribution of net exports will be slightly lower than in 2023. We should add that despite this relative change, 2024 will be a year in which we can observe the positive impact of new foreign direct investment on Hungary's foreign trade figures. Due to the ongoing investment, the expansion of Hungary's export won't be slowed down by unfavorable conditions in Western European markets, especially in Germany. In 2024, the SK innovation plant in Iváncsa will start production, BMW's Debrecen plan promises to start test runs in September 2024. However, the biggest increase in GDP and exports is expected in 2025, when the latest foreign direct investments will already be in operation.

**Government and monetary steps to boost investments**

There are two classic policy instruments to stimulate investment: monetary policy measures (lowering interest rates and increasing liquidity) and fiscal policy measures (government and/or subsidized investment programs). Under the current circumstances, it is difficult to launch government investment programs due to the relatively high public deficits, but the government is stepping up its efforts to provide further impetus for new investments.

8 https://www.vg.hu/vilaggazdasag-magyar-gazdasag/2024/01/elemzok-2024-rol-vege-a-nehez-idoszaknak-itt-az-ideje-hogy-beinduljon-a-lakossag-fogyasztasa

The Hungarian government has extended the so-called Baross Gabor Industrial Renewal Credit Program until 1 July 2024 and is making an additional 200 billion forints available. This brings the government's total commitment to the economy to 1.2 trillion forints, with a focus on sectors such as food, construction, telecommunications, pharmaceuticals, tourism, automotive, logistics and green industries. The allocated 200 billion forints will be used for production, service-related investments, foreign ventures of Hungarian companies and the financing of logistics and production equipment. Interest rates for domestic companies will be even more favorable under this extension – 5 percent for forint-based loans and 3 percent for euro-based loans. The program, which was launched in February 2023, aimed to secure jobs and promote an investment-oriented economy. It offered advantageous fixed interest rates of up to 6 percent for forint-based loans and 3.5 percent for euro-based loans until 2023. Its popularity led the government to increase the loan from the original 700 billion forints to 1 trillion forints. At present, completed transactions amount to over 950 billion forints and disbursements to 700 billion forints.[9]

Monetary policy moves are not easy to predict due to external conditions. Whether the Hungarian central bank can cut interest rates, it significantly depends very much on the Fed's decisions. It seems obvious that the Hungarian central bank wants to maintain a policy of positive real interest rates. It is also obvious that the central bank will lower interest rates in the next 13 months, but it is not certain how aggressively the central bank is prepared to pump money into the economy.

**Summary**

It the beginning of 2024, the Hungarian economy faces challenges including geopolitical uncertainties, high interest rates, inflation and weaker global demand. In 2022, rising energy prices due to the war in Ukraine caused a foreign trade deficit and worsened the terms of trade in Hungary. In 2023, however, the situation stabilized despite continued high global and European energy prices, indicating an adjustment to a new energy price norm. The adjustment included lower domestic demand and increased exports, supported by the success of Hungary's

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9 https://kormany.hu/hirek/2024-ben-is-folytatodhat-minden-idok-egyik-legsikeresebb-kormanyzati-hitelprogramja-a-baross-gabor-ujraiparositasi-hitelprogram

"Eastern Opening Policy" and the growth of battery production. As the crisis subsides, domestic demand is expected to increase, which will have a positive impact on the foreign trade balance.

The latest foreign trade data from October 2023 shows a trade surplus of 1 billion euros, which means an end to months of deficits. Exports were 3 percent higher than in October 2022, while imports fell by 2.5%. The regional analysis showed a 0.1 percent improvement in exports to the EU 27 and a 5.6 percent decrease in imports, resulting in a surplus of 1.6 billion euros. Despite a reduction in the deficit of 1.3 billion euros in trade with the rest of the world from October 2022 to October 2023, a deficit remained. In November 2023, exports fell by 3.8 percent, but the trade balance improved significantly as imports fell by 25 percent. The positive trend continued in November and contributed to a growing trade surplus. The forint reacted positively to the normalization of energy prices and strengthened, so that 1 euro cost only 380 forints on 4 January 2024.

Foreign direct investment played a crucial role in reshaping trade dynamics, as Hungary attracted a record volume of foreign direct investment of EUR 13 billion in 2023, double the previous year's level. Despite a 20 percent decline in FDI volumes globally in 2022 and a 30 percent decline in the first half of 2023, Hungary's performance stood out. The influx of investments, especially from China, targeting the production of electric vehicle batteries and electric vehicles, positions Hungary as a major player in the European electric vehicle and electric vehicle battery production sector, potentially becoming the second largest in the world.

Domestic investment fell by 12.1 percent in the third quarter of 2023 compared to the same period in 2022. Only manufacturing and public administration recorded growth, while nineteen other sectors suffered a decline. The importance of attracting foreign direct investment became clear as Hungary's foreign policy aimed to offset the impact of unfavorable international conditions. Experts expect a healthier economic structure in 2024, now that the country has survived the worst of the crisis. Restoring consumer confidence remains a challenge despite the real wage increases since September. Weak domestic demand is affecting both production and services. The forecasts of Hungarian experts point to a positive economic outlook for 2024 and emphasize the crucial role of consumer spending in the economic recovery.

To stimulate investment, the Hungarian government has taken monetary and fiscal policy measures. The Baross Gabor Industrial Renewal Credit Program, which was extended until 1 July 2024, received an additional HUF 200 billion injection of funds. Favorable interest rates for domestic companies, including 5 percent for forint-based loans and 3 percent for euro-based loans, are intended to stimulate investment. Predicting future monetary policy moves remains difficult as the Hungarian central bank aims to maintain positive real interest rates.