

Macroeconomic and financial environment in 2023

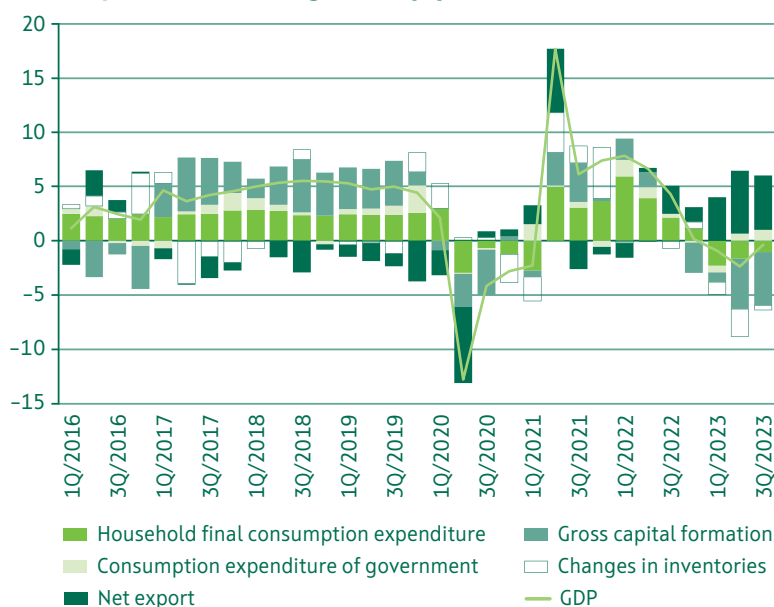
Having elevated after the rapid recovery that followed the Covid crisis and the outbreak of the Russian-Ukrainian war, inflation in advanced economies started to slow in 2023, but the developed world's central banks had to raise interest rates aggressively until the end of the year. It was not before the year was nearing its end that the tightening cycle stopped and the debate on the possible timing of an interest rate cut began. Meanwhile, the labour market remained tight, with low unemployment and strong wage dynamics. Developed markets' long-term yields hit multi-decade highs in the autumn, before a sharp fall began at the end of 2023.

Economic growth printed different patterns on the two sides of the Atlantic. The USA's economic expansion accelerated in 2023, as opposed to the expected slowing, and growth shifted into higher gear in the second half of the year. The robust figures were driven by supportive fiscal policy, the large stocks of savings household had accumulated during the pandemic, and the low effective lending

rates caused by the high share of loans with fixed interest rates. Headline inflation peaked in June 2022 (+8.9%), but the subsequent decline briefly stalled in the middle of 2023. However, core inflation continued to drop, easing to 3.9% y-o-y by the end of the year. The very loose fiscal policy, which raised the budget deficit from around 5% to 8% of GDP, required tight monetary policy to bring inflation down. The Fed has aggressively raised its base rate to 5.25-5.5% and began to reduce its balance sheet.

The energy crisis brought the euro area to its knees, and the economy has been unable to recover amid high inflation and high interest rates, thus output has been practically stagnant since the third quarter of 2022. Countries with industries that used to rely heavily on Russian energy (e.g. Germany) were hit particularly hard. Elevated interest rates have led to a slowdown in lending, which has also hindered kick-starting growth in Europe. Disinflation was strong in the euro area in 2023: headline and core inflation fell

Decomposition of GDP growth (%)



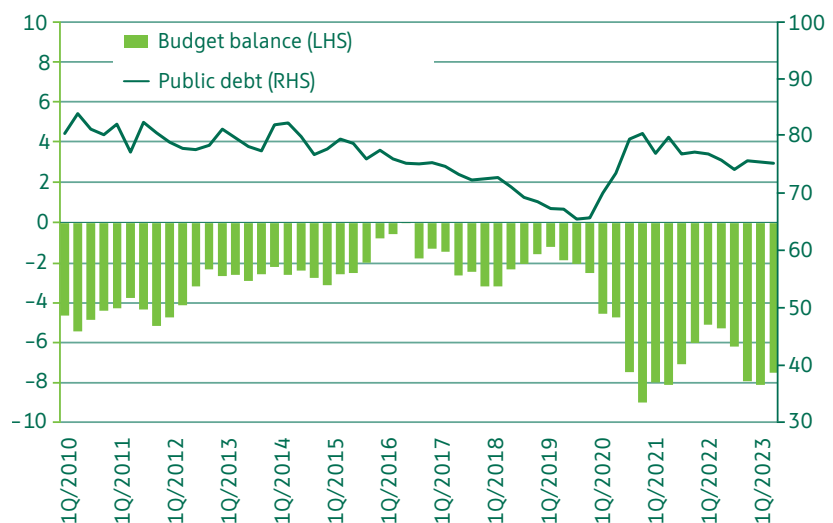
Sources: KSH, OTP Research

to 2.8% and 3.3%, respectively by the end of the year. The biggest concern in this context is services inflation, which has been stagnating at 4.0% y-o-y since November 2023. Despite all the weakness in the economy and strong disinflation, the ECB has not yet considered cutting interest rates, thus the euro area ended last year with a deposit rate of 4% and a lending rate of 4.5%.

Hungary's economy fell into a longer and deeper recession than the rest of the CEE region in 2023 (GDP y-o-y: 1Q: -0.9%; 2Q: -2.4%; 3Q: -0.4%; 4Q [flash]: 0,0). However, the recession ended

in the third quarter, and growth started to pick up on quarterly basis, helped by the base effect of an unprecedented poor agriculture season in 2022. Overall, regarding the Hungarian economy's underlying processes, activity fell sharply in 4Q 2022 and in 1Q 2023, and it has been stagnating or trivially rising since then. The structure of growth is unfavourable, as the sharp fall in domestic use was moderated by an increase in net exports, but it was caused by the decline in imports owing to the sluggish domestic demand, rather than by exports' strong expansion.

Budget balance and public debt (as % of GDP)



Sources: KSH, OTP Research

Inflation peaked at 25.7%, ten percentage points higher than the average of the CEE region, before disinflation started in the spring.

As disinflation accelerated starting from mid-2023, the pace of price increases accelerated, bringing down CPI to 5.5% y-o-y by December; the annual average rate of inflation was 17.6% in 2023. From the middle of the year, real wages started to rise again month-on-month, but this passed on to consumer spending only modestly. After running 8% current account deficit in 2022, Hungary's external balance turned into surplus last year, as gas prices collapsed and imports fell due to a drop in domestic demand. The rapid rise in debt ratios between 2020 and 2023 has stopped.

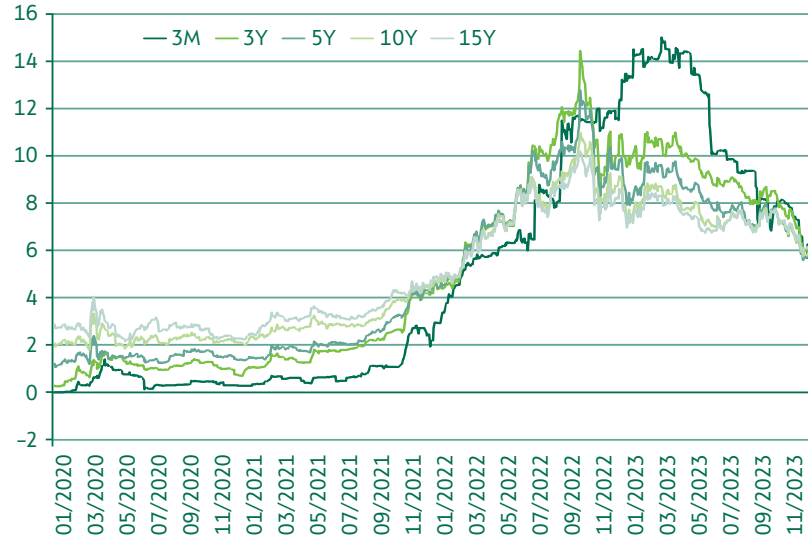
The original budget deficit target of 3.9% of GDP proved to be unsustainable, so it was raised to 5.2% in October, but the accrual-based deficit probably exceeded 6% of GDP last year, even with the dividend payment by MVM and with the savings of the 'utility protection fund'.

Having raised the effective rate to 18% in autumn 2022, the MNB cut it in several steps by a total of 725 bps, to 10.75% by the end of the year. The base rate regained its role in September, when the former overnight deposit facility was phased out. The EUR/HUF fell from around 400 at the beginning of the year to below 370 at one point in the summer, but stabilized around 380 by the end of 2023.

Hungary made headway in accessing EU funds at the end of last year as the European Commission approved the so-called horizontal enabling conditions for the judicial reform

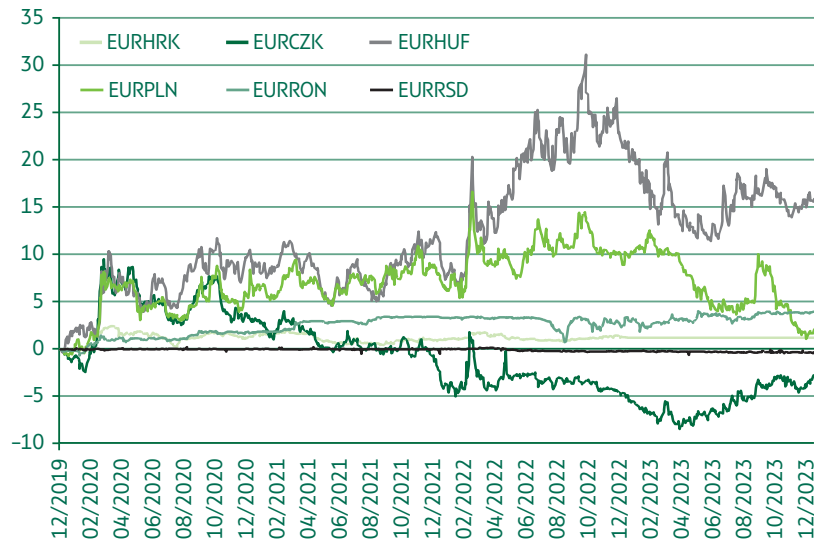
in December. The government unblocked about EUR 11 billion worth of EU funds, thanks to the measures implemented last year.

Hungarian yield curve (%)



Sources: MNB, ÁKK, OTP Research

CEE currencies' exchange rates (31.12.2019=0)



Sources: Refinitiv, OTP Research

Starting from autumn 2022, the credit market froze in the CEE region, including Hungary, and similarly to Western Europe. There was a slight pick up at the end of 2023, particularly in retail lending, within that in 'baby loans' and housing loans; demand for cash loans

also jumped at the end of the year. In full year 2023, the volume of housing loans rose by 1.3% (2022: 7.6%), that of cash loans grew by 6.9% (2022: 9.3%), and corporate loan volumes increased by an FX-adjusted 6% (2022: 15.5%).

