HUNGARY

Highlights

• The coronavirus crisis has pushed the economy into recession. Hungary had already entered a cyclical slowdown in 2019, although GDP growth had been impressive relative to its regional peers. A stringent lockdown introduced in March 2020, including shutdown of businesses and schools, halted much economic activity and resulted in the first recession in the country since 2012.

• A comprehensive set of crisis response measures was introduced. The expected total value of all government measures for tackling the economic effect of the pandemic is between 18 and 20 per cent of GDP.

• The banking sector has softened loan repayment conditions. Domestic banks were instructed by the central bank to ease loan repayment conditions for all borrowers (individuals and businesses). Interest and amortisation payments on loans were suspended until the end of 2020, short-term loans were extended and interest rates on consumer loans were capped at five percentage points above the base rate.

Key priorities for 2021

• Fiscal measures to restart growth should target innovation and upskilling of the labour force. The current scarcity of skilled labour suggests that boosting education and employment opportunities would go a long way to addressing private sector needs.

• A funding ecosystem to manage the rising wave of corporate succession should be further developed. In September 2019, the Hungarian Development Bank set up the first fund to provide financing for corporate succession. Currently, about 75 per cent of Hungarian private companies are first-generation businesses, versus 33 per cent globally.

• Further financing is needed to develop the green economy and promote environmental sustainability. The demand-side interest for green products has soared for both the first government green bond and those provided by corporates.

Main macroeconomic indicators %

<table>
<thead>
<tr>
<th></th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020 proj</th>
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</thead>
<tbody>
<tr>
<td>GDP growth</td>
<td>2.1</td>
<td>4.3</td>
<td>5.4</td>
<td>4.6</td>
<td>-5.0</td>
</tr>
<tr>
<td>Inflation (average)</td>
<td>0.4</td>
<td>2.4</td>
<td>2.9</td>
<td>3.4</td>
<td>3.7</td>
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<tr>
<td>Government balance/GDP</td>
<td>-1.8</td>
<td>-2.5</td>
<td>-2.1</td>
<td>-2.0</td>
<td>-8.3</td>
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<tr>
<td>Current account balance/GDP</td>
<td>4.5</td>
<td>2.0</td>
<td>0.3</td>
<td>-0.2</td>
<td>-1.6</td>
</tr>
<tr>
<td>Net FDI/GDP [neg. sign = inflows]</td>
<td>-2.2</td>
<td>-1.6</td>
<td>-2.0</td>
<td>0.1</td>
<td>0.0</td>
</tr>
<tr>
<td>External debt/GDP</td>
<td>95.4</td>
<td>83.5</td>
<td>80.1</td>
<td>73.6</td>
<td>n.a.</td>
</tr>
<tr>
<td>Gross reserves/GDP</td>
<td>20.1</td>
<td>19.5</td>
<td>19.6</td>
<td>19.5</td>
<td>n.a.</td>
</tr>
<tr>
<td>Credit to private sector/GDP</td>
<td>69.4</td>
<td>64.3</td>
<td>62.3</td>
<td>59.4</td>
<td>n.a.</td>
</tr>
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</table>
Covid-19: macroeconomic implications

**Pandemic-related containment measures have led to a recession.** Hungary had registered the strongest GDP growth in the central Europe and Baltic states (CEB) region, at 4.9 per cent, in 2019, largely induced by a solid double-digit investment growth and strong household consumption. Nevertheless, the lockdown, introduced by the government in March 2020 to prevent uncontrolled transmission of Covid-19, brought much economic activity to a halt. In the first half of 2020, the economy shrank by 6.1 per cent, weighed by a massive slide in net exports (the drop in exports was higher than that of imports), investment and tourism revenues. The unemployment rate increased to 4.9 per cent in June 2020, after registering an historic low of 3.4 per cent in January 2020. Tourism and exports represent 13 and 98 per cent of GDP, respectively. The automotive industry (28 per cent of manufacturing output) is at the core of the country’s high global value chain integration. The temporary closures of all four car plants weighed significantly on short-term GDP growth and employment. (For illustration, a one-month closure of the car plants is estimated to cost 0.4 per cent of annual GDP.) Some car plants restarted production at the end of April, and the majority of lockdown restrictions were gradually lifted from May. Moreover, some automotive suppliers started complaining again about labour shortages in September 2020.

**Investment has dropped from high rates, but large projects remain in the pipeline.** In 2019, investment to GDP amounted to 28.6 per cent, above regional peers, but it then dropped by 9.2 per cent in the first half of 2020 as a result of the pandemic and associated lockdowns and disruptions. The fall in investment, especially in the second quarter of 2020, was severe, despite the lending support by government and the central bank. However, the pipeline of large investment projects remains promising. Scheduled (but delayed) projects include South Korean investments in the electric car industry, the construction of a BMW car plant in eastern Hungary, a Lidl logistics base near Budapest, and the Budapest-Belgrade railroad upgrade, completion of which is scheduled in 2025.

**The fiscal deficit is rising because of the weaker economy and generous economic stimuli measures.** The expected total value of all government measures (see below) for tackling the economic effects of Covid-19 is between 18 and 20 per cent of GDP. According to the International Monetary Fund’s October 2020 estimates, the general government deficit is expected to rise to 8.3 per cent of GDP in 2020, before falling again in 2021 as the economy rebounds. Similarly, public debt is expected to jump to 77.4 per cent of GDP in 2020 but projected to return to a downward trend as of next year.

**Positive GDP growth is likely to return in 2021.** Given Hungary’s exposure to trade and global value chains, the magnitude of the expected recovery will largely depend on external developments in the EU (European Union) and outside the EU. GDP is forecast to fall by 5.0 per cent in 2020 and then recover to 4.0 per cent growth in 2021. The forecasts are subject to major uncertainty, and depend to a large extent on whether targeted shutdowns of economic activities are needed because of a possible resurgence of Covid-19 cases.

**Policy response to Covid-19**

**The Covid-19 pandemic-related restrictions were rapidly followed by protective measures.** The government and the National Bank of Hungary launched various relief measures to preserve employment, support companies in a state of hibernation and support household incomes to soften the already historically deep recession in 2020. Under measures announced by the government in April 2020, businesses that suffered more than a 40 per cent drop in revenues were able to delay payroll deductions for their staff and advance corporate income tax (CIT) payments. Employers and the compulsorily insured self-employed, who saw their turnover or income fall by 40 per cent or more, were able to delay the owed social security contributions, unemployment and health insurance payments until the end of July. In May 2020, the government launched another wage subsidy programme to enhance new employment. If a newly employed person remains on the job for a period of nine months, the monthly salary is subsidised by HUF 200,000 (€570).
Further changes to the economic protection package were adopted by parliament in June 2020. These included a cut in social contributions by 2 percentage points to 15.5 per cent and a reduction in small business taxes. At the same time, the exemption from CIT for reinvested profits was expanded from 50 to 100 per cent for a period of four years and capped at HUF 10 billion (€28.5 million). Financing of the economic protection package comes partly from new and relatively small retail and banking taxes. In addition, in June 2020 the government created an economic protection operating committee, consisting of up to 10 state institutions such as the tax administration or the consumer protection office, to work on a further reduction of administrative burden on companies.

Domestic banks softened loan repayment conditions for all borrowers. In March 2020, the National Bank of Hungary (NBH) introduced a moratorium on corporate and retail loan repayments under its Funding for Growth Scheme + until the end of 2020 and instructed other banks to do the same for other borrowers. As a result, the interest and amortisation payments on loans were suspended until the end of 2020, short-term loans were extended and interest rates on retail loans capped at 5 percentage points above the base rate. According to the NBH’s estimates, a full use of the moratorium will mean a deferral of HUF 3,600 billion (€10.2 billion) of loan payments by the end of 2020. However, the actual impact of the moratorium is likely to be lower as between 30 and 50 per cent of those loans have remained serviced so far. In April 2020, the NBH launched a new cheap lending scheme called Funding for Growth Scheme Go! to support small and medium-sized enterprises from the impact of the coronavirus pandemic. The scheme is available through the banking system with a fixed interest rate capped at 2.5 per cent. In May 2020, the NBH launched quantitative easing, targeting mainly government bonds with at least three years to maturity. In July 2020, the NBH eliminated capital requirements for eight systemically important banks, to be gradually rebuilt over a three-year period starting from 2022.

Some of the 2014-20 EU funds were re-allocated to economic protection. In May 2020, the government re-allocated HUF 420 billion (€1.2 billion) of unused EU funds to economic support measures related to the pandemic. About 75 per cent of the funds will be spent in the form of grants, while the remaining resources will be used for interest-free loans under the economic development programme. The larger part of the funds will finance the government’s wage subsidy scheme. The upcoming 2021-27 EU funds will consist of two pillars, the regular multiannual financial framework (MFF) and an extraordinary Covid-19 recovery fund. Hungary is expected to receive a total of about €41 billion from both pots, and the rule of law conditionality is expected to be in place.

Assessment of transition qualities (1-10)
**Structural reform developments**

**Magyar Bankholding was created.** In June 2020, three domestic banks – MKB, Takarekbank and Budapest Bank – set up Magyar Bankholding. The new structure is expected to be a vehicle for the potential merger of the three institutions, and potentially a privatisation of Budapest Bank. Nevertheless, according to the government, the state, which is the sole owner of Budapest Bank, is likely to keep a minority stake in the new bank. MKB and Takarekbank are privately owned and controlled by domestic entrepreneurs. Should a potential merger materialise, the new bank would be the second largest in terms of assets (HUF 5,800 billion or €16.5 billion) and would have the largest branch network, accounting for almost half of the total network in Hungary.

**Disagreement over the rule of law has remained unresolved.** The European Parliament (EP) and the Hungarian government have continued to engage in the rule-of-law dialogue in the framework of the Article 7(1) procedure of the Treaty on European Union triggered by the EP on 12 September 2018. Changes adopted with the Act CXXVII on 17 December 2019 have allowed the introduction of structural changes that may have a significant impact on the organisation of the justice system. This has caused concern from the Council of Europe Commissioner for Human Rights and a number of other international bodies over their possible impact on judicial independence. The European Commission took action against Hungary on 8 November 2019 at the European Court of Justice (ECJ) on the asylum legislation adopted in 2018. On 18 June 2020, the ECJ concluded that Hungarian law on foreign-funded non-governmental organisations violates EU law on the free movement of capital and fundamental rights.