HUNGARY

Highlights

- **Gross domestic product (GDP) is recovering steadily.** Following a decline in GDP of 4.7 per cent in 2020, the export-oriented sectors and a gradual easing of epidemiological measures have propelled a vibrant economic recovery in 2021.
- **The European Union (EU)'s Recovery and Resilience Facility (RRF) plan envisions investment to strengthen competitiveness and promote green transition.** The national plan is worth €7.2 billion in grants. Investment in its five strategic areas (green transition, healthcare, research, digital, and cohesion and public administration) will be important in supporting the country's economic recovery. The European Commission has still not approved Hungary's RRF plan, so the government is pre-financing its RRF programmes.
- **The issuance of forint-denominated green government bonds has been welcomed by the market.** The first issue of a 30-year forint-denominated green bond met strong investor demand.

Key priorities for 2022

- **Fiscal policy needs to remain supportive and targeted.** Government support for the labour market and certain sectors should continue, to assist the recovery until all Covid-19 restrictions are lifted. Measures should then be oriented towards strengthening the innovation capacity of small and medium-sized enterprises (SMEs) and employability through upskilling.
- **For EU funds to be properly absorbed and the RRF to be implemented successfully, there needs to be enhanced reform capacity and political will, including with regard to the rule of law.** Hungary has been allocated €38 billion of cohesion, regional development and other EU funds, while the RRF national plan envisages €7.2 billion in grants – all EU funds to be used up until 2027.
- **Policies that address skills shortages and improve inclusivity would strengthen and make better use of labour supply.** Policies that embrace diversity and inclusion practices, including for the LGBT+ community, and better migrant job matching could attract and retain talent, such as in the tech and creative industries.

Main macroeconomic indicators %

	2017	2018	2019	2020	2021 proj.
GDP growth	4.3	5.4	4.6	-4.7	7.7
Inflation (average)	2.4	2.9	3.4	3.4	5.0
Government balance/GDP	-2.5	-2.1	-2.1	-8.0	-6.6
Current account balance/GDP	2.0	0.2	-0.7	-1.6	0.6
Net FDI/GDP [neg. sign = inflows]	-1.6	-1.9	-0.5	-1.6	-0.8
External debt/GDP	83.3	79.8	73.6	83.6	n.a.
Gross reserves/GDP	19.5	19.6	19.5	25.6	n.a.
Credit to private sector/GDP	64.4	62.6	60.2	65.2	n.a.

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Covid-19: macroeconomic implications

A substantial recovery in exports has boosted GDP growth. Being an open and export-oriented economy, the Covid-19 pandemic hit the Hungarian economy hard, with a drop in GDP of 4.7 per cent in 2020. The recovery of industry and exports, especially in the automotive sector, in the first half of 2021 led to GDP growth of 7.6 per cent year-on-year, bringing the level of GDP above pre-crisis levels. The industrial sector began to recover at the end of 2020 and its production is also above pre-pandemic levels, with the highest growth rate in the manufacturing sector. However, the Hungarian automotive sector, which generates almost 15 per cent of Hungary's GDP (including suppliers), has been facing a global semiconductor shortage, which has hampered production. Despite that, economic confidence indicators have been recovering solidly since February 2021 and a large investment by Mercedes-Benz and BMW in electric-vehicle production continues.

Unemployment remains below the regional average, while wage pressure is building. With restrictive measures still partially in place, especially in the services sector, the unemployment rate did not change significantly during the Covid-19 pandemic, reaching 4.1 per cent in the second quarter of 2021, below the average for central Europe and the Baltic states (CEB). As the economy recovers, real wage growth is set to increase further, from 6.2 per cent in 2020, underpinned by a lack of skilled workers. Due to further pressure on wages, higher energy prices and demand recovery, inflation could exceed 5 per cent in 2021.

The fiscal deficit rose sharply. On account of the government's fiscal stimulus during the Covid-19 pandemic, the general government deficit totalled 8.0 per cent of GDP in 2020, exceeding that of all other CEB economies. Public debt increased to a relatively high 80.1 per cent of GDP. These ratios are likely to remain elevated in the short term.

Strong growth will continue, but higher energy prices and global shortages of components and chips are risk factors. GDP growth is expected to remain strong throughout 2021, at 7.7 per cent, before slowing to 4.8 in 2022. The post-crisis recovery is likely to be boosted by investment, co-financed by EU funds. While Hungary is still waiting for the European Commission to approve the RRF, the government has sold the equivalent of €4.5 billion in Eurobonds to pre-finance RRF projects. As higher energy prices and global shortages hamstring the manufacturing sector, however, especially automotive companies, this is likely to weigh on Hungary's exports in the short term.

Policy response to Covid-19

The policy response in 2020 alleviated some of the Covid-19 pandemic's negative effects. The government's overall response to the crisis was wide ranging. Through the newly established anti-epidemic fund, the increased needs of the health sector were addressed, while the Economic Protection Fund provided support for the labour market, businesses and households. The overall size of the fiscal response was around 12 per cent of GDP.

The 2021 budget assumes continued support for the economy. The budget envisions continued support for employment and subsidies for wages in vulnerable sectors. In December 2020, part of the central budget, amounting to 2 per cent of GDP, was transferred to public-sector institutions and the remaining funds can be used throughout 2021. A general reduction in social-security contributions has been ongoing and, as a part of the new family care plan, families with children can benefit from duty exemptions when purchasing residential properties, as well as from a one-off income tax rebate for 2021.

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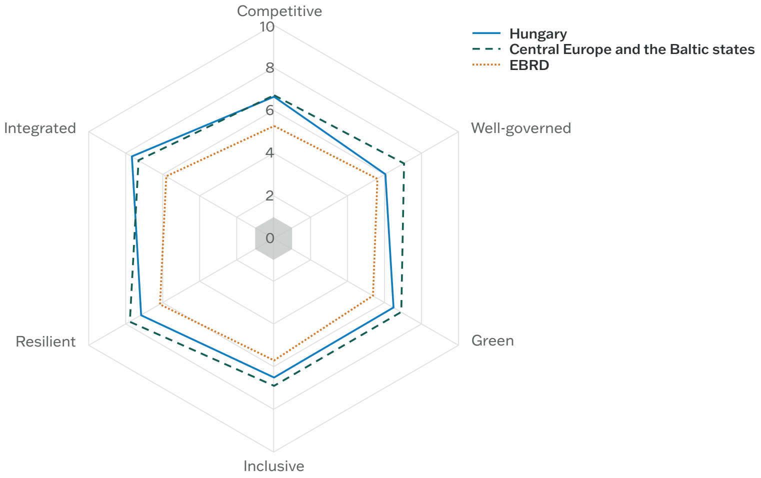
Assessment of transition qualities (1-10)



Structural reform developments

The government's plan for the use of RRF funds will support further economic transformation. The national plan, worth €7.2 billion in grants, is based on five pillars: green transition, healthcare, research, digitalisation, and cohesion and public administration. The government decided not to use loan financing under the RRF, but to limit it to grants. To address the country-specific recommendations of the European Commission, the national plan foresees a digital upgrade to the prosecution service, fewer informal payments in the health sector and an improved legal framework for public procurement.

The government has introduced new measures to support investment. To facilitate larger investments, the government is adding more regions where investments of more than €5 million will receive state support. With regard to research and development, investments worth more than €1 million (up from €3 million previously) will be considered for additional support. From 2021, medium-sized enterprises with an investment value of at least HUF 300 million (equivalent to around €0.8 million) will be eligible for development tax incentives. Lastly, foreign-owned companies can now employ up to 20 per cent non-residents, rather than 10 per cent.

The central bank embarked on a monetary tightening cycle to control inflation. Rising inflation, brought about by the economic recovery and global market disruption, prompted the National Bank of Hungary (NBH) to raise the central bank base rate already five times since mid-2021, from 0.6 per cent to 1.8 per cent in October 2021. The monetary tightening cycle is likely to continue until the inflation rate stabilises within the NBH's target range of 2 per cent to 4 per cent.

The authorities started to issue forint-denominated green bonds. The first issue of a 30-year forint-denominated green bond took place in April 2021. Registering high demand and with an average yield of 3.69 per cent – a percentage point above its usual 10-year bonds – primary dealers' bids reached HUF 30 billion (€86.1 million equivalent). The second issue was in July 2021 and Hungary will continue to issue quarterly to fund green transition projects, such as a more energy-efficient railway. In addition, the central bank announced the launch of a green mortgage bond-buying programme and green loans from October 2021.

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The state is bidding for majority ownership of the airport in Budapest. Sixteen years after privatisation, the government submitted a bid in July 2021 to retake majority ownership of the airport. Currently, the biggest shareholder in Budapest Airport, with a 55 per cent stake, is AviAlliance. The offer was self-initiated and the government claims it is in the country's strategic interest.

The government is advocating regional cooperation projects within the Visegrad Group (V4). From the beginning of July 2021, Hungary chairs the V4. As a goal of its presidency, the country is emphasising regional cooperation in the field of financial regulation, with a focus on fintech and digitalisation. Regional integration will be further promoted through working group meetings on V4 high-speed rail links and negotiations to finance the project with EU funding.