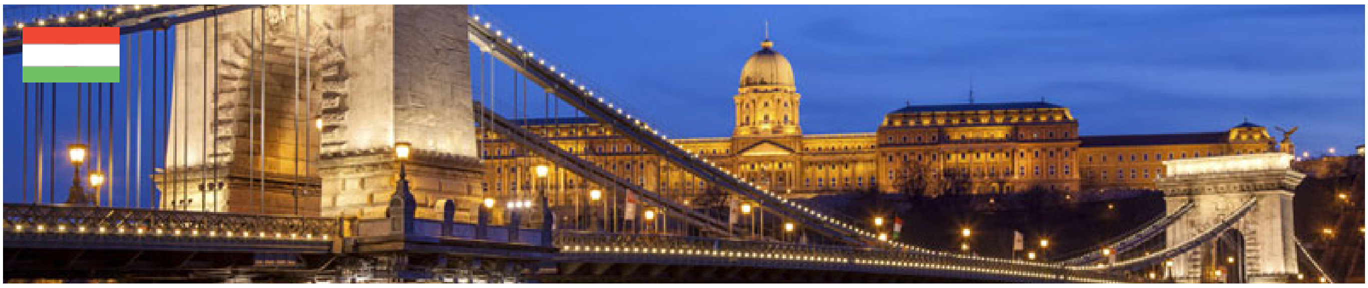

Hungary

Highlights

- **Economic growth has been strong but it is starting to slow.** Gross domestic product (GDP) continued to rise rapidly during the first half of 2022, but high commodity and energy bills, weakening external demand and higher interest rates are dragging growth down in the second half of 2022.
- **The government has launched a seven-point plan to address the energy crisis.** The plan comprises placing an export ban on energy sources, increasing domestic gas and coal production, re-starting the coal-fuelled Matra power plant, extending the working hours of the Paks nuclear power plant, purchasing additional gas for storage, and increasing regulated utility prices to better reflect market conditions.
- **The state is planning to boost its stake in "strategically important sectors".** According to an announcement in August 2022, the government is planning to participate in the buyout of telecoms company Vodafone Hungary by the end of 2022.

Key priorities for 2023

- **The European Union (EU)'s rule of law concerns need to be addressed to unlock EU funds.** Even though the conditionality mechanism procedure, a tool that suspends EU funds to EU member states that breach the rule of law, is separate from the approval of the country's Recovery and Resilience Facility (RRF) plan, a solution to rule of law concerns will be important for unfreezing EU recovery funds.
- **Greater investments in the green economy are needed.** Concrete progress in areas such as energy efficiency in buildings and developing capacity in renewable energy production would enhance energy security and the economy's resilience.
- **More investment in sustainable water management and waste management is needed.** The intensifying droughts have already prompted substantial losses in the agriculture sector, which in 2022 had an almost 40 per cent lower yield than in the previous year.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	5.4	4.9	-4.5	7.1	5.0
Inflation (average)	2.9	3.4	3.4	5.2	14.0
Government balance/GDP	-2.1	-2.0	-7.5	-7.1	-4.9
Current account balance/GDP	0.2	-0.8	-1.1	-4.2	-6.7
Net FDI/GDP [neg. sign = inflows]	-1.9	-0.8	-1.7	-1.8	-1.1
External debt/GDP	79.8	74.2	84.1	87.1	n.a.
Gross reserves/GDP	19.6	19.4	26.3	23.9	n.a.
Credit to private sector/GDP	31.2	31.9	34.9	34.7	n.a.

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Macroeconomic developments and policy response

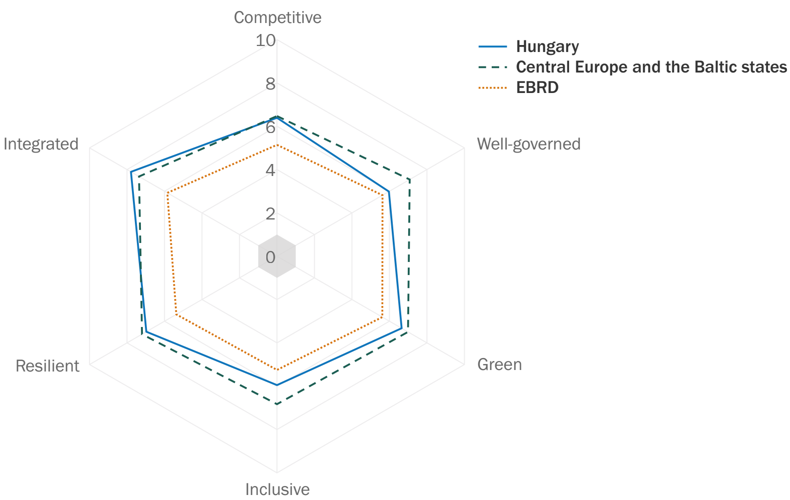
Economic growth has been strong post-pandemic but it is slowing. Following GDP growth of 7.1 per cent in 2021, the Hungarian economy continued to grow rapidly during the first half of 2022, at 7.3 per cent year on year. The weakening forint supported exports, while the tourism sector rebounded somewhat from the low base registered during the Covid-19 pandemic. Overall, domestic demand continued to be strong, fuelled by high corporate investment, especially in the automotive sector. The agriculture sector performed much worse, however, adversely affected by a severe drought which resulted in wheat output falling by 25 per cent relative to the average of the previous five years. The unemployment rate fell to 3.1 per cent in June 2022, one of the lowest levels in the EU, but employment growth in both the private and public sectors has slowed during 2022, and the government has planned redundancies in the public sector, with estimated savings of HUF 30 billion (€73.5 million) in 2023.

Inflation has risen sharply, prompting a monetary and fiscal response. Forint depreciation, elevated commodity and energy prices, increasing wages and strong domestic demand have all fuelled high inflation rates during 2022, with the rate reaching 20.1 per cent in September 2022. In response, the National Bank of Hungary (NBH) has been gradually raising its policy rate since June 2021, to 13.0 per cent in September 2022. Meanwhile, the government has extended to the end of 2023 the price caps on fuel (at HUF 480/€1.2 per litre) and food, which were initially introduced in November 2021 and February 2022, respectively. Small fuel stations are receiving financial support as they experience difficulties in operating under regulated fuel prices. At the same time the cap on mortgage interest rates, introduced in January 2021, was extended until the end of June 2023. In July 2022 however, the European Commission launched an infringement procedure against Hungary for the fuel price cap which only applies to domestic vehicles.

Substantial fiscal consolidation is expected to be carried out mainly by expenditure cuts. The government intends to consolidate the public finances by 3.0 per cent of GDP in 2022 in order to reduce the general government deficit from 6.8 per cent in 2021 to 6.1 per cent of GDP in 2022, as stated in the latest Excessive Deficit Procedure report. Larger savings are expected on the expenditures side, amounting to 1.7 per cent of GDP, mostly through cuts in ministries' budgets and postponed investments. The revenue-side measures, worth 1.3 per cent of GDP, include new windfall taxes, such as for the oil and gas group MOL, as well as increases in company car and public health taxes. Public debt is expected to gradually fall from about 76.8 per cent of GDP in 2021 to 73.8 per cent of GDP in 2023, according to the government's 2023 draft budget.

Slower growth is expected in the short term. We anticipate GDP growth in 2022 to remain high, at 5.0 per cent, before it drops to 1.5 per cent in 2023. High commodity and energy bills, weakening external demand and high interest rates are all contributing to a notable slowdown in economic growth during the latter part of 2022 and this is expected to continue into 2023. Private-sector investments, especially those by automotive manufacturers, will add to GDP growth and employment in the coming years, but the deteriorating global outlook, including potential new energy supply disruptions, will weigh on confidence and economic activities.

CHART Assessment of transition qualities (1-10)



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Structural reform developments

The first road shipment of liquefied natural gas (LNG) has reached Hungary. In August 2022 the first LNG rail tanker delivered LNG to Hungary, directly from a vessel at the LNG terminal in Krk, Croatia, which started operations in January 2021. This new way of transporting natural gas complements the traditional method of pipes, and will be used for industrial purposes. At the same time, Gazprom increased its gas deliveries to Hungary via the Balkan Stream pipeline, as the government requested to buy an additional 700 million cubic metres of gas to cover the anticipated shortages during the upcoming winter. A long break in gas supply could result in output losses in more than 40 per cent of companies, and a complete shutdown in a third of them, according to a survey by the German-Hungarian Chamber of Industry and Commerce.

The government has launched a seven-point plan to address the energy emergency. The plan, which came into force in August 2022, envisages an export ban on energy sources and firewood, with the exception of gas stored in Hungary by foreign entities. The plan also envisages upping domestic gas production from 1.5 to 2 billion cubic metres a year, including through more expensive technologies, as well as substantially increasing coal mining, re-starting the coal-fuelled Matra power plant, extending the working hours of the Paks nuclear power plant, purchasing additional gas for storage and increasing regulated utility prices to better reflect market conditions. Eligible amounts of gas with reduced prices should be available only up to the level of the average household consumption, with an expected 75 per cent of households remaining under regulated prices. In addition, nearly 100,000 small and medium-sized enterprises remain under the scheme.

The government is supporting the agriculture sector in the face of drought. The agriculture sector is expected to experience a 25 per cent loss in wheat crops and see damage to corn crops in 2022 because of severe drought. In response, the government in September 2022 placed a moratorium on loan repayments for working capital and investment loans for agricultural companies, which will last until the end of 2023. Farmers will also be awarded subsidies to purchase animal feed and offset higher energy costs for irrigation. The support package also covers extraordinary water usage approvals and requires insurers to assess drought damage and pay any compensation promptly. In July 2022 the government extended indefinitely restrictions on grain exports that impose some notification requirements for exporters, and it has a pre-emptive right to buy grain intended for export.

Expansion of the nuclear power plant has started. Construction licences for two new nuclear reactors at the Paks nuclear power plant were issued by the Hungarian Atomic Energy Authority in August 2022. The plant's expansion will increase its installed capacity from 2,000 to 4,400 megawatts by 2030. The Paks nuclear power plant is based on Russian fuel and its expansion is excluded from the EU sanctions on Russia.

The biggest investment in Hungary is taking place in 2022. The Chinese company CATL, the world's largest electric battery producer, is expected to invest €7.34 billion in a new battery plant in Debrecen in eastern Hungary, close to the new German BMW plant. This will be the fifth electric battery plant in Hungary following the three facilities owned by Korean SK Innovation and Samsung SDI's plant. About 9,000 jobs are expected to be created. In addition, German car producers Mercedes and Audi are planning major new investments in electric car production.

The state is to boost its stakes in selected "strategically important sectors". The government announced in August 2022 that it was planning to take part in the buyout of telecoms company Vodafone Hungary by the end of 2022. The transaction is set at HUF 715 billion (€1.74 billion) and should be divided between the government-owned 4iG and state foundation Corvinus, with 51 and 49 per cent stakes, respectively. This transaction is in line with the government's strategy to increase the state's presence in strategically important sectors, which started in 2010. Also, energy companies, important for national energy security, will be placed under government supervision in case of emergency, according to a government decree issued under the current state of emergency due to the war on Ukraine.