Hungary

Highlights

- **The economy entered into recession in the first half of 2023.** Hungary currently has the highest inflation in the European Union (EU), damaging households' purchasing power since late 2022, and the slowdown in consumption has been accompanied by ongoing fiscal consolidation and subdued investment.
- **The government launched its economic protection plan.** It is designed to alleviate the negative impacts of the Russian war on Ukraine, including high energy and food inflation, energy insecurity, supply-chain disruptions and tight financing conditions for companies and households.
- **New energy supply routes and sources have been secured.** While the government signed agreements on gas supplies from new sources, it has not reduced its dependence on Russian energy, unlike Hungary's peers in central Europe and the Baltic states.

Key priorities for 2024

- **To unfreeze EU funds, including those from the Recovery and Resilience Facility (RRF), all super-milestones must be implemented.** Rule of law is one of the key concerns of the European Commission, and it will be important to follow the recommendations of the anti-corruption working group, established in 2022, which published its first report in March 2023.
- **Fiscal sustainability would benefit from more market-friendly support measures.** Ongoing fiscal consolidation will be critical once Hungary triggers the EU's excessive deficit procedure, and more targeted (rather than universal) fiscal support measures would put the economy on a more sustainable path.
- **Checks and balances need to be preserved amid increased state participation in the economy.** The government should take particular care to ensure high corporate governance standards in sectors where the state is expanding its ownership, following the recent acquisition of two major telecommunications companies and the announcement of plans to increase state ownership in other strategic sectors.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	4.9	-4.5	7.1	4.6	-0.2
Inflation (average)	3.4	3.4	5.2	15.3	18.0
Government balance/GDP	-2.0	-7.6	-7.2	-6.2	-5.5
Current account balance/GDP	-0.8	-1.1	-4.2	-7.2	-1.0
Net FDI/GDP [neg. sign = inflows]	-0.6	-1.6	-2.1	-2.8	-2.0
External debt/GDP	74.3	84.3	87.3	91.0	n.a.
Gross reserves/GDP	19.4	26.2	23.9	23.3	n.a.
Credit to private sector/GDP	31.8	34.9	34.7	32.6	n.a.

Macroeconomic developments and policy response

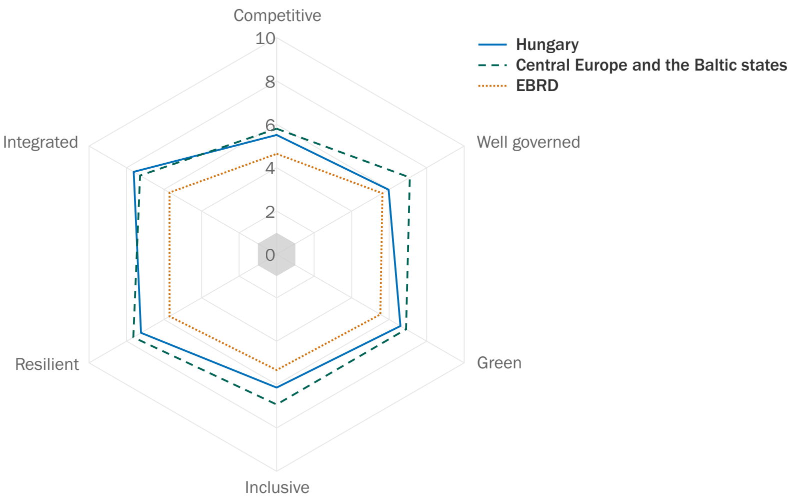
The economy entered a recession in the first half of 2023. Following robust growth in gross domestic product (GDP) of 4.6 per cent in 2022, economic activity shrank by 1.7 per cent year on year during the first half of 2023. The previous year's strong household consumption was largely fuelled by the government's pre-election fiscal expansion and anti-inflation shield programmes. But higher government spending led to elevated demand, and increased energy and food prices caused inflation to rise sharply, which has been damaging households' purchasing power since late 2022. Ongoing fiscal consolidation and decelerated investment have weighed on GDP performance since the fourth quarter of 2022. Fiscal consolidation in 2022 forced a freeze of several infrastructure investments, and total investment grew by just 0.1 per cent in 2022. It since plunged by 10.7 per cent in annual terms in the first half of 2023.

Inflation rates are the highest in the EU. The annual Harmonised Index of Consumer Prices (HICP) inflation rate peaked at 26.2 per cent in January 2023, and while it has been falling since then, it was still the highest among EU member states as at September 2023, at 12.2 per cent. As a result, real wages have been decreasing since the middle of 2022, dropping by 14 per cent year on year as at August 2023. The unemployment rate remains at a historical low, below 4 per cent since summer 2021, and the government relaunched its job-creation programme in January 2023 with the aim of keeping the economy at full employment during the current slowdown. Through subsidising employers' wage costs, the programme is expected to create more than 20,000 jobs, with a total cost of HUF 17.6 billion (€45.8 million).

Fiscal consolidation continues, but subsidised utility prices have been extended into 2024. The government has focused on fiscal consolidation, which led to a narrowing of the general government deficit to 6.2 per cent of GDP in 2022. Further savings are expected in 2023 and 2024, in line with plans to generate savings and enhance the efficiency of public spending. The government launched a public spending review to address the EU country-specific recommendations from May 2023. The general government deficit is expected to fall to 5.5 per cent of GDP this year before dipping below 3 per cent of GDP in 2024, as stated in the 2024 budget law, which parliament approved in July 2023. At the same time, the government earmarked HUF 1,340.7 billion (€3.5 billion, 2 per cent of GDP) in the 2024 budget to support regulated utility prices, to be largely financed out of windfall taxes on energy suppliers. These measures include subsidies to utilities to cover losses stemming from the fixed regulated utility prices, and support schemes for energy-intensive companies.

Economic growth stalled in 2023 but should pick up in 2024. Stagnant external demand and postponed investments, amid tight financing conditions and delayed inflows of EU funds, will likely result in a 0.2 per cent contraction of GDP in 2023. However, with inflation on a downward path from current highs, household purchasing power is expected to start improving in late 2023, as nominal wages continue to grow at double-digit rates. A recovery in economic activity, of 2.8 per cent, is forecast in 2024, when domestic demand strengthens and planned investments, some funded by the EU and others by foreign direct investors, materialise.

Assessment of transition qualities (1-10)



Structural reform developments

New energy supply routes and sources have been secured. The government wants to reduce its dependence on energy imports. Amid increasing solar electricity generation, more electricity should be produced in the new Russian-built Paks nuclear power plant. In August 2023 the expansion of the nuclear plant entered the construction phase and electricity production is expected by the beginning of the next decade. The government has secured new liquefied natural gas (LNG) deliveries from Azerbaijan and Croatia, and is working on new potential deliveries from Romania and Qatar, as well as from Algeria through a new gas pipeline with Slovenia. At the same time, in April 2023 Hungary signed a new agreement with Russia to buy additional quantities of gas on top of the 4.5 billion cubic metres per year under the ongoing long-term gas contract. There is also a continuous oil supply from Russia through the Druzhba pipeline through Ukraine. Meanwhile, in May 2023 the state-owned oil and gas group, MOL, signed a contract for oil deliveries via a Croatian pipeline, and in March 2023 it started supplying its refinery in Bratislava with its own crude oil extracted in Azerbaijan, where the company has a 9.57 per cent stake in an oil field.

Mandatory food price discounts and a price monitoring system have been introduced. Both initiatives were launched in June 2023 because the food price caps were set to terminate in August 2023. The mandatory price discount scheme is another anti-inflation tool that forces supermarkets to provide a 15 per cent discount, from the lowest price in the preceding 30 days, on one food product from each of 20 categories, to be applied on a weekly basis. At the same time, the competition authority launched a new price monitoring system that allows customers to browse through the offers of six retail chains.

Progress on the rule of law is uneven, delaying the disbursement of EU funds. Hungary will be able to tap into funding from the RRF only once it has fulfilled 27 super-milestones, mostly concerning the rule of law, requested by the European Commission in November 2022. In addition, in December 2022 the Commission approved Hungary's partnership agreement on 2021-27 cohesion funds worth €21.7 billion, to be allocated among 11 operational programmes supporting regional development, digitalisation, green investment and inclusion. In its July 2023 Rule of Law Report, the Commission noted some progress, but reiterated its concerns with respect to Hungary's judicial system, especially its lack of transparency around case allocations in lower courts and the lack of a robust track record of investigating corruption allegations concerning high-level officials. Pending the Commission's green light, further delays in the disbursement of EU funds are possible.

Subsidised loan programmes have been launched. In December 2022 state-owned development bank MFB launched its lending scheme for small and medium-sized enterprises (SMEs), worth HUF 313 billion (€820 million), to help reduce SMEs' operating costs through fixed, zero-interest-rate loans. In January 2023 state-owned Eximbank launched a corporate lending programme, extended to HUF 1,000 billion (€2.6 billion), to provide companies with forint loans capped at 6 per cent interest and euro-denominated loans fixed at 3.5 per cent interest. On top of the existing subsidised loan schemes, a three-pillar capital support programme worth HUF 600 billion (€1.6 billion) was launched in March 2023. Its first pillar, worth HUF 150 billion (€390 million), is designed to support the construction sector, including green construction, and investments on the Budapest stock exchange. The government aims to provide financial support to the economy worth HUF 3,600 billion (€9.4 billion or 5 per cent of GDP) in order to help companies secure cheaper financing and refinance their maturing loans from the Funding for Growth Scheme (FGS), the central bank's previous subsidised lending scheme. The schemes damp the negative economic impact of tight monetary policy, but also weaken the monetary transmission mechanism.

The government is encouraging savings in sovereign bonds. In June 2023 the government introduced a new 13 per cent social contribution tax on incomes generated from exchange-rate gains on bank deposits, investment funds and life insurance. In practice, it constitutes a form of capital control. The personal income tax rate of 15 per cent on capital gains is still in place on the remaining taxable income once payments to the new social contribution tax is deducted. In contrast, investments in government bonds are exempt from the new tax.