24. HUNGARY

Hungary's economy has begun to bounce back from its pandemic-induced recession, but a second wave of infections could stall the recovery. Economic growth could resume in 2021-2022 with the help of economic policy support. Public finances are set to deteriorate in the short term due to the economic downturn and the measures adopted to mitigate the socio-economic effects of the pandemic.

Second wave of pandemic to stall the recovery

COVID-19 interrupted a period of strong economic growth in Hungary. After increasing by 4.6% in 2019, real GDP fell by 13.6% year-on-year in the second quarter of 2020. Although the policy measures to mitigate the first wave of infections were less stringent than the EU average, Hungary's economy was affected due to its large exposure to highly cyclical industries (e.g. the automotive sector), as well as tourism and air transport, which have been severely constrained by the pandemic.

Economic activity rebounded vigorously as the lockdown measures were eased and international supply chains were restored. By August 2020, industrial production and retail sales were only down by 2.1% and 1.2% year-on-year, respectively. Employment also recovered, posting just a 0.4% year-on-year decrease in August.

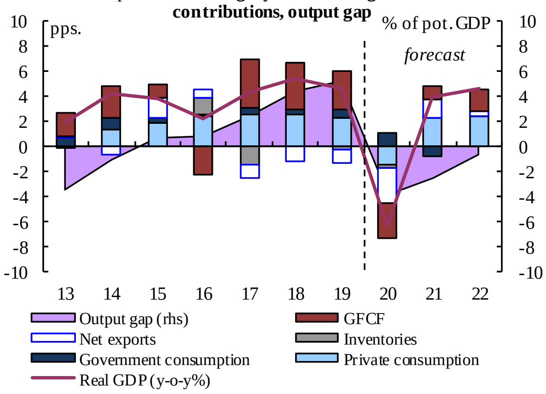
However, Hungary is experiencing a strong second wave of the pandemic this autumn. Household confidence and some mobility indicators have decreased recently. With a temporary wage subsidy programme due to expire towards the end of the year, a second wave of layoffs could be expected. Thus, the recovery is set to pause in the last quarter, and GDP is forecast to decrease by 6½% in 2020.

Gradual recovery in 2021-2022

Economic growth is forecast to resume from 2021 onwards when health concerns and containment measures are assumed to gradually ease. Economic policy supports the recovery, but in some sectors, notably tourism and real estate, growth is expected to be back-loaded. Real GDP is forecast to increase by 4% in 2021 and 4½% in 2022. It is set to reach its pre-recession level in 2022.

Private consumption is forecast to grow again from 2021, in tandem with disposable income. It is set to receive a boost from improving consumer confidence and the lifting of sanitary constraints affecting certain services. Investment is projected to recover only when the pandemic-related uncertainty abates and capacity utilisation returns near pre-recession levels. Private investment receives significant policy support, including grants, cheap financing and a temporary VAT cut on new housing from 2021. Exports stand to benefit from improved cost competitiveness following the Hungarian forint's recent depreciation. However, export market shares will only pick up gradually because international tourism is projected to recover slowly. The trade balance is set to improve after a temporary slump in 2020 and the current account deficit is projected to shrink in the years ahead.

Graph II.24.1: **Hungary - Real GDP growth and contributions, output gap**



Downside risks to the forecast stem from the precautionary behaviour of households and corporations in the face of the pandemic, which could weigh on consumption and investment. Upside risks are related to further policy support measures (e.g. to household investment), which are still under discussion. The baseline forecast does not include any measures funded by grants from the Recovery and Resilience Facility.

Inflation to remain high

Inflation eased to 3.4% in September 2020 as the impact of the recession began to take hold and the earlier shock to food prices started to fade. The recent currency depreciation may continue to pass through into consumer prices. Rising excise duties on tobacco will also add significantly to inflation in 2021. By 2022, disinflationary forces are set to prevail as demand remains weak while wage growth is limited by labour market slack. Inflation is forecast to reach 3.4% in 2020, remain at 3.3% in 2021 before easing to 3% in 2022.

Public finances to worsen

Government finances have suffered from the COVID-19 crisis, and the general government deficit is expected to rise to 8½% of GDP in 2020. Current revenues, in particular indirect tax receipts and social security contributions, were severely impacted both by the contraction of tax bases and some tax cuts, notably temporary reductions in the most affected sectors and a general 2 pps. cut to employers' social contributions as of July. On the expenditure side, measures to contain the economic impact of the pandemic resulted in higher-than-budgeted spending. These include a short-time work scheme and other measures aimed at protecting employment, temporary support to specific sectors and a one-off bonus for health workers. The medical emergency has also led to significantly higher health-related expenditure. Overall, the fiscal measures introduced so far are estimated to have a net budgetary impact of nearly 3% of GDP. Some of them are being financed from the reshuffling of existing budgetary chapters and from new taxes on banks and retail companies.

In 2021, the deficit is set to narrow to 5½% of GDP, driven by the economic recovery and the expiry of the emergency measures. The improving labour market situation, growing consumption and higher excise duties on tobacco are expected to drive increases in tax revenue. New expansionary measures include, among others, a wage increase programme for doctors and a reduced VAT rate on newly built houses. Under a no-policy-change assumption, the deficit is expected to fall to 4¼% of GDP in 2022.

Government debt is set to rise sharply from 65.4% of GDP in 2019 to 78% in 2020. This is because of the sizeable government deficit, the revaluation of foreign currency debt and a projected increase of liquidity buffers from their low value at the end of 2019. The debt ratio is then expected to decrease to 77¼% of GDP by 2022.

Table II.24.1:

Main features of country forecast - HUNGARY

	2019		Annual percentage change						
bn HUF	Curr. prices	% GDP	01-16	2017	2018	2019	2020	2021	2022
GDP	47513.9	100.0	2.1	4.3	5.4	4.6	**-6.4**	**4.0**	**4.5**
Private Consumption	23320.3	49.1	1.7	5.0	5.1	4.5	**-3.1**	**4.4**	**4.8**
Public Consumption	9334.2	19.6	1.8	2.5	1.7	3.5	**5.2**	**-3.6**	**0.2**
Gross fixed capital formation	12936.7	27.2	1.2	19.7	16.4	12.2	**-10.4**	**4.1**	**6.9**
of which: equipment	4757.7	10.0	2.9	16.1	13.0	8.8	**-16.4**	**11.0**	**8.4**
Exports (goods and services)	39050.8	82.2	7.5	6.5	5.0	5.8	**-8.5**	**8.3**	**7.9**
Imports (goods and services)	37569.0	79.1	6.3	8.5	7.0	7.5	**-5.3**	**6.7**	**7.7**
GNI (GDP deflator)	46231.9	97.3	2.3	2.8	5.7	5.6	**-5.6**	**3.5**	**4.5**
Contribution to GDP growth: Domestic demand			1.6	6.9	6.5	6.0	**-3.4**	**2.5**	**4.2**
Inventories			-0.3	-1.6	0.1	-0.3	**-0.1**	**0.0**	**0.0**
Net exports			0.8	-1.0	-1.2	-1.1	**-2.9**	**1.5**	**0.3**
Employment			0.5	1.9	2.3	1.3	**-3.5**	**0.4**	**1.3**
Unemployment rate (a)			7.9	4.2	3.7	3.4	**4.4**	**4.4**	**3.9**
Compensation of employees / head			5.4	7.0	6.5	5.2	**6.3**	**4.7**	**5.3**
Unit labour costs whole economy			3.7	4.5	3.3	1.9	**9.6**	**1.1**	**2.0**
Real unit labour cost			-0.5	0.5	-1.4	-2.8	**3.9**	**-2.2**	**-1.0**
Saving rate of households (b)			10.7	11.1	12.7	11.1	**12.9**	**11.7**	**11.1**
GDP deflator			4.2	4.0	4.8	4.8	**5.5**	**3.4**	**3.0**
Harmonised index of consumer prices			4.2	2.4	2.9	3.4	**3.4**	**3.3**	**3.0**
Terms of trade goods			-0.3	-0.3	-1.0	0.5	**1.5**	**-0.1**	**-0.1**
Trade balance (goods) (c)			-0.3	1.4	-1.3	-2.1	**-1.6**	**-0.9**	**-1.2**
Current-account balance (c)			-3.2	1.9	0.3	-0.3	**-1.1**	**-0.3**	**-0.3**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			-1.7	2.8	2.6	1.5	**0.4**	**1.4**	**1.5**
General government balance (c)			-4.9	-2.4	-2.1	-2.1	**-8.4**	**-5.4**	**-4.3**
Cyclically-adjusted budget balance (d)			-4.8	-3.5	-4.1	-4.4	**-6.6**	**-4.2**	**-4.0**
Structural budget balance (d)			-	-3.9	-4.1	-4.3	**-6.6**	**-4.2**	**-4.0**
General government gross debt (c)			69.3	72.2	69.1	65.4	**78.0**	**77.9**	**77.2**

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.