24. HUNGARY

The economic shock from the pandemic hit Hungary's economy at the peak of the business cycle. With a strong specialisation in sectors affected by the decline in global demand and the pandemic containment measures, and taking into account the muted fiscal policy response, Hungary is projected to experience a sharp recession in 2020, followed by a gradual recovery. The general government deficit is set to peak in 2020.

The virus is expected to cause a deep recession in 2020…

Before COVID-19, Hungary's economy was on track for a gradual slowdown after several years of outstanding growth. Real GDP rose by 4.9% in 2019, and the first monthly indicators in 2020 signalled continued momentum.

Economic performance in 2020 is expected to depend on the health impact of the virus, the sectoral specialisation of the economy, and the economic policy response. Confirmed case numbers have remained limited so far. Sanitary measures have severely restricted certain services. Tourism and transport, which account for half of service exports, are among the most affected sectors. Constraints on industrial and construction activity remain moderate, but the international recession can hit manufacturing particularly strongly due to the dominant role of highly cyclical industries (e.g. automotive). The initial policy measures have focused on liquidity provision, including a debt moratorium for all borrowers until the end of 2020, but the overall fiscal policy response has been muted so far.

Economic activity is estimated to have begun contracting in March, and should reach its trough in the second quarter of 2020. A gradual economic recovery is projected in the second half of the year as containment measures are assumed to be gradually lifted. Unemployment could rise sharply, due to the flexibility of the labour market. The liquidity support and temporary job protection measures offered to companies are expected to provide limited containment only. Consequently, household consumption is set to fall sharply. Declining demand and high uncertainty are expected to reduce private investment. The trade balance could improve thanks to the shrinking demand for imported consumer durables and capital goods, and also due to falling energy import prices. Thus, the current account is projected to return to a surplus after a modest deficit in 2019.

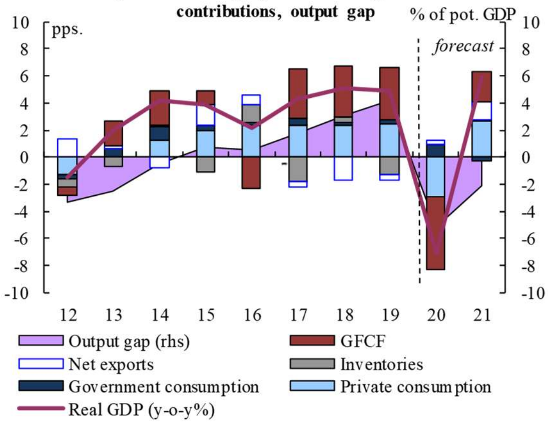
In 2020, GDP is projected to decrease by 7%, while unemployment rate could rise from an annual average of 3.4% in 2019 to 7%.

…to be followed by a partial recovery in 2021

GDP is projected to bounce back by 6% in 2021, while the unemployment rate could fall back to 6%. Output could remain below its 2019 level, due to the gradual recovery of external demand and tourism flows, and domestic headwinds. The latter include elevated unemployment and limited income support to households, delaying the recovery of consumption; and the lagged impact of declining house prices on real estate projects.

There are both upside and downside risks to the projection. More vigorous fiscal policy support could limit the economic fallout in 2020 and hasten the recovery in 2021. On the other hand, a wave of corporate bankruptcies could weigh on the recovery by restricting job creation and lending.

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



Inflation is projected to decrease

Inflation peaked at 4.7% in January 2020, but has eased more recently thanks to falling fuel prices and favourable base effects. Overall, the recession is set to reduce inflation. However, this process is dampened by the pass-through of currency depreciation as well as the impact of supply bottlenecks on food prices. Headline inflation is forecast to decrease from 3.4% in 2019 to 3.0% in 2020 and 2.7% in 2021.

Limited fiscal response

The budget deficit improved only marginally in 2019 to 2.0% of GDP. Higher-than-budgeted revenues, thanks to high income and consumption growth, were offset by higher expenditure. These were partly the result of tightening budgetary rules, which limit budgetary institutions' possibility to carry over unused funds to the following fiscal years. Public investment continued growing also on the back of increased EU funds absorption, while capital transfers were boosted by the take-up of the prenatal funding scheme of the 'demography programme'.

In 2020, the deficit is forecast to increase to 5¼% of GDP. The deterioration is mainly driven by lower tax revenues as a result of the economic downturn. Fiscal measures adopted so far to contain the economic impact of the pandemic amount to 1% of GDP and include some temporary tax cuts in the most affected sectors; bringing forward the planned 2 pps. cut to employers' social contributions from October to July; a job protection scheme that covers part of lost wages for three months under certain conditions; a wage subsidy scheme for R&D jobs; and a one-off bonus for health workers. Moreover, medical emergency expenditures have amounted to ¾% of GDP until now. Overall, these measures are financed largely from the reshuffling of existing budgetary chapters and reserves as well as from new taxes on banks and retail companies, with a net budgetary impact of ¼% of GDP. Additional measures to support the recovery have been announced: they are planned to be financed through further budgetary reallocations and their details are yet to be specified. Government spending is also set to increase with higher unemployment benefits and rising expenditure on the demography programme (by ¼% of GDP compared to 2019). The deficit in 2021 could fall to 4% of GDP, on the back of the expected improvement in macroeconomic conditions and assuming moderate expenditure growth.

The debt-to-GDP ratio decreased significantly in 2019, to 66¼% of GDP. It is forecast to increase to 75% in 2020 and to decrease to 73½% of GDP in 2021.

Table II.24.1:
Main features of country forecast - HUNGARY

	2018			Annual percentage change						
	bn HUF	Curr. prices	% GDP	00-15	2016	2017	2018	2019	2020	2021
GDP		42661.8	100.0	2.2	2.2	4.3	5.1	**4.9**	**-7.0**	**6.0**
Private Consumption		20776.4	48.7	1.5	4.9	4.7	4.8	**5.1**	**-6.0**	**5.5**
Public Consumption		8404.5	19.7	2.0	0.7	2.4	0.9	**1.7**	**5.0**	**-1.4**
Gross fixed capital formation		10739.3	25.2	2.3	-10.6	18.7	17.1	**15.3**	**-18.7**	**8.9**
of which: equipment		4163.3	9.8	3.0	2.5	16.1	10.2	**10.7**	**-27.6**	**15.8**
Exports (goods and services)		36236.5	84.9	8.7	3.8	6.9	4.3	**6.0**	**-14.0**	**11.2**
Imports (goods and services)		34370.5	80.6	7.5	3.4	8.2	6.8	**6.9**	**-15.0**	**10.1**
GNI (GDP deflator)		40952.1	96.0	2.3	4.3	2.8	5.1	**5.1**	**-6.0**	**5.1**
Contribution to GDP growth:	Domestic demand			1.8	0.2	6.5	6.4	**6.7**	**-7.3**	**4.6**
	Inventories			-0.4	1.4	-1.8	0.4	**-1.3**	**0.0**	**0.0**
	Net exports			0.8	0.6	-0.5	-1.7	**-0.4**	**0.2**	**1.3**
Employment				0.3	3.7	1.9	2.4	**1.7**	**-3.8**	**1.1**
Unemployment rate (a)				8.0	5.1	4.2	3.7	**3.4**	**7.0**	**6.1**
Compensation of employees / head				6.2	2.4	7.0	6.2	**9.4**	**5.0**	**4.4**
Unit labour costs whole economy				4.3	4.0	4.5	3.4	**6.0**	**8.6**	**-0.4**
Real unit labour cost				-0.5	3.0	0.8	-1.0	**1.5**	**4.2**	**-3.4**
Saving rate of households (b)				10.6	11.9	11.4	11.6	**13.2**	**15.9**	**14.8**
GDP deflator				4.8	1.0	3.7	4.5	**4.5**	**4.2**	**3.1**
Harmonised index of consumer prices				4.8	0.4	2.4	2.9	**3.4**	**3.0**	**2.7**
Terms of trade goods				-0.5	1.5	-0.3	-1.0	**0.5**	**1.0**	**0.0**
Trade balance (goods) (c)				-1.0	3.4	1.5	-1.3	**-1.9**	**0.7**	**0.8**
Current-account balance (c)				-4.0	4.7	2.3	-0.3	**-0.9**	**1.3**	**1.5**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-2.4	4.6	3.1	2.1	**0.9**	**3.3**	**3.4**
General government balance (c)				-5.0	-1.8	-2.5	-2.1	**-2.0**	**-5.2**	**-4.0**
Cyclically-adjusted budget balance (d)				-4.9	-2.1	-3.3	-3.6	**-3.9**	**-2.8**	**-3.1**
Structural budget balance (d)				-	-2.0	-3.6	-3.6	**-3.8**	**-2.6**	**-3.1**
General government gross debt (c)				68.2	75.5	72.9	70.2	**66.3**	**75.0**	**73.5**

(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.