24. HUNGARY

Policy stimulus is set to sustain Hungary's economic expansion despite headwinds from global supply chain disruptions. Economic growth is set to remain dynamic in 2022 but slow down in 2023 as policy support is gradually withdrawn. Rising commodity prices and wage pressures contribute to persistently high inflation. Despite a strong rebound in output, the government deficit and debt are projected to decline only gradually.

Fiscal stimulus offsets external headwinds

Hungary's economy continued to grow robustly, with GDP recovering to the pre-pandemic level in the second quarter of 2021, despite temporary restrictions on certain services to contain the pandemic. While the services sector bounced back in the summer, global supply chain disruptions are set to dampen GDP growth in the second half of the year. Annual GDP is projected to grow by 7.4% in 2021 following a 4.7% contraction in 2020. Economic growth is set to remain strong at 5.4% in 2022, boosted by continuing fiscal stimulus. Growth is expected to slow to 3.2% in 2023 as output returns close to its potential and policy support is gradually withdrawn.

Household consumption is forecast to benefit from robust income gains, government support measures and buoyant consumer confidence. Stimulus measures aimed at boosting consumption in 2022 include a one-time income tax refund to families with children, an income tax cut for workers under age 25, the re-introduction of the 13th monthly pension and administrative wage increases.

Investment is set to remain buoyant owing to the improving economic outlook and to significant policy support through grants and favourable financing conditions. Public investment is also expected to grow markedly in 2021-22. Capital accumulation is set to slow down in 2023 after public investment peaks and some support schemes (i.e. the pre-natal loan and the home renovation subsidy) are phased out.

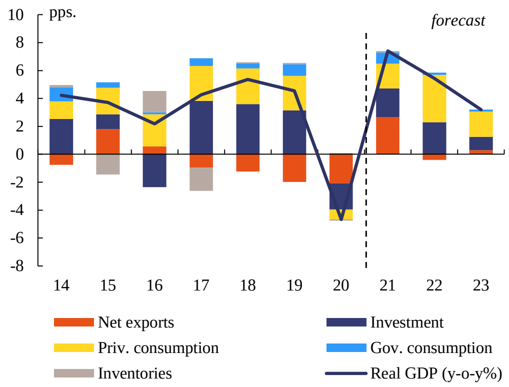
The Hungarian economy is strongly integrated into global value chains, making exports sensitive to supply disruptions. As material shortages are expected to abate from 2022, exports are projected to remain dynamic despite slowing global demand. At the same time, strong domestic demand is forecast to fuel imports, while higher global energy prices are set to worsen Hungary's terms of trade. The current account is thus forecast to deteriorate in 2022, before improving again in 2023.

Uncertainty regarding consumer behaviour creates symmetric risks to the outlook. Fiscal stimulus may boost consumption even more than assumed, but at the same time, higher than expected inflation might impair households' purchasing power.

Wage pressure is building up

Employment reached its pre-pandemic level in the summer of 2021 and job creation is set to continue as the economy grows. Unemployment is forecast to fall to historic low levels. Wage growth is set to remain robust amid emerging signs of labour shortages. A 20% minimum wage hike and sizeable salary increases in the public sector are projected to add to wage pressures in 2022.

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



Rising production costs keep inflation high

HICP inflation is set to peak at 6.7% in Q4 2021, on the back of price hikes after the reopening of the economy, global increases in goods and commodity prices and the pass-through of earlier currency depreciation. Regulated prices for residential energy partially shield households from commodity price increases. Still, firms are expected to pass their higher energy and wage costs on to consumers, boosting non-energy inflation. After averaging 5.1% in 2021, inflation is forecast at 4.8% in 2022 and 3.4% in 2023.

Fiscal expansion in 2021 and 2022

In 2021, despite a strong rebound in economic activity, the general government deficit is forecast to remain high, reaching 7.5% of GDP. Over the course of the year, stronger-than-expected revenue growth was matched by new expansionary measures. The budgetary impact of the planned refund of income tax to families, which will take place in early 2022, is of more than 1% of GDP, but will have a deficit-increasing impact in 2021 in line with accrual recording. Other discretionary measures in 2021 include, among others, a subsidised loan programme for SMEs, a temporary reduction in the local business tax, support for home buying and renovation and a reduced VAT rate on newly built houses. Public investment is also set to accelerate markedly.

In 2022, the deficit remains at 5.7% of GDP despite strong economic GDP growth. The additional fiscal space generated by a robust growth in revenues is set to be utilised for new expansionary measures addressed to various social groups. Those include, among others, a full re-introduction of the 13th monthly pension, the abolition of the vocational training contribution, an additional 2.5 pps. cut to employers' social contributions, a service benefit for military and law enforcement employees brought forward to 2022, and a reduction in personal income tax for employees under the age of 25.

The headline deficit in 2023 is set to decrease to 3.8% of GDP against the background of continued expansion and gradual reduction in discretionary spending. Revenue growth is expected to remain robust, while spending in some of the categories, such as public investments, capital transfers and purchases of goods and services, is projected to slowly revert to the pre-crisis path.

Over the forecast horizon, the debt-to-GDP ratio is projected to decrease from 80.1% of GDP in 2020 to 76.4% in 2023. Although the high gross financing need is set to decrease and the low maturity of debt has risen, these remain challenges in the medium term.

In absence of a Council Implementing Decision approving Hungary's RRP, this forecast builds on the technical assumptions laid out in Box I.5.1 and includes expenditures financed by RRF grants envisaged in the plan, which are set to increase from 0.7% of GDP in 2021 to 1.1% in 2023.

Table II.24.1:

Main features of country forecast - HUNGARY

		2020			Annual percentage change						
	bn HUF	Curr. prices	% GDP	02-17	2018	2019	2020	2021	2022	2023
GDP		47988.5	100.0	2.1	5.4	4.6	-4.7	**7.4**	**5.4**	**3.2**
Private Consumption		23846.8	49.7	1.7	5.1	5.0	-1.4	**3.6**	**7.1**	**3.7**
Public Consumption		10132.5	21.1	1.7	1.8	4.2	0.4	**3.7**	**0.8**	**0.7**
Gross fixed capital formation		12857.0	26.8	2.2	16.3	12.8	-6.9	**7.6**	**8.4**	**3.4**
of which: equipment		4842.2	10.1	3.9	12.9	12.4	-9.0	**8.9**	**7.4**	**6.0**
Exports (goods and services)		38141.2	79.5	7.3	5.0	5.4	-5.9	**10.9**	**9.5**	**8.8**
Imports (goods and services)		37324.6	77.8	6.5	7.0	8.2	-3.5	**7.7**	**10.3**	**8.6**
GNI (GDP deflator)		46698.7	97.3	2.2	5.5	6.0	-4.7	**6.9**	**5.3**	**3.1**
Contribution to GDP growth:	Domestic demand			1.8	6.5	6.5	-2.5	**4.6**	**5.9**	**2.9**
	Inventories			-0.3	0.1	0.1	-0.1	**0.1**	**0.0**	**0.0**
	Net exports			0.6	-1.2	-2.0	-2.1	**2.7**	**-0.4**	**0.3**
Employment				0.6	2.3	1.1	-1.0	**3.0**	**2.0**	**0.8**
Unemployment rate (a)				7.8	3.7	3.4	4.3	**4.1**	**3.1**	**2.9**
Compensation of employees / head				4.8	6.4	6.9	1.9	**7.7**	**9.4**	**6.4**
Unit labour costs whole economy				3.3	3.3	3.4	5.9	**3.2**	**5.8**	**4.0**
Real unit labour cost				-0.5	-1.4	-1.3	0.0	**-1.4**	**1.2**	**0.3**
Saving rate of households (b)				10.8	15.1	14.9	15.1	**17.9**	**14.6**	**14.1**
GDP deflator				3.8	4.8	4.8	5.9	**4.7**	**4.5**	**3.7**
Harmonised index of consumer prices				3.8	2.9	3.4	3.4	**5.1**	**4.8**	**3.4**
Terms of trade goods				-0.3	-1.0	0.5	2.0	**-1.9**	**-0.9**	**0.5**
Trade balance (goods) (c)				-0.1	-1.7	-2.5	-1.0	**-0.7**	**-2.2**	**-2.2**
Current-account balance (c)				-3.1	0.0	-0.8	-1.6	**-1.1**	**-2.4**	**-1.9**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-1.6	2.2	1.0	0.1	**0.6**	**0.2**	**0.7**
General government balance (c)				-4.8	-2.1	-2.1	-8.0	**-7.5**	**-5.7**	**-3.8**
Cyclically-adjusted budget balance (d)				-4.7	-3.6	-3.7	-5.8	**-6.8**	**-5.7**	**-3.6**
Structural budget balance (d)				-2.6	-3.6	-3.5	-5.8	**-6.8**	**-5.7**	**-3.6**
General government gross debt (c)				70.5	69.1	65.5	80.1	**79.2**	**77.2**	**76.4**

(a) Eurostat definition. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.