24. HUNGARY

Hungary's bounce back from the 2020 recession might be temporarily interrupted by a third wave of the COVID-19 pandemic, but a recovery is expected to resume once containment measures are lifted. Strong growth is expected to sustain inflationary pressures in 2022, while the economic recovery is expected to drive an improvement in public finance figures.

Quick rebound expected once health-related restrictions are lifted

Hungary's economy started to emerge from the pandemic-induced recession in the second half of 2020. Real GDP fell by 5% in 2020 but industrial and construction activity returned to their pre-pandemic level before the end of the year. Real GDP continued rising even in the fourth quarter of 2020, despite the re-imposition of health-related restrictions. However, a third wave of infections has led to tighter restrictions for some services and supply chain disruptions affected industry at the beginning of 2021. Real GDP is thus set to decrease mildly in the first quarter of 2021. Most services are expected to rebound quickly after restrictions are eased, boosting economic activity from the second quarter of 2021.

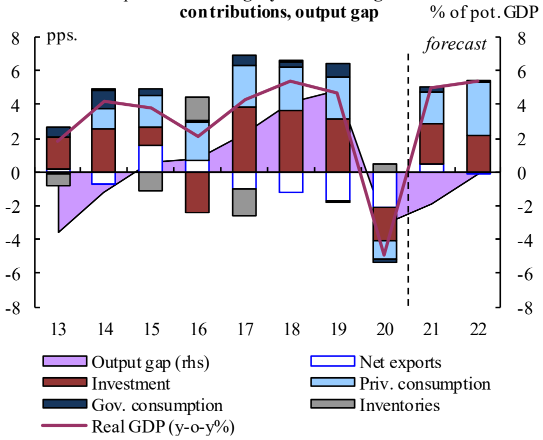
Buoyant growth driven by domestic demand

Real GDP is projected to grow by 5% in 2021 and 5.5% in 2022. GDP is forecast to reach its pre-pandemic level by the end of 2021. Household consumption is poised to rebound thanks to steady real income growth, and the increasing ability and willingness, of consumers to spend once restrictions are lifted. Household income is set to rise owing to the improving labour market, the gradual reintroduction of a 13th monthly pension and an income tax cut for employees below the age of 25 in 2022. Private investment is expected to be bolstered by rising capacity utilisation and significant government subsidies. Public investment is set to remain high over the forecast horizon, at around 6.5% of GDP, thanks to the support of grants from the RRF. In the absence of sufficiently detailed information about the national RRP at the cut-off date, this forecast assumes a simplified and linear integration of RRF-financed expenditure, as explained in Box I.2.3.

Export growth is set to benefit from recovering external demand and recent capacity increases in manufacturing. The revival of tourism and air travel could take longer, extending beyond 2022. The current account is expected to remain in a small deficit. The rising trade surplus is set to be offset by a growing deficit of the income balance as the profitability of foreign-owned firms recuperates. However, large EU fund inflows should maintain the net saving position of the economy.

Employment stood at 1.1% below its pre-pandemic level in the first quarter of 2021, according to seasonally adjusted Labour Force Survey data. However, labour market slack (including unemployment, underemployment and potential job seekers among the inactive) remained low by historic standards and strong wage growth has persisted. In February 2021, nominal wages rose by 8.9% y-o-y in the private sector and 13.5% in the public sector, the latter driven by salary increases for health workers. Over the forecast horizon, the economic recovery is expected to absorb the labour market slack, and maintain robust wage growth.

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



There are also upside risks to the forecast related to potentially re-emerging labour shortages that could result in even faster wage growth.

Inflation to remain high

Inflation, which has risen in recent months on the back of higher commodity prices and excise duty increases, is forecast to peak near 5% in April-May

2021. Although headline inflation is projected to recede, core inflation may remain high due to the gradual pass-through of past currency depreciation and emerging price pressures following the reopening of the economy. After averaging 3.4% in 2020, HICP inflation is forecast at 4.0% in 2021 and 3.2% in 2022.

Public finances to improve slowly

The general government deficit deteriorated by 6 pps. to 8.1% of GDP in 2020, as a result of the COVID-19 pandemic and the measures taken to contain its effects. While tax revenues increased only marginally compared to 2019, expenditures grew strongly. The evolution of tax revenue was driven by the economic slowdown and tax cuts; notably temporary reductions for the most affected sectors and a 2 pps. cut to employers' social contributions in July 2020, which were only partly compensated by the introduction of new taxes on banks and retail companies. Around two thirds of all expenditure measures to contain the effects of the pandemic were capital expenditures, including investment grants and capital transfers. The remaining part included, among others, wage subsidy schemes, a one-off bonus for health workers and emergency medical expenditures.

In 2021, the deficit is forecast to decrease to 6.8% of GDP, due to the recovering economy and the phasing out of most of the government's anti-crisis measures. However, new measures are expected to weigh on the deficit. These include, among others, vaccine purchases, planned wage increases for healthcare workers, a subsidised loan programme for SMEs, a temporary reduction in the local business tax, home buying and renovation support for families with children, a reduced VAT rate on newly built houses, and a gradual re-introduction of the 13th monthly pension. Risks stem mainly from higher spending ahead of the 2022 elections.

In 2022, the deficit is set to decline to 4.5% of GDP, driven mostly by the more favourable macroeconomic developments. New expansionary measures include an additional 2 pps. cut to employers' social contributions at the beginning of the year and the personal income tax exemption for employees under the age of 25.

Government debt surged to 80.4% of GDP in 2020, driven also by the revaluation of foreign currency debt and the build-up of liquid reserves. It is expected to decrease to 78.6% in 2021, thanks also to a more favourable stock-flow adjustment, and to 77.1% in 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	47524.0	100.0	2.1	4.3	5.4	4.6	**-5.0**	**5.0**	**5.5**
Private Consumption	23455.2	49.4	1.7	5.0	5.1	5.1	**-2.3**	**3.7**	**6.0**
Public Consumption	9409.4	19.8	1.8	2.5	1.7	4.0	**-1.0**	**5.0**	**-1.6**
Gross fixed capital formation	12890.0	27.1	1.2	19.7	16.4	12.8	**-7.3**	**3.8**	**8.4**
of which: equipment	4881.9	10.3	2.9	16.1	12.9	11.8	**-23.6**	**12.7**	**8.9**
Exports (goods and services)	39104.5	82.3	7.5	6.5	5.0	5.8	**-6.8**	**10.3**	**8.8**
Imports (goods and services)	37769.1	79.5	6.3	8.5	7.0	8.2	**-4.4**	**9.2**	**8.4**
GNI (GDP deflator)	46281.7	97.4	2.3	2.8	5.7	5.8	**-4.0**	**4.5**	**5.1**
Contribution to GDP growth: Domestic demand			1.6	6.9	6.5	6.5	**-3.3**	**3.9**	**4.9**
Inventories			-0.3	-1.6	0.1	-0.2	**0.4**	**0.0**	**0.0**
Net exports			0.8	-1.0	-1.2	-1.7	**-2.1**	**1.1**	**0.6**
Employment			0.5	1.9	2.3	1.1	**-2.2**	**1.2**	**1.3**
Unemployment rate (a)			7.9	4.2	3.7	3.4	**4.3**	**4.3**	**3.8**
Compensation of employees / head			5.4	7.0	6.5	6.6	**4.9**	**6.9**	**6.3**
Unit labour costs whole economy			3.7	4.5	3.3	3.0	**7.9**	**3.0**	**2.1**
Real unit labour cost			-0.5	0.5	-1.4	-1.7	**2.1**	**-0.7**	**-1.5**
Saving rate of households (b)			10.7	11.1	12.7	12.2	**14.3**	**14.0**	**12.2**
GDP deflator			4.2	4.0	4.8	4.8	**5.7**	**3.7**	**3.7**
Harmonised index of consumer prices			4.2	2.4	2.9	3.4	**3.4**	**4.0**	**3.2**
Terms of trade goods			-0.3	-0.3	-1.0	0.5	**1.9**	**-1.1**	**0.0**
Trade balance (goods) (c)			-0.3	1.4	-1.3	-2.1	**-0.6**	**-1.1**	**-1.4**
Current-account balance (c)			-3.2	1.9	0.4	-0.4	**-0.3**	**-0.6**	**-0.5**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			-1.7	2.8	2.6	1.4	**1.8**	**1.5**	**1.8**
General government balance (c)			-4.9	-2.4	-2.1	-2.1	**-8.1**	**-6.8**	**-4.5**
Cyclically-adjusted budget balance (d)			-4.8	-3.5	-3.9	-4.1	**-6.3**	**-5.7**	**-4.3**
Structural budget balance (d)			-2.2	-3.8	-3.9	-3.9	**-6.3**	**-5.7**	**-4.3**
General government gross debt (c)			69.3	72.2	69.1	65.5	**80.4**	**78.6**	**77.1**

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