Hungary's economic outlook

Restoring sustainable and inclusive growth

March 2021

MINISTRY OF FINANCE

Key highlights

Hungary entered the COVID-19 crisis with strong economic fundamentals that helped partially absorb the shock of the pandemic. Consistent economic policies over the last decade have contributed to a turnaround in employment and a positive investment dynamics, allowing the country to become one of the fastest growing economies in Europe since 2013. This economic momentum has led Hungary to record a milder recession in 2020 than other EU countries, with real GDP contracting by 5.0% compared to 6.4% for the EU.

The country's economic expansion over the last ten years has been achieved while preserving fiscal balances, with a debt-to-GDP ratio on a firmly declining path and a fiscal deficit constantly below the Maastricht threshold over 2012-2019. Supportive fiscal policies, combined with the erosion of the tax base as a result of the pandemic, led to a one-off deterioration in fiscal deficit and public debt metrics for 2020.

However, Hungary remains strongly committed to restoring fiscal discipline when the impact of the crisis recedes. Public debt remains below the EU average and is expected to decrease from 2021 onwards, while a prudent medium-term debt management strategy will continue to be implemented. Hungary benefits from a favourable debt structure thanks to permanent efforts to lower the share of debt denominated in foreign currency, increase public debt's average maturity, and develop a highly diversified, deep, and liquid domestic debt market with a financially inclusive retail bond market.

Although Hungary has been hard hit by the COVID-19 crisis like its neighbours, the Government promptly took exceptional measures to contain the virus and alleviate the social and economic impact of the pandemic by protecting lives and preserving jobs. An exceptional support package, amounting to 30% of GDP, has been deployed, targeting companies, workers, and households, in line with the recommendations of international institutions. The Central Bank has also implemented accommodative monetary policies to mitigate the impact of the crisis on Hungary's economy. The launch of the vaccination campaign marks a new phase in the fight against the virus. The Government expects Hungary to be able to vaccinate 6.8 million people by early June - 3.5 million more people than similarly sized European countries, thanks to the country's reliance on all available vaccines deemed safe. All these combined measures support estimates of a rapid return to growth, with a double-digit growth rate of 14.2% YoY as soon as the second quarter of 2021.

Looking ahead, Hungary has a clear roadmap to achieve its vision of becoming one of the five countries in Europe with the best quality of work and life by 2030. In that respect, the Government recently announced a new action plan to ensure a sustainable economic recovery while promoting social inclusion. Hungary will capitalize on its key comparative advantages, being the European country with one of the highest employment and investment rates. In addition, Hungary aims to unlock its full potential by expanding its position in the value chains, increasing competitiveness through automation and robotics, investing more in higher education and vocational training, and promoting a balanced regional development to enhance the country's growth prospects.

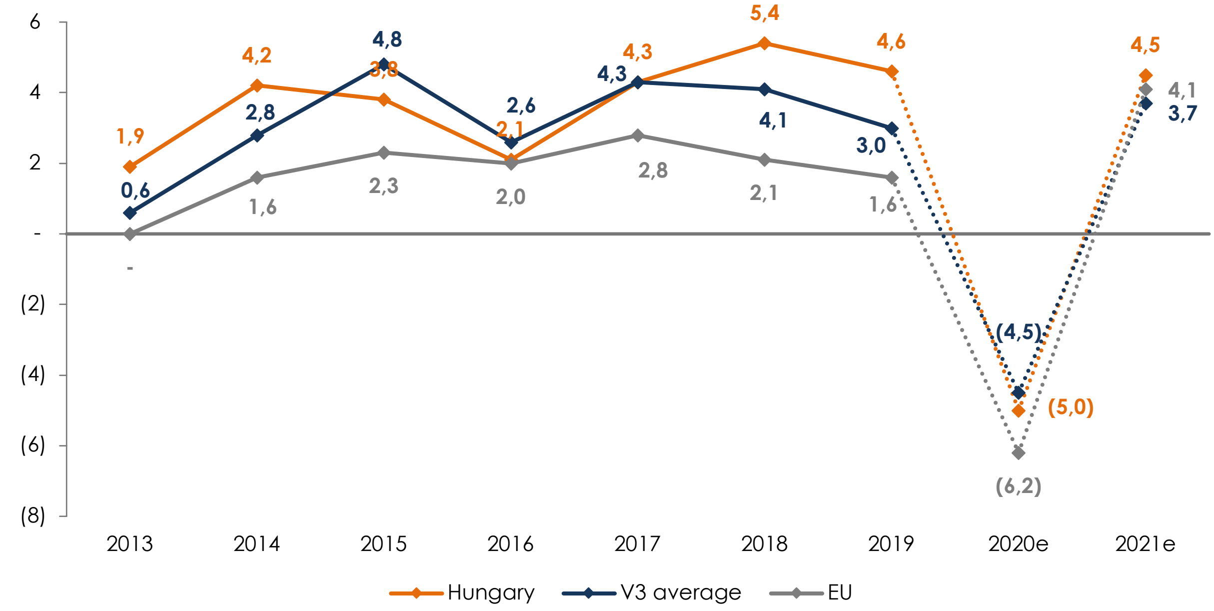
1. MACROECONOMIC AND FISCAL UPDATE

1.1 Hungary entered the COVID-19 crisis with strong economic fundamentals that helped partially absorb the shock

Hungary has been among the fastest growing economies in Europe since 2013. This strong performance has been allowed by structural reforms implemented in the wake of the 2008 crisis, including comprehensive reforms to the tax regime, which have contributed to a turnaround in employment. Growth has been supported by household consumption, while investment also picked up in recent years.

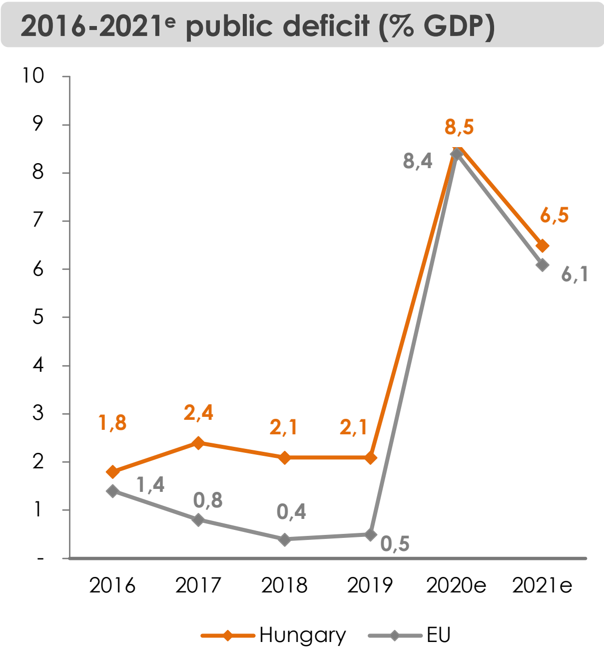
The country entered the COVID-19 crisis from a relatively strong economic position. First estimates indicate a real GDP growth contraction of 5.0% in 2020 – better than for the EU at 6.2% – and the economic outlook is more favourable in Hungary than in many peer countries. Comprehensive and effective crisis management measures also contributed to a relatively more moderate decline in real GDP growth for Hungary in 2020.

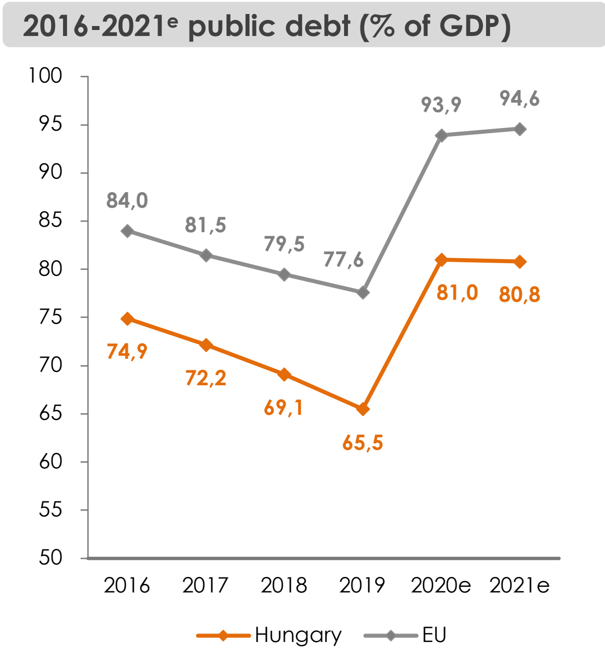
2013-2021e real GDP growth (YoY, %)



Sources: Ministry of Finance, Eurostat, European Commission: Economic Forecast – Autumn 2020, KSH

1.2 Public debt will temporarily increase in 2020 due to the economic downturn caused by the pandemic and a higher public deficit, but fiscal consolidation remains a priority





Sources: Ministry of Finance, Eurostat, European Commission: Economic Forecast – Autumn 2020

Hungary's debt-to-GDP ratio was on a firmly declining path between 2011 and 2019, and its level was more than 10 percentage points below the EU's average debt ratio as of December 2019. This trajectory, from 80% of debt-to-GDP in 2011 to 65% before the pandemic, results from effective fiscal consolidation efforts implemented over the past few years, with a fiscal deficit constantly below the Maastricht threshold from 2012 to 2019.

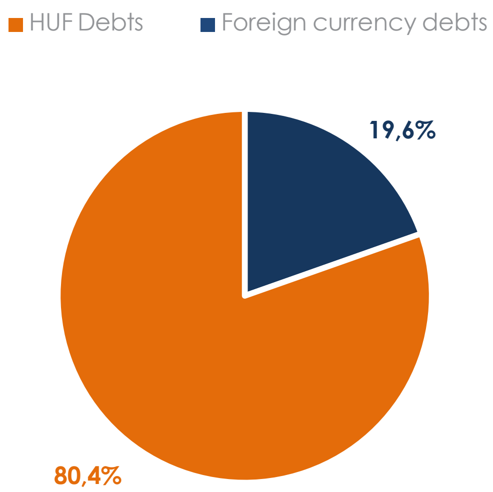
The Government has taken exceptional measures to contain the virus and alleviate the social and economic impact of the COVID-19 crisis. This, together with the erosion of the tax base due to the pandemic, has led to a temporary increase in fiscal deficit and public debt in 2020. However, budget deficit was in line with European peers during the pandemic while public debt remains below the EU average.

Although the focus will remain on containing the pandemic and relaunching the economy in the months to come, fiscal consolidation is a priority for Hungary. Reducing public debt represents one of the main objectives of the Government under Hungary's Fundamental Law, which states that only budgets that provide for a reduction of the public-debt-to-GDP ratio can be adopted as long as the Government debt exceeds 50% of GDP. The public-debt-to-GDP ratio will hence progressively decrease from 2021 onwards.

1.3 Hungary's public debt structure remains favourable despite the crisis, supported by a prudent debt management strategy

It is also important to note that a sound debt management strategy has continued to be implemented despite the crisis. Hungary benefits from a very favourable public debt structure, with a share of foreign-currency denominated debt below 20% – a key objective for the Government – despite the successful issuance of several international bonds during 2020. This achievement results from the implementation of Hungary's "self-financing policy" aiming to increase the resilience of the country's public finance by reducing the share of debt denominated in foreign currencies. Hungary enjoys a highly diversified, deep, and liquid domestic market fuelled by its MAP+ program introduced in 2019, which has allowed the development of the retail market and the expansion of a stable domestic investor base while supporting financial inclusion. This financially inclusive retail bond market represents today c. 25% of total debt. In addition, the term-to-maturity of Hungary's public debt continues to increase, reaching 5.3 years as of February 2021.

Government debt by currency (% of total)



Government debt structure (as of 01.02.2021)

	% of total debt	Average time until maturity
Total debt[1]	**100.0**	**5.3**
HUF Debts	**80.4**	**4.7**
HUF bonds	49.8	5.5
Discount treasury bills	1.9	0.3
HUF retail government bonds	25.5	3.1
HUF loans	3.2	7.5
Foreign currency debts	**19.6**	**7.9**
Foreign currency loans	3.5	7.5
Domestic foreign currency bonds	1.5	1.3
incl. retail	0.5	1.8
International foreign currency bonds	15.4	8.5
Net swap	(0.7)	5.4

Note 1. Excluding foreign currency deposits held by AKK as a collateral for repo and risk management transactions
Source: AKK

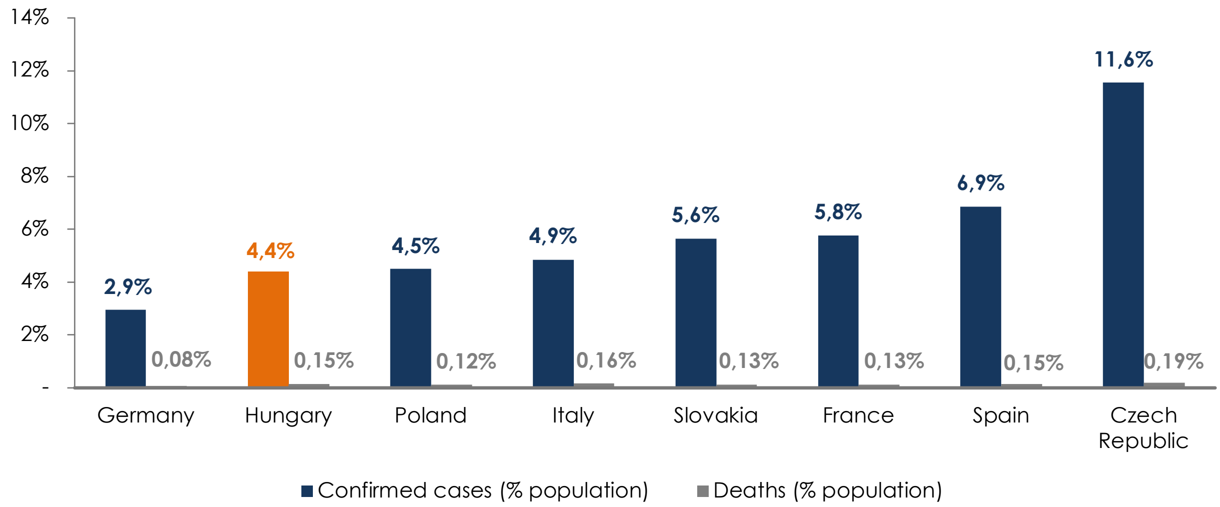
Credit ratings' stability throughout the crisis and a positive revision of Moody's outlook from stable to positive in September 2020 also demonstrate Hungary's strong resilience, while a number of peer countries have been downgraded at least once since the beginning of the Covid-19 crisis. Credit rating agencies (S&P, Moody's and Fitch) underline the country's strong structural indicators and excellent track record in terms of economic growth. They expect the economy to recover as soon as 2021, in line with authorities' forecasts.

2. IMPACT AND RESPONSE TO THE COVID-19 PANDEMIC

2.1 Hungary has been deeply affected by the COVID-19, like all its neighbours, but promptly took exceptional measures to contain the virus and is now engaged in a massive vaccination campaign

As of February 28, 2021, the total number of confirmed coronavirus cases in Hungary is of 428,599 with 14,974 deaths[1] . The first coronavirus cases were identified on March 4, 2020 in the country – compared to January 31, 2020 in Italy. **The Government promptly took measures to limit the pandemic, with the introduction of a state of emergency as soon as March 2020.**

Impact of the COVID-19 pandemic in Hungary and peer countries (as of 28.02.2021)



Sources: Johns Hopkins University (Coronavirus Resource Center), IMF

Several restrictive measures, such as a curfew or the prohibition of public gatherings, remain in force to protect all Hungarian lives. These measures could be phased out progressively if the trend becomes more favourable. The Government will however closely monitor the situation in other countries and the specific conditions in Hungary to decide how to best proceed as more contagious mutations could lead to a deterioration of the situation.

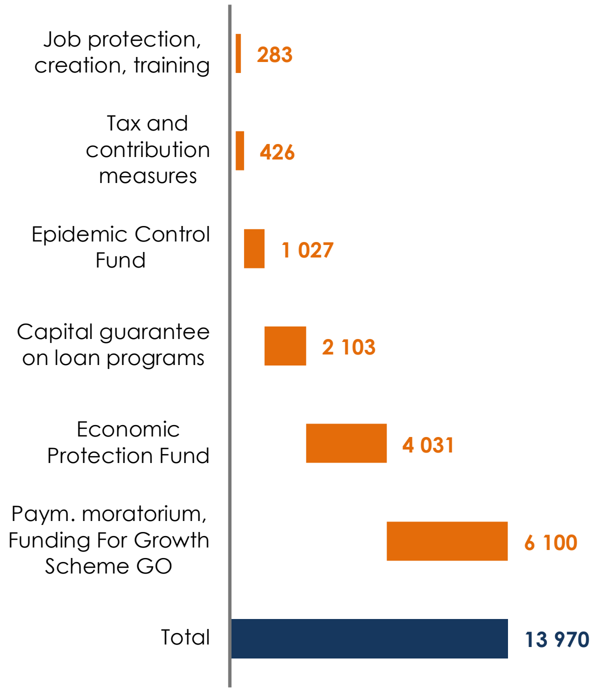
While the pandemic is not over, the launch of the vaccination campaign marks a new phase in the fight against the virus. The Government expects Hungary to be able to vaccinate 6.8 million people by early June, 3.5 million more than in European countries of similar size thanks to its reliance on all available vaccines deemed safe. More specifically, authorities plan on the Russian vaccine for 1.0 million people and Chinese vaccine for 2.5 million people.

[1] Johns Hopkins University (Coronavirus Resource Center)

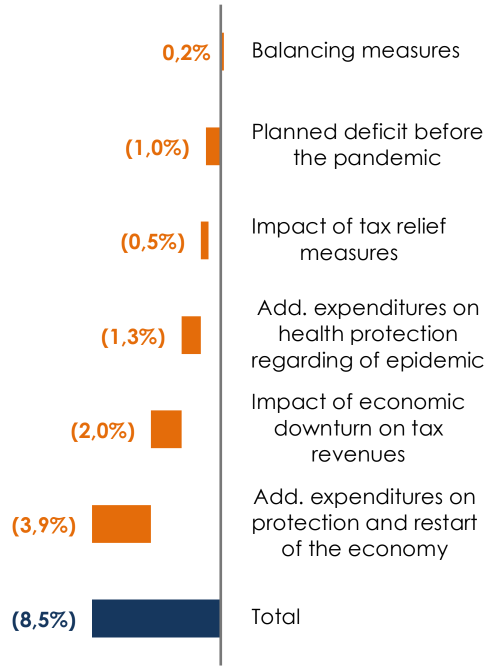
2.2 An exceptionally large support package to combat the economic and social impacts of the pandemic has also been adopted by the Government

The Government has introduced social and economic measures on an unprecedented scale to protect households, workers, and companies, in line with what international financial institutions (IMF, World Bank, OECD, etc.) recommend.

Scale of the measures introduced in 2020 (HUFbn)



Preliminary budget deficit for 2020 (% of GDP)



Source: Ministry of Finance

These measures amount to close 30% of GDP in total[2]. They include direct budgetary measures with tax cuts, wage subsidies, but also indirect ones with debt repayment moratorium or the extension of a public guarantee programmes. More specifically, the Government established two budgetary funds in April 2020 to provide the necessary resources to fight the pandemic and restart the economy:

- HUF 1,027bn were spent through the **Epidemic Control Fund** to finance the costs of protection against the pandemic. To serve these objectives, new taxes were also created – with an estimated budget of HUF 100bn[3] – and additional funds spent by Governmental bodies (approximatively HUF 600bn by the end of November)
- HUF 4,031bn were spent through the **Economic Protection Fund** and withdrawals from ministries by the end of November 2020 to ensure job protection and creation, protect priority sectors, families and pensioners, and finance domestic enterprises (see below)

[2] Measures to be implemented over several years
[3] HUF 45bn from the special retail tax and HUF 55bn through the modification of the bank levy

Job protection	▪ Administrative and tax burden reliefs to ensure work flexibility, including through the reduction of the social contribution tax ▪ Wage supplements provided by the Government
Job creation	▪ Simplified tender arrangement for innovative companies or companies with planned investments ▪ More flexible award conditions introduced for university degrees
Priority sectors protection	▪ Investment support schemes, subsidised guaranteed loans, support for infrastructure developments and tax cuts over the next three years ▪ Targeted sectors including tourism, health, food industry, agriculture
Domestic enterprises financing	▪ Subsidized guaranteed loans and State guarantee program ▪ Capitalisation programmes to protect Hungarian companies
Measures to help families and pensioners	▪ 13th month pension to be reintroduced in the pension allowance from 2021 onwards ▪ Liquidity assistance provided to households including through the repayment moratorium or the extension of various maternity entitlement

Source: Ministry of Finance

The Central Bank of Hungary also revised its monetary policy framework to mitigate the effects of the pandemic on the real economy and financial markets. It has developed a balanced approach to ensure ample liquidity and achieve low long-term rates, with highly accommodative policy rates, enhanced liquidity through the introduction of new facilities, asset purchase programs and a new and enlarged Funding for Growth Scheme to ensure access to required and affordable funding for domestic Small and Medium Enterprises (SMEs).

The comprehensive support package deployed by the Government underpins the expectation of a rapid return to a dynamic growth path for the country, especially as a new action plan has recently been announced. According to the Ministry of Finance's estimates, these measures already managed to mitigate the rate of economic decline by 5.6 percentage points while the support schemes protected 586 thousand jobs.

3. ECONOMIC OUTLOOK AND THE WAY FORWARD

3.1 A new action plan has been announced by the Government to further boost economic recovery and social inclusion

The Government announced a new action plan in February 2021 to ensure a sustainable economic recovery while promoting social inclusion. The long-term goal of the country is to return to its dynamic growth trajectory pre-COVID-19 and to become one of the five countries in Europe with the best quality of work and life by 2030.

In that respect, the new action plan is expected to be implemented in three phases and includes ambitious and unprecedented measures in a wide array of sectors (see below).

Overview of the key measures of the new action plan announced on Feb. 15, 2021

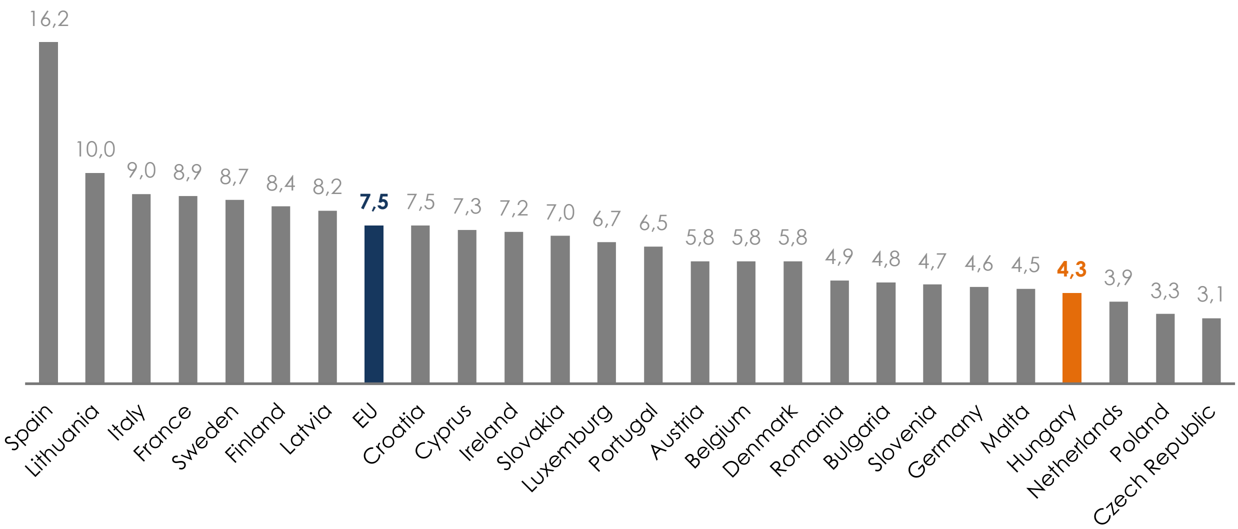
Housing	▪ VAT reduced on new home constructions from 27% to 5% ▪ Up to HUF 6m of 10Y loans to be granted for home renovations
Social protection	▪ Gradual phasing in 4 steps of the payment of a 13th month pension ▪ Exemption from personal income tax for people below the age of 25 with lower salaries
Healthcare	▪ Large medical wage increase program being launched ▪ HUF 65bn granted to domestic healthcare manufacturers as part of the Health Industry Funding Scheme
Assistance business ı difficulties and SMEs	▪ Wage subsidies for businesses in difficulties (50% of the wage paid by the State and no salary contributions payment) ▪ Up of HUF 10m of 10-year interest free loans to be granted to SMEs with a 3-year credit moratorium
Education	▪ Between HUF 1,500bn and HUF 2,000bn to be allocated to the development of higher education
Sustainable and green" development	▪ Development of green energies and building of 12 GW of solar power capacities by 2040 ▪ Initiatives to develop green public and private transportations and promote the circular economy
Competitiveness	▪ Ensure full digitalization to develop an efficient and competitive economy based on modern technologies and information networks

Source: Ministry of Finance

3.2 Hungary's comparatively low level of unemployment will support the country's sustainable recovery

Hungary benefits from one of the lowest levels of unemployment in Europe, with an unemployment rate of 4.3% as of December 2020 despite the pandemic.

Unemployment rate in Europe in December 2020 (seasonally adjusted data, %)



Sources: Eurostat, KSH

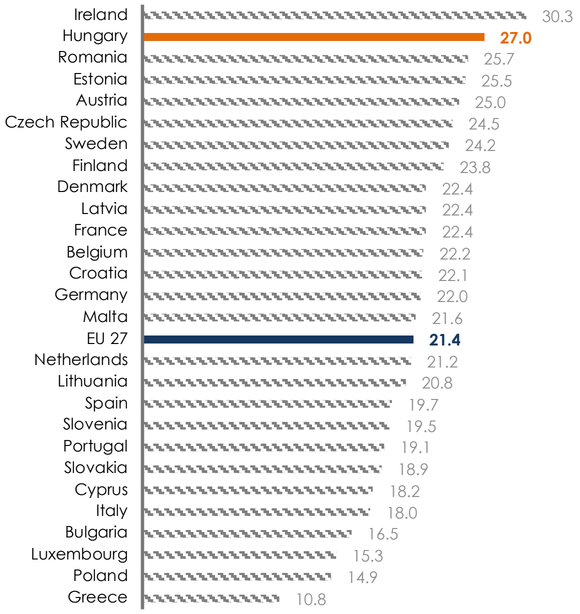
Whereas employment declined in last spring due to the pandemic, the labour market started to recover as soon as Q2 2020 following the lifting of restrictions, the end of temporary industrial shut-downs and the recovery of domestic tourism in mid-summer.

Wages dynamics also remained strong during the year – with real value of wages in Hungary increasing by 6.2% in 2020. **This favourable labour market trends support economic recovery through household consumption, especially as wages are expected to further rise on the back of a global rebound.**

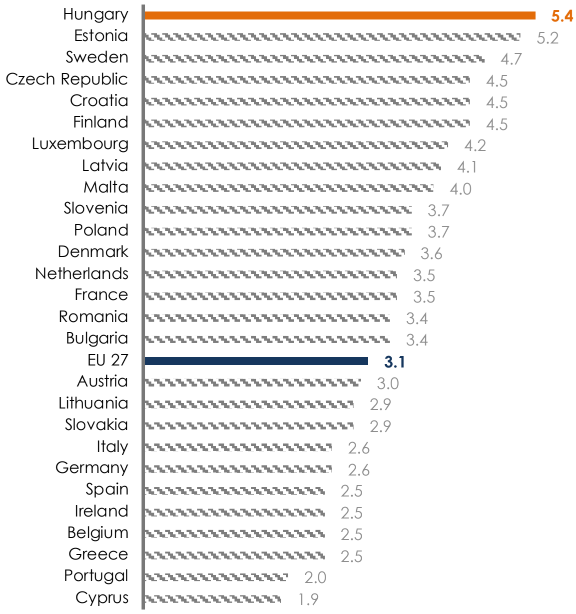
3.3 Hungary's investment dynamics, targeted policy support as well as the effective absorption of EU funding are also supportive of the country's economic outlook

Hungary benefits from a very high investment rate with the second highest in Europe for the first nine months of 2020, representing 27% of GDP. Effective investment incentives have been developed by the country in recent years such as large corporation investment subsidy programs, training subsidies or tax incentives. Besides, Hungary's public investment rate is the highest among all European countries at 5.4% of GDP (2020 Q1-Q3).

National investment rate in 2020 Q1-Q3 (% of GDP)



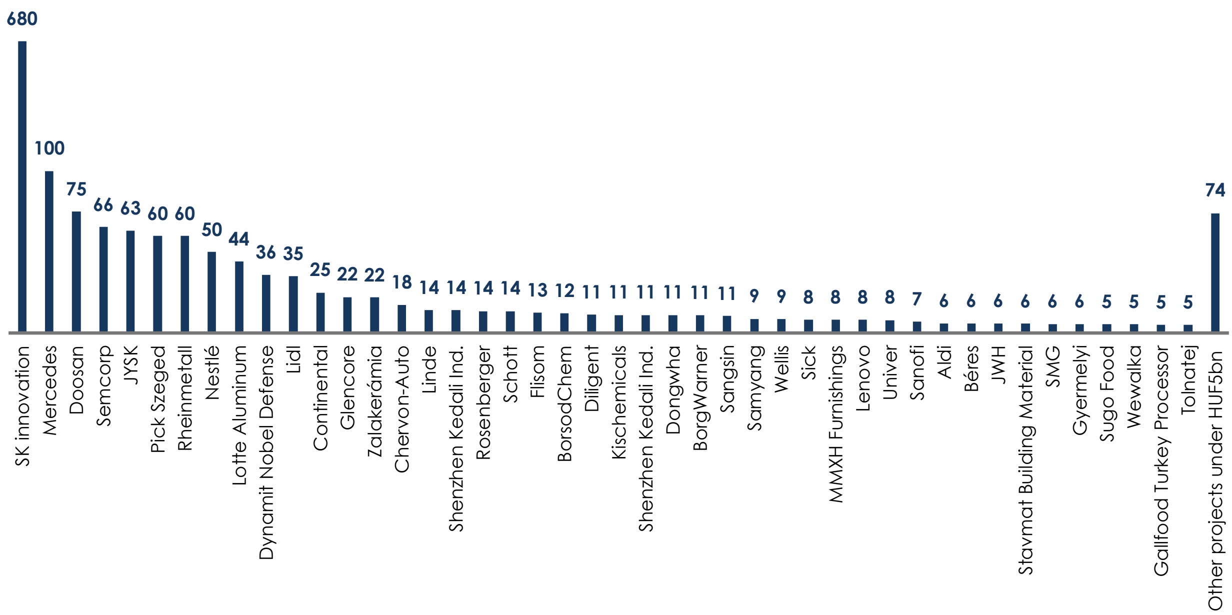
Public investment rate in 2020 Q1-Q3 (% of GDP)



Source: Eurostat, calculations by the Ministry of Finance

Hungary is among the top 10 countries in terms of investment per capita and the country's ability to attract Foreign Direct Investments (FDIs) has been preserved despite the crisis. Since the beginning of 2020, over HUF 2,500bn of investment (c. 5.4% of GDP) in total were announced and should boost export volumes and GDP in the forthcoming periods by 20-34% and 8-10% respectively.

High-volume investments announced since early 2020 (HUFbn)

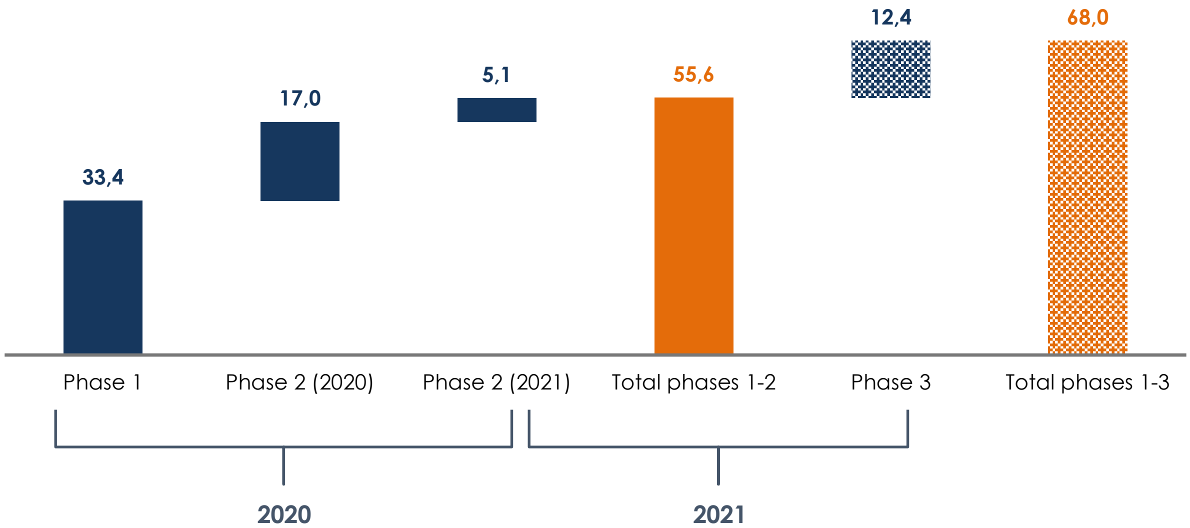


Source: Ministry of Finance

In order to further attract foreign investors and boost the domestic economy, the Government implemented additional measures to incentivize investment and support exports: the HUF 1,490bn credit, guarantee and equity schemes of the Hungarian Development Bank, the mitigation program package of Eximbank, and the competitiveness-enhancing support to help medium-sized and large enterprises operating in the manufacturing and business services sector. In addition, the amount of investment aid for large enterprises was expanded, special economic zones were established, and companies investing in Hungary have been granted corporate tax exemption on re-invested profits for the next four years.

To complement this investment dynamics, targeted policy support is provided to strategic sectors, most notably the health industry. An ambitious Health Industry Funding Scheme (ETP / Egészségipari Támogatási Program) has been designed to address some vulnerabilities identified during the COVID-19 crisis. It provides for HUF 68.0bn to be allocated to domestic healthcare manufacturers to ensure that the procurement and manufacturing of sanitizers, masks, surgical gloves and ventilators among others can be carried out through Hungarian investments. 51 companies were already granted a HUF 55.6bn subsidy for projects with a total value of HUF 71.3bn in the first two phases of this scheme.

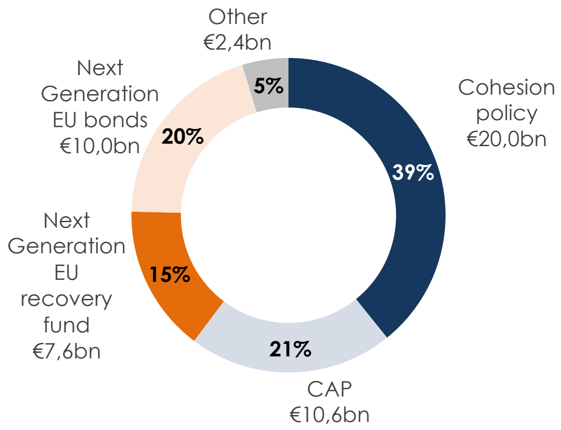
Results of the Health Industry Funding scheme (HUFbn)



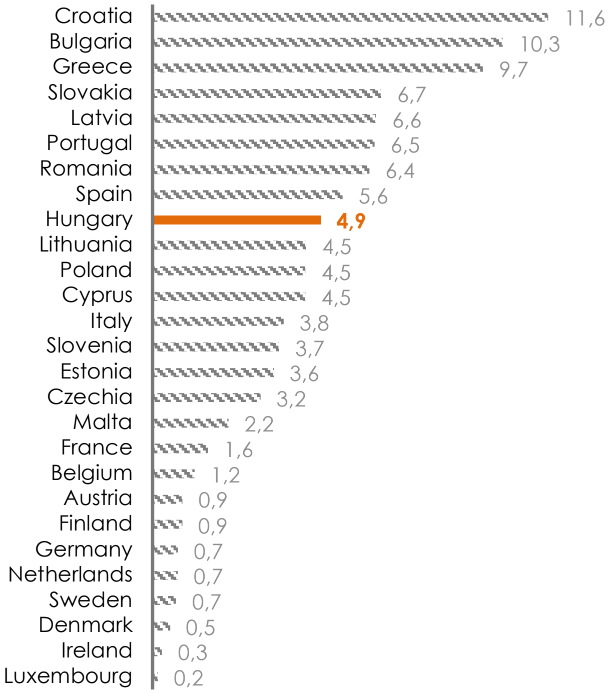
Source: Ministry of Finance

Financial support from the EU and the effective absorption of EU funds will also contribute to Hungary's economic recovery and development. Untapped resources from the 2014-2020 EU cycle as well as EU's recently launched Next Generation EU Funds will be channelled to Hungary's economy from 2021 onwards, further supporting investment and growth.

EU funds available to Hungary over 2021-2027 (€bn at 2018 prices)



Next Generation EU funds by country: recovery and resilience facility (% of 2019 GDP)

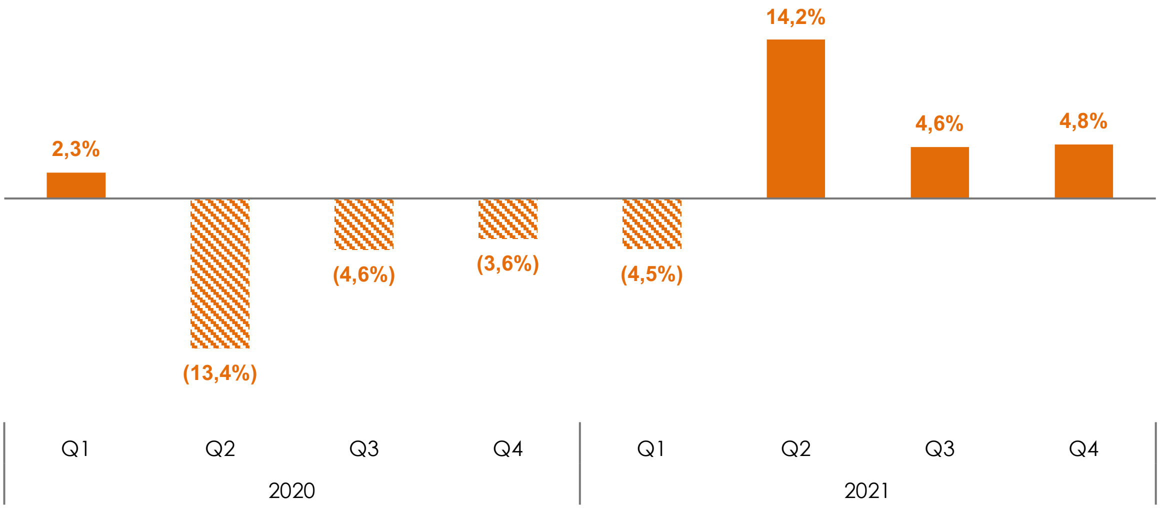


Sources: European Commission, Ministry of Finance, Eurostat

3.4 In this context, Hungary should return to economic growth with a double-digit growth rate as soon as Q2 2021

Hungary should return to economic growth with a double-digit growth rate as soon as Q2 2021 on the back of the Government's action plan and the launch of an efficient COVID-19 vaccination campaign. Q2 2021 growth rate is anticipated at 14.2% YoY which is the highest growth rate ever anticipated for the country.

Changes in GDP in Hungary (YoY, %)



Sources: KSH (March 2021 – unadjusted, raw data), calculations by the Ministry of Finance

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