

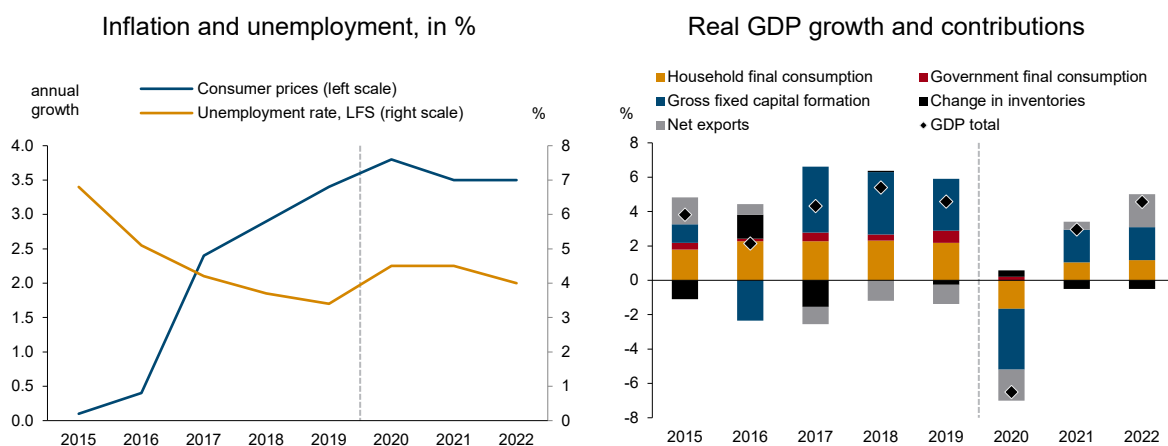


HUNGARY: Next Generation EU funds crucial to avoid delayed recovery

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The COVID-19 crisis has hit the economy hard, with the export of vehicles and tourism suffering the most. Household consumption and investment have declined sharply, due partly to sub-optimal crisis management by the government. The pre-crisis economic level will only be reached in late 2022, at the earliest. Support from the EU rescue programme is indispensable for this, but non-compliance with rule-of-law requirements may render participation problematic.

Figure 4.8 / Hungary: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

In the second quarter, GDP dropped by 13.6% year on year. The decline was over 20% in manufacturing, and was 13% in construction and 12% in services. The lockdown and the partial break-up of international production linkages hit the output of transport vehicles especially hard (a sector that accounts for about a third of manufacturing output). Within services, income from cross-border tourism and transportation suffered a decline of over 25%. Agriculture, the information and telecom sector, financial services and the food industry all proved resilient to the COVID-19 crisis: they showed either minimal decline or even modest expansion.

On the expenditure side of GDP, the decline in household consumption (over 8%) contributed massively to the Q2 shrinkage of the economy. This resulted from the loss of jobs and related income, more cautious spending by households (reflected in an increased propensity to save) and the lockdown-related restriction of opportunities to spend earned income, primarily through the purchase of services. Government consumption increased but was only sufficient to moderate the contraction of actual final

consumption, which amounted to 6.7%. While gross fixed capital formation dropped by 11%, gross capital formation fell by only 6%, indicating a strong accumulation of inventories (or measurement problems). Foreign trade contributed heavily to the GDP decline, with a huge quarterly deficit. Exports and imports of goods fell by over 20% in nominal euro terms. As for trade in services, exports fell by no less than 40%, following the disruption to inward cross-border tourism, while services imports dropped by 27%.

The Hungarian government's strategy for crisis management deviated from that pursued by most other EU members. Its principal consideration was that the resources to address the crisis should come primarily from a restructuring of budgeted government expenditure and by generating additional fiscal revenues. Although the strict EU requirements for fiscal deficits were eased, Prime Minister Orbán has long had strong reservations about excessive fiscal deficits: he regards these as potential triggers that could enable the EU Commission or the IMF to gain influence over the Hungarian economy, should a bailout programme prove unavoidable. This consideration has limited the government's readiness to employ a classical deficit spending programme to check the shrinkage of aggregate demand. The original fiscal deficit target for 2020 of less than 3% of GDP was maintained well after game-changing information about the gravity of the economic crisis became known. In the critical Q2, public investment decreased by 19% – nearly twice as much as private-sector investment. In line with Orbán's vision of turning Hungary into a 'work-based society' (i.e. all social support should be kept at the lowest possible level), the government has been reluctant to supplement household incomes hit by the COVID-19 crisis. Unemployment benefits continue to be paid for a maximum of three months, and the Hungarian version of short-time working (or *Kurzarbeit*) has been far from generous. Those involved in public workfare earn EUR 150 a month, and those relying on social aid get EUR 63.

The main tool of crisis management has been a moratorium on credit repayment for both households and businesses. This is intended to curb the decline in aggregate demand, and the positive effect was supposed to be in the region of 4% of GDP. However, the households involved do not necessarily spend what they thus save, while those who are hardest hit by the crisis – i.e. low-income households and small or micro businesses – are typically not involved in the moratorium. The unemployment statistics do not include data for firms with fewer than five employees, and the lost incomes of people in the unreported economy are also missing from the statistics. This explains the sharp fall in household consumption, despite a relatively mild deterioration in reported unemployment and a strong increase in wages.

The current second wave of the epidemic means that the likelihood of a V-shaped economic recovery is small. GDP is expected to decline by 6.5% in 2020, within a band of -5.5% to -8.5%. All major GDP components will contribute to the contraction of the economy: consumption, investment and net exports. As a result of both plunging budget revenues (due to the deep recession) and the increased expenditure undertaken in the second half of the year (following a slight easing of the government's aversion to classic deficit spending), the fiscal deficit may amount to 8-9% of GDP this year. Public debt will again rise to well over 70% of GDP, with an increased share of foreign financing. The central bank has been forced to tacitly tighten its monetary policy, in order to curb the depreciation of the HUF (which amounted to 9% against the euro in the first three quarters of the year).

The pre-crisis level of economic activity will only be achieved in late 2022, at the earliest.

Participation in the Next Generation EU (NGEU) programme is crucial in this respect. The programme would enable the huge resources earmarked for Hungary (about EUR 6 billion in transfers and EUR 10

billion in preferential credits) to be accessed from early 2021. Such a capital injection could plug the 'hole' in free external financing that has been punched by (a) the deliberate early utilisation of EU transfers from the 2014-2020 EU Multiannual Financial Framework (MFF), and (b) the severely delayed start of actual money flow from the next, 2021-2027 EU MFF. However, the arrival of NGEU funds is by no means assured, as strings could be attached in the form of a 'rule of law' requirement – potentially a major problem for the Hungarian government. With the NGEU recovery programme now coming on top of MFF, clearly there is more money at stake. The desire to rein in EU transfer-related corruption is stronger than ever both in the European Parliament and in those member states that are net contributors to the EU budget. Obvious non-compliance by the Hungarian government with certain fundamental political values of the EU may aggravate the situation still further.

Table 4.8 / Hungary: Selected economic indicators

	2017	2018	2019 ¹⁾	2020 1Q	2020 2Q	2020 1-2Q	2020 Forecast	2021 Forecast	2022
Population, th pers., average	9,788	9,776	9,771	.	.	.	9,700	9,670	9,620
Gross domestic product, HUF bn, nom.	39,233	43,347	47,514	10,985	10,831	21,816	45,800	48,700	52,500
annual change in % (real)	4.3	5.4	4.6	2.2	-13.6	-6.1	-6.5	3.0	4.6
GDP/capita (EUR at PPP)	20,390	21,830	23,110	.	.	.	.	.	.
Consumption of households, HUF bn, nom.	18,961	20,522	22,397	5,664	5,283	10,947	.	.	.
annual change in % (real)	4.7	4.8	4.6	4.6	-8.3	-2.0	-3.5	2.2	2.5
Gross fixed capital form., HUF bn, nom.	8,699	10,742	12,937	2,297	3,273	5,570	.	.	.
annual change in % (real)	19.7	16.4	12.2	-4.1	-10.9	-8.2	-13.0	7.0	7.0
Gross industrial production									
annual change in % (real)	4.7	3.5	5.4	0.3	-25.4	-12.6	-9.5	6.0	6.0
Gross agricultural production									
annual change in % (real)	-4.1	2.7	-0.3	.	.	.	.	.	.
Construction industry									
annual change in % (real)	29.7	21.2	20.7	-0.3	-12.4	-7.3	.	.	.
Employed persons, LFS, th, average	4,421	4,470	4,512	4,466	4,408	4,437	4,420	4,464	4,510
annual change in %	1.6	1.1	1.0	-0.7	-2.3	-1.5	-2.0	1.0	1.0
Unemployed persons, LFS, th, average	192	172	160	173	214	194	180	210	190
Unemployment rate, LFS, in %, average	4.2	3.7	3.4	3.7	4.6	4.2	4.5	4.5	4.0
Reg. unemployment rate, in %, eop ²⁾	5.6	5.2	5.1	4.4	5.8	5.8	.	.	.
Average monthly gross wages, HUF ³⁾	297,017	329,943	367,833	384,307	406,903	395,605	400,900	424,100	445,500
annual change in % (real, gross)	10.3	8.3	7.7	4.6	8.3	6.4	5.0	2.2	1.5
Average monthly net wages, HUF ³⁾	197,516	219,412	244,609	255,564	270,591	263,078	266,600	282,000	296,200
annual change in % (real, net)	10.3	8.3	7.7	4.6	8.3	6.4	5.0	2.2	1.5
Consumer prices (HICP), % p.a.	2.4	2.9	3.4	4.4	2.5	3.4	3.8	3.5	3.5
Producer prices in industry, % p.a.	3.3	5.6	2.1	4.1	2.8	3.5	3.5	3.0	3.0
General governm.budget, EU-def., % of GDP									
Revenues	44.1	43.8	43.3	.	.	.	41.0	45.0	45.0
Expenditures	46.5	45.9	45.3	.	.	.	49.0	49.9	48.9
Net lending (+) / net borrowing (-)	-2.4	-2.1	-2.0	.	.	.	-8.0	-4.9	-3.9
General gov.gross debt, EU def., % of GDP	72.2	69.1	65.3	.	.	.	74.0	73.0	71.0
Stock of loans of non-fin.private sector, % p.a.	5.5	10.6	13.2	18.4	13.7	13.7	.	.	.
Non-performing loans (NPL), in %, eop ⁴⁾	7.5	5.4	4.1	4.2	4.0	4.0	.	.	.
Central bank policy rate, % p.a., eop ⁵⁾	0.90	0.90	0.90	0.90	0.75	0.75	0.60	0.60	0.60
Current account, EUR mn ⁶⁾	2,490	377	-363	317	-847	-531	-2,300	-1,900	-900
Current account, % of GDP ⁶⁾	2.0	0.3	-0.2	1.0	-2.8	-0.8	-1.8	-1.4	-0.6
Exports of goods, BOP, EUR mn ⁶⁾	85,285	88,662	93,078	23,346	18,160	41,506	81,400	89,500	98,500
annual change in %	8.5	4.0	5.0	-0.4	-22.8	-11.6	-12.5	10.0	10.0
Imports of goods, BOP, EUR mn ⁶⁾	83,573	90,346	96,069	23,538	18,948	42,487	84,100	93,800	103,200
annual change in %	12.0	8.1	6.3	-0.6	-20.6	-10.6	-12.5	11.5	10.0
Exports of services, BOP, EUR mn ⁶⁾	23,817	25,359	26,928	5,542	4,087	9,630	17,500	20,100	24,100
annual change in %	8.9	6.5	6.2	-7.3	-40.2	-24.9	-35.0	15.0	20.0
Imports of services, BOP, EUR mn ⁶⁾	16,870	17,671	19,363	4,107	3,437	7,544	13,600	15,000	17,300
annual change in %	7.1	4.7	9.6	-5.9	-27.0	-16.8	-30.0	10.0	15.0
FDI liabilities, EUR mn ⁶⁾	7,083	8,937	-294	243	-647	-404	1,000	.	.
FDI assets, EUR mn ⁶⁾	5,037	6,202	-197	-323	-916	-1,238	2,000	.	.
Gross reserves of NB excl. gold, EUR mn	23,261	26,273	27,010	24,287	28,593	28,593	.	.	.
Gross external debt, EUR mn ⁶⁾	105,600	107,975	105,734	103,014	107,356	107,356	110,000	110,000	110,000
Gross external debt, % of GDP ⁶⁾	83.2	79.4	72.4	78.7	82.0	82.0	84.1	82.4	77.5
Average exchange rate HUF/EUR	309.19	318.89	325.30	339.08	351.71	345.40	350	365	370

1) Preliminary. - 2) From 2020 unemployed in % of working-age population 15-64 (% of labour force before). - 3) Enterprises with 5 and more employees. From 2018 new source to define the staff categories; from 2019 based on tax administration data, survey data before. -

4) Loans more than 90 days overdue and those unlikely to be paid. - 5) Base rate (two-week NB bill). - 6) Excluding SPE.

Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.