GOVERNMENT OF HUNGARY

CONVERGENCE PROGRAMME OF HUNGARY

2021-2025

April 2021

Contents

1. Introduction 1
2. Economic Policy Objectives 2
3. Macroeconomic Processes and Forecast 4
3.1. External Environment 4
3.2. Components of growth 8
3.2.1. Foreign trade 12
3.2.2. Investments 13
3.2.3. Consumption 21
3.3. Labour market 25
3.3.1. Employment 25
3.3.2. Earnings 27
3.4. Inflation trends 28
3.5. Cyclical developments 29
3.6. External balance 30
3.7. Assessment of the economic consequences of government measures 31
3.8. Monetary and exchange rate policy 34
3.9. Financial sector 36
4. General government deficit and debt 39
4.1. Budget Policy Objectives 39
4.2. The 2020 budgetary outcome 39
4.3. The 2021 budget 46
4.4. 2022-25 budgetary processes 50
4.5. Structural balance 52
4.6. General government debt 52
5. Sensitivity analyses 56
6. Long-term sustainability of public finances 58
7. Quality of general government 59
7.1. Structure and efficiency of general government expenditure 59
7.2. Structure and efficiency of revenues 60
8. Institutional characteristics of general government 67
8.1. Budgetary framework 67
8.2. Structure of the general government's statistical data reporting 67
Tables 68

1. Introduction

The Member States of the European Union submit their stability or convergence programmes to the Council of the European Union and the European Commission by the end of April in every year. (The euro aera Member States are required to prepare a stability programme, while non-euro area Member States a convergence programme.)

Hungary's Convergence Programme for 2021-2025 provides information on the Government's economic policy objectives, describes the macroeconomic and budgetary developments, with particular attention to the effects of the coronavirus crisis and the economic policy responses and, as part of medium-term planning, presents the forecasts for the current and the following four years. Within the sensitivity analysis, it analyses the macroeconomic effects of two alternative scenarios that differ in the extent of post-pandemic recovery.

The Convergence Programme has been prepared together with the National Reform Programme. The document provides detailed information about the implemented and planned policy measures. The cut-off date of the Convergence Programme was 30 April 2021.

2. Economic Policy Objectives

In the year since the 2020 Convergence Programme, measures to address the health effects of the pandemic and offset the negative effects on the economy have become dominant worldwide. Hungary had strong foundations and sound public finances thanks to the consistent economic policies of recent years, so the pandemic hit a resilient, balanced economy in March last year.

The government deficit was below 3% of GDP from 2012 to 2019, and accordingly, public debt has been steadily declining year on year, with the debt ratio decreasing from 80.4% in 2011 to 65.5% by the end of 2019. Thanks to responsible finance, the established budgetary reserves and effective fiscal policy measures have provided significant room for manoeuvre to address the economic difficulties caused by the coronavirus pandemic.

As demonstrated by last year's convergence programme, the Hungarian Government made the decisions that were essential to successfully control the pandemic in time, and in the meantime additional or extended measures have become necessary due to new waves of the pandemic. Within this framework, the 2020 Budgetary Act was reworked and the Parliament is currently discussing the amendment of the 2021 Budgetary Act, which takes into account the joint aspects of the sustainability of public finances and the provision of the necessary budgetary background for protection against and recovery from the pandemic.

Expenditure on epidemiological measures and economic protection, tax measures to alleviate the burden of the crisis, and the operation of automatic stabilisers resulted in a budget deficit of 8.1% of GDP in 2020 and public debt rising to 80.4% of GDP. Fiscal policy was fundamentally based on the concept that the debt ratio should be reduced *in good times*, while *in bad times* the state needs to intervene to mitigate the negative effects of the economic crisis by accepting a temporary increase in the debt-to-GDP ratio.

Looking at economic developments we can conclude that, although the pandemic hampered economic activity to an unprecedented extent in the second quarter of 2020, a rapid correction took place from the third quarter and the recovery continued in the fourth quarter, despite the reintroduction of measures to limit the spread of the pandemic. Strong fundamentals and comprehensive and effective crisis management dampened the decline in GDP, so that the performance of the Hungarian economy as a whole in 2020 proved to be more resistant to the pandemic than the average of the EU countries.

Under the Economic Protection Action Plan, significant resources flowed into the economy, helping businesses, households and employees alike. From the point of view of income trends, an outstanding economic policy result is that despite the pandemic, the volume of employees' incomes in the national economy did not decrease, which was due to measures to support job preservation and significantly rising wages even in the midst of the crisis.

It is also favourable that the investment rate, which has been rising to a record high in recent years, remained at an exceptionally high level of 27.3% in 2020, despite the negative impact of the crisis. The anti-cyclical nature of economic policy is well illustrated by the fact that last year the ratio of public investment to GDP increased to 6.4%, which puts Hungary in first place in EU comparison. The investment rate which has been among the leading figures in the EU, the ongoing large-scale capacity expansions and the attractive corporate tax environment provide the basis for further expansion of investment performance.

The success of the vaccination programme in international comparison will provide an opportunity for a return to dynamic growth this year, following last year's economic downturn, which could be followed by a further acceleration in 2022. The convergence programme projects an expansion rate of 4.3% by 2021 and 5.2% by 2022.

The economic growth is supported by the fact that, based on the results of the Economic Protection Action Plan, the Government announced the Action Plan for Restarting the Economy in February this year, which will be implemented in three phases. In the first phase, among other things, interest-free loans available to the most vulnerable small and medium-sized enterprises were introduced, and an expanded home creation and home renovation programme was launched. In the next phases, the Action Plan will focus on areas that will support the development of the economy during the recovery from the crisis, also in the long run. As a result of the transformation, a higher education system reacting more quickly to market needs and playing a key role in research and development and innovation will be created. In the third phase of the restart, green transition and the digitalisation of the economy will play a central role, and furthermore, significant resources will also be available for the development of the Hungarian agriculture and the food industry.

In addition, it will contribute to the recovery of the economy that a record amount of new EU funds will be available to Hungary in the 2020s. On the one hand, in the period of 2021-2027, Hungary can count on 22.5 billion euros of cohesion and 11.9 billion euros of agricultural policy funds. On the other hand, Hungary is also entitled to a non-refundable amount of 8.5 billion euros from the Next Generation EU envelope. The amount of more than 40 billion euros available over the period 2021-2027 will average around 3.4% of GDP per year over the next seven years.

During and after the coronavirus crisis, the Government is committed to encouraging childbearing, supporting families raising children and improving their quality of life. It helps to create and renovate homes, recognizes the extra efforts of families, and encourages the complex development of small communities through a number of measures. Among other things, in order to promote home creation, the Family Housing Allowance (CSOK) has been expanded, a new home renovation programme is available, which provides assistance in the form of a non-refundable grant of up to HUF 3 million to families expecting or raising at least 1 child, whereas young people will be exempt from personal income tax from 2022.

Looking ahead, the unchanged objective of economic policy is to reduce the tax and contribution burden and to improve the employment- and business-friendly nature of the tax system. In line with this, tax policy focuses on reducing taxes on labour and the tax and administrative burden on businesses, increasing the efficiency of tax collection and simplifying the tax system.

The objective of Hungary's public debt management strategy is to maintain the stable financing position achieved in recent years, in the framework of which four main goals still prevail: to gradually reduce the ratio of public debt to GDP, keep the share of foreign currency debt low, increase household participation in financing public debt and increase the maturity of public debt.

The convergence programme envisages maintaining the investment-led economic growth in recent years, which will increase GDP by more than 4% year on year in the medium term. With a disciplined fiscal policy that will gradually reduce the budget deficit, the deficit will shrink to 2% of GDP in 2025. As a result, Hungary's public debt will fall to 73.1% of GDP by the end of the planning horizon.

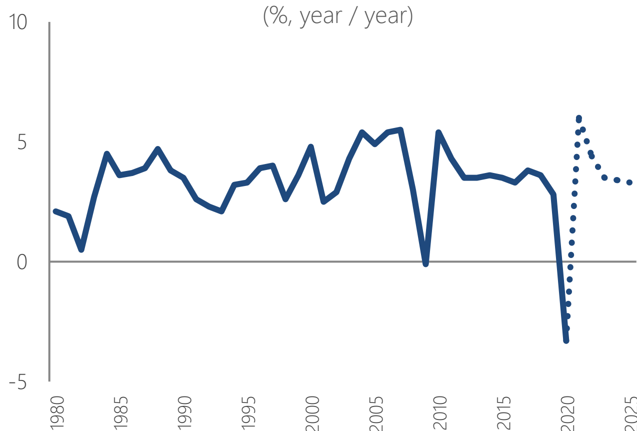
3. Macroeconomic Processes and Forecast

3.1. External Environment

In 2020, the world economy contracted by more than 3%, which is unprecedented in recent decades (*Figure 3.1*). The pandemic and the restrictions to control its spread, despite the large-scale supportive fiscal and monetary measures, have led to an unprecedented decline in output and mass job losses in many areas. Although immunization of the population has begun worldwide, the waves of the pandemic continue to slow down the recovery and make it more difficult in many areas. The developments significantly dampened external demand, which is substantial for the Hungarian economy, as a result of which the volume of domestic exports decreased in 2020 to a comparable extent to that experienced during the 2008 financial crisis.

Figure 3.1: Global GDP developments

(%, year / year)



Source: IMF

The US economy outperformed the European Union again last year, in which, in addition to less stringent epidemiological measures, effective fiscal and monetary intervention played a role. The supportive steps taken under Trump's presidency and President Biden's first spending bill have given the U.S. economy a major boost. In addition, at the end of March 2021, the President announced another 2,000 billion USD scheme (American Jobs Plan) with the primary objective of infrastructure development and job creation. The plan may be followed by an additional bill that will focus on U.S. families, social and health care, childcare benefits and education. Taken together, these project a rapid recovery in the U.S. with a significant increase in government debt.

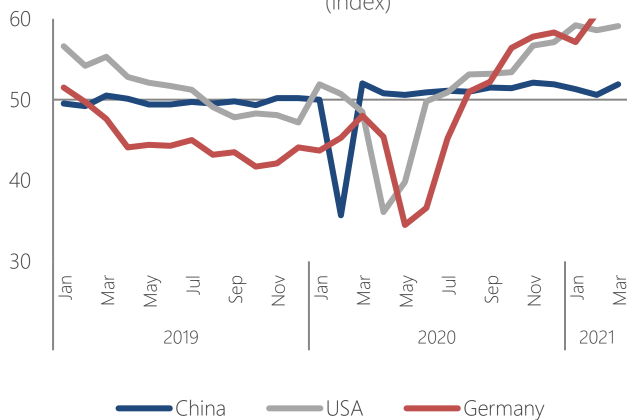
The Member States of the European Union have also tried to cushion the decline with large-scale stimuli built from a number of similar elements. While even the consequences of the 2008 crisis have not yet been fully eliminated, the performance of the southern Member States, where tourism has a significant weight in the economy, has been severely hampered by the pandemic. At EU level, with some delay, the Next Generation EU funds could help the recovery. However, looking ahead, it is unfavourable that the loss of momentum in the euro area threatened with a recession even before the pandemic, mainly due to the slowdown in manufacturing and declining new car sales, a measure of gloomier expectations. The pandemic has triggered dramatic processes that have virtually shut down personal services and dropped the industrial production of the currency zone to unprecedented depths in April 2020. As a result of the strengthening of the resistance of the economies to the pandemic, the latter decreased by 5.1% in 2020 as a whole, which is more moderate than it was in spring. While it is positive that the EU opened the year with a 0.1% increase in industrial performance, there are still restrictions in place in most countries due to the coronavirus, holding back primarily the performance of services. Beyond the pandemic, the EU, which is losing its weight in the world economy, continues to face a number of challenges, such as electromobility, digitalisation and IT developments, in which Europe is mostly a follower.

At the origin of the pandemic, China, a high decline was witnessed on a historical scale in the first quarter of last year, but this was followed by a rapid recovery. Thus, China was the only economic power that could achieve growth (2.3%) in 2020. The expansion is mainly explained by a surge in government lending as a result of loose fiscal and monetary policies, which has helped industry and construction recover quickly, while consumption lagged significantly behind pre-viral

levels. However, low domestic demand was offset by well-performing Chinese exports, which took advantage of the huge increase in demand for health products worldwide. The positive numbers since the beginning of the year are partly explained by the base effect, but according to statistics that exceed analysts' expectations, the Asian economy will continue to be one of the main drivers of world trade in 2021.

Figure 3.2: Development of the manufacturing purchasing managers index

(index)



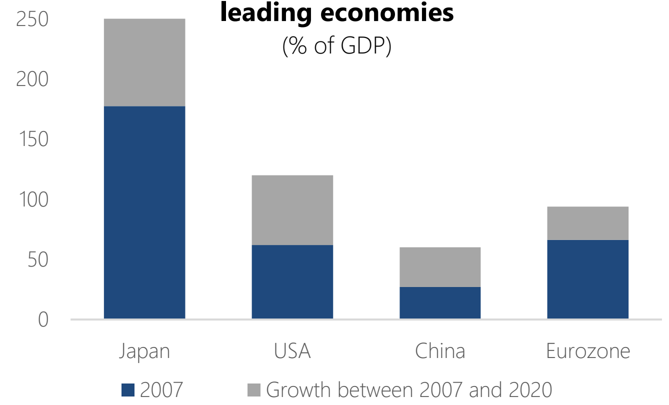
Source: Trading Economics

Economic processes are currently fundamentally pandemic-driven. As a result, recovery will be largely driven by the production, distribution, speed, and spread of vaccines. Therefore, the establishment and administration of vaccination capacities has become an essential crisis management measure. With the containment of the pandemic and the increase in the number of vaccines administered, the economy will also gain strength in our external markets. The growth of the world economy may accelerate in the second half of 2021, as a result of which the opportunities for domestic exporters will also expand. As a result of the gradual recovery and favourable spillover effects, the growth of our main foreign markets in 2022 is expected to be higher than this year.

However, the economic recovery trends in the world economy are accompanied by significant risks: the emergence of further waves of the pandemic cannot be ruled out, and the trade policies of the world-powers protecting their internal markets may restrict the expansion of international trade of goods. The global growth outlook is also subject to risks from a financial perspective. Over the past 20 years, total global debt has risen in the first half of last year from 225% of GDP to a historic high of 331%. In the current fragile economic environment, for many countries, a low-yield environment ensures the sustainability of high debt levels.

Figure 3.3: Public debt of the world's leading economies

(% of GDP)

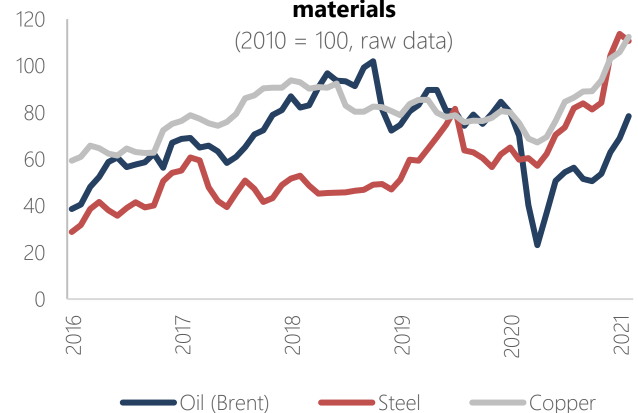


**Forecast, Source: OECD, IMF, Eurostat, European Comission,*

At the same time, in consideration of supporting growth trends, it is favourable that the inflationary environment has allowed the world's leading central banks to maintain loose monetary conditions. However, the uneven nature of the global recovery and the gradually returning demand are increasingly reflected in price developments: in addition to transport costs, the prices of key commodities have also approached their multi-year highs (*Figure 3.4*). In addition, the revival of currently hibernated services (tourism, hospitality) may also have a price-increasing effect. As a result of these factors, a higher-than-expected increase in import prices can be expected through foreign trade and industrial producer prices.

Figure 3.4: Price development of major raw materials

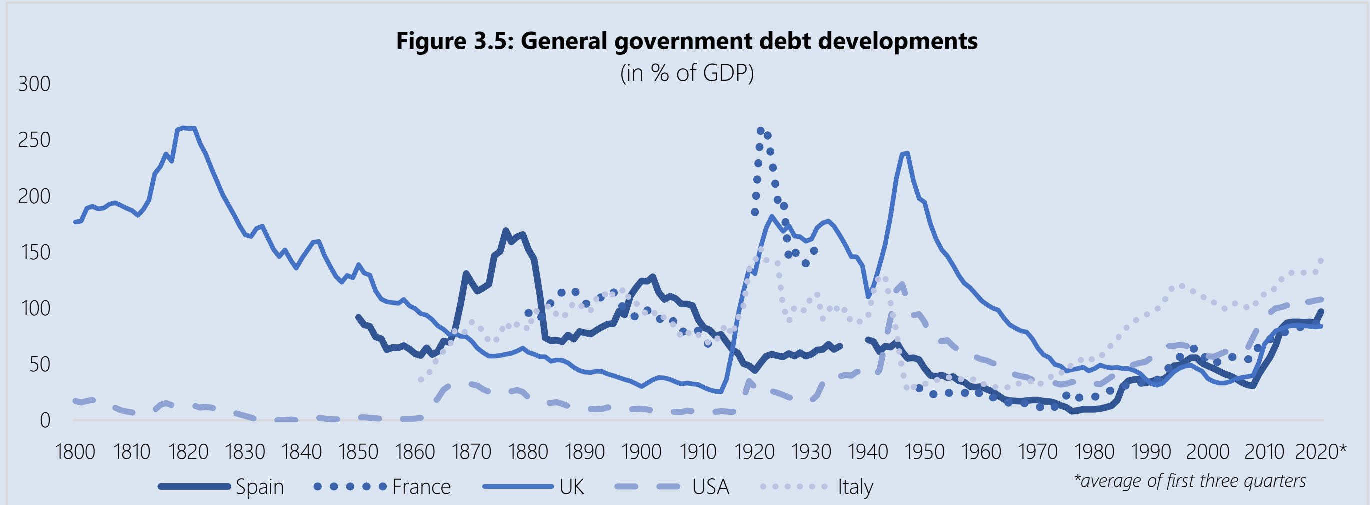
(2010 = 100, raw data)



Source: FRED

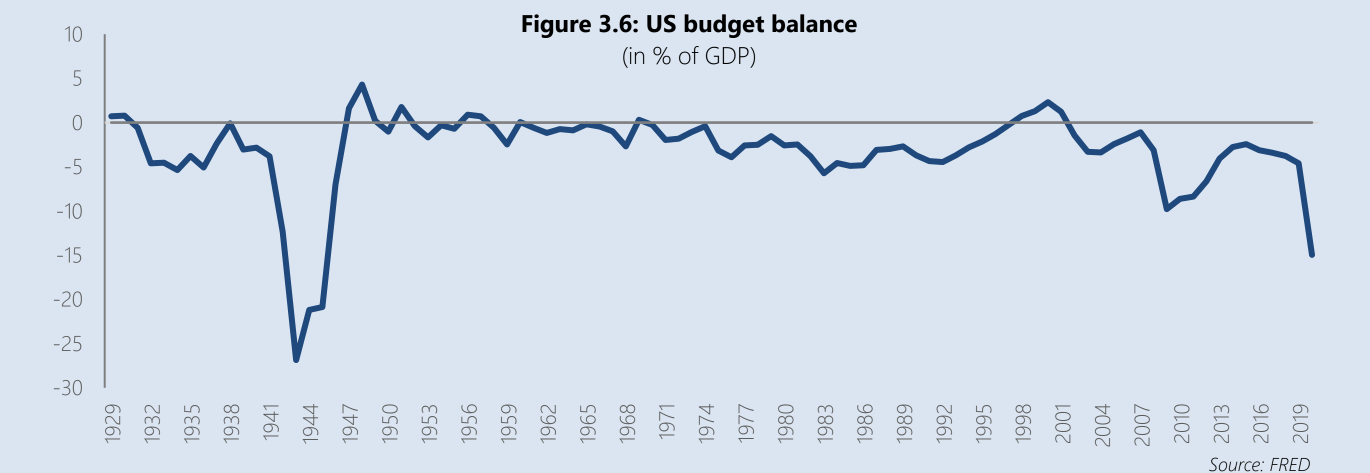
Box 1: Public debt trends

A significant number of the world's dominant economies have announced historic fiscal stimulus measures to combat the negative economic effects of the coronavirus pandemic. As a result, government debt-to-GDP ratios have risen sharply in most countries, and in many countries are projected to increase further in the coming years, according to forecasts and announcements for the future. At the same time, by placing contemporary developments in a historical context, it is possible to assess the extent to which current processes are unprecedented and how they could mark the beginning of a paradigm shift, or be fitted into a long-standing trend.



Centuries-old data sets clearly show that the world's leading economies have experienced in the past that public debt exceeded several times the annual performance of the economy. The pace of debt reduction was also varying: in most cases, the debt that soared after the wars was reduced to manageable levels within a few decades. In contrast, in the early nineteenth century it took an entire century to consolidate the English debt that soared during the Napoleonic Wars and the following economic crisis. Subsequently, in the second half of the 19th century, the countries of the world were hampered by the American Civil War and the ensuing long depression, which until 1929 was called the Great Depression. A few decades later, in the post-World War I period, significant amounts of public debt arose in Europe's advanced economies, whose reduction was hampered by the Great Depression. This was followed by World War II, which resulted in spiking debt levels similar to World War I, or in many cases it even exceeded the earlier scales, which was followed by a long period of debt reduction.

In the 1970s, however, the evolution of government debt changed because, with the exception of a minor stagnation in the early 2000s, the trend in government debt-to-GDP ratios began to increase in many developed countries. As U.S. data show, this has its roots in a quasi continually deteriorating budget balance since the 1970s.



In the post-World War II period, the principle of spend in crises and reduce debt in rising periods mostly prevailed. Accordingly –with the exception of a periods of great shocks– between 1929 and 1970, the U.S. budget was mostly balanced. In contrast, between 1970 and 2020, 47 occasions of annual deficit and only 4 years of surplus were

recorded. However, this is not just a US phenomenon, for example, since its inception, the EU average has never been in surplus.

There are several explanations for the increased budget deficits and the increase in tolerance for public debt. Looking at the United States, the stagflation caused by the oil crisis and the subsequent monetarist turn, as well as the abandonment of the gold standard, can be highlighted. The debt of a state could no longer be compared to that of a household, which had to repay its debts in the medium term and not spend too much. It is possible that a state, if it restrains its spending, could potentially lose even more revenue than it would save due to the multiplier effect. Like households, the obligation to pay interest on large debt in itself reduces the room for manoeuvring with the budget, but in the declining interest rate environment and growing money supply of recent decades, states can relatively easily refinance their liabilities.

Meanwhile, even after the financial crisis of 2008, the international institutions influencing economic policies (IMF, ECB, European Commission, OECD) urged with a rigid attitude to remove as soon as possible the fiscal policies helping the recovery. This is partly due to the fact that the European Union experienced a double-dip recession in 2009 and 2012. Learning from their past mistakes, they are more understanding of fiscal measures supporting the economy at the time of the coronavirus pandemic, and also emphasize in their analyses the importance of restarting economic growth, with the success of which it will be possible to restore fiscal balance at the same time.

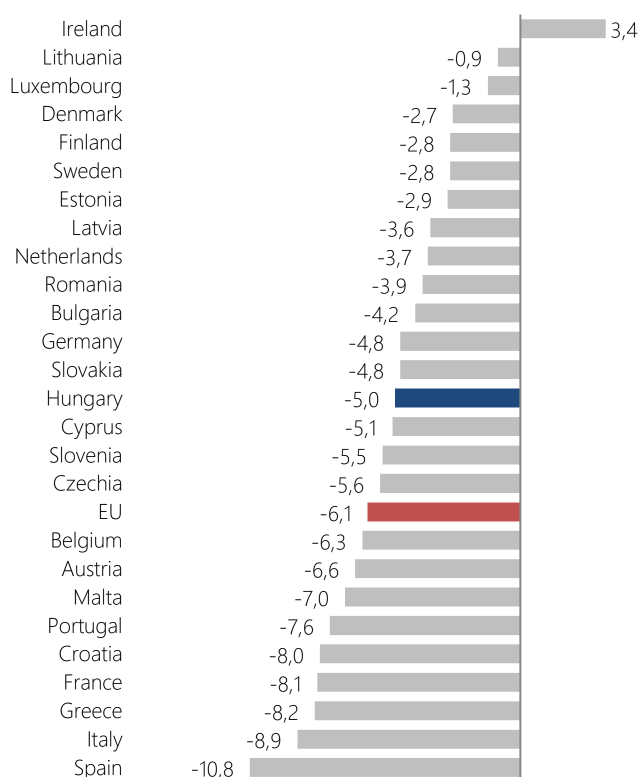
However, the risks associated with high government debt are significant. High debt can reduce the sustainability of a country’s finances, with the result that financiers, be it the population, banks or even external creditors, may lose confidence in the country and look for alternative investment opportunities. In addition to debt levels, the composition of debt is also an important factor. On the one hand, if the debt is in external hands (international institution, country or investor), it could easily lead to a loss of national economic policy independence, as has been the case with Greece or countries in need of IMF credit. On the other hand, in a way that is less obvious than in the former case, funding from external actors can create significant and complex interdependencies. An example of this is the case of the United States and China, which has a significant share of US debt: on the one hand, China's trade surplus with the US (and other countries), which the latter seeks to mitigate with protectionist measures to protect its internal market, provides demand for US government bonds. On the other hand, due to the accumulated significant bond portfolio, China has also become increasingly interested in maintaining US solvency and, indirectly, its prosperity. As in the case of Hungary, these risks in terms of dependency and the reduced ability to pursue independent economic policies are reduced as a significant part of a country's debt is owned by internal investors, mainly the population.

As a result of the measures taken to protect against the unfavourable economic consequences of the coronavirus, debt rates have increased worldwide, including in Hungary. At the same time, in addition to supporting the restart of the economy, looking ahead, the debt ratio in Hungary is on a declining path again. As a result of this, the interest burden on the budget will remain low, investor confidence may be further strengthened, it will be possible to secure demand mainly from domestic resources, and thus those risks that arose already in 2008 may be avoided, which would arise in the event of a need for external financing. The post-2010 developments confirm that regaining room for autonomous economic policy has greatly contributed, for example, to the successful management of inherited foreign currency loan burdens, and has enabled the adoption of measures that ensured fiscal balance and put the Hungarian economy on a dynamic growth path.

3.2. Components of growth

In 2020, as a result of the pandemic affecting the whole of Europe, although the unfavourable effects were effectively mitigated by the economic protection measures taken, the Hungarian GDP also decreased. At the same time, the decline was smaller than the EU average, so Hungary maintained its growth surplus. Respect to convergence, it is outstanding that among the Visegrad countries, Hungary survived the crisis with less shock than Slovakia and the Czech Republic, which shows the resilience of the Hungarian economy based on strong foundations *(Figure 3.7)*.

Figure 3.7: GDP changes in the EU, 2020
(percent)



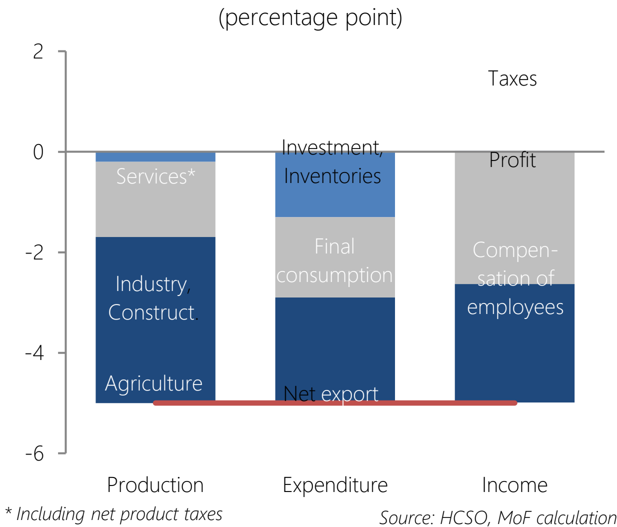
Source: Eurostat, MoF calculation

Services were the largest contributors to the decline in GDP, within which the performance of many sectors was significantly curtailed by the epidemiological restrictions. On the positive side, industrial production, which fell sharply last spring, has made positive contribution to growth in the last quarter, proving the international competitiveness of the domestic manufacturing industry. Construction produced high dynamics in recent years, after which the slowing of the sector could already be witnessed in 2019, however despite the high basis, it offset a significant part of the decline by the end of the year. Overall, industry contributed with 1, construction with 0.5, services with 2.7 and the balance of product taxes with 0.6 percentage points to the decline in GDP.

Regarding income trends, an outstanding result is that despite the pandemic, the volume of employees' incomes did not decrease, which was due to measures taken to support job preservation and therising wages inspite of the crisis. Reduced corporate profits and tax revenues contributed roughly to the same extent to the decline *(Figure 3.8)*. Employee incomes retained their real value, in which the Government's economic protection measures, which served both the preservation of jobs and the protection of businesses, played a major role. In addition to wage subsidies, companies that retained their employees were helped by subsidised credit schemes, moratorium on instalment payments of loans also available to businesses, temporary tax reliefs and tax cuts. Of the latter, it should be noted that the rate of social contribution tax decreased again by 2 percentage points last year. At the same time, the retention of employees was financed by enterprises partly through a temporary reduction of their profits, while the government's tax revenues have also declined.

On the expenditure side, net exports dampened growth the most, driven by a sharp decline in exports of services due to the shortage of foreign guests. It is favourable, however after declining last spring, the export of goods in the second half of the year already exceeded their volume year-on-year, thanks to which the balance of goods as a whole made a positive contribution to growth in 2020.

Figure 3.8: Decomposition of the 5.0% GDP growth in 2020
(percentage point)



** Including net product taxes* *Source: HCSO, MoF calculation*

Investment activity, which was very strong even in European comparison prior to the crisis, also declined but still remained at elevated levels. This is due to the confidence of enterprises in Hungary, government measures to support household investments and the creation of homes, and public investments in health care and other areas. The lower consumption is not the result of less household incomes but of limited supply because of the closures and a strengthening of cautionary considerations. This also led to an increase in household savings.

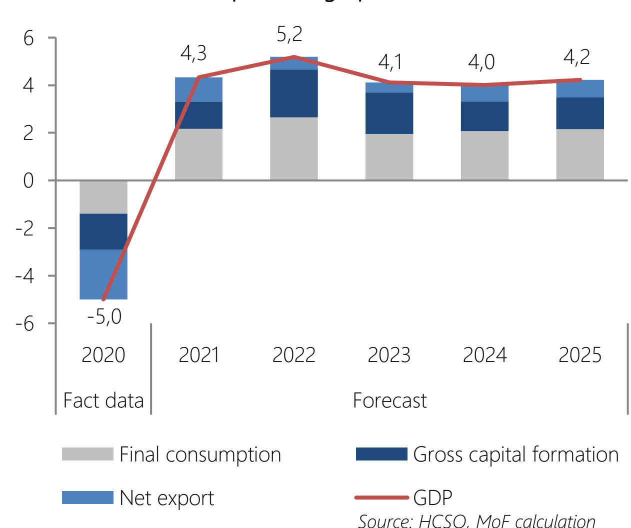
Looking ahead, a gradual normalization of economic circulation is expected parallel with the increasing immunization of the population. On the one hand, the economic recovery has already begun in the previous periods, as economic actors have learned to adapt to the extraordinary situation as much as possible. This is well illustrated by the fact that the restrictive measures had less impact on economic performance in the first quarter of this year compared to the low point in Q2 last year. From this aspect, the industry can be highlighted, which is now producing smoothly in contrast with the almost complete shutdown experienced last spring. In addition, as a result of the lifting of restrictions, the most affected sectors (such as tourism, cultural and leisure activities) may restart, which could give another boost to economic growth.

The above process is strengthen by the high savings rate of 6.1% of GDP in 2020, and on the other hand, the second lowest loan portfolio in the EU, which will form a significant growth reserve through consumption in the coming years. It helps to meet the growing demand that a significant part of the capacities on the supply side has been maintained thanks to government measures.

Despite the negative impacts of the crisis, the exceptionally high investment rate of 27.3% of GDP in 2020 may increase further after the crisis, thanks to rising corporate investment due to the competitiveness of the domestic economy. This process is reinforced by the expansion of household and government investments, not least thanks to the use of EU cohesion and the Next Generation funds. The above forecast is supported by the fact that in the period since the beginning of the pandemic, a number of very significant investments have been announced by companies in Hungary, moreover, private investments may gain new momentum once the uncertainty has passed. All this foresees a further expansion of production capacities, which will result in a further increase in exports and an increase in Hungary's export market share.

As a result of these developments, if the baseline scenario materializes, GDP growth of 4.3% is likely this year, after which growth could accelerate to 5.2% in 2022 (*Figure 3.9*).

Figure 3.9: GDP growth: demand side
(percentage point)



Source: HCSO, MoF calculation

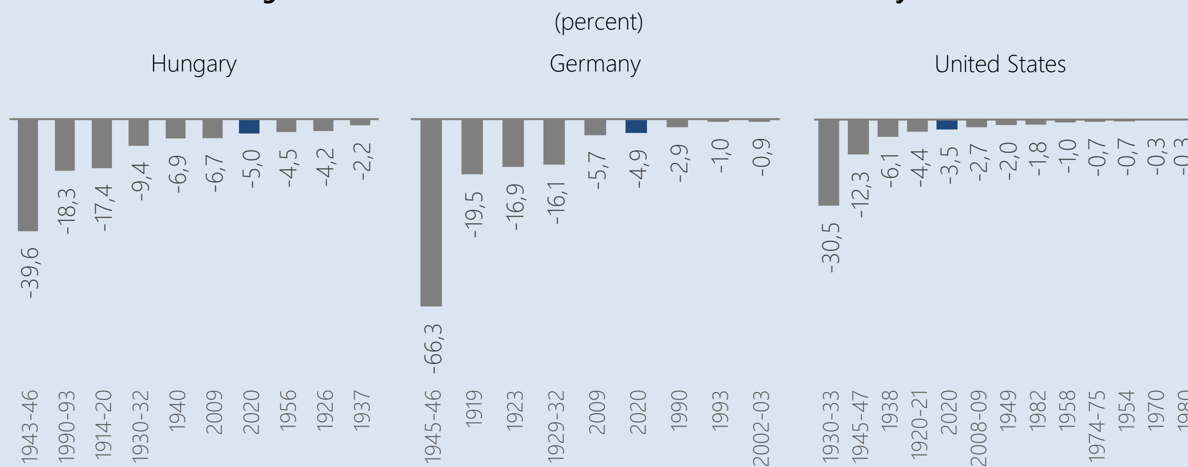
Box 2: Recessions of the century - similarities and differences

A crisis situation being experienced always seems more severe and painful than those that have faded over time. The coronavirus pandemic caused a significant economic downturn in many countries in 2020, which in many cases is regarded as centuried, as it was said for the financial crisis of 2009, which took place less than a decade ago.

Based on data from the last hundred years, the decline caused by the 2020 coronavirus pandemic is indeed significant, however, it is much smaller than the great shocks of the twentieth century. This is well illustrated by the fact that in the period between 1930-32 and even after World War II there were much greater declines. In the case of Hungary, the transformation crisis following the change of regime also caused a significantly larger loss than last year, which was affected by the coronavirus, and the financial crisis also brought a deeper recession. That is, according to the available historical data, the 2020 performance decline was the seventh largest in terms of scale.

Figure 3.10: The economic downturns of the last hundred years

(percent)



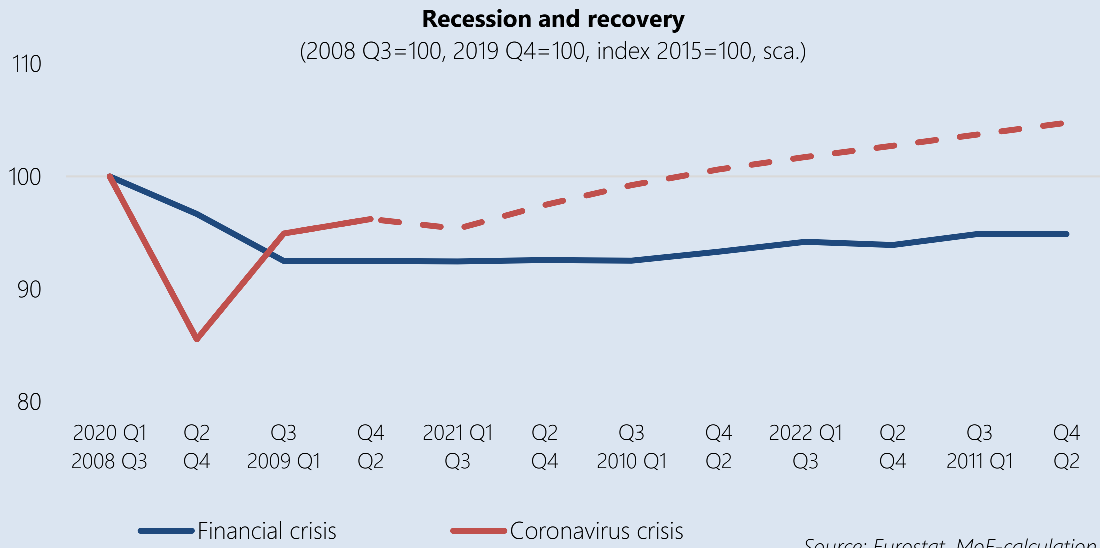
Source: Maddison, Eurostat, BEA, World Bank

Although the extent of the decline caused by the financial crisis that erupted in Hungary at the end of the 2000s was similar to the current one, it is important to note that there are significant differences between the two periods in terms of the causes, nature and the course of the crisis. The twin deficit of the balance of payments and the budget then undermined the country's financial stability, and growth momentum also waned after the turn of the millennium. Around 2008, in parallel with the lending cycle, risk-taking peaked, as in many other countries around the world, resulting in, among other things, the accumulation of bad-quality loans on banks' balance sheets. In Hungary, the high share of foreign currency loans was an increased problem, which worsened the financial position of debtors through the weakening national currency as a result of the crisis, which further exacerbated the downturn as a vicious circle. In contrast, at the beginning of 2020 the pandemic hit a much more resilient and balanced economy: the Hungarian economy was in growth momentum, both external and internal balance indicators developed favourably, and the operation of financial intermediaries became more prudent due to stricter requirements for the sector.

Another important difference is that while the focus of the previous crisis was the overheated U.S. real estate market and excessive risk-taking in the banking system, the current downturn was triggered by a health emergency independent of the economy. While the financial crisis had a lasting impact on the economy through declining demand until the necessary and lengthy balance sheet adjustments took place, now, after weeks temporarily crippling the activity in the spring of 2020, thanks to epidemiological restrictive measures limited only to services requiring personal contact, which also helped to restart the economic circulation, the second quarter was followed by a rapid rebound in the third quarter, to an extent never seen before.

The spillover of the crisis in the affected sectors and the reduction of capacities were prevented by the inflow of significant resources into the economy under the Economic Protection Action Plan, which helped businesses, households and employees alike. As a result, in contrast with the crisis of 2008, by being able to contain the

pandemic, the Hungarian economy has a good chance to quickly surpassing its performance in the period before the outbreak.



Source: Eurostat, MoF-calculation

3.2.1. Foreign trade

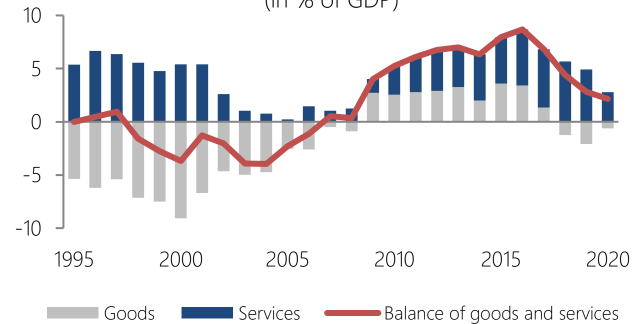
In the spring of 2020, the pandemic disrupted production chains on the supply side and made many branches of services impossible, while on the demand side, it hampered consumption and investment activity. As a result, after the 2008 downturn, the volume of exports and imports fell sharply again in 2020.

On the export side, the volume of services shrank by an unprecedented 24.0% last year. This is mainly due to the downturn in tourism and air transport sector most affected by the pandemic. Exports of goods decreased by only 1.8% compared to 2019, chiefly due to the outstanding performance in the last quarter. Last year, only the exports of the group of food, beverages and tobacco expanded. Exports of road vehicles, which account for a significant share of foreign trade, were significantly lower than in the previous year. Thus, overall, domestic exports fell by 6.8% in 2020.

On the import side, services decreased by 15.4% while imports of goods decreased by 2.2% compared to the previous year. The sharp decline in tourism and transport services, parallel with exports, contributed significantly to the decline in imports of services. In the case of imports of goods, the decline was mainly caused by fuels and energy and the group of machinery and transport equipment. The 7.3% decline in investment also contributed to the 4.4% decline in imports last year.

As a consequence of the these processes, foreign trade surplus continued to decline after the peak in 2016, and accounted for 2.2% of the GDP last year *(Figure 3.12)*. This was primarily due to the decrease in the internationally high surplus of the services balance which was principally due to the deterioration of the balance of tourism and transport services, which are the most exposed to the closures. In contrast, in the two years preceding that period, the negative balance of goods deficit improved significantly, mainly due to lower domestic demand and, to a lesser extent, the favourable change in terms of trade thanks tothe fall in oil prices, and showed only a minimal deficit in 2020. As a result, net exports as a whole contributed negatively to GDP growth last year.

Figure 3.12.: Balance of external trade in goods and services
(in % of GDP)

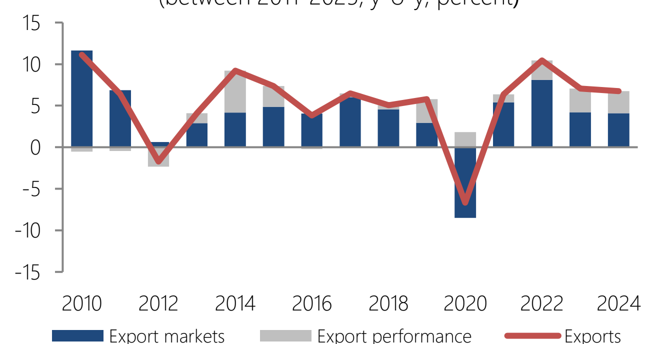


Source: KSH, calculations by the Ministry of Finance.

Looking ahead, export prospects dampened in the short term by the negative economic effects of the coronavirus, but with the reduction of the pandemic worldwide, foreign trade is expected to expand from mid-2021 onwards *(Figure 3.13)*. With the already announced large-scale corporate investments of 6,600 billion HUF in the following years, export performance can expand significantly, helping to increase Hungary's export market share.

In the case of foreign trade, the demand-reducing effect of the coronavirus pandemic is also decisive, prevailing in terms of consumption, investment and export goods. At the same time, parallel with the gradual recovery of the external and domestic demand, imports and exports may also increase significantly. As a result, net exports may again substantially support growth from 2021 onwards.

Figure 3.13.: Exports' developments
(between 2011-2025, y-o-y, percent)

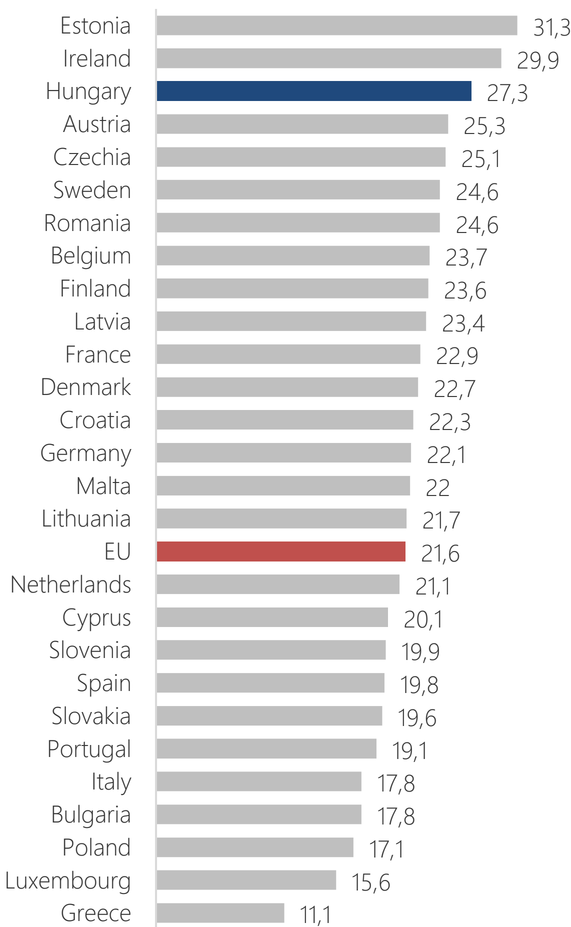


Source: Eurostat, HCSO, MoF calculation

3.2.2. Investments

During 2020, more than HUF 13,000 billion worth of development was implemented in Hungary, which performance is 7.3% lower than in the previous year. Nevertheless, developments have increased by a total of 61% since 2010, thus Hungary's investment rate increased from 20.1% in 2010 to 27.3% in 2020 maintaining the result achieved before the coronavirus crisis: Hungary is still on the podium in the European Union with the historically record investment rate (Figure 3.14).

Figure 3.14: Investment rate development in 2020 (in % of GDP)

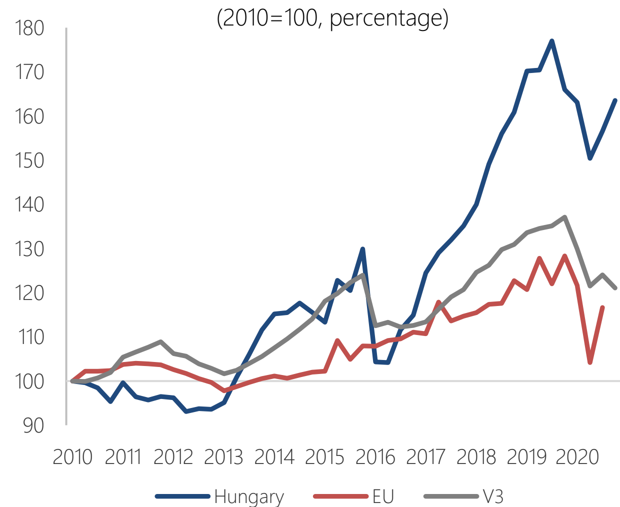


Source: Eurostat

The upscale position shows an even more favourable picture of Hungarian economic situation, since a unique large investment of a company operating in the IT sector lies behind the outstanding investment activity of the leading Estonia. Furthermore, in contrast to the Hungarian performance, a significant part of investments in the second place in Ireland can only be related to the accounting practices of multinational companies taking advantage of favourable tax opportunities.

The level of investments rose to an unprecedented height in the third quarter of 2019, to which all three sectors contributed. Government developments have been supported by the efficient use of EU funds, and household investments have been driven by home creation subsidies and the reduced VAT rate on dwellings. Furthermore, a number of corporate developments were completed in the autumn of 2019, as while investment activity increased by 16.2% in the first three quarters of 2019, only 4.5% year-on-year growth was recorded in the fourth quarter. Thus, in the last months of 2019, a correction began, further deepened by the escalation of coronavirus crisis. At the same time, examining the processes in an international comparison, it can be stated that Hungary's investment performance was at the forefront even during the downturn.

Figure 3.15: Gross fixed capital investment developments in international comparison
(2010=100, percentage)



Source: Eurostat, MoF calculation

It is particularly positive that the economic protection measures taken in connection with the coronavirus crisis at the end of last year had already substantially supported the expansion of investments: in the fourth quarter of 2020, developments gained new momentum, showing an increase of 1.3% year-on-year and 4.4% quarter-on-quarter. The resumption of investment was mainly driven by the increasing activity of government and households sector, supported by a double-digit growth rate in the fourth quarter in real estate transactions, public administration, education

and, partly related to the pandemic, health branches. Overall, it can be stated that the investment rate, which has been at the forefront of EU for a while, the ongoing large-scale capacity expansions as well as the attractive corporate tax environment all form the basis of Hungary's gradually strengthening investment performance in 2021.

Corporations

Among corporations, investments decreased by 7.5% in 2020, since the development activity of foreign-owned companies became more subdued due to the unfavourable economic environment as a result of pandemic. Although investment in manufacturing industry with the largest weight, a quarter of total, fell by 8.1% last year, the picture is nuanced by the fact that, the electrical industry, partly related to the battery manufacturers, increased its investment activity by 57%, whereas pharmaceutical industry, food industry and textile industry developments have also expanded over the past year.

Even in the context of coronavirus crisis, looking ahead, there is a risk that, due to declining demand, some projects may take longer to implement than planned, and fewer investment decisions will be made in the future. Despite all this, a number of new corporate developments have already been announced this year in a total value of HUF 2600 billion supporting Hungary's still outstanding ability to attract capital. The results of successful investment promotion are also reflected in the fact that, investors have become more diversified over the last 2-3 years with the increase in the weight of the Far East countries, and on the other hand large-scale investments arrive to industries with development potential, such as electromobility (*Box 3*).

In order to mitigate the adverse economic effects of the pandemic, restart the economy, maintain success in export markets and create jobs, the Government has taken a number of economic protection measures in 2020. As part of this, in order to protect domestic enterprises, a decision was made on new investment incentivisation and export support measures: the HUF 1,490 billion credit, guarantee and equity schemes of the Hungarian Development Bank, the mitigation programme of Eximbank, and the competitiveness-enhancing support to help medium and large enterprises operating in the manufacturing and business services sector, currently struggling due to the outbreak of the pandemic. The financing of the SME sector is also supported by the MNB's HUF 3,000 billion Funding for Growth Scheme and the new loan schemes introduced under the Széchenyi Card Programme. In addition, the amount of investment aid for large enterprises was expanded, special economic zones were established, and it was decided that in the next four years, companies planning to invest in Hungary would be fully exempt from corporate income tax in terms of the amount of profit re-invested.

As part of the Economy Restarting Action Plan, the Government decided to introduce a new credit scheme for small and medium-sized enterprises in distress due to the coronavirus pandemic: they can utilise an interest-free loan of up to HUF 10 million for 10 years, which they have to start to repay only after a 3-year grace period. In addition, a number of non-refundable grants have been announced for micro, small and medium-sized enterprises, such as the Hungarian, high-tech and green tenders, as well as the green national champions programme.

In addition, the pandemic highlighted the strategic importance of health industry, the production of care equipment and medicines, therefore the Health Industry Support Programme helps the development of domestic enterprises that play a role in strengthening this sector with a budget of HUF 50 billion. The listed programmes make it possible to implement previously planned corporate investments despite the crisis caused by the pandemic (Box 7).

Box 3: FDI inflow - uninterrupted even during pandemics

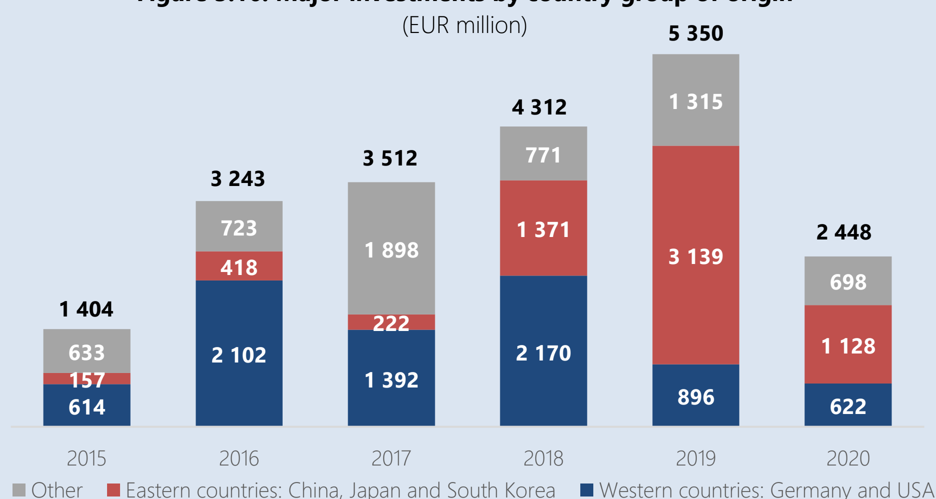
In the successful modernization of Hungarian economy Foreign Direct Investments (FDI) have been important pillars since 1990. Developments by international companies incorporating advanced technologies, while creating new export capacities and jobs, contribute to productivity growth, broaden the opportunities for domestic suppliers, and last but not least, working capital inflows improve the balance of payments position in both the investment and production phases.

The utilisation of growth potential of FDI is supported by the fact that Hungary's ability to attract capital has significantly strengthened in recent years. The corporate income tax rate, which has been reduced to 9% from 2017 and still the lowest rate in the EU, significantly reduces the cost of capital and plays a key role in the upscale position in the competition for investments. Other important factors are the developed infrastructure ensuring the interconnection and quick availability of producers and their markets, the competitiveness of Hungarian workforce and active investment promotion policies. As a result, even the outbreak of coronavirus pandemic did not break the favourable processes: the large-scale corporate developments announced since the beginning of 2020 amount to HUF 2,600 billion, which is about 5.5% of the annual domestic GDP. In the medium term, the additional capacities developed through these investments could increase Hungary's export performance by about HUF 8,000-13,000 billion annually, which means 20-34% of current annual Hungarian exports of goods. All in all, in the coming years, the above investments can generate a total GDP surplus of 8-10 percentage points.

In recent years, there has been a significant shift in emphasis among investors. While in the past the countries of North Atlantic region, mostly Germany and the United States, were dominant in terms of developments coming to Hungary, in recent years the companies of the Far East, mainly South Korea, China and Japan, have gained ground. According to the Hungarian Investment Promotion Agency (HIPA), 50% of investments in 2015-2018 came from Germany and the USA, while their share fell to 19% in 2019-2020. In contrast, only 10% of capital investments came from South Korea, China and Japan in 2015-2017, while this ratio rose to 32% in 2018 and jumped to 55% on average in 2019-2020. In nominal terms, out of the EUR 12.1 billion invested with the cooperation of HIPA over the past three years, the three eastern countries carved out EUR 5.6 billion, while EUR 3.7 billion in investments arrived to Hungary from Germany and the USA.

Figure 3.16: Major investments by country group of origin

(EUR million)



Source: HIPA

It is positive that in 2020 the Government's investment incentive policy directly contributed to the implementation of 907 projects, thus investments worth of EUR 4.1 billion will be realized in Hungary, creating 12.9 thousand jobs. Within this, on the one hand, the successful tenders of 810 medium-sized and large enterprises participating in the two support programmes aimed to increase competitiveness, launched under the Economic Protection Action Plan, represent an investment volume of EUR 1.6 billion. On the other hand, 97 large-scale FDI projects worth EUR 2.5 billion were also approved last year, which will mean 10.1 thousand new jobs in the coming period.

In terms of sectoral breakdown, the trend in electronics branch and electromobility deployment continued in 2020, with manufacturers of components for batteries for electric vehicles launching significant developments: 3.3 thousand jobs will be created and EUR 808 million will be invested thanks to 22 projects announced last year. Last year, the favourable increasing trend in number of high value added shared services centres continued to prevail, as in 2020 more investments were decided upon in this area than ever before: 25 projects have been approved in the areas of shared service centres, infocommunication investments and research and development, creating more than 3,000 new jobs.

The composition of foreign direct investment is also marked by the continued expansion of the Eastern opening: Asian investors will make a total of 30 investments worth EUR 1.7 billion and create 3.6 thousand new jobs for the Hungarian economy. In terms of investment volume, last year China ranked first with 27% and South Korea ranked third with 18%. Nevertheless, the strong German and American investor base was also represented in 2020: Germany implements the most new investments with 20 projects, and took the third place with 1.5 thousand jobs in terms of the number of jobs created. The United States leads the job creation list with 2,500 jobs, accounting for about a quarter of all jobs created.

The increase in investment from the East is also evidenced by large-scale projects announced in recent months. Outstanding among these is the investment of the South-Korean SK Innovation, as the company will supplement the existing units in Komárom with another battery plant with an annual capacity of 30 GWh. The greenfield investment is planned to be realised from about EUR 2 billion (approximately HUF 700 billion), a historically record amount in Hungary. The production unit in Iváncsa will produce every year the energy storage capacity needed to produce about half a million electric cars. At the same time, many Asian-based battery component suppliers, such as Doosan, Dongwha, Semcorp, Lotte Aluminum, Sangsin, Shenzhen Kedali or Chervon Auto, are also expanding their operations in Hungary, which will build a wide range of battery production chains, thus strengthening Hungary's position in the field of electromobility with great potential for development.

Hungary's achievements in the field of investment promotion are also widely recognized abroad. On the one hand, according to the Global Best to Invest 2020 report of the investment magazine Site Selection, Hungary was ranked among the top 10 investment destinations in the world for the third time in a row, and HIPA retained its first place as the best investment promotion agency in the region. On the other hand, at the Annual Investment Meeting (AIM), HIPA won the title of Best Investment Agency in the Region for the second time.

Overall, it can be concluded that, Hungary is an attractive destination for FDI investments. In recent years, as a result of developments from the Far East, the investor base has become more diversified and Hungary's economic relations with this dynamically growing region have strengthened. Furthermore, it can be stated that most of the developments from China, South Korea and Japan can be attributed to electromobility that will determine the coming decades, which will provide Hungary with a solid position during the technological transformation in the automotive industry.

Figure 3.17: High-volume investments announced since early 2020
(HUF billion)

Investment	HUF billion
SK Innovation (battery factory)	680,0
Mercedes (press plant, electric vehicle factory)	100,0
Doosan (electric battery foil factory)	75,0
Semcorp (lithium-ion battery foil factory)	65,5
JYSK (logistics base)	63,0
Pick Szeged (new salami factory)	60,0
Rheinmetall (combat vehicle factory)	60,0
Nestlé (pet food factory)	50,0
Lotte Aluminum (battery parts factory)	44,0
Vitesco (automotive electronics)	36,0
Dynamit Nobel Defense (military industry)	36,0
Lidl (logistics center)	35,0
Coca-Cola (capacity expansion)	30,0
Continental (vehicle electronics prod. lines)	25,0
Glencore (vegetable oil refinery)	22,2
Zalakerámia (cladding material factory)	22,0
Chervon-Auto (car parts factory)	17,5
Metrans (rail-road logistics terminal)	15,7
Seiren (car seat cover)	15,2
Lipóti (bread factory)	15,0
Tamási Hús (bacon production capacity exp.)	14,1
Linde (industrial and medical gas factory)	14,1
Shenzhen Kedali Ind. (battery component factory)	14,1
Rosenberger (electronics supplier)	13,5
Schott (pharmaceutical packaging)	13,5
Flisom (solar panel factory)	12,5
BorsodChem (nitric acid production)	12,0
Diligent (SaaS product development R&D center)	11,3
Kischemicals (pesticide plant)	11,0
Shenzhen Kedali Ind. (battery components)	11,0
Dongwha (battery electrolyte factory)	11,0
BorgWarner (production of turbochargers)	10,9
Sangsin (electric battery parts factory)	10,5
NT (sunflower processing)	9,8
Samyang (medical device factory)	8,7
Wellis (pool production)	8,5
Sick (automotive sensor factory)	8,2
MMXH Furnishings (logistics center)	8,2
Lenovo (computer factory)	8,2
Falco (construction plate production line)	8,2
Univer (development of product manufacturing)	8,0
Nolato (manufacture of medical products)	7,7
Hilti (manufacture of hand machine tools)	7,2
Sanofi (syringe factory)	7,0
Aldi (cold store)	6,0
Béres (robot technology production line)	6,0
JWH (electric battery parts factory)	6,0
Stavmat Building Material (capacity expansion)	5,8
SMG (automotive plant)	5,6
Gyermelyi (wheat milling plant)	5,5
Sugo Food (tortilla chips factory)	5,4
Wewalka (pasta factory expansion)	5,4
Gallfood Turkey Processor (capacity expansion)	5,0
Tolnatej (cheese factory)	5,0
Pellet Produkt (raw materials for furnitures)	5,0
Other projects under HUF 5 billion	85,1

ECONOMIC EFFECT OF THE ANNOUNCED INVESTMENTS

HUF 2,600 billion
TOTAL INVESTMENT PROJECTS
~ 5.5% OF ANNUAL GDP

HUF 8-13,000 billion
ADDITIONAL EXPORT PERFORMANCE PER YEAR

8-10% points
TOTAL GDP GROWTH
INVESTMENT & EXPORT EFFECTS

Other projects under HUF 5 billion:

Kőröstej (4.6), Marso (4.6), Mould Tech (4.5), Apollo Tyres (4.4), Neopac (4.2), Iljin Materials (3.8), Denso (3.5), IBM (3.5), Siemens (3.3), Autoliv (3.3), General Electric (3.3), Ericson (3.0), Arm (3.0), SBS (2.8), SEWS Komponens (2.8), Florin (2.5), 3DHISTECH (2.3), Thyssenkrupp (2.2), Balluff (2.1), West Hungária Bau (2.0), EU-FIRE (1.9), Patec (1.7), Meditop (1.6), Sanatmetal (1.5), Sensirion (1.5), Haldex (1.5), Medicor Elektronica (1.3), Knaus Tabbert (1.3), Óvártej (1), Dometic (1.0), Mateco (1.0), Jabil (1.0), ExtractumPharma (0.9), VITA-Sütő (0.8), Schwarzmüller (0.8), Re-Glass (0.7), Florin (0.7), Medicontur (0.6), Bock (0.6), Valeo Siemens (0.6), Masterplast (0.6), Ferro-Press (0.6), S.E.G.A (0.6), Bálind (0.6), Fenstherm Future (0.5), Heineken (0.5), FF Fémfeldolgozó (0.5), Thermotechnika-Crown Cool (0.5), Dana (0.4), Synlab (0.3), Airvent (0.3)

Source: MoF collection

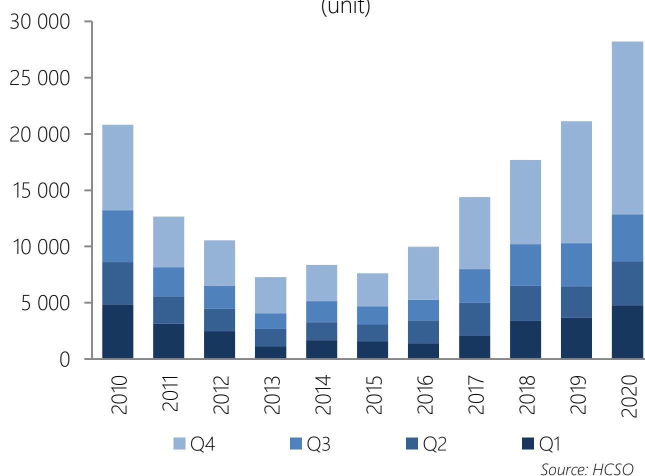
Households

In December 2015, the Government adopted several measures to stimulate housing constructions on both the demand and supply side. Among other things, a decision was made to temporarily reduce the VAT rate on dwellings to 5%, to increase the Family Housing Subsidy Scheme (CSOK) and to introduce a tax refund subsidy. As a result, the housing market, after the historical trough, was able to leave behind the shock of the economic crisis of 2008 and the sector has seen dynamic growth over the past five years *(Figure 3.18)*.

As the strongest performance of the last 11 years, 28.2 thousand dwellings were built in 2020, which means a 34% increase year-on-year. It is important to point out that, in the whole territory of the country, especially in the countryside, handovers increased dynamically last year: by 8.6% in the capital, by 55% in cities with county rights, by 31% in smaller towns and by 45% in villages.

Figure 3.18: Number of dwelling constructions

(unit)



Source: HCSO

The favourable developments are expected to continue in the coming period, thanks to the largest Home-creating Programme announced so far last fall. As part of this, on the one hand, from 1 January 2021, the VAT content of the sale of newly built homes will be reduced from 27% to 5%, and on the other hand, families who use the Family Housing Subsidy Scheme (CSOK) will be able to claim back 5% VAT when buying or building their new home. Thirdly, within the framework of the Home Renovation Programme, which can be applied for by the end of 2022, half of the renovation costs of families raising at least one child will be borne by the state up to a maximum of HUF 3 million, and families are eligible for subsidised home renovation loans for up to HUF 6 million. Fourthly, the Government will grant a full duty exemption to those who buy new or used real estate with CSOK from January. Finally, from 2021, the maximum amount of the Family Housing Subsidy Scheme, up to HUF 10 million, can also be used for the creation of a multigenerational home - i.e. for the attic refurbishment of new family homes.

The processes are also supported by the fact that, as a result of the Government's decision, the VAT for new dwellings in brownfield areas is 5% instead of 27%, which will also apply to the sale and rental of new dwellings in the areas concerned. The reduced VAT applicable to brownfield areas is an incentive for property developers to change the function of typically disused, former industrial areas, contributing to a significant expansion of housing supply.

Taken together, the home creation measures announced in 2020 will have a significant impact on growth: the annual number of newly built dwellings could exceed 20,000 throughout the forecast horizon until 2025. The value added of housing segment as a share of GDP is expected to be around 0.7% on an annual average, which is 0.25 percentage points higher than the forecast performance in the absence of these measures. In addition, within the framework of Home Renovation Programme, more than 100 thousand dwellings can be modernized in both 2021 and 2022, which will increase the value added for national economy by 0.4% in each year. Overall, it can be stated that the Home-creating Programme, through the housing constructions and renovation, will provide effective support for the realization of 1.1% value added to the national economy during 2021-2022.

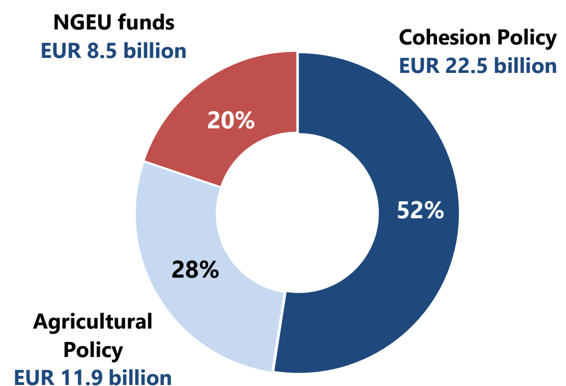
Government

During 2020, public investments increased by 4.5% in nominal terms on year-on-year, as government developments worth more than HUF 3,000 billion were implemented in the economy. Within this, the volume of investments in health care increased by 15% due to developments related to inpatient care, whereas investment activity in education increased by 7%. As a result, the Hungarian public investment rate of 6.4% of GDP remains number one in EU comparison (*Box 4*).

The dynamics of public investments over the forecast horizon is also affected by the allocation of funds from EU budget cycles. By the end of 2020, a total of EUR 31.7 billion were awarded for projects representing 109% of the total budget of EUR 29.7 billion. It should be emphasized that, by the end of April 2021, HUF 9,000 billion had been paid out of the EU financial framework available to Hungary between 2014 and 2020. At the same time, about 60% of the financial framework has been utilised so far in the economic performance, so the remaining 40% of the funds (almost EUR 12 billion together with co-financing) used in accordance with the so-called n+3 rule, will substantially support growth processes in the period of 2021-2023.

Looking ahead, a record amount of new EU funds will be available to Hungary in the 2020s. On the one hand, in the period of 2021-2027, Hungary can count on EUR 22.5 billion of cohesion and EUR 11.9 billion of agricultural policy funds. On the other hand, Hungary is also entitled to a non-refundable amount of EUR 8.5 billion from the Next Generation EU framework. The amount of more than EUR 40 billion available over the period 2021-2027 will average around 3.4% of GDP per year over the next seven years.

Figure 3.19: EU funds available to Hungary in the 2021-2027 period
(EUR billion)



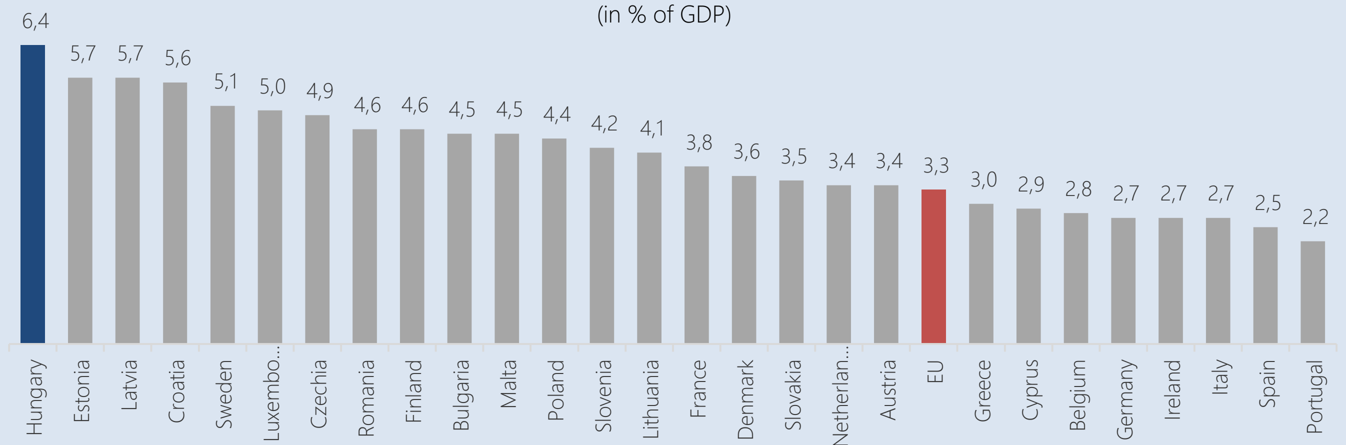
Source: European Commission, MoF

Box 4: The Hungarian public investment rate in the EU remains the leader

Public investments already had strong demand for the private sector before the coronavirus crisis, but this increased further last year, alleviating the economic hardship of companies related to the pandemic. It is therefore particularly favourable that, in 2020 government developments worth HUF 3,059 billion was implemented in the economy, which is still an exceptionally high amount as in previous years. Based on this, the value of public projects increased by 4.5% in nominal terms last year, in which government decisions to protect against the coronavirus also played a significant role. It should be emphasised that, in 2020, partly due to the pandemic, the volume of investments in health care increased by 15% due to developments related to inpatient care, whereas investment activity in education increased by 7%.

As a result, Hungary's public investment rate as a share of GDP rose to 6.4% in 2020, which, like the previous year, is at the top of the podium both among the countries in the region and in the EU, and almost double the 3.3% EU average. As Hungary spent 6.2% of GDP on government developments in 2019 as a whole, the public investment rate in 2020 managed to exceed this, achieving an improvement of 0.2 percentage points.

Figure 3.20: Public investment rates in 2020
(in % of GDP)



Source: Eurostat

The state developments implemented last year continued to provide demand for construction production even during the coronavirus crisis, thus contributing to the increase in the number of people employed in the sector to 362 thousand in 2020, which is higher by 17.1 thousand or 5% than in the previous year. It is important to emphasize that the construction industry also has a positive effect on the performance of related sectors: the design phase of projects increases the value added of professional and technical activities branch, while the production of construction raw materials within the manufacturing industry, increases the production of non-metallic raw materials and the metal production subsectors.

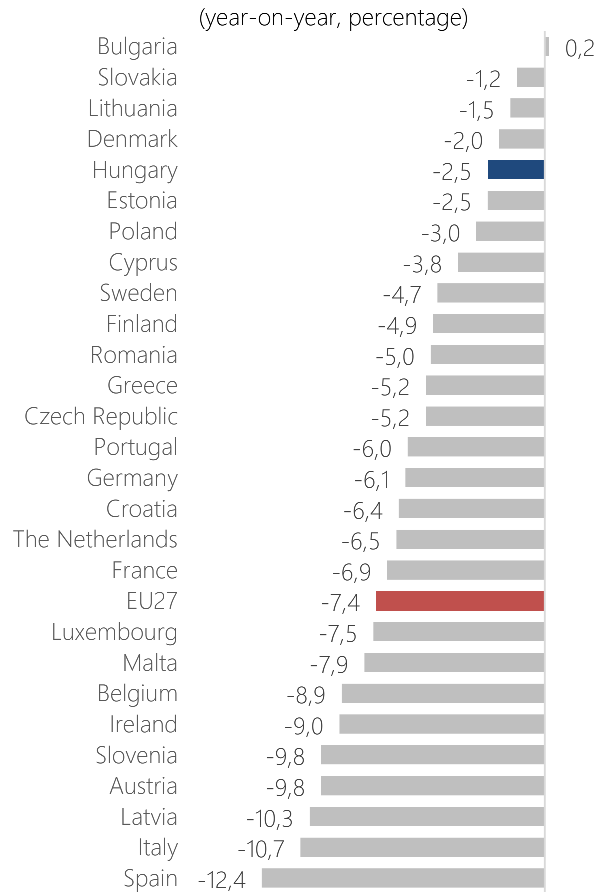
It can be stated that Hungary's public investment activity was outstanding last year as well and made a positive contribution to the economic recovery, despite the fact that the launch of new projects takes considerable time (planning, public procurement) and the acceleration of those in progress has in many cases encountered capacity constraints. As a result, public projects launched in 2020 have not only supported growth in 2020, but will strengthen growth performance to a significant extent this year as well as in the subsequent years.

3.2.3. Consumption

The coronavirus pandemic appearing in Hungary in March 2020 had an adverse effect also on household consumption. The restrictive measures introduced in the spring to curb the spread of the pandemic resulted in a large decline in the consumption of services, as well as in the transformation of consumer behaviour and purchasing habits. The shortage of foreign tourists had a negative impact not only on tourism but also on retail due to their lack of spending. At the same time, household disposable income continued to grow. On the one hand, by the end of 2020, compared to 2019, more people worked already in the domestic primary labour market. On the other hand, real wages have been rising steadily since early 2013, rising by 6.2% in 2020. Despite the favourable income trends at the national level, the precautionary considerations of households became stronger again: the purchase of non-essential goods was typically postponed due to the volatile situation caused by the waves of the pandemic and the minimization of infection risks. As a result, households' consumption expenditure fell by 2.5% in 2020 as a whole, which can be considered small in European comparison (*Figure 3.21*).

Figure 3.21: Household consumption expenditure development in 2020

(year-on-year, percentage)

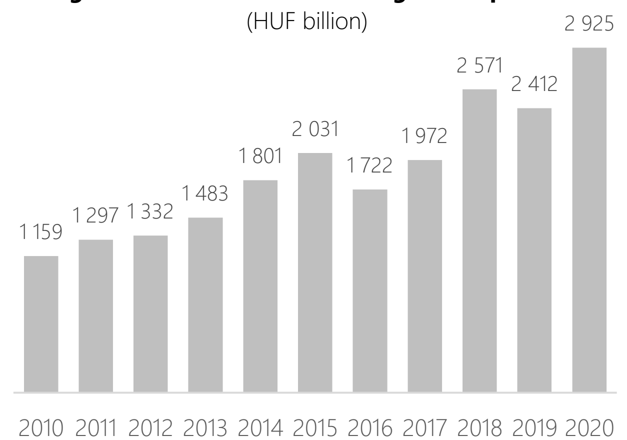


Source: Eurostat

Government measures, including the exemption from the payment of KATA (tax for small enterprises) contributions, the loan repayment moratorium, waiving the obligation to pay contributions, and the extension of the entitlement to child care fee, child care allowance and child care support until the end of the state of the emergency, helped to mitigate the social and economic damage, and preserve jobs, thereby helping to increase households' disposable income. This is partly due to the fact that last year households were able to further increase their savings *(Figure 3.22)*.

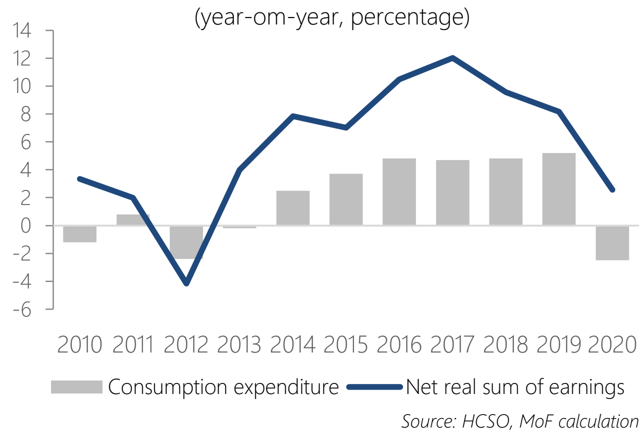
Figure 3.22: Households' saving development

(HUF billion)



Source: MNB, MoF calculation

Figure 3.23: Household consumption expenditure and net real sum of earnings development
(year-om-year, percentage)



Source: HCSO, MoF calculation

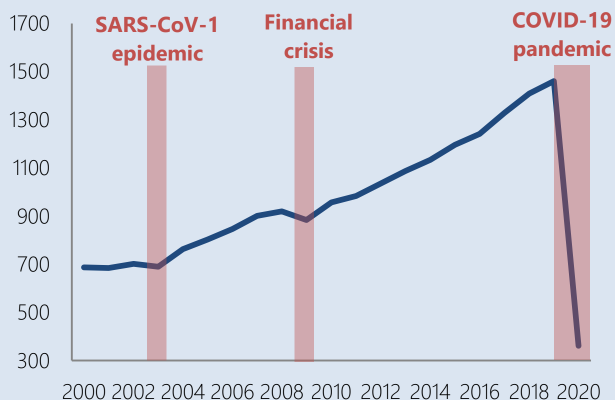
The household loan portfolio as a whole expanded in 2020 even amid restrictions, supported by the increased interest in the prenatal baby support and housing loans, as well as the loan repayment moratorium. The loan portfolio increased by HUF 1,028 billion last year, so at the end of December the outstanding portfolio was 14.5 percent higher than in 2019. The moderating effect of the moratorium on payments contributed to the strong dynamics, however, even without this, a significant increase of 8 percent would have taken place. At the end of 2020, the portfolio of prenatal baby support loans exceeded HUF 1,000 billion, so this instrument, which also stimulates demographic trends, already accounted for about 13 per cent of the entire retail loan portfolio. The credit market represents further growth potential for the coming years, as the loan-to-GDP ratio is lower than the average for both the countries in the region and the euro area.

Looking ahead, by easing epidemiological restrictive measures, consumption could also pick up. This process is reinforced by the high savings rate nd the low stock of loans, which will form a significant growth reserve through consumption in the coming years. State-supported loan programmes (Family Housing Subsidy Scheme (CSOK) and the Prenatal baby Support Loan) can also provide support for household lending in the next period. As the economy recovers, the labour market will also pick up, to which government measures will contribute. Thanks to all this, household consumption may support economic growth again from 2021, which may be further boosted by the gradually rebuilt 13th-month pension, as well as the personal income tax exemption for those under 25 from 2022.

Box 5: Recovery of tourism after the pandemic: past experience

The pandemic broke the booming recent trend prevailing in global and domestic tourism. In 2020, international arrivals dropped by 74% worldwide compared to the previous year, due to severe travel restrictions and the declining demand caused by precautionary measures related to people's health. Last year, destinations worldwide welcomed about a billion fewer international tourist arrivals. As a result, countries around the world had a loss of USD 1.3 trillion in export revenues and the crisis has put 100 to 120 million jobs at risk, according to the WTO. This compares, with the 1.5% and 4% decline in global tourism during the 2003 SARS epidemic and the 2009 global economic crisis, respectively..

Figure 3.24: Number of international arrivals in the world (million)



Source: World Tourism Organization

Table 3.1: Developments in the number of SARS cases in some of the countries concerned

Country	SARS case number, pcs	Date of diagnosis of first and last case
China	5 327	16/11/2002 and 03/06/2003
Hong Kong	1755	15/02/2003 and 31/05/2003
Singapore	238	25/02/2003 and 05/05/2003
Taiwan	346	25/02/2003 and 15/06/2003
South Korea	3	25/04/2003 and 10/05/2003

Source: WHO

In 2020, Hungarian tourism also suffered significant losses. The gross added value of accommodation and food service activities decreased by 32% on an annual basis. The number of tourism nights spent fell by 58% and the revenue of commercial accommodation by almost 60% from a year earlier. Following the loss of revenue, the number of people employed in the tourism sector also decreased. In the fourth quarter of 2020, Hungary employed 7% less people in the accommodation and hospitality sector than a year earlier, according to the Eurostat Labour Force Survey. At the same time, by international comparison, sectoral wage subsidies, temporary tax reliefs and preferential corporate loans can be considered effective in retaining jobs in the sector, as the decline in accommodation and hospitality employment was more pronounced in the Visegrad countries, at 16-18% in the last quarter of 2020.

Although the coronavirus pandemic is unique in its severity and global nature, over the past two decades some regions of the world have already faced a number of epidemics (such as SARS, MERS, Ebola, swine flu, bird flu) that have affected local tourism. These episodes also highlighted the vulnerability of the tourism sector to epidemics. However, in retrospect, the negative effects of previous epidemics on tourism proved to be much smaller than the current ones, as they lagged far behind the severity of Covid-19 in terms of their geographical extent, rate of spread and time course. Yet, earlier periods may provide lessons for tourism demand recovery and for the recovery in tourism sector after the coronavirus pandemic.

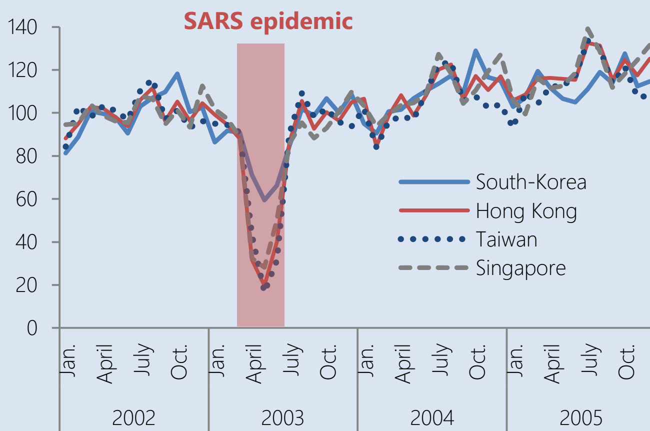
The emergence of SARS-CoV-1 (coronavirus causing severe acute respiratory syndrome) in 2002 and MERS-CoV (Middle Eastern respiratory coronavirus) in 2012 and 2015 was followed by a rapid spread. The mysterious disease caused by SARS-CoV-1 first appeared in China in November 2002, and by March 2003 it was spreading more and more rapidly. Due to the intensive air travel, the presence of the virus was detected in more than 8,000 patients in a total of 29 countries, including the Southeast Asian countries, coupled with a high mortality rate. The number of cases also varied in Asian countries, e.g. while 1755 cases were registered in Hong Kong, only 3 cases were found in South Korea. Yet the effects on tourism have been similar in the countries concerned.

Similar to last year, the SARS-CoV-1 epidemic among Southeast Asian countries also caused a negative shock in aviation and tourism. At the same time, this was much less intense than the current pandemic: the number of foreign tourists collapsed in the spring months of 2003 but recovered quickly after the last case was discovered. As a result of a 9% decline in the number of international arrivals, global tourism contracted by 1.5% in 2003. At

the same time, in 2004 compared to 2003, almost 30% more foreign tourists arrived in the region, suggesting growth beyond a rapid correction in the short term.

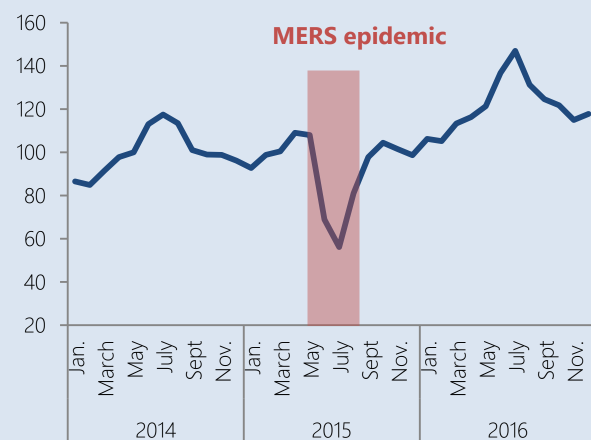
MERS-CoV is a virus with a rather low infectivity, however, it causes severe respiratory infection. The diseases are mainly linked to the Middle East, but since its appearance in 2012, a total of two and a half thousand cases have been diagnosed in 27 countries and it has caused 850 deaths. The largest MERS outbreak is linked to South Korea, where a tourist returning from the Middle East spread the virus in May 2015. A total of 185 cases and 38 related deaths were registered. Although no formal entry restrictions came into force, many countries declared South Korea as a country not recommended as a travel destination. This led to a significant decline in the number of foreign tourists during the period concerned. The last MERS case was identified in July 2015, meaning that the spread of the epidemic was curbed in two months, and the WHO declared the end of the MERS epidemic in December 2015. From June to September, the estimated total impact was a loss of nearly 2 million foreign tourists. Although the number of arrivals already was higher in September 2015, compared to the same period of the previous year, the number of international arrivals decreased by 7% for the whole year. International arrivals exceeded the 2015 level by 30% in the year following the crisis, in which supporting measures of the government also played a role.

Figure 3.25: Trends in international arrivals in South-East Asian countries (%, 2002 monthly average=100)



Source: Korea Tourism Organization, www.hongkongairport.com, Taiwan International Airport, Singapore Department of Statistics

Figure 3.26: Trends in international arrivals in South Korea (%, 2014=100, seas. adj.)



Source: Korean Tourism Organization

The outcome of the above episodes is encouraging in the sense that global tourism can also recover quickly by curbing the current pandemic, lifting travel restrictions and achieving adequate levels of vaccination. At the same time, it seems far-fetched to make travel globally safe from a health point of view, and a hysteresis effect is also expected: as the shock caused by the pandemic proves to be quite long and intense, capacity may be lost also on the supply side. Furthermore, on the demand side there are also developing trends that may persist in some segments, such as the relocation of business meetings and conferences to the online space, or the appreciation of international travel within the region. Nevertheless, the outlook for the Hungarian tourism sector is favourable. On the one hand, in the current situation, the faster progress of vaccinations compared to other EU Member States may be a competitive advantage, i.e. Hungary may become a safe destination sooner. On the other hand, thanks to this, domestic tourism can break records this summer as well, similar to the period last year. Thirdly, in connection with the pandemic, certain demands have intensified, such as hygiene and cleanliness, in which respect Hungary ranks seventh in the WEF tourism competitiveness ranking, i.e. we can consider this strength as a competitive advantage. Finally, although the rise in international arrivals may be slower, it is favourable that the supply of accommodation and the quality of many tourist attractions have improved over the past year, largely due to development programmes, so Hungary can remain an attractive destination for relaunching tourism.

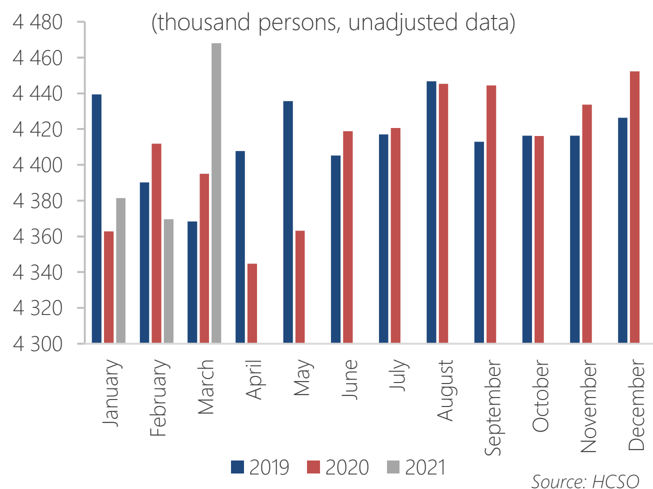
3.3. LABOUR MARKET

3.3.1. Employment

Prior to the outbreak of the pandemic, domestic labour market indicators were also favourable: the number of employees approached 4.7 million due to high labour demand (4,683,000 in August 2019), while the unemployment rate fell to a record low and the real earnings increased significantly.

As a result of the coronavirus pandemic, previously favourable labour market developments stalled in March 2020. Employment fell sharply in the spring months, with an average of 86.8 thousand fewer people (1.9 per cent) working in the second quarter than a year earlier. Following the lifting of restrictions, in parallel with the end of temporary industrial shutdowns and the recovery of domestic tourism in mid-summer, more and more people returned to the labour market. After the low point in April (4,523 thousand people) the number of employed started to increase and in August, partly due to seasonal effects, 4655 million people worked again. The decrease in employment in the second half 2020 was caused by the decline in the number of people working abroad and the number of public workers, while employment people in the domestic primary labour market exceeded the values of the year before the epidemic.

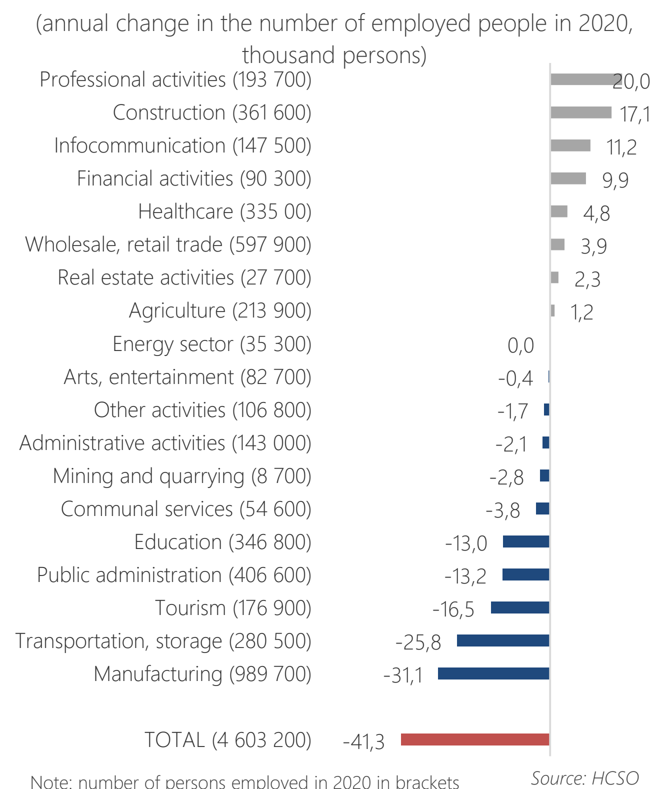
Figure 3.27: Employment in the domestic primary labour market



In 2020, the average number of employed people was 4,603 thousand, 0.9 percent lower than the previous year. In 2020, employment fell short of the previous year by 41,000. The employment rate for the 15-64 age group fell by 0.3 percentage points to 71.9 percent. The decline in female employment has outpaced that of men.

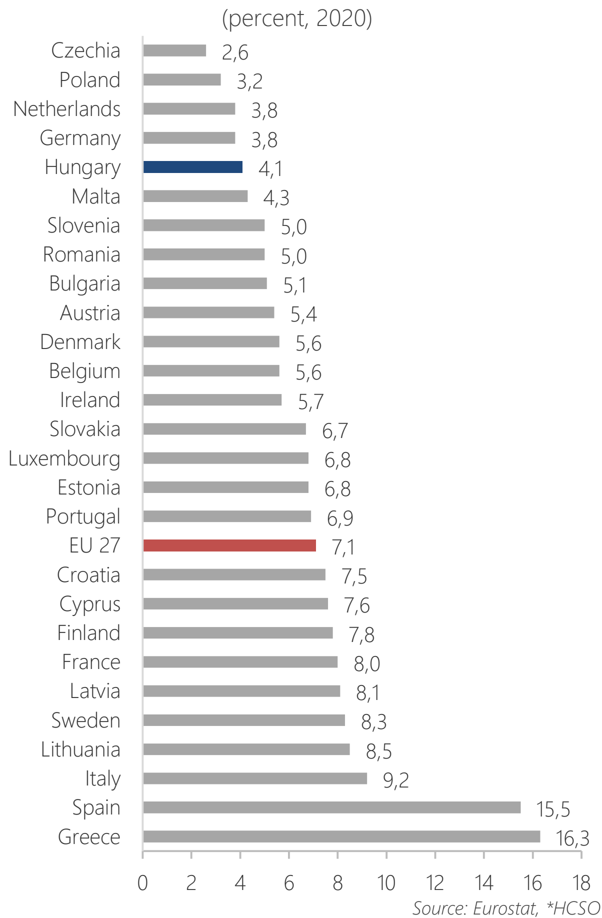
Last year, there was a significant influx of labour between sectors of the national economy. Employment increased significantly in the following economic branches: scientific and professional activities, infocommunication, financial sector and construction, while the number of persons employed decreased in the tourism and transportation, storage sectors.

Figure 3.28: Structural adjustment of the labour market



In connection with the economic consequences of the pandemic, the unemployment rate rose by 0.8 percentage points to 4.1 per cent in 2020 compared to a year earlier, but it remains one of the lowest rates in the EU.

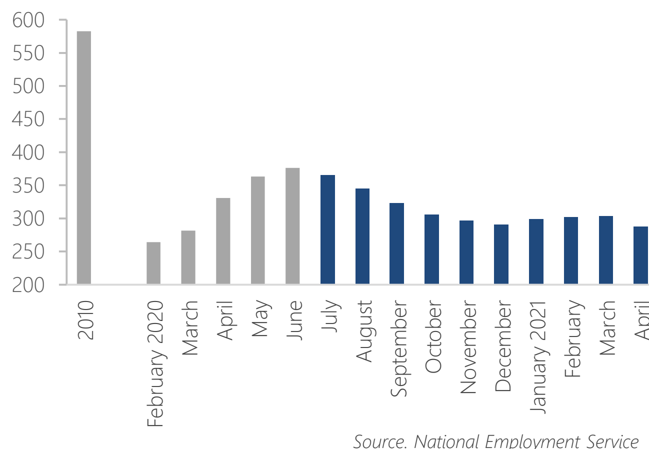
Figure 3.29: Unemployment rate in EU member states
(percent, 2020)



*Source: Eurostat, *HCSO*

According to the administrative data of the National Employment Service an average of 316,055 jobseekers were registered in 2020, 65.1 thousand (25.9%) more than in the previous year. The number of registered jobseekers peaked in mid-June and then steadily declined until the end of the year. The temporary increase in early 2021 can be largely attributed to the cyclical features of public employment programmes.
The recovery of the labour market is supported by the government measures taken: wage subsidies, tax reliefs, a 2 percentage point reduction in the social contribution tax rate, support for investments to maintain and create jobs, payment moratorium, protection of priority sectors, preferential and state guarantee credit schemes for Hungarian companies, flexible labour law rules for teleworking. The Government's actions to date have supported more than 1.6 million employees.

Figure 3.30: Number of registered jobseekers
(thousand persons, unadjusted data)



Source. National Employment Service

Although employment began to grow by the end of the year after the spring sway, the beginning of 2021 brought a slowdown. In February 2021, the number of employed people was 4,550 thousand, down 104 thousand (2.2%) on the previous year, mainly due to the economic consequences of the pandemic. Compared to January, employment increased by 14,000. The employment rate was 71.8% in February 2021. On an annual basis, the number of unemployed rose by 46,000 to 213,000, and the unemployment rate was 4.5%.

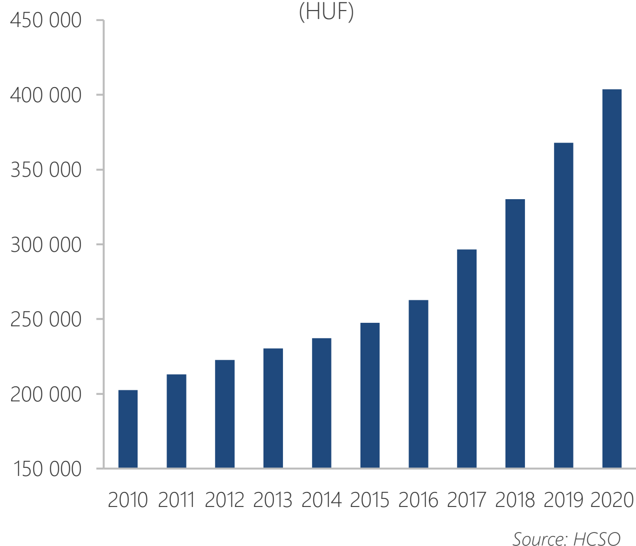
According to the latest data, the average number of employed people in the period from December 2020 to February 2021 was 4,573.6 thousand, which is a decrease of 50.1 thousand compared to the same period of the previous year. The decline in employment is mainly due to the decrease in the number of people working abroad by 39.2 thousand (-33.2%) and the number of public employees by 11.7 thousand (-11.1%). The number of people employed in the domestic primary labour market, which provides the backbone of employment, did not change significantly (+0.8 thousand people, +0.0%) compared to the same period of the previous year.

Employment recovered rapidly after the restrictions were lifted last summer. A similarly favourable process can be forecast in a cyclical position that will pick up again in parallel with the increase in vaccination, where the demand for labour will start to increase in the sectors previously hardest hit by the pandemic.

3.3.2. Earnings

Despite the economic downturn and lower employment, wage dynamics remained strong in 2020, with average gross earnings rising by 9.7% to HUF 403.6 thousand compared to the previous year. The 8% higher minimum wage and the guaranteed minimum wage, bonus and other non-regular payments, and the planned wage raises in certain government branches (including the increase in the remuneration of judges and prosecutors, wage increases for territorial administration workers, and higher basic salary of health-professionals) played a role in the dynamic wage growth.

Figure 3.31: Changes in average gross earnings
(HUF)

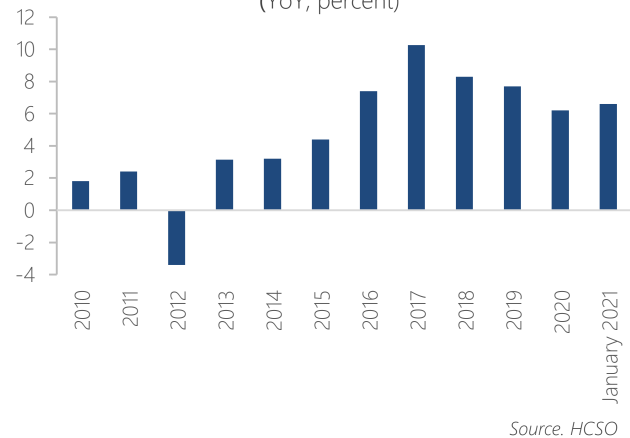


Source: HCSO

Real earnings increased by 6.2% in 2020, with consumer prices rising by 3.3% year-on-year. In 2020, average gross regular earnings (excluding premiums and bonuses) were 9.3% higher than a year earlier. Compared to 2019, wages increased by 9.8% in the private sector and by 9.6% in the public sector excluding public workers. The most significant wage increase was seen among health care workers who received a one-time HUF 500 000 (gross) bonus in June in recognition of their additional work performed during the state of emergency.

The financial appreciation of health care workers is reflected in the fact that the salaries of skilled workers increased by 14 per cent from January 2020 and by a further 20 per cent from November. This will be followed in January 2022 by a further 30 percent wage increase. The Government will also gradually implement the medical salary increase programme from January 2021, so that by 2023 the medical salary of a novice resident doctor will increase to nearly HUF 700,000, while the salary of a specialist doctor with 40 years of professional experience will reach HUF 2,380,000.

Figure 3.32: Net real earnings
(YoY, percent)



Source. HCSO

In order to mitigate the economic impact of the coronavirus pandemic and to protect jobs, employers' tax burdens were further reduced in 2020. Based on the decision of the Government, the social contribution tax rate was reduced from 17.5% to 15.5% from 1 July 2020, and the priority sectors received additional tax benefits.

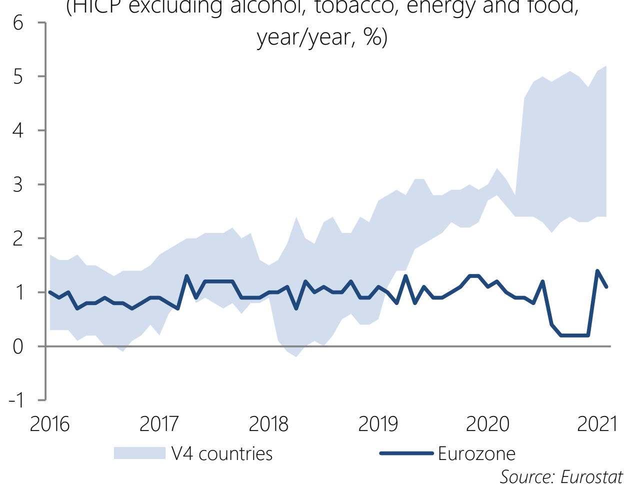
At the beginning of 2021, wage dynamics were measured near to double-digit. In January gross average earnings increased by 9.5% in the national economy. In the private sector, the rate of wage outflows decreased slightly (8.5%), while in the public sector, due to planned wage raises in certain government branches, the average wages rose by 13.3% compared to the same period of the previous year. According to the estimates of the Hungarian Central Statistical Office, average gross regular earnings in the national economy grew slightly faster than gross average earnings, by 9.8%. Retaining or hiring skilled labour in sectors less affected by the restrictions may continue to lead to high wage growth. In addition, the growing demand for services after the lifting of restrictions will also boost wages in the sectors concerned. Thus, overall, the pace of wage increases may temporarily decline in 2021 but may gain momentum again as the economic activity returns.

3.4. Inflation trends

Inflation slightly decreased to 3.3% in 2020, from 3.4% in 2019. Policy measures did not exert a meaningful influence on the development of prices. Indirect tax changes increased inflation by about 0.1 percentage point due to an increase in excise duty on tobacco products and fuels, but this effect was offset by the temporary introduction of free textbooks and free parking.

As in previous years, price developments in the region slightly differed from the EU trend (Figure 3.33). While inflation in the Visegrad countries using a national currency increased in the first half of the year, the rate of price increase in the euro area declined. The difference is partly due to the strong wage dynamics that have persisted from previous years, and the fact that the first wave of the pandemic was mild in the countries of the region. In addition to this, the depreciation of the currencies in the region may have contributed to the increased inflation which explains why price development in Slovakia was different in comparison to the other Visegrad countries.

Figure 3.33.: Underlying inflation in the EU and the region
(HICP excluding alcohol, tobacco, energy and food, year/year, %)



Source: Eurostat

Nevertheless, the downward price pressure of subdued demand became more apparent in Hungary, too, thus in the second half of the year the disinflation effect felt across the EU emerged in the country. In addition, the strong food price dynamics carried over from the previous year have also weakened.

Looking ahead this year, indirect tax changes will lead to higher price increases. The tax change is still partly related to the convergence of excise duty on tobacco products to the EU level, but a significant effect is that excise duty on vehicle fuels are declining due to high oil prices.

However, inflation may be slightly higher than last year. Lower demand than before the pandemic results in moderate price pressures. At the global economy level, with the exception of one or two segments, such as devices supporting telework, lower prices are likely for durable goods due to lower demand in this product category, which will slow down price dynamics in Hungary as well, although this effect may be offset by the recent weakening of the forint. At the same time, higher-than-expected oil prices pose an upside risk, which could be offset by lower excise duty on vehicle fuels. Demand growth, which will appear in parallel with the recovery, may be reflected in prices in mid-2021 due to the vaccination and the improving economic outlook. Microchip shortages affecting some industrial products also pose an upside risk.

Overall, although higher inflation data may be recorded temporarily in the second quarter due to last year's low base, consumer price inflation could be 3.6% in 2021. From 2022, in line with the MNB's medium-term target, the rate of general price increase may be 3%.

3.5. CYCLICAL DEVELOPMENTS

The performance of the Hungarian economy in the 2000–2008 period exceeded its potential level. Prior to the financial crisis, economic growth was marked by excessive public deficit, excessive lending and the rapid accumulation of external debt, which made economic growth unsustainable. With the outbreak of the global financial crisis in 2009, the focus shifted to the repayment of the accumulated debt, and in parallel with that, the performance of the economy fell well below its potential level. In the subsequent years, the slow closing of the negative output gap was observed.

In 2018, the output gap could turn into the positive as a result of strong domestic demand. Subsequently, in 2019, although economic growth was significantly higher than previously expected, at the same time growth may have noticeably moved away from its potential level, capacity constraints in some sectors manifested themselves in the form of significant price increases as a sign of overheating.

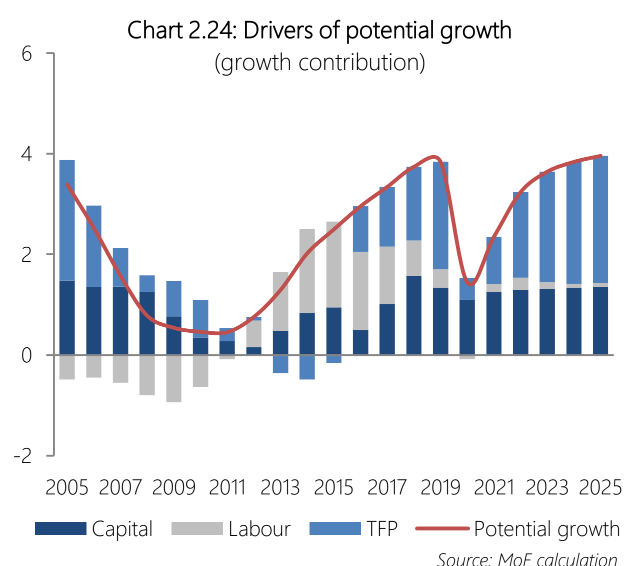
In 2020, as a result of the decline in demand caused by the coronavirus pandemic, the output gap fell back into negative territory, with an absolute value higher than in the post-financial crisis period. Due to the nature of the pandemic, the cyclical downturn proved to be strong in most sectors. At the same time, while in industry and construction this may have been almost entirely corrected, recovery in tourism and closely related sectors is still to come.

In the coming period, economic growth may once again exceed the level enabled by structural factors, thereby gradually closing the output gap. On the positive side, catching up with potential output levels could be much faster than in the protracted process after 2009, as the pandemic hit the Hungarian economy in a much more resilient position. On the one hand, internal and external financial indicators, and the rate and structure of public debt are much more favourable. On the other hand, thanks to strong economic policy support, the recovery may also be faster. The output gap could thus rise to -2.7 percent in 2021 after -4.5 percent in 2020 and then close by 2025.

In terms of potential growth, medium-term trends have remained broadly unchanged. In 2025, the potential growth of the economy could reach a rate of 4%. In terms of growth factors, the trend prevailing in 2017-2019 continues, according to which the emphasis is increasingly shifting from labour-intensive, quantitative growth to qualitative development, i.e. efficiency and capital accumulation come to the fore. As a consequence of positive processes, the contribution of total factor productivity to the growth potential may gradually increase, approaching 3 percentage points in 2025.

However, the downturn due to the pandemic also adversely affected potential growth in the short term. In 2020, the potential growth rate of the Hungarian economy slowed down significantly as a result of declining investment sentiment, declining employment and, in particular, epidemiological restrictions that necessarily reduced productivity. At the same time, on the one hand, it is favourable that the investment rate remained high during the downturn, above 27%, so that the contribution of capital accumulation to potential growth can remain massive over the forecast horizon. On the other hand, after the temporary downturn, employment may also improve, thanks to the low level of structural unemployment as a result of the reforms implemented since 2010.

Chart 2.24: Drivers of potential growth
(growth contribution)



Source: MoF calculation

3.6. External balance

The record high current account surplus in 2016 have been gradually declining in recent years. This can be explained mainly by the realization of previously postponed consumption and the massive increase in investments. The decline in the surplus was a trend observed throughout the region. This is because the Visegrad countries have been able to grow dynamically despite the slowdown in the economies of their main European trading partners, which has necessarily raised import demand.

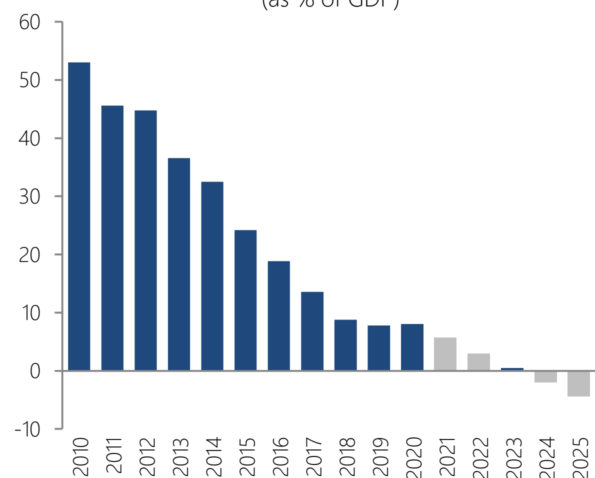
In 2020, however, previous trends stalled: amid a significant rearrangement of the components, Hungary's current account improved. For the year as a whole, the current account closed with a surplus of 0.1% of GDP, while the financing capacity vis-à-vis the rest of the world closed with a surplus of 2.1%. In terms of sub-items, the decline in the foreign trade surplus is the result of factors with opposite effects. The decline in domestic demand and the improvement in the terms of trade reduced the deficit in the balance of goods. At the same time, the surplus of services decreased significantly due to the lack of foreign guests, mainly in tourism and transportation services. The deficit in incomes and unrequited payments has moderated due to the erosion of corporate profits. The value of capital transfers from the EU was 3.3% of GDP, 0.4 percentage points higher than in the previous year.

Looking ahead, with the suppression of the coronavirus pandemic, export opportunities will also gradually intensify. This is a growth reserve, especially for tourism and aviation, which have generated significant foreign trade surpluses in previous years. However, as a result of strengthening domestic demand, both consumption and imports will increase in 2021, and as a result of higher oil prices the terms of trade will deteriorate so ultimately the foreign trade surplus may shrink slightly this year. The current account balance may increase slightly further in 2021 due to an improvement in the income balance. At the same time, a substantial improvement in financing capacity is expected, thanks to the faster settlement of capital transfers from the EU than last year.

In the medium term, after the normalization of the business cycle and the accompanying increase in the number of guest nights spent by foreigners, the foreign trade balance is projected to continue to improve, as manufacturing capacities which have caused the major part of the deterioration in the implementation phase in recent years will increase export when productions restart. In addition, thanks to significant capital transfers from the EU, net lending capacity vis-à-vis the rest of the world may remain high in the longer term.

Overall, favourable financial indicators in the regional comparison strengthen Hungary's resilience to negative external shocks. As a consequence of persistent external surplus and the return of dynamic economic growth once the pandemic subsides, Hungary may become a net lender in a few years' time after being a net borrower for half a century *(Figure 3.35)*.

Figure 3.35.: Net external debt
(as % of GDP)



Source: MNB . PM-calculation

3.7. Economic impact assessment of government measures

This chapter contains the macroeconomic impact assessment of key government measures taken since the publication of 2020 Convergence Programme. The most notable decision is the Economic Protection Action Plan to counteract the adverse economic effects of coronavirus pandemic and the Economy Restarting Action Plan to ensure post-crisis economic recovery. The primary objective of their elements is to preserve jobs and create new ones, to protect domestic businesses and families. Regarding the economic scale of measures, the decisions announced since April 2020, together with the increased expenditures of previous decisions, amount to 17% of GDP:

- From 2021, the VAT rate on the sale of newly built homes has been reduced from 27% to 5% by the end of 2026, provided that the building permit becomes final by 31 December 2022 and the simplified notification is made by that date.
- Within the framework of Home Renovation Programme, half of the renovation costs of families raising at least one child will be borne by the state up to a maximum of HUF 3 million. The support can be applied for from 1 January 2021 to 31 December 2022.
- Sectoral wage subsidy programme for distressed enterprises, as part of which the Government provides 50% wage subsidies in the catering, accommodation, arts, entertainment and leisure sectors, and for private bus enterprises and tour operators until the end of emergency.
- Doctors will receive a significant salary increase in 3 steps. Their salaries will increase at a higher rate than ever before in three years starting in 2021. The income of not only specialist doctors but also doctors and professionals working in primary care is rising.
- The 13th month pension will be reintroduced, the first instalment of which has already been paid in February 2021.
- Young people under the age of 25 will benefit from a personal income tax exemption from 2022 onwards.
- The employer's tax credit for those entering the labour market will be available in the case of three months of unemployment instead of the current six months.
- Introduction of an Interest-Free Restart Quick Loan for SMEs, under which small and medium-sized enterprises can take out a 0% loan for up to HUF 10 million for ten years, with a three-year repayment moratorium in order to restart the economy.
- In the accommodation services sector, reimbursement of 80% of net revenue calculated for bookings registered until 8 November in the first 30 days after the November 2020 closing.
- Some administrative procedures are exempted from payments, such as the issuance of approval certificate for business establishments, marriage or registered partnership, and those living in the same household or at the place of residence of citizens, etc.
- From 1 January 2021, the purchase of both new and second-hand flats will be exempt from the duties on transfer of property if the buyer uses the Family Housing Subsidy Scheme (CSOK) for the purchase.
- The VAT rate on food and beverages purchased for take-away was temporarily reduced to 5% until the end of the emergency.
- Measures related to the Széchenyi Recreational Card (fringe benefits) are extended for 2021. On the one hand, between 1 January 2021 and 30 June 2021, the social contribution tax was abolished, on the other hand, the envelope may be HUF 800,000 in the private sector and HUF 400,000 in the public sector. On the proposal of National Competitiveness Council, the favourable rules will remain in force until the end of 2021.
- Exemption from social contribution tax on representation and business gifts until the end of 2021.
- Providing employers' contribution relief for beneficiary sectors from November 2020 for the duration of emergency.
- KIVA (small business tax) can be chosen up to a revenue limit of HUF 3 billion from 2021, instead of HUF 1 billion. In line with this, the limit from which this tax payer status cannot be applied is increased from HUF 3 billion to HUF 6 billion.
- In the case of corporate income tax, the 50% limit of development reserve in proportion to pre-tax profit was abolished in 2020, which made it possible to use the full amount of pre-tax profit (back to 2019),

and from January 2021 the upper limit of HUF 10 billion was also abolished.

- The local business tax rate was halved in 2021, to 1% instead of 2% among small and medium-sized enterprises with less than HUF 4 billion in revenue or balance sheet total, as well as for those self-employed.
- The rates of excise duty on tobacco products rises in two further steps.

In addition to the above, the subject matter of impact assessment was also the expenditures of Epidemic Control Fund increased since April 2020: the additional expenditures related to the epidemiological protection and the one-off salary supplement for healthcare workers in 2020, which amounted to HUF 500,000 per person, should be highlighted. On the other hand, the increased expenditures of Economy Protection Fund since April 2020 have also been quantified in the modelling, which aims to protect and create jobs, restart the economy, protect key sectors, and help finance companies.

The impact assessment was prepared using the DINAMO model of the Ministry of Finance. The structure of the DINAMO model rests on long-term neo-classical growth relationships, however, several short-term frictions slow down the adjustment to the equilibrium. The characteristics of the model make it suitable for the preparation of impact of Government measures. On the one hand, this is explained by the fact that it uses a wide range of macroeconomic variables, thus modelling the behaviour of specific economic players. On the other hand, it appears as a consistent representation of relations between the national accounts and the financial accounts of public finances. In addition, several such transmission channels have been incorporated in the model through which the fiscal variables exert their effects on the economy. At the same time, beyond the direct cyclical stimulation by budgetary implications, the individual measures also have such structural impacts that will result in additional growth pointing beyond the mechanisms integrated into the DINAMO model. One example of this in practice could be the introduction of wage subsidies, which can be presented directly as a transfer made from the budget to households within the framework of the model. At the same time, the wage subsidy also allows for the continued employment of employees, protecting jobs and production capacity; because of this, out-of-the-model calculations were also used in order to quantify these effects.

The macroeconomic effects of the measures quantified using the DINAMO model are shown in *Table 3.2*. The modelled economic policy measures support growth primarily by strengthening investment activity as well as by increasing employment dynamically, and thereby boosting household consumption. Capacity expansions improve the growth potential of economy in the long run as well, since after their completion, they stimulate GDP growth through additional channels, primarily through export and higher labour incomes. On the whole, these government measures have a modest inflationary impact.

To quantify this, government actions since April 2020 will improve the economy's performance by 4.1% this year and 4.6% next year. It is important to highlight that the measures will continue to support the performance of economy after 2022 to the extent of 4.0-4.7%.

Table 3.2: Macroeconomic impacts of the measures

(cumulated % difference in variables compared to the baseline scenario)

	2020	2021	2022	2023	2024	2025
GDP	**1.8**	**4.1**	**4.6**	**4.0**	**4.4**	**4.7**
Households' consumption expenditure	3.2	3.2	4.1	3.9	4.3	4.3
Investments	3.2	14.8	15.0	6.2	6.6	7.3
Exports	0.0	1.7	2.3	3.4	4.0	4.5
Imports	1.2	2.1	2.4	2.1	2.2	2.2
Inflation	0.0	0.5	0.6	0.2	0.3	0.4
Private sector employment	0.5	1.9	1.7	0.7	0.8	0.9
Gross average wage in the private sector	0.2	1.4	1.9	2.5	2.8	3.1

Source: MoF calculation

Box 6: Macroeconomic impacts of measures taken since the outbreak of coronavirus pandemic

The Government made the decisions in a timely manner that are essential to successfully combat the pandemic, as well as to support the relaunch of economy once the pandemic is over. One of the main objectives of measures is to protect jobs, and as part of this, the wage burden of companies facing forced reductions in working hours due to a significant drop in demand was partially taken over. In addition to wage subsidies, many companies operating in sectors affected by restrictions are not required to pay employer contributions, and employee contributions were also reduced significantly. Also, in order to protect employers, preferential and guaranteed credit and equity schemes supporting corporate liquidity were announced, which can protect Hungarian-owned companies from the economic downturn and foreign acquisitions.

Following the coronavirus crisis, the creation of new jobs is also of primary importance, therefore tenders for technology development, environmental and energy efficiency investments totalling HUF several hundred billion were announced, aimed at companies who were able to retain their employees. Furthermore, 95% of training fees are taken over by the state and job seekers are eligible for interest free adult education student loans. A priority measure is also the moratorium on instalment payments of loans in order to alleviate the repayment burden on businesses and households. In addition, the expiring childcare benefits, childcare allowances and child raising supports were extended for the duration of emergency, also the 13th month pension will be reintroduced in four phases from February 2021.

During the coronavirus crisis, the Government is also spending significant resources to protect key sectors that have been fundamentally hampered by the pandemic. These include tourism, health industry, food industry, agriculture, arts and entertainment, construction, transportation and storage. The Government will continue to help these sectors with investment support programmes, preferential loans with state guarantee and capital subsidy, infrastructure development programmes and tax reductions. For the tourism, development and loan programmes for hotels and restaurants are available. The health industry receives more significant support than ever before, in order to facilitate that the products of Hungarian pharmaceutical and medical device manufacturers appear in the Hungarian health care at a higher rate.

The broad range of government measures effectively help the Hungarian economy in meeting the challenges posed by coronavirus pandemic. This is confirmed by the fact that the measures taken since the outbreak of coronavirus crisis together represent an unprecedented economic stimulus package, amounting to 37% of annual domestic GDP. It can be stated that the measures taken since the outbreak of coronavirus pandemic protected the Hungarian economy from a double-digit decline in GDP last year, and this year it will put Hungary's economic performance back on a growth path. In addition, the decisions taken will provide significant support not only in 2020-2021 but also over the entire forecast horizon, so that the economic performance of Hungarian economy can once again expand by more than 4% during the post-pandemic economic recovery in a sustainable manner.

Table 3.3: Total macroeconomic impacts of the measures taken since the outbreak of the coronavirus pandemic
(cumulated % difference in variables compared to the baseline scenario)

	2020	2021	2022	2023	2024	2025
GDP	**5.5**	**8.4**	**4.6**	**4.0**	**4.4**	**4.7**
Households' consumption expenditure	10.0	12.0	4.1	3.9	4.3	4.3
Investments	16.6	28.7	15.0	6.2	6.6	7.3
Exports	0.1	5.4	2.3	3.4	4.0	4.5
Imports	3.3	4.8	2.4	2.1	2.2	2.2
Inflation	0.0	1.0	0.6	0.2	0.3	0.4
Private sector employment	6.7	9.6	1.7	0.7	0.8	0.9
Gross average wage in the private sector	0.7	3.4	1.9	2.5	2.8	3.1

Source: MoF calculation

3.8. Monetary and exchange rate policy

The current Act on the Central Bank of Hungary sets out the achievement and preservation of price stability as the primary objective. This is still the objective of the central bank in the macroeconomic environment that has changed as a result of the effects of the coronavirus pandemic, as well as the preservation of financial stability and the support of the Government's economic policy. Since 2001, the MNB has been shaping monetary policy in the inflation targeting system. Within the framework of this, the Monetary Council set a 3% mid-term inflation target; however, in March 2015, it defined a tolerance range of ±1 percentage point around this value in order to create room for manoeuvre to mitigate the effects of eventual economic shocks. The monetary policy ensures inflation targeting by changing the base rate, exploiting the flexibility provided by the floating exchange rate, and using its non-conventional toolkit.

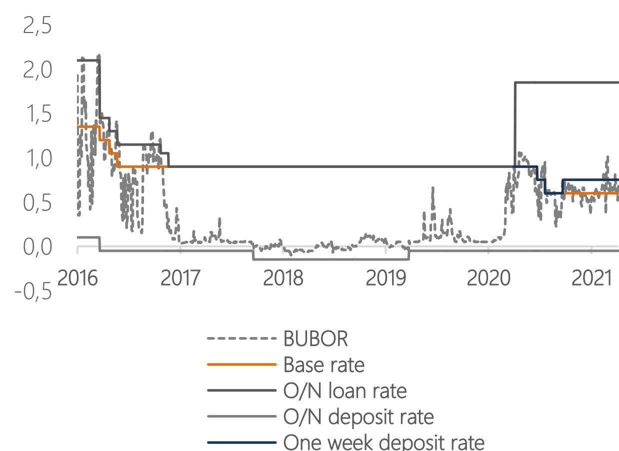
In 2020, the central bank took significant measures on both the interest and liquidity sides to mitigate the negative economic effects of the coronavirus: In 2020, the role of the guiding instrument was implicitly taken over by the one-week deposit facility. From April 2020, the one-week deposit facility, potentially part of the toolbox since 2016, has been announced on a weekly basis, paying a more favourable interest rate than the O/N deposit facility. The interest rate on the one-week deposit facility became adjustable in a targeted manner from 7 April, i.e. it may deviate from the base rate in the +/- direction within the interest rate corridor. This happened in September, with the Monetary Council deciding to raise the one-week rate by 15 basis points.

The Central Bank also supported the economic recovery through the base rate, so the Monetary Council reduced it to 0.6% in two steps over the summer.

The level of BUBOR around 0% shifted upwards during the year. This rate fluctuates around the interest rate on the one-week deposit facility, which is currently 0.75%.

On 7 April 2020, the interest rate on overnight O/N collateralised loans, which served as the upper limit of the interest rate corridor, increased from 0.9% to 1.85%. This made the interest rate corridor symmetric again.

Figure 3.36: Monetary policy instruments



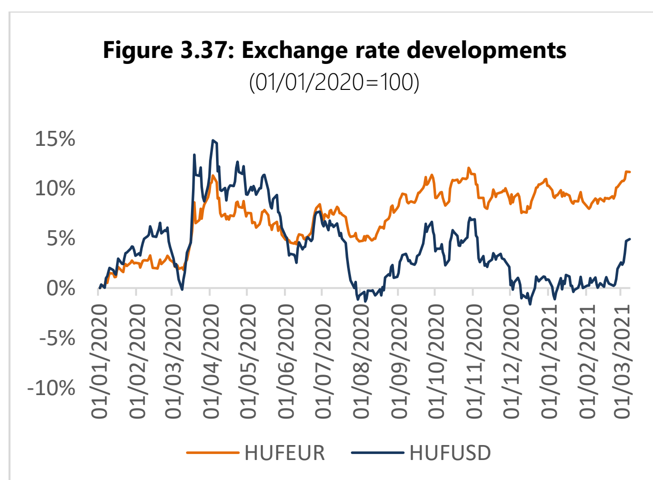
The MNB implemented several measures to ensure bank liquidity. As a first step, it temporarily suspended the reserve ratio of 1%, required uniformly for credit institutions.

The MNB continues to provide excess liquidity to the banking system through its currency swap facility, but the stock of this instrument is declining. To provide the necessary liquidity, it introduced a fixed rate secured loan (repo) from 25 March until withdrawal, with maturities of 3, 6, 12 months and 3, 5 years.

As a step to strengthen bank liquidity, the Central Bank decided to accept corporate loans as collateral, expanding the previous HUF 7,000 billion banking collaterals by another HUF 2,600 billion.

At the beginning of May, the MNB also decided on a new asset purchase programme on the secondary market. As part of this, it bought nearly HUF 1,800 billion in government securities until this spring. The central bank also relaunched its mortgage bond purchase programme to increase the long-term funding of the banking system. It purchased approximately HUF 300 billion worth of assets under the programme until the spring of 2021.

The excess liquidity of bond and loan programmes announced as a part of the non-conventional monetary policy toolkit (BGS, FGS) is offset by the preferential deposit having a base interest rate. In contrast, the MNB will pay an interest rate of 4% for the portfolio growth of the BGS and FGS "Hajrá" arrangements by the end of June 2021, in order to encourage market participants to recover from the crisis as quickly as possible.



The pandemic also affected the domestic currency. In the spring, the Hungarian Forint reached a historic low, from which it was able to strengthen somewhat by the end of the year. In addition to economic developments, the Hungarian Forint exchange rate was affected by the reactions of the central bank and the world economy.

Overall, it can be said that the focus of Hungarian monetary policy in 2020 was on mitigating the economic and market effects of the coronavirus pandemic. The new monetary policy mix has effectively pushed the long end of the yield curve down by the additional liquidity pumped in the financial system.

Internationally, leading central banks began intensive easing in the spring of 2020 to mitigate the adverse economic effects of the coronavirus pandemic. The central banks typically announced major interest rate cuts and quantitative easing programmes in order to remedy the issues arising. The most important ones are the Fed's two rate cuts (50 and 100 basis points), resulting in the decrease of the prevailing rate to 0%-0.25%. In addition, 1–3-month repo programmes of USD 500 billion each, followed by an asset purchase programme with an unlimited amount of funds, and a temporary disregard for the capital requirement were announced. In addition, the Fed changed its inflation targeting system and has been following an average inflation targeting strategy since the summer. The ECB also relaunched its asset purchase programmes. The European Central Bank also decided to ease the conditions for the SME lending programme of commercial banks (LTRO, TLTRO III) and to temporarily suspend strict compliance with liquidity and capital requirements. The balance sheets of both major central banks have increased significantly as a result of crisis management.

3.9. FINANCIAL SECTOR

The previous year has brought new challenges for the financial sector. The continuously improving indicators in the years before 2020, the record profitability and the good portfolio quality testify to a resilient banking system. Due to these achievements, the Hungarian banking sector played an important role in mitigating the adverse economic effects of the coronavirus pandemic, together with government and central bank measures.

Although the loan portfolio of non-financial corporations expanded in 2020 in terms of transactions, the negative economic impact of the pandemia reflected in lending trends. The exchange rate-adjusted annual growth rate was more modest, at 9.4%, for the corporate sector as a whole, compared with 12.4% for the SME sector (the growth was 14.2 and 14% a year ago). The share of SME loans continued to rise, with more than three-quarters of annual transactions related to this sector. There has been an increase among the freshly disbursed loans: loans to non-financial corporations exceeded the 2019 figure by 5.8% in 2020 (only 0.2% for SMEs). It should be noted that a significant portion of the loan disbursements was created by the yearly extensions of short-term corporate loans.

The FGS Fix programme, which ended in May 2020, aimed to increase the share of long-term and fixed-rate loans. Within the framework of the arrangement, more than 17 thousand companies entered into loan or leasing agreements worth approximately HUF 564 billion.

The pandemic has caused on corporate operations lost sales and supply disruptions, as well as employment levels and the postponement of investments. The regulator supported the operation of the corporate sector with several measures. The moratorium on payments of loans provides general assistance to distressed families and businesses, while the Bond Funding for Growth Scheme has eased the constraints on corporate financing. In April 2020, with the FGS "Hajrá" a preferential, fixed-rate loan facility to support the SME sector was created. As a result of the scheme, more than 31,000 companies received a total of HUF 2,044 billion in loans in the past year. The FGS "Hajrá" is currently running with a total allocation of HUF 3,000 billion, so the range of participating SMEs is expected to expand further.

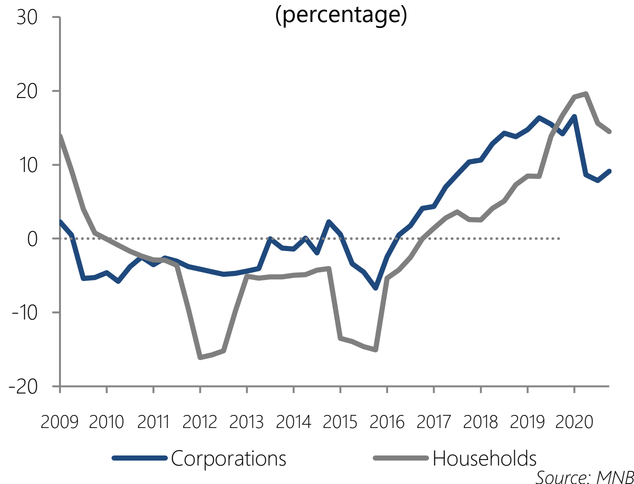
The Government made the conditions of guarantee programmes even more favourable, assuming an even larger portion of interest risks than before (up to 90%) in order to facilitate the funding of companies. In addition, interest-subsidised arrangements also mitigate the related difficulties of companies. In March 2021, the "Interest-free Restart Quick Loan" with an allocated HUF 100 billion was launched as Hungary's first publicly funded microcredit scheme, which aims to provide funds to entrepreneurs who are excluded from bank lending. The Government ordered a debt repayment moratorium for 2020 and then extended until June 2021, thus protecting the household and corporate sector that had become distressed in the economic downturn. The moratorium is approximately used by 50% of retail and 38% of corporate customers. As in previous years, the corporate NPL rate declined in 2020. After a decline of 0.4 percentage points, the ratio of non-performing loans of non-financial corporations stood at 3.5% at the end of 2020. The pandemic may increase the number of non-performing bank customers, however thanks to the moratorium this has not been currently realized in the increase in the NPL rate.

The favourable income conditions of the banking sector had moderated in 2020. Although interest income and, to a lesser extent, fee and commission income increased, operating expenses continue to absorb a significant portion of the revenue. In preparation for the deterioration of the quality of their portfolios, banks has increased their level of impairment and provisions almost tenfold (to HUF 280 billion) in the past one year, thus reducing their pre-tax profit by more than half compared to the end of 2019.

Despite the pandemic, the Hungarian banking sector met the liquidity and capital requirements with a significant surplus, all of which have been supported by a series of decisions since the beginning of the coronavirus. The previously formed capital buffers

have been released, the payment of dividends by credit institutions is now suspended until September 2021, and the acceptance of large corporate loans as collateral is also a step to strengthen liquidity.

Figure 3.38: Annual growth rate of loans to non-financial corporations and households (percentage)



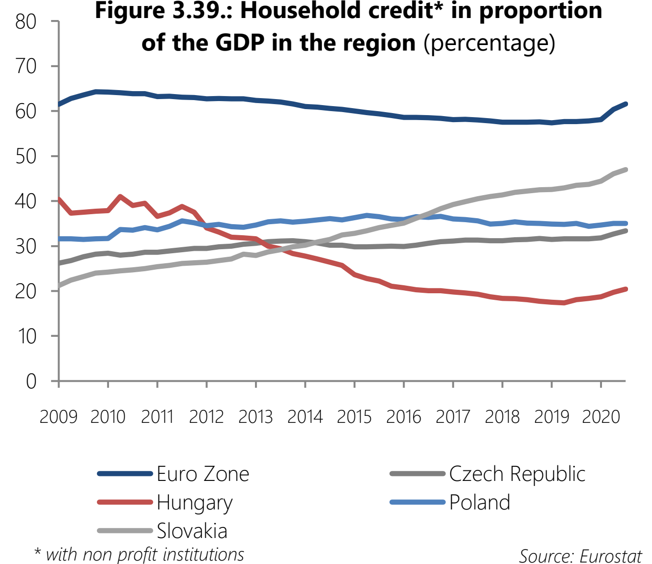
Source: MNB

Household borrowing declined in 2020, the pandemic pushed back consumer and other lending. Despite all this, the loan portfolio of households increased by HUF 1,030 billion last year, which corresponds to a growth rate of 14.5%. The discrepancy is explained by the moratorium on the instalment payments of loans, as in 2020 households repaid a total of HUF 215 billion less loans compared to the previous year.

Last year, HUF 2,208 billion in new loans were disbursed, which is 8.7% less than in 2019. Although the issuance of consumer loans fell by 15.5% in one year, most of the disbursements were made from this group of loans (HUF 1,155 billion). The high interest in consumer loans is still due to the popularity of the prenatal baby support loan, of which HUF 587 billion was disbursed last year. Of the housing loans, HUF 928 billion in new loans were issued, which means a 1.8% increase compared to 2019, despite the crisis. HUF 125 billion was disbursed from other loans, which is equal to a decrease of 12%.

Despite the outstanding growth of the loan portfolio in previous years, the indebtedness of Hungarian households is still one of the lowest in the region and is significantly below the euro area average, which means that there is still significant growth potential in household lending.

Figure 3.39.: Household credit* in proportion of the GDP in the region (percentage)



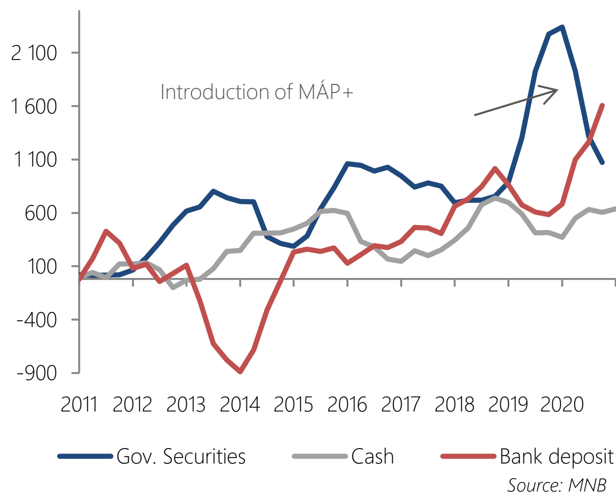
* *with non profit institutions*

Source: Eurostat

Loans overdue for more than 90 days amounted to HUF 146 billion at the end of 2020, which is only 1.8% of the total household loan portfolio. The indicator was 0.9 percentage points lower compared to the previous year, by HUF 46 billion. Following the lifting of the moratorium, non-performing loans are expected to increase in the medium term. In terms of credit dynamics, although both consumer and housing lending were more subdued at the beginning of 2021, we expect rapid growth in all loan categories as the pandemic passes.

Household savings increased by a record amount of HUF 4,215 billion in 2020. Most of the new savings (HUF 1,695 billion) were transferred into deposits. The increase in deposits is primarily due to the rise in precautionary motives caused by the pandemic. The volume of government bonds increased by HUF 1,073 billion last year, which means that the Hungarian Government Bond Plus, introduced in 2019, has succeeded in boosting and maintaining the population's demand for government bonds.

Figure 3.40: Changes in key retail savings
(4 quarters, HUF billion)



Source: MNB

The coronavirus pandemic and its effects will certainly mark a turning point in the processes of the financial sector. Nevertheless, thanks to the economic policy measures taken in recent years, the domestic banking sector was in a very good shape when the crisis struck. Forint conversion, a higher rate of loans having a fixed interest rate and macroprudential measures to prevent excessive indebtedness all contributed to the creation of a more healthily structured lending portfolio. Favourable economic developments and demographic programmes, as well as various subsidised corporate lending schemes, have also contributed to boosting demand for credit, which has ultimately benefited the banks' business and financial indicators.

On the other hand, measures to mitigate the adverse economic effects of the pandemic were implemented efficiently, allowing economic policy to not only postpone but also, as we expect, substantially mitigate many of the negative consequences of the crisis, such as the later increase of non-performing assets, which might decrease the banks' profitability and capital. This, in turn, will enable the financial sector to adequately contribute to boosting the circulation of the economy in the future through lending.

4. General government deficit and debt

4.1. Budget Policy Objectives

As a result of the recent years' fiscal consolidation, the general government deficit was below 3% of GDP from 2012 to 2019, and, consistently with this, the government debt-to-GDP ratio has been steadily declining, year on year. The debt ratio fell from 80.4% in 2011 to 65.5% at the end of 2019. Responsible management, the developed fiscal buffer and budgetary reserves provided substantial room for manoeuvre to tackle the economic difficulties caused by the coronavirus pandemic.

In fighting the crisis, fiscal policy has taken a targeted, sufficiently flexible approach to respond appropriately and deliver the necessary countercyclical demand stimulus. In line with this, expenditure on epidemiological measures and economic protection, tax measures to alleviate the burden of the crisis, and the operation of automatic stabilisers resulted in a budget deficit of 8.1% and public debt rising to 80.4% of GDP. This fiscal policy was fundamentally based on the concept that the debt ratio should be reduced *in good times*, while *in bad times* the state needs to intervene to mitigate the negative effects of the economic crisis by accepting a temporary increase in the debt-to-GDP ratio. Developed countries and EU Member States proceeded similarly in the extraordinary situation created by the pandemic.

Table 4.1: The medium-term fiscal path (% of GDP)

	2020	2021	2022	2023	2024	2025
General government balance	-8.1	-7.5	-5.9	-3.9	-3.0	-2.0
Gross government debt	80.4	79.9	79.3	77.5	75.7	73.1

Source: KSH, MNB, calculations by the Ministry of Finance

4.2. The 2020 budgetary outcome

When planning for 2020, the budget anticipated a GDP growth of 4.0% and inflation of 2.8%. The deficit target was set at 1% of GDP, with safety reserves (Country Protection Fund and extraordinary government measures) equalling 1% of GDP.

However, last year's economic and budgetary processes were completely rewritten by the coronavirus pandemic. In the Convergence Programme of the spring of 2020, the Government calculated with a GDP decrease of 3%, and as result of this as well as the disease control measures and economic protection measures, it forecasted a deficit of 3.8% of the GDP. However, in October it became clear that a worse-than-expected pandemic and a more significant, foreseeably 6.4% economic downturn would place a greater fiscal burden on the government, resulting in an even higher deficit of 8-9% of GDP. The economic downturn eventually proved to be more favourable, with GDP contracting by 5.0%, partly due to the government's economic recovery measures. The deficit approached the lower end of the targeted band, as the spring notification showed a deficit of 8.1% of GDP. Public debt rose to 80.4% of GDP. Both the deficit level and the increase in government debt were in line with trends in other EU Member States.

When the pandemic broke out, the government announced an economic protection scheme, mobilising both budgetary and non-budgetary resources. The sectors most affected by the crisis were the first to enjoy tax benefits and exemptions, although the overall tax burden was reduced for all companies as well.

Job protection and job creation programmes were announced, in which from the very beginning there has been an effort to provide companies with an

opportunity to use the capacity freed up due to a temporary drop in demand and turnover, and implement training and investment programmes.

The government has created three budget funds, with funds allocated to fight the pandemic and to re-launch the economy. An amount of HUF 643 billion has been allocated to the Epidemic Control Fund, the largest item of which, the Central Reserve for Epidemic Control, has already been made available in the amount of HUF 378 billion. With reassignments from the ministries, a total of HUF 1,366 billion was available in the Economy Protection Fund.

Revenues

Tax revenues clearly reflected the impact of the economic downturn caused by the coronavirus pandemic, although, on the other hand, tax revenues were also reduced by government tax measures taken to mitigate the negative consequences of the pandemic. According to the EU methodology, in 2020, the government sector (central and local government budgets) collected HUF 1,116 billion less tax revenue than planned.

Although the rate of wage growth was lower than planned due to the crisis, and therefore the wage growth condition under the tripartite agreement between the government, employees and employers has not been met, the government has reduced the social contribution tax rate by 2 percentage points. Simultaneously with the social contribution tax, the small business tax rate was reduced by a further 1 percentage point as of 1 January 2021.

In the period March-June 2020, the sectors most severely affected by the pandemic received tax and contribution reliefs in order to mitigate short-term damages, i.e. employers were not required to pay the social contribution tax, vocational training contribution and rehabilitation contribution. Significant benefits were provided to employees in these sectors too, as their labour market and pension contribution payment obligation was temporarily suspended, and the amount of the health insurance contribution deducted did not exceed the minimum required level specified in law (HUF 7,710). In accordance with the measures related to contributions, in the most severely affected sectors, personnel costs were not included in the tax base in the case of those selecting the small business tax (KIVA), and the payment obligations of the smallest enterprises, and of the self-employed, taxable under KATA were suspended until 30 June. In addition to this, the tax authority suspended tax collections until the end of the state of emergency.

In order to stimulate tourism and catering, benefits provided by employers through SZÉP cards were temporarily exempted from social contribution tax, which may remain in force until the end of 2021, as proposed by the National Competitiveness Council.

To improve the situation of families, entitlement to health insurance and family support allowances provided for the care and upbringing of children was extended until the end of the state of emergency.

As of 1 July 2020, individual contributions have been merged into a single contribution, and redefined in a consolidated statutory regulation. The family allowance has also become more easily applicable, up to the amount of the social insurance contribution.

The Government also made a decision that those participating in digital education will receive land-based Internet access services free of charge for a term of thirty days.

Given that the pandemic has hit the tourism sector particularly hard, companies operating in this sector will be exempted from paying the tourism development contribution from 1 March 2020 until the end of 2021, and from paying the tourism tax from 1 March 2020 until the end of the state of emergency.

When the closure of restaurants in an effort to slow down the spread of the pandemic became unavoidable in November 2020, at the same time, a 5% VAT rate was introduced on food and drink sold for takeaway or home delivery.

As of 22 July 2020, a reduced VAT rate of 5% has been introduced for the sale of residential properties under 150 square metres built in brownfield areas.

In parallel with the restrictive measures taken in view of the emergence of a second wave of the pandemic in the autumn, the government decided to reintroduce tax reductions and exemptions. As of 2020 November, businesses operating in the catering and leisure industry sectors were exempted from the payment of the tax burdens of the employers. Furthermore, similarly to the spring period, in the case of small business tax personnel costs will not be considered as part of the tax base in the sectors most severely affected by the crisis.

As a source from the Epidemic Control Fund to cover the costs of combating the pandemic, in line with the principle of sharing of burdens, the retail tax and the special tax on credit institutions were also introduced from 1 May 2020. The amount of the excess contribution paid in 2020 can be deducted in equal instalments from the tax liability of the special tax on financial institutions for five years starting in 2021.

Expenditure

The government action plan announced in spring 2020 included 5 schemes:

1. Job retention: in the case of shortened work (a working time reduction of 15%-75%) the Government took over – subject to the conditions specified in law – 70% of the net base salary for the unused working time for up to 70%, but maximum for the double of the minimum salary. The support was available for up to 3 months. Engineers and those working in R&D activities were able to apply for a 40% wage supplement.
2. Job creation: a simplified tender arrangement has been set up for companies that have planned investments, technological update, improvements in line with the protection of the environment, and undertook the online training of employees furloughed during this difficult period. As many graduates will be needed, university students who have completed their studies were awarded their degree even in the absence of a language exam that is required by law.
3. Protection of key sectors: the Government will promote the recovery of tourism, health industry, food industry, agriculture, construction industry, logistics, transportation, film and creative industry by means of investment promotion programmes, preferential loans with capital and guarantee subsidy, by supporting infrastructural developments and applying tax cuts.
4. Financing of domestic enterprises: interest-rate and guarantee-subsidised loans have been opened to Hungarian companies, for which state guarantee schemes have been launched. In addition, capitalisation programs were also implemented to protect Hungarian companies.
5. Family and pensioner programme component: The 13th month pension will be reintroduced in the pension allowance in four instalments from the beginning of 2021. Between 2021 and 2024, in addition to the January pension, those receiving a pension and a pension-like benefit will receive a 1-2-3-4 weekly pension / benefit.

In December, the Government decided to extend the wage support scheme in the tourism and catering sectors until 31 January 2021, and expand it to businesses providing tour operator activities.

Hotels receive a compensation of 80% for reservations received until 8 November 2020, as long as they undertake to keep their employees employed.

The impact of the tax, family and job protection measures, including the measures announced by the government in November and December, amounted to HUF 709 billion.

As the Economy Protection Fund played a key role in financing the economic protection measures, there was a significant overspending of HUF 3,088.2 billion by the end of the year, which was possible as the fund had no ceiling.

Investments implemented from domestic sources also accelerated. The government has spent a significant amount on transportation development. In 2020, HUF 228 billion was paid out from the domestic appropriation for highway developments, HUF 175 billion was paid out from the solely domestic appropriations for refurbishing the public road network, and HUF 144 billion was disbursed from the domestic appropriation for developing the railway network. From the appropriation “Modern Cities

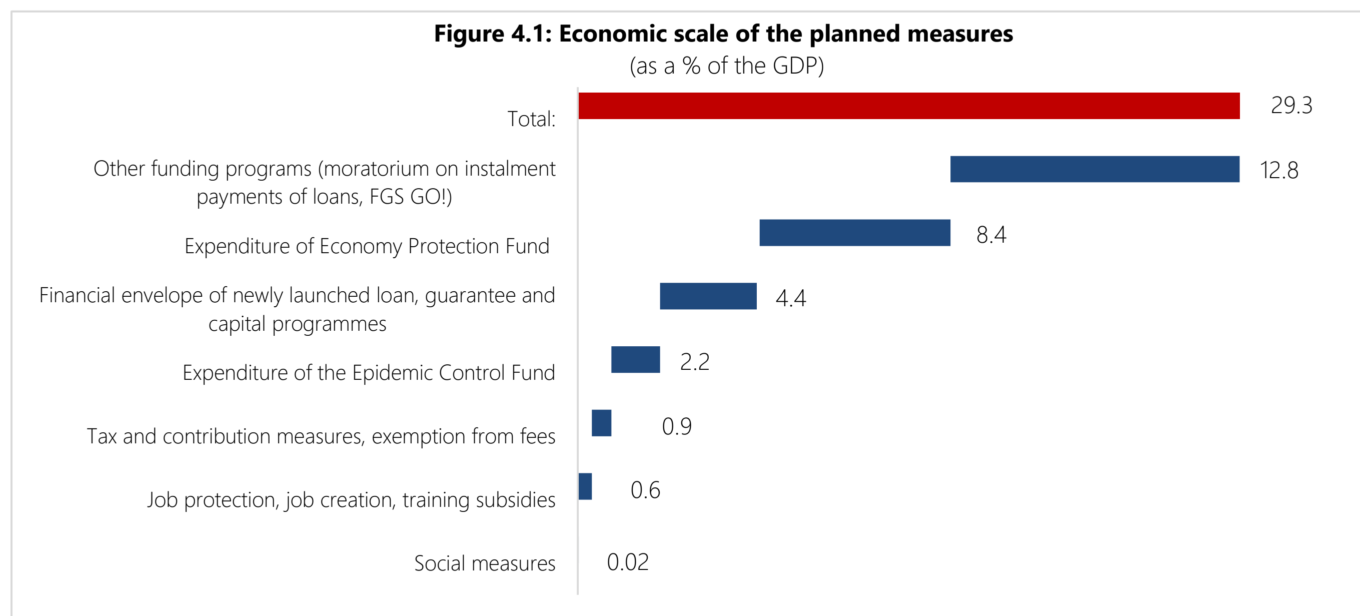
Programme", HUF 48.4 billion was paid for a number of developments modernising the major provincial cities and increasing competitiveness, attractiveness for tourists and quality of life. Despite the pandemic, government investment increased both in nominal terms and in proportion to the GDP in 2020, compared to the previous year.

The Epidemic Control Fund was also overperformed, with a final disbursement of HUF 1,027.4 billion, i.e. HUF 385 billion more than initially planned, due to the more severe than expected development of the pandemic situation. In November 2020, nurses and health professionals received a 20 percent salary increase amounting to nearly HUF 82 billion. In the fight against the pandemic, as recognition of the work of health care workers, the Government granted a gross one-off allowance of HUF 500,000 to every health care worker, which represented an expenditure of HUF 101.3 billion.

The limit for measures with no direct budgetary expenditure amounted to more than HUF 8,200 billion, including a moratorium on the instalment payments of loans and state-supported guarantee and capital programmes for enterprises, as well as favourable borrowing facilities.

The magnitude of the measures taken – partly fiscal and partly other – amounted to nearly 29.3% of GDP, thereby mitigating the rate of economic decline by nearly 6 percentage points, and the support schemes protected 704 thousand jobs.

Figure 4.1: Economic scale of the planned measures
(as a % of the GDP)



Source: Ministry of Finance

The expenditures of the public work programme amounted to HUF 125 billion, nearly HUF 41 billion lower compared to the previous year, despite the fact that the opportunity for public work was open to those who lost their jobs. The average number of persons participating in the public work programme decreased from 101,000 in 2019 to 89,000 in 2020.

The amount of passive benefits was nearly HUF 40 billion higher than in 2019 due to the coronavirus pandemic. The lower-than-expected increase was attributable to the effectiveness of the job creation and job protection programmes announced by the Government in an effort to offset the effects of the pandemic, as a result of which unemployment indicators increased at a lower rate than anticipated.

In respect of the 2014-2020 EU financial cycle, the emphasis shifted towards utilisation of the funds disbursed. Implementation of the projects advanced by the domestic budget in the previous years accelerated, which contributed to the previous years' economic growth.

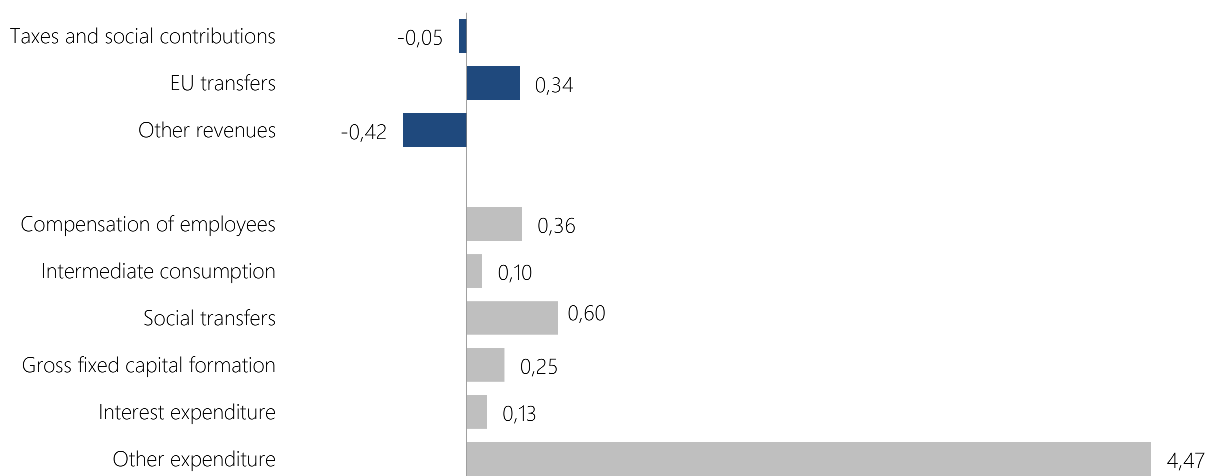
An important government objective in development policy was to use up EU funds as quickly as possible. By the end of 2017, calls for proposals had already covered 100% of the funds available in the period

between 2014-2020, and by the end of 2020, the level of commitment had risen to 109%.

In 2020, transfers amounted to more than HUF 1,600 billion, almost all of which went to cohesion programmes (plus around HUF 200 billion for agricultural subsidies). With the new measures taken in an effort to fight the pandemic and to mitigate its economic impact (e.g. React EU), a modest increase in the use of resources can be anticipated.

The 100% co-financing for the 2020-2021 business year, introduced by the Commission as an extraordinary measure, has helped and will help to ensure a swift absorption of EU funds. This resulted in approximately HUF 120 billion (approximately EUR 0.3 billion) more transfers in 2020.

Figure 4.2: Key expenditure and revenue changes 2020–2019
(in % of GDP)



Source: Ministry of Finance

Box 7: Results of the Ministry of Finance's Health Industry Funding Scheme

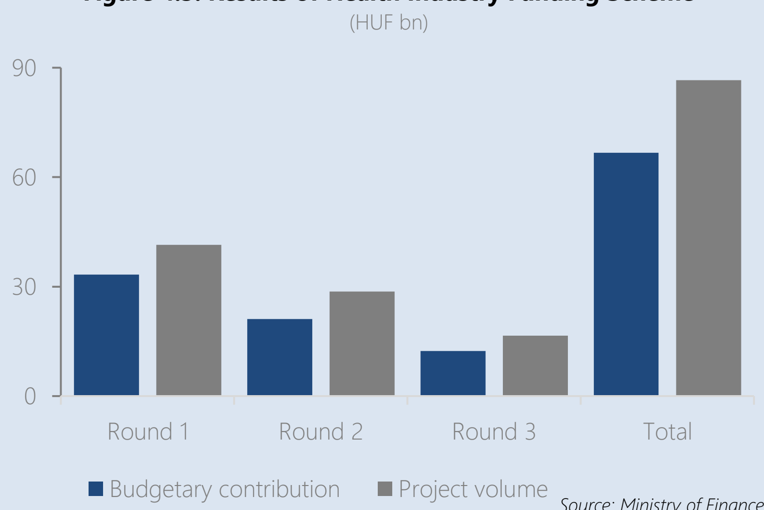
The coronavirus pandemic has highlighted that security of supply is of key importance in the health sector as well. This is why the Government of Hungary has decided to strengthen domestic healthcare and create supply capacities. Based on WHO recommendations issued for these situations, the Ministry of Finance has identified the health commodities the availability of which is of strategic importance.

Following preliminary assessments, the HUF 50 billion Health Industry Funding Scheme was announced on 3 August 2020. The available support can be used to develop existing capacity, to bring other manufacturing capacity into the healthcare sector or to create new capacities. In the span of a week, more than 40 companies have applied for support worth around HUF 60 billion, for the implementation of more than HUF 70 billion total project value. Most of the applications included development plans for mask, disinfectant and raw material production. Applications were also received for the production of X-ray and ventilation equipment, pharmaceuticals, and other items. The programme is not only targeted at end-product manufacturing, but also the entire horizontal value chain: applications for the production of raw materials, components and packaging were also evaluated favourably if the criteria and expectations were met. This also enhances security of supply, as the pandemic period highlighted the need for continuity not only in the delivery of finished products, but also in the supply of raw materials for critical products.

In the first round, 30 companies were selected for funding, and received budgetary resources in the total amount of HUF 33.3 billion for an investment of HUF 41.4 billion. Due to the significant interest, the Government has increased the budget for the tender. The Ministry of Finance therefore reopened the call for proposals in November 2020 and January 2021. In the second and third rounds, 32 additional companies submitted applications for a total of nearly HUF 35 billion in support for investments worth HUF 45 billion in total. This means that, out of a total budget of HUF 68 billion under the Health Industry Funding Scheme, nearly HUF 90 billion worth of production investments will be implemented in Hungary, mostly this year *(figure 4.3).*

Figure 4.3: Results of Health Industry Funding Scheme

(HUF bn)



Source: Ministry of Finance

Creating capacities quickly is of key importance. The proof of the effectiveness of the Health Industry Funding Scheme in this respect is the fact that 10 projects from the first round of tenders have already been delivered. This has provided the health sector, and thereby the country's security of supply, with manufacturing capacities that are of key importance in the current circumstances, including the production of automatic disinfectants, domestically developed air purification equipment, masks, rubber gloves and medical equipment used for vaccination.

In relation to this programme, the Ministry of Finance has expressed its expectation that projects implemented from the funds allocated under the Health Industry Funding Scheme are required not only to increase the security

of supply but also to facilitate economic diversification. To this end, the Ministry of Finance will also promote the development of professional relations between the companies participating in the programme. The objective of mentoring is to encourage knowledge transfer, to interconnect companies at different points in the production chain and to discuss experiences in the context of a supportive and consultative follow-up. The Ministry of Finance expects that this will help firms to achieve better results in their domestic markets as well as in regional markets and even globally. This reason for this is that Hungary's geographical location, high-quality medical and technical education system, qualified and cost-effective workforce, as well as the business-friendly domestic economic policy environment together create the preconditions for Hungary to become a stronger participant in the market for the export healthcare products. Consequently, in addition to its direct impact on improving the security of supply, the Health Industry Funding Scheme also provides an opportunity to increase the diversification and competitiveness of the economy.

4.3. THE 2021 BUDGET

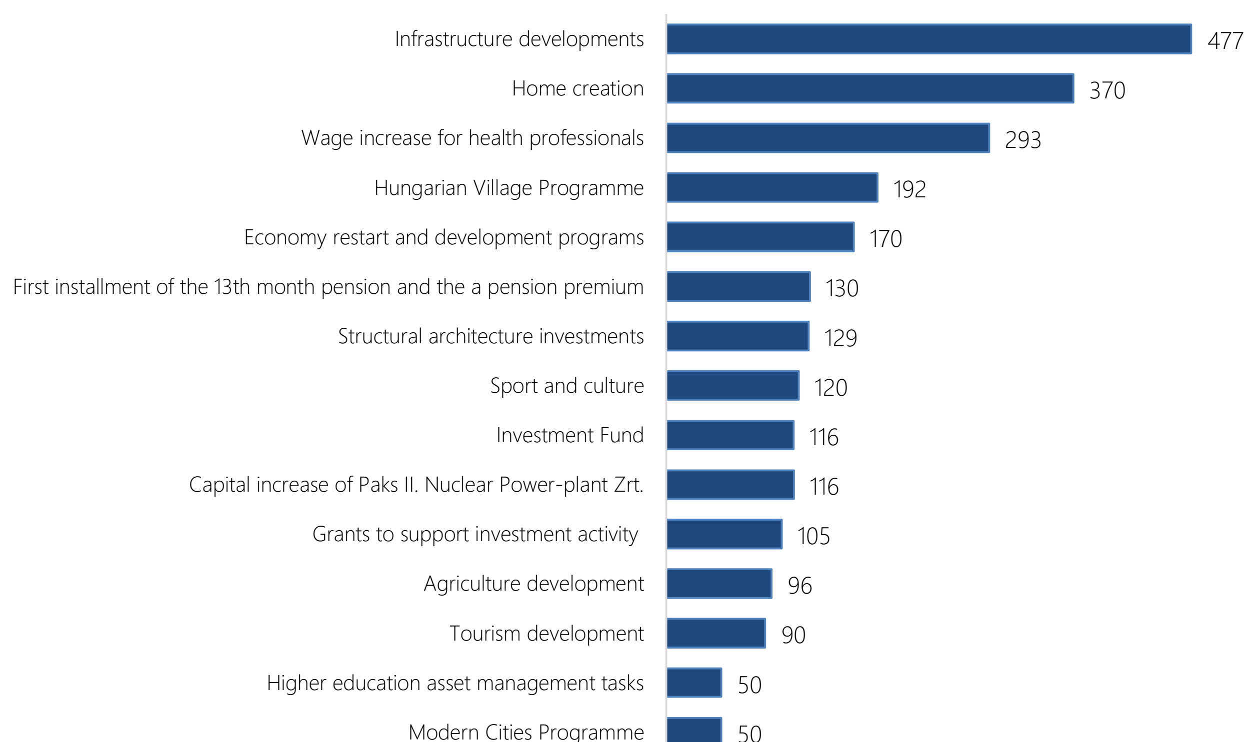
When preparing the 2021 budget, the Government set a deficit target of 2.9%, anticipating 4.8% economic growth and 3% inflation, with a safety margin of more than 0.5% of the GDP.

The 2021 budget act also focuses on the continuation of the fight against the global coronavirus pandemic, and identifies as a priority task not only health protection, but also the protection and re-launch of the economy, as well as the preservation of the main lines (family protection and home creation) of the recent years' successful government policies.

The budget bill created an Economy Protection Fund (EPF) with a HUF 2,610 billion to help the economy recover from the economic crisis caused by the pandemic and to maintain the economy's capacity to grow. As the amendment of the 2021 Act provides additional resources for measures and programmes to re-launch the economy, the funds allocated for this purpose will be used under the Economy Restarting Action Plan. The resources provided for under the Economy Restart Fund section will, inter alia, provide a possibility for the continuation of the Healthy Budapest Programme in 2021, thereby improving healthcare services in the capital and Pest County, renewing the infrastructure of the institutions concerned, facilitating access to services and improving the efficiency of emergency care. The Hungarian Village Programme is meant to strengthen the attractiveness of rural areas, reduce territorial inequalities and improve the life standard of people living in small settlements, through, inter alia, the renovation of roads and transport facilities affecting these settlements. The Modern Cities Programme promotes the modernisation and competitiveness of large rural towns and cities.

The infrastructure development programme will continue with the extension of motorways to the state border and the connection of regional centres to the high-speed road network. In addition to EU co-financed rail projects – in addition to the development of the Hungarian section of the Budapest-Belgrade railway line – some rail infrastructure investments enhancing economic growth will continue to be financed from domestic budgets. The Paks2 investment will also continue, contributing to the long-term competitiveness of the Hungarian economy through inexpensive and predictable electricity.

Figure 4.4: Economy Restarting Action Plan – national resources in 2021
(in HUF billion)



The Government continues to give priority to the continuation of the development projects already started, such as the National Public Education Infrastructure Development Programme, now in its sixth year, with high-quality gyms, classrooms and swimming pools being built within its scope. National defence spending will continue to increase in proportion of the GDP in 2021. This will provide an opportunity to continue the developments started under the Zrínyi 2026 National Defence and Military Development Programme and to improve the appreciation of personnel.

Businesses and families will also receive substantial support this year through tax credits worth around HUF 380 billion.

Following the adoption of the 2021 budget act, the macroeconomic environment in 2020 turned out to be more adverse than anticipated, while this year's economic performance is not expected to reach the 2019 level. In these circumstances, it is justified to support economic recovery with more robust budgetary means than previously planned. This year, it has become clear that the third wave of the pandemic has caused the cost of defence to exceed the original budget by an order of magnitude, while our contribution to the EU budget has increased substantially. In view of all this, the new deficit target for 2021 is 7.5%, which, despite the additional resources required to restart the economy and fight the pandemic, is lower compared to the previous year, and will result in a debt reduction to 79.9%.

In order to mitigate the consequences of the pandemic, to restart the economy and to protect jobs during the state of emergency, significant decisions were taken at the level of government regulations concerning the 2021 Budget Act. These government decrees and measures will, however, expire once the emergency is over, so those decisions, the reinforcement and maintenance of which is still justified, will be ensured by amending this year's budget act during the spring session.

After the adoption of the 2021 budget act, in view of the pandemic and the worsening economic outlook, the government decided to implement additional measures for 2021:

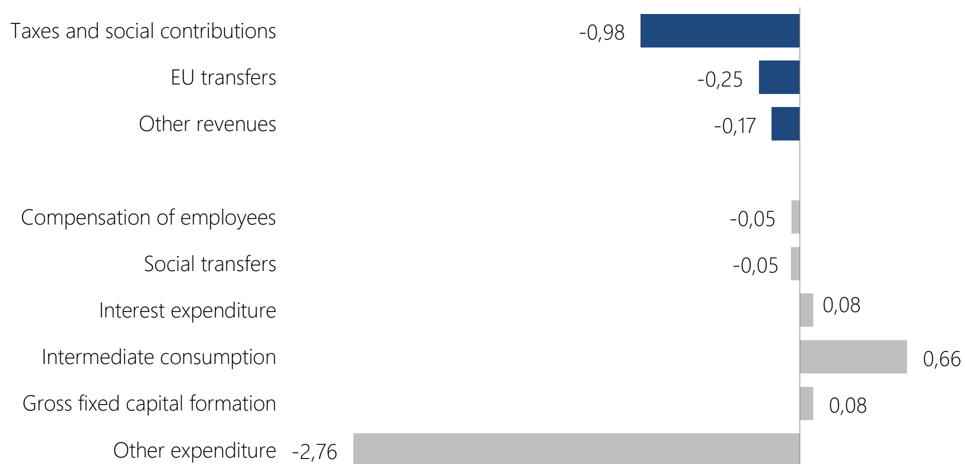
- Medical doctors will receive a significant pay rise in 3 steps, with salaries rising more than ever before in all three years from 2021, for which the budget provides sufficient resources. Not only medical specialists but also dentists and doctors and professionals working in primary care can expect an increase in their income. Thus, the funds allocated to health care salary increases are around HUF 355 billion.
- The local business tax will be temporarily halved in 2021, to 1 percent for small and medium-sized enterprises with a sales revenue or balance sheet total below HUF 4 billion as well as private entrepreneurs, instead of 2 percent. In the case of small settlements with less than 25 thousand inhabitants, the Government compensates them for the lost business revenues, and in the case of larger local governments, the Government will assess the financial situation on a case-by-case basis.
- The Government provides a HUF 10 million interest-free quick loan for 10 years to the most vulnerable small and medium-sized enterprises. The HUF 100 billion credit line scheme provides a three-year grace period to commence repayment.
- The VAT rate on the sale of newly built homes under the Home Creation Action Plan was reduced again to 5 per cent from 1 January 2021.
- Families raising children can apply for a Government support for renovation up to HUF 3 million from 2021. Furthermore, in addition to the home renovation scheme, the Government also provides a soft loan option. The loan amount is up to HUF 6 million, with a discounted interest rate at 3%. The loan includes a HUF 3 million non-refundable grant, which can be applied for at the end of the renovation.
- Also from 1 January 2021, in order to facilitate home creation for families with children, the purchase of both new and second-hand flats will be exempt from the property acquisition tax for consideration if the acquirer uses the Family Housing Allowance (CSOK) for the purchase.
- Instead of HUF 1 billion, KIVA (small business tax) can be chosen up to a revenue limit of HUF 3 billion from 2021. In line with this, the limit from which this tax payer status cannot be applied is increased from HUF 3 billion to HUF 6 billion.
- The social contribution tax attached to SZÉP cards will be cancelled by 31 December 2021. The transition among SZÉP card sub-accounts will also be free until the end of the year. In 2021, the amount levied under preferential tax increased to HUF 800 thousand in the private sector until the end of the state of emergency, contributing to the revival of domestic tourism.
- To support the catering and tourism sector, the suspension of the tourism development contribution will be extended until the end of the year. The social contribution tax on representation and business gifts will be cancelled until 31 December 2021.
- Additional liquidity-enhancing measures will be adopted in an effort to help businesses in difficulty. Companies in financial difficulty can benefit from a payment discount. The faster VAT repayment remains for SME-s until the end of the year.
- Businesses will benefit further from the provision that the social contribution tax credit can be claimed after three months of unemployment instead of the previous six months.
- In order to mitigate the liquidity difficulties of businesses, from 2021, the income tax of energy suppliers will also allow for deferral of loss incurred from 2020 onwards, similarly to the corporate income tax.
- As of November 2020, the Government provided exemption to businesses in the catering and leisure industry sectors from the payment of employer tax and will provide wage subsidies until the end of the state of emergency. When the third wave of the pandemic broke out, the wage support scheme and the tax credits were extended to sectors that had to close, in view of the closures ordered as from 8 March 2021.
- The amendment of the Budget Act provides additional resources, inter alia, for the replacement of PPP funding of higher education institutions, the institutional guarantee fee subsidy and crisis reconstruction related to the Széchenyi Card Programme, road renovation, the resource needs of the Road Programme Arrangement, the fight against the pandemic, including the implementation of the National Vaccine Plant and the National Coronavirus Vaccine Plant, and the treatment of illegal waste.

In addition to domestic resources, all EU funds available or not yet allocated for the 2014-2020 period will be used in 2021 primarily to re-launch the economy. In order to help remedy the immediate economic and social damage caused by the coronavirus pandemic, kick-start recovery and re-launch the economy, the EU Recovery and Resilience Facility (hereinafter: RRF) was introduced by the EU. The RRF facility is primarily suitable for financing structural reforms and investment projects closely related to them, in the course of which particular focus is to be placed on the contribution to green and digital transitions. At least 37% of spending must be green and at least 20% digital. The limit for the non-refundable RRF support is around HUF 2,500 billion. The RRF plan projects will be classified under 9+1 national strategic objectives in total. The following areas are eligible for funding under the RRF:

A. Demography and public education
B. Renewal of universities
C. Emerging settlements
D. Water management
E. Sustainable green transport
F. Energy (green transition)
G. Transition to a circular economy
H. Digitalisation reform for competitiveness
I. Health care
J. Horizontal

Another action initiated by the EU is the REACT-EU programme, which is an additional support relating to the measures intended to mitigate the crisis caused by the coronavirus pandemic, and must be used within the scope of the 2014-2020 cohesion operational programmes. The programme has a budget of around HUF 400 billion and its areas of intervention include job protection (wage support), re-launch of the economy, and provision of support for the health care system, public education and the social sector. The authorisation for the financing of the EU remediation package related to the coronavirus crisis is included in the new self-financing resolution; it is expected to enter into force in 2021, and will entail a significant increase in the amount of the EU contribution compared to previous years.

Figure 4.5: Key expenditure and revenue changes 2021–2020
(in % of GDP)



4.4. 2022-25 BUDGETARY PROCESSES

For the last four years of the programme period, the convergence programme's forecast mainly takes into account decisions already taken by the Government.

The main elements on the revenue side are tax and contribution revenues and EU transfers. In view of the gradual reduction of the social contribution tax and the measures planned in the competitiveness programme to support the SME sector, tax centralisation could be reduced by 1.8 percentage points between 2022 and 2025. Employment expansion and support for families and businesses will continue. As regards EU support, a new EU budget cycle has already started from 2021. In the years ahead, overall, significant EU resources will be available for drawn down, although contributions will also increase.

Tax revenues are growing at a slower pace than GDP – partly as a result of the tax reduction measures decided – which may reduce the centralisation rate. Total government revenue in proportion to the GDP could fall by 3.6 percentage points over the last four years.

Table 4.2: Main revenues of the general government (in % of GDP)

	2022	2023	2024	2025
Taxes and social contributions	34.7	33.9	33.2	32.9
Other revenues without EU transfers	4.2	4.0	3.8	3.7
Total revenue without EU transfers	38.9	38.0	37.1	36.6
EU transfers	2.3	2.6	1.6	1.1
Total revenue	41.3	40.6	38.7	37.7

Note: Due to rounding, the summed data might differ from the sum of the detailed data. *Source: MF calculation*

In the period from 2022 to 2025, without the EU transfers the total revenue-to-GDP ratio may be reduced by 2.3 percentage points, while expenditures without EU transfers may drop by 6.2 percentage points. From 2022 onwards, the re-launch of the economy will focus on measures and programmes (e.g. housing, infrastructure development, tourism and agriculture development) that will support economic development in the long run as well. Green transition and digitalisation will also contribute substantially to re-launching the economy.

The forecast takes into account the following:

- reduction of the VAT on newly bought or built homes from 27% to 5%,
- and the exemption from property transfer tax for property purchased from a Childbirth Incentive Loan (CSOK), for the entire time horizon,
- income tax exemption for persons under 25 years of age, which will help young persons to participate in the labour market, and to start an independent life and a family,
- further reduction of the employers' tax burden and the related small business tax (KIVA) rate,
- the reinstatement of the 13th month pension, the preservation of the real value of pensions and the introduction of a pension premium in the case of increases exceeding 3.5%,
- a wage increase programme for doctors, starting in 2021 and lasting several years,
- new wage increases for health professionals, other career development programmes that have already been started,
- increase in spending on national defence in the proportion of the GDP,
- investment support schemes to protect the sectors most vulnerable to the effects of the pandemic with investment support programmes, preferential loans with state guarantee and capital subsidy and infrastructure development schemes,
- infrastructure developments, such as public road and railroad developments, creation of industrial parks, regional development tasks, and capital city developments of similar significance as those implemented in the previous years,
- the Investment Fund intended to finance the preparation and flexible implementation of investment projects,

- progress of the Hungarian Village and Modern Cities Programme,
- the investments taking place in the scope of the Healthy Budapest Programme,
- touristic and other economic developments.

Wages are rising in the public sector, including inter alia the health, law enforcement and the judiciary sectors, although cuts in employers' burdens are moderating this expenditure. The amount spent on compensation of employees may fall by 1.3 percentage points by 2025.

Savings prevail in the government sector's operating expenditures, reflected in a decline in the proportion of GDP spent on goods and services purchased from purely domestic sources from 6.6% to 5.7%.

The level of benefits provided through market producers in the proportion of the GDP is stable from 2022 onwards, before declining slightly towards the end of the period.

The development of social benefits is still influenced by the structural reforms implemented earlier. Financial benefits will decrease in proportion to the GDP due to the fast return of dynamic economic growth, despite the gradual implementation of the 13th month pension. Between 2022 and 2025, total social transfers as a percentage of the GDP may decrease by 1.1 percentage point, by which they will contribute at a significant rate to the reduction of the redistribution ratio.

Interest expenditure, although rising in nominal terms between 2022 and 2025, is expected to be 0.3 percentage points lower as a proportion of the GDP in 2025. Although the increase of the volume of government bonds held by the public raises interest expenditures as the interest rate of residential securities is higher than that of other government bonds, the interest income obtained by Hungarian households also contribute to the increase in GDP and, indirectly, to rising tax revenues.

Investments funded from domestic sources are expected to remain stable at a high level. While in 2022, 76 percent of all government investments are expected to be implemented from domestic sources (including domestic co-financing for EU development), this proportion may grow to 83 percent by 2025. The Paks 2 investment is not included in this ratio, as statistics take this project into account as capital transfer.

Table 4.3: Main expenditures of the general government (% of GDP)

	2022	2023	2024	2025
Balance	-5.9	-3.9	-3.0	-2.0
Total revenue	41.3	40.6	38.7	37.7
Total expenditure	47.2	44.5	41.7	39.7
Total expenditure without EU transfers	44.8	41.9	40.1	38.6
of which:				
compensation of employees	10.1	9.9	9.3	8.8
purchases of goods and services from purely domestic resources	6.6	6.1	5.9	5.7
investments from domestic sources (including co-financing)	5.4	4.7	4.7	4.3
social transfers	12.4	12.0	11.7	11.3
interest expenditure	2.4	2.4	2.3	2.1

4.5. STRUCTURAL BALANCE

Structural balance is defined as the cyclically-adjusted general government balance net of one-off measures. The *medium-term budgetary objective* is the target value determined for structural balance, which is defined as a structural deficit of 1.0% of the GDP in the period between 2020 and 2022 in line with the methodology outlined in the "Code of Conduct".

To estimate the structural balance, the convergence programme uses a coefficient of 0.45 for the calculation of the cyclically adjusted balance, which is in line with the methodology adopted by the Output Gap Working Group of the EU. This coefficient means that the general government balance changes by 0.45 percentage points as a result of a 1% difference between actual and potential GDP (assuming no change in its composition).

As a result of the strong domestic demand, the output gap turned into positive in 2018, and its value continued to increase in 2019 due to the persistent exceptional growth performance. Due to the coronavirus crisis, the value of the output gap may be significantly negative this year. Based on a baseline estimate, it is likely to be -2.7% in 2021. A gradual closing of the output gap can be foreseen on the forecast horizon of the convergence programme.

Due to the negative output gap, the structural balance – without excluding the one-off items – is currently estimated to show a deficit corresponding to 6.3% of the GDP in 2021.

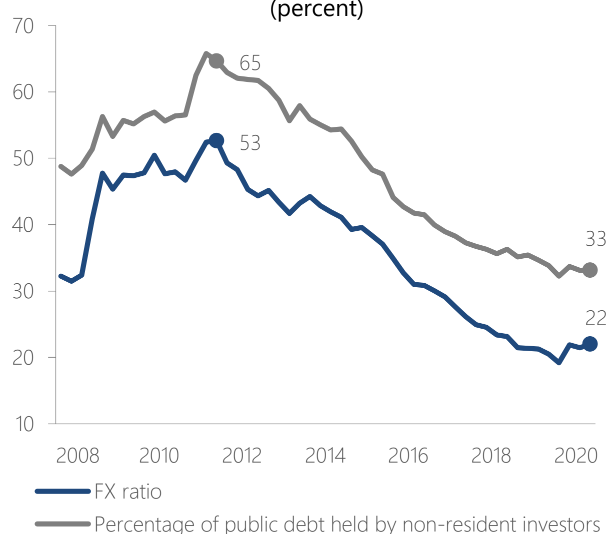
4.6. GENERAL GOVERNMENT DEBT

In 2020, the main strategic trends of previous years remained in the management of Hungarian public debt. Reducing external exposure, curbing the currency ratio as well as extending the repayment term of the debt portfolio continue to be important factors in implementing the financing plan. In line with this, the share of foreigners in total general government debt dropped from 65% to 33%. Meanwhile the pace of decline in the foreign currency ratio slowed down, although the ratio still remained close to 20%, even with the successful issuance of foreign currency bonds by the debt manager on a number of occasions in the past year. *(Figure 4.6).*

The mark-up of the five-year euro-denominated Hungarian government bond over the risk-free euro government bond, which currently best reflects country risk, rose from 28 basis points in the middle of the year 2020 amid turbulent global market developments and then stabilised at 44 basis points, as a result of a continuous decline.

Figure 4.6: FX share of the government debt and the share of government debt held by foreigners

(percent)



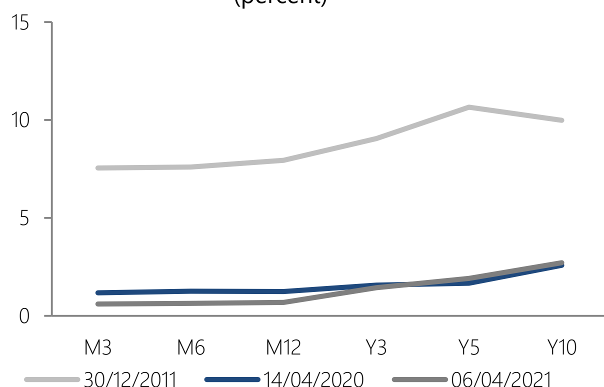
Source: MNB

Since 2012, yields on both short-term and long-term government bonds have fallen significantly, by around 7-9 percentage points, with 3-month yields falling from 7.5% to 0.6% and five- and ten-year yields from 10% to 1.9-2.7%. However, after the lows, some pick-up in yields could be noticed in 2020-2021, in line with international developments, including the impact of the coronavirus pandemic in recent weeks. Over the past year, the yield curve has not shifted significantly,

although it slightly steepened, with the shorter end down 57 basis points, while the long end has shown a 13-25 basis point rise in yields.

Figure 4.7: Shift of the yield curve

(percent)



Source: ÁKK

Similarly, on the primary market, auction yields largely followed the secondary market trends. Nonetheless, in the still favourable yield environment debts can still be financed at apparently low costs: while in 2012 the implicit interest rate for the debt was 5.3%, this average interest burden decreased to 3.5% by 2019 and 3.2% by 2020.

In previous years, the issuing of foreign currency bonds was not absolutely necessary, its sporadic application was justified by the international yield environment which was at its historical low as well as by efforts of diversification. In 2020, these considerations were complemented by the need to create reserves for the financial impact of the coronavirus pandemic. Foreign currency bonds were issued on a number of occasions, with outstanding interest and success in every case. As part of the April transaction, 6-year and 12-year Eurobonds were issued with interest rates of 1.125% and 1.625% respectively. With the issue, Hungary was the first European non-eurozone sovereign to demonstrate that it is able to raise funds from mainly European long-term investors at a low interest rate, for an amount exceeding any previous example without the support of the European Central Bank available to eurozone countries, in the midst of the coronavirus crisis, among hectic market conditions. Two other Eurobond series were also issued in November, in that case aiming for even longer maturities of 10 and 30 years, in line with international practice, reaching interest rates of 0.5% and 1.5%, respectively. In addition to debt financing in euro, the inclusion of green bonds into the portfolio presented a new aspect, and therefore Hungary issued a 15-year green bond in June. Building on the success of this bond type, and aiming to maintain Japanese market presence, samurai bonds were issued in September, too. Of the four bond series, two were also green bonds with 7-year and 10-year maturities. The two conventional series were issued with 3-year and 5-year maturity to test the market. Coupon rates were also favourable, between 0.52% and 1.29%. On the one hand, the success of the issues has confirmed investors' unwavering confidence in the government's economic policy since 2010, while the resources collected through them raised not only government reserves to the desired high level, but also increased foreign exchange reserves.

The role of domestic sectors in the investment structure of government debt financing remained substantial in the meantime. Purchases made by institutional investors - similarly to international examples - were supported by the bond purchase schemes of the central bank. It should also be noted that the share of the households in financing government debt has remained strong. The MÁP+ introduced in 2019 with great success has put the stock of government bonds held by the retail sector on a powerful growth path, and although in the first months of 2020, due to the uncertainties caused by the pandemic, the rate of sales slowed down, from May the MÁP+ became one of the most popular savings instruments. Currently more than a quarter of the government debt is in the hands of the retail customers, the government bond portfolio held by households grew by HUF 1,300 billion to HUF 9,300 billion from the beginning of 2020. The retail sector is a reliable investor, and due to its increasing role, debt financing has become even more stable. This is because this sector is less likely to suddenly sell out its government bonds in case of market turbulences, and the interest paid will remain in the Hungarian economy, increasing the revenues of the families. Reliance on domestic sectors potentially leads to a

healthier debt structure, by which the foreign exposure and vulnerability of the country decreases.

The third priority in debt management is increasing the debt's term to maturity. As both residential as well as domestic and foreign institutional investors tend to be looking for long-term government bonds, in the past years, the term to maturity and duration of the debts have continued to climb sharply, the former reaching 5.3 years and the latter 4.6 years by January 2021. In addition to the success of MÁP+, the issuing of the 15-year and 30-year foreign currency bonds also contributed substantially to this. With this, the renewal risk of debt has decreased substantially.

Table 4.4: Government bond market share of certain sectors (%, February 2021)

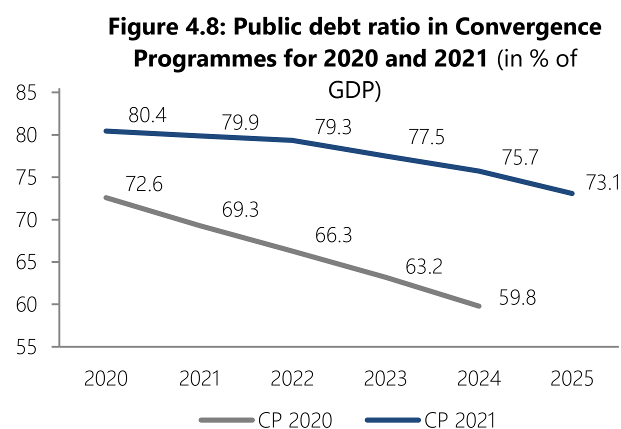
Investor groups	
Foreigners	29
Credit institutions	29
Households	26
Insurance companies, pension funds	7
Other	9

Source: MNB, MF calculation

Looking forward, debt management priorities will be increasingly enforced. In 2021, the currency ratio will further decline together with a decreasing foreign share, while the role of domestic investors, primarily of the retail sector, in financing will continue to strengthen, through which the volume of sovereign bonds held by the population, in line with the goals of the Government, will reach HUF 11 thousand billion by 2023. Government efforts to achieve a healthier debt structure, and to reduce external vulnerability while doing so, are recognised not only by investors, but also by rating agencies, as Hungary is one of those EU Member States whose results the rating agencies have rewarded by improving rating outlooks even in the uncertain times of the pandemic. All this reflects that Hungary is an economy having strong, stable fundamentals.

The steady decline in public debt-to-GDP ratios since 2011 inevitably came to a halt in 2020, as a result of the economic effects of the coronavirus crisis and the government measures taken in an effort to address them, as the debt ratio stabilised at 80.4% at the end of 2020, with a 365.1 HUF/EUR exchange rate. Afterwards, however, a dynamic decrease is expected to return, as a result of which the debt ratio is likely to drop back to 73.1% by the end of the planning horizon in 2025 (Figure 4.8).

Figure 4.8: Public debt ratio in Convergence Programmes for 2020 and 2021 (in % of GDP)



Source: MoF calculation

The current Convergence Programme anticipates a debt trajectory running at a higher level than last year, reflecting the economic and financial effects of the coronavirus pandemic and the measures taken to mitigate them. The debt-increasing impact of all these, together with a gradual normalisation, will push up the debt level over the whole time horizon, which could be somewhat offset by the positive impact of the economic recovery.

Table 4.5: Difference between debt trajectory forecasts for 2020 and 2021 (percentage points)

2021	2022	2023	2024
+10.6	+13.0	+14.3	+15.9

Source: MNB, MF calculation

(1) Nominal GDP: Higher nominal GDP than the 2020 Convergence Programme figures shift the debt trajectory slightly lower compared to the previous year's forecast.

Table 4.6: The impact of different nominal growth on the debt trajectory (percentage point)

2021	2022	2023	2024
-0.1	-1.1	-1.4	-1.6

Source: MNB, MF calculation

(2) Numerator effect: The substantially higher debt projection for the period between 2021 and 2024 than in the 2020 Convergence Programme in itself modifies the 2020 debt trajectory forecast, as described below.

Table 4.7: The impact of different debt volumes on debt trajectories (percentage point)

2021	2022	2023	2024
+10.7	+14.2	+15.8	+17.5

Source: MNB, MF calculation

The shift is due to a combination of factors, of which, in addition to the changes in 2020, the higher deficit than planned last year is the main driver for the years ahead.

(2a) Gross interest expenditure and primary balance: The primary balance figures have decreased significantly over the entire planning horizon compared to what was planned in the 2020 Convergence Programme, which in itself results in a debt trajectory higher by 1.7-4.8 percentage points. Meanwhile, the small increase in the interest rate forecast alone pushed up the debt trajectory by 0.2-0.4 percentage points.

(2b) Other items: Furthermore, the change of the debt trajectory is also significantly, however in a complex way affected by the difference in the balance of other items (the so-called SFA, stock-flow adjustments): In 2021, it reduces the primary deficit by 2.5 percentage points, while later it pushes it slightly higher, whereby in 2021, with a virtually unchanged interest trajectory, half of the significant 4.8 percentage-point increase in the primary deficit is offset by SFA items. The technical exchange rate assumption used for debt prediction (HUF/EUR 360.9) is 1.2% weaker than the HUF/EUR exchange rate of HUF/EUR 356.6 in the 2020 Convergence Programme. The assumed exchange rate is 4.3 point higher than last year's figure and is in itself pushing up the debt trajectory by 0.2 percentage point. In addition, the change in cash reserves (Single Treasury Account and the foreign currency deposit at the MNB) and in the repo stock, also causes a larger deviation from the previous forecast.

The future development of the debt ratio is sensitive to changes in the following major factors, ceteris paribus:

(A) Primary balance: A 1 percentage point upward shift in the primary balance in terms of GDP from 2021 until the end of the horizon would mitigate the debt-to-GDP ratio by 1 percentage point in 2021 and by 0.8 percentage point by 2024.

(B) Exchange rate: The share of foreign currency denominated gross Maastricht debt is expected to be around 19% in 2024. After the inevitable slowdown in 2020, owing to a new decrease in foreign currency share from 2021, the foreign exchange exposure of the debt will downslide, which is clearly reflected in the fact that 1 percentage point shift would change the debt ratio by 0.05 percentage point in 2021 and just 0.04 percentage point at the end of the time horizon. Therefore, a nominal exchange rate 1% weaker than the exchange rate assumption specified in the convergence programme (HUF/EUR 364.5) would result in a 0.16 percentage point higher gross debt ratio in 2021 and in only 0.14 percentage point in 2024.

(C) Economic growth: Should the nominal GDP growth end up 1 percentage point higher in 2021, the debt trajectory would see a 0.5–0.7 percentage point downward shift over the entire time horizon.

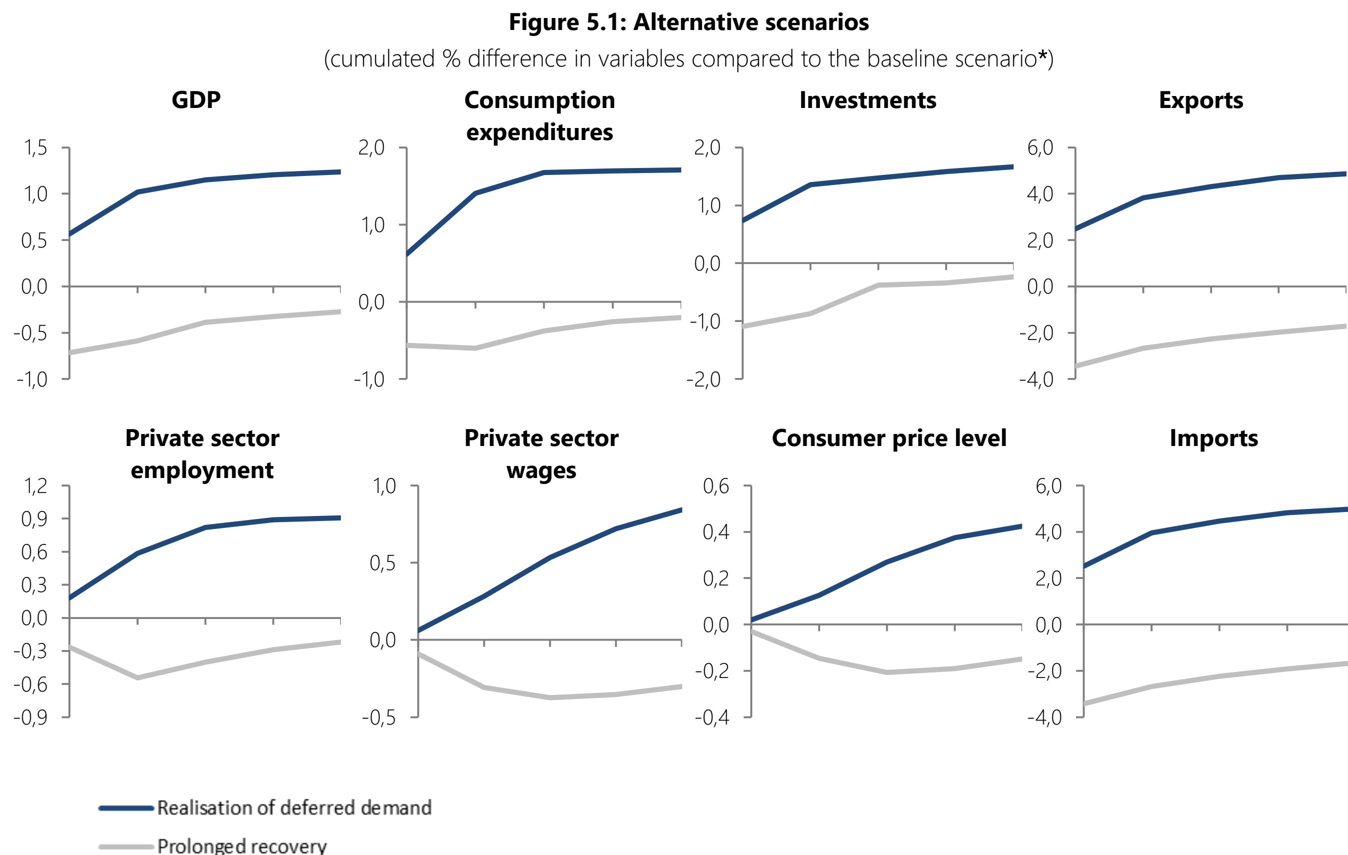
Although the adverse economic and market effects accompanying the coronavirus pandemic, together with the government's efforts to mitigate them, have rewritten the successful debt management processes of recent years with respect to 2020, this one-off and inevitable event will give way to the previous developments from 2021. The intention of the Government on the planning time horizon remains the ensuring of the continued long-term improvement of the debt trajectory and debt structure in accordance with the traditions of the past years.

5. Sensitivity analyses

The macroeconomic forecast of Convergence Programme is surrounded by risk factors, particularly in the present situation, when the coronavirus pandemic has a significant effect on economic performance worldwide. In relation to this, two alternative scenarios and the resulting economic impacts are presented below. Prepared with the DINAMO model of Ministry of Finance, the sensitivity analyses quantify the extent by which the levels and growth rates of major macroeconomic variables would deviate from the baseline scenario as a consequence of shocks *(Figure 5.1 and Table 5.1).*[1]

Figure 5.1: Alternative scenarios

(cumulated % difference in variables compared to the baseline scenario*)



Source: MoF calculation based on the DINAMO model

** The horizontal line represents years from 2021 to 2025.*

The baseline scenario of Convergence Programme is based on the assumption that the pandemic will be pushed back across Europe in the second quarter, thanks to the high vaccination coverage achieved by then.

It can be identified as a positive risk of macroeconomic forecast is that, following the containment of pandemic, the previously deferred demand will emerge more strongly than expected in economy. This is quantified in Scenario 1, in which the consumption grows faster than forecasted in the baseline scenario as a result of a combination of a faster easing of precautionary motives and the realisation of deferred purchases. In addition, tourism is also showing gradual improvement, which is benefiting our country's export of services. The stronger external and internal demand will result partly in an increase in the exports of goods and partly in a more dynamic investment trend leading to a growth in employment. In addition to the rise in imports, the pick-up in domestic demand also has an impact on moderate price increases. The increase in production and income resulting from consumption and additional capacities, generates additional revenue for the budget as a whole. As a result, overall GDP growth this year could be around 0.6 percentage points higher than projected in the baseline, assuming a positive scenario.

At the same time, a prolonged economic recovery can be identified as a negative risk for the Convergence Programme projections, in the event that the containment of pandemic is implemented more slowly than assumed in the baseline. This is modelled in Scenario 2, in which a less favourable external demand would directly and significantly further reduce the Hungarian export opportunities. The slowdown of export dynamics would result in a more moderate expansion of domestic production capacities than expected, and therefore employment and investment levels would also decrease. Furthermore, the easing of households' precautionary motives would be more slowly, which would have a moderating effect on consumption dynamics especially through durable consumption goods. More subdued external and internal demand would entail a more moderate inflation rate. In line with the economic developments, the general government balance would be worse than projected in the baseline scenario. Overall, in the negative scenario, economic growth in 2021 would be 0.7 percentage points lower than anticipated in the baseline scenario.

Table 5.1: Risk scenarios

(difference in growth rates of the variables from the baseline scenario, in percentage point)

Scenario 1: **Realisation of deferred demand**	**2021**	**2022**	**2023**	**2024**	**2025**
GDP	0.56	0.47	0.13	0.06	0.03
Households' consumption expenditure	0.65	0.81	0.28	0.02	0.01
Gross fixed capital formation	0.76	0.66	0.12	0.11	0.08
Exports	2.37	1.35	0.48	0.38	0.16
Imports	2.43	1.47	0.51	0.35	0.15
Inflation	0.02	0.11	0.15	0.10	0.05
Private sector employment	0.18	0.41	0.23	0.07	0.02
Gross average wage in the private sector	0.06	0.23	0.26	0.19	0.13
Income taxes*	0.02	0.07	0.11	0.13	0.15
Employer contributions*	0.01	0.05	0.08	0.10	0.11
Turnover taxes*	0.06	0.13	0.17	0.19	0.21
Corporate taxes*	0.07	0.09	0.08	0.08	0.07
Interest expenditure of the general government*	0.00	-0.01	-0.01	-0.02	-0.03
General government balance*	0.16	0.34	0.43	0.48	0.52

Scenario 2: **Prolonged recovery**	**2021**	**2022**	**2023**	**2024**	**2025**
GDP	-0.70	0.13	0.21	0.07	0.05
Households' consumption expenditure	-0.59	-0.04	0.23	0.13	0.05
Gross fixed capital formation	-1.11	0.24	0.53	0.04	0.10
Exports	-3.28	0.86	0.42	0.31	0.28
Imports	-3.29	0.82	0.48	0.33	0.28
Inflation	-0.03	-0.12	-0.06	0.02	0.04
Private sector employment	-0.27	-0.28	0.14	0.11	0.07
Gross average wage in the private sector	-0.10	-0.23	-0.07	0.02	0.05
Income taxes*	-0.03	-0.07	-0.06	-0.05	-0.04
Employer contributions*	-0.02	-0.05	-0.05	-0.04	-0.03
Turnover taxes*	-0.05	-0.07	-0.06	-0.05	-0.04
Corporate taxes*	-0.08	-0.03	-0.01	-0.01	-0.01
Interest expenditure of the general government*	0.00	0.01	0.01	0.01	0.01
General government balance*	-0.18	-0.20	-0.16	-0.14	-0.12

Source: MoF calculation based on the DINAMO model

** Difference of main fiscal items obtained in shock scenario are in percentage of nominal GDP estimated in baseline scenario.*

6. LONG-TERM SUSTAINABILITY OF PUBLIC FINANCES

The sustainability of public finances is basically determined by the current fiscal stance (budget balance, government debt-to-GDP ratio), the future developments of age-related government expenditure and the demographic trends.

The financing of health care and economic protection measures implemented as a consequence of the coronavirus crisis, as well as the fall in GDP have led to a significant increase in the budget deficit and debt-to-GDP ratio in 2020. In the period following the coronavirus crisis, the Government's budget policy objective will be to reduce the debt ratio and to gradually realise a balanced budget, bearing in mind the economic recovery and growth. The declining government debt level and budget deficit create sufficient room to tackle the challenges of an ageing population in the long run. Additionally, the Government implemented several measures to support families, which could mitigate the budgetary consequences of the projected ageing of the Hungarian population through demographic changes.

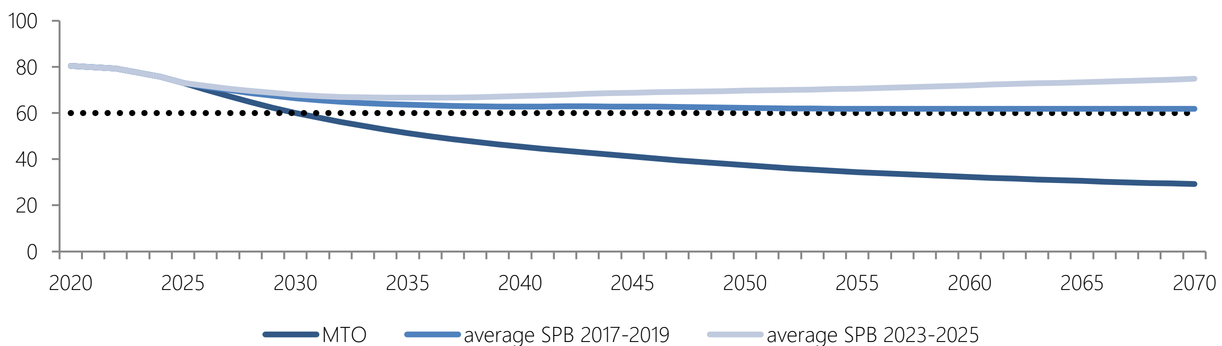
According to the estimates approved by the European Commission and the EU's Economic Policy Committee, age-related budgetary expenditure in Hungary in 2030 are anticipated to develop at 17.1% of GDP, the same as in 2019. In the long term, spending appears to converge towards the EU average and will reach 22.5% of GDP by 2070. The projections for the main areas are as follows: as a result of an ageing population, pension expenditure in proportion of the GDP will increase from 8.3% to 12.4%, health-related expenditure from 4.8% to 5.6%, long-term care expenditure from 0.6% to 1.2% and education expenditure will change from 3.4% to 3.3% of GDP between 2019 and 2070.

According to the European Commission's Debt Sustainability Monitor published on 5 February 2021, the risk to the sustainability of the Hungarian budget is low in the short term, while in the medium and long term, medium-level risks were identified in comparison to all EU Member States, primarily due to the future budgetary expenditure associated with growing older. Considering the baseline of the debt sustainability analysis presented in the report, Hungary's debt will fall to 66.2% of GDP by 2030.

The Convergence Programme projects the debt ratio to decline to 73.1% of GDP in 2025; and maintaining of the prudent medium-term budgetary position, it will drop to 60% of GDP by 2030. The public debt trajectory is expected to remain sustainable in the long run, based on either the mid-term fiscal path forecast presented in the convergence programme or the fiscal policy implemented before the crisis (*Figure 6.1*).

Figure 6.1: General government debt developments

(in % of GDP)



Note: until 2025 the macroeconomic trajectory is based on the assumptions described in the convergence programme, and thereafter on the macroeconomic assumption presented in the 2021 Ageing Report. The structural balance data are based on the estimations of the convergence programme. SPB: structural primary balance

Source: MF calculation

7. Quality of General Government

7.1. Structure and Efficiency of General Government Expenditure

The improvement of the efficiency of public spending is supported not only by labour market measures, but also by measures taken in the area of education and science policy, which indirectly contribute to achieving a higher quality level. In the light of this, the convergence programme outlines in a concise manner the steps taken and planned by the Government in the areas of vocational education and training as well as in higher education. A detailed description of the structural measures is included in Hungary's 2021 National Reform Programme.

Vocational training

In 2020, the new vocational training act entered into force, creating a more streamlined training structure and more flexible training conditions than before, thereby further strengthening the system's capacity to adapt to labour market needs. In parallel with this, vocational trainers have received a 30% wage increase, which will support the efforts to keep qualified trainers in their jobs and to further improve the quality of vocational training. In order to strengthen dual training, the related tax credit for employers who operate as practical apprenticeships and the wages of apprentices participating in dual training have also been almost tripled. Significant improvements in vocational training curricula and in training and examination centre infrastructure are planned to be implemented from the resources of the EU budget cycle 2021-2027 and at the expense of RRF resources.

Higher education

The process of changing the model of higher education began in 2019, with the replacement of the maintainer of the Corvinus University of Budapest (hereinafter: BCE). In 2020, the Parliament decided to change the model of 9 further public higher education institutions, seven of which changed their maintainers in 2020, and 2 more will change their maintainers in 2021. In the summer of 2021, 11 further public higher education institutions will change their model, whereby almost two thirds of Hungarian higher education will operate under a new model. In the context of the model change, the state will transfer the right to maintain the institutions to a trust foundation established for this specific purpose. This has not changed the funding of the universities (with the exception of BCE, which is funded from the proceeds of a share package transferred to it free of charge), as they continue to receive budget support on the same terms as public higher education institutions.

It is also worth highlighting that in autumn 2020, the Parliament adopted the foundations of the new performance-based funding system for higher education institutions, which will enter into force on 1 September 2021. Within this framework, the Government concludes a long-term (15-25 years) strategic agreement with the maintaining foundation in the case of the model-changing institutions, and a 3-5 years financing contract with the institution itself in the case of public higher education institutions, in which it stipulates the provision of education & training, research, other public services, and special regional and third-mission tasks (the term “third-mission" covers all institutionalised relationships with partners in the non-academic world, including the transfer and utilisation of intellectual property generated during the activities, and the contributions to the elaboration of professional policies).

Funding is planned to be based on three pillars: education, research and infrastructure maintenance. When ordering the task, in addition to updated training cost and research task performance, quality indicators would also be included, which, according to international examples, are typically output performance indicators. Each indicator can be adapted to the characteristics, expected regional, third-mission and national aspects of the university. The strategic agreement may identify areas of training that the university is required to strengthen, and may also identify courses that are not justified for continuation and that strengthen the profile of other universities. The training transition specified in the strategic agreement, on the other hand, is to be reflected in financing contracts and government training orders.

7.2. Structure and efficiency of revenues

A number of significant steps have been taken since 2010 to make the tax system more competitive. The most significant structural changes were implemented between 2010 and 2014, followed by the continued enhancement of tax collection efficiency, considerable reductions in labour and income taxes and broadening the scope of targeted tax benefit schemes to push forward economic growth.

The reduction of taxes and contributions, alongside with enhancing the employment- and enterprise-friendly character of the tax system remain key economic policy objectives. In line with these objectives, tax policy continues to focus on reducing taxes on labour, the tax and administrative burden on businesses, increasing the efficiency of tax collection and simplifying the tax system in the coming period as well.

Measures for tax reduction

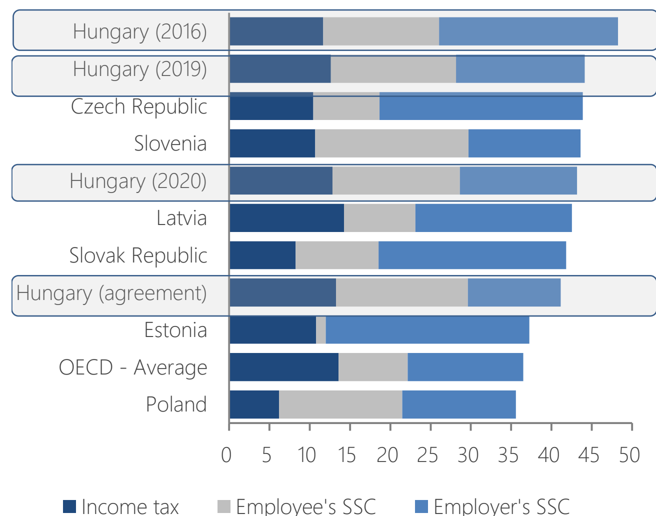
Taxes on labour

With the reforms launched in 2010 a new tax system has been created that significantly supports employment and rewards extra work. The main foundation of the new tax system is the entirely linear taxation introduced in multiple stages between 2010 and 2013.

One of the Government's economic policy objectives is the reduction of labour taxes. The fast economic growth fuelled by the favourable processes and the successful fight against shadow economy made the implementation of a reduction in the personal income tax rate possible, from 16% to 15% by 2016. In the same year, an agreement was made between the private sector and the Government on a phased reduction of employers' social security contributions, under which the Government would progressively reduce social security contributions on labour from 2017. Considering the limited room for fiscal manoeuvre, the social contribution tax rate decreased by 11.5 percentage points in total between July 2016 and July 2020. Although real wage growth in the private sector did not reach the level specified in the agreement at the time of the July 2020 reduction, the Government reduced the social contribution tax rate by a further 2 percentage points, in an effort to mitigate the effects of the crisis caused by the coronavirus and to protect jobs. Further tax reductions are expected to be implemented in the coming years on two occasions.

Thanks to the steps taken by the Government, the tax wedge has fallen spectacularly over the last few years, dropping by more than 5 percentage points from 2016 to 43.2% in the second half of 2020. Taking into account the further reduction of the tax burden expected under the agreement, the tax wedge calculated excluding tax benefits will potentially decrease by more than 7 percentage points compared to 2016, and Hungary may reach a level similar to its regional competitors.

Figure 7.1: Tax wedge
(single, no children, average wage)



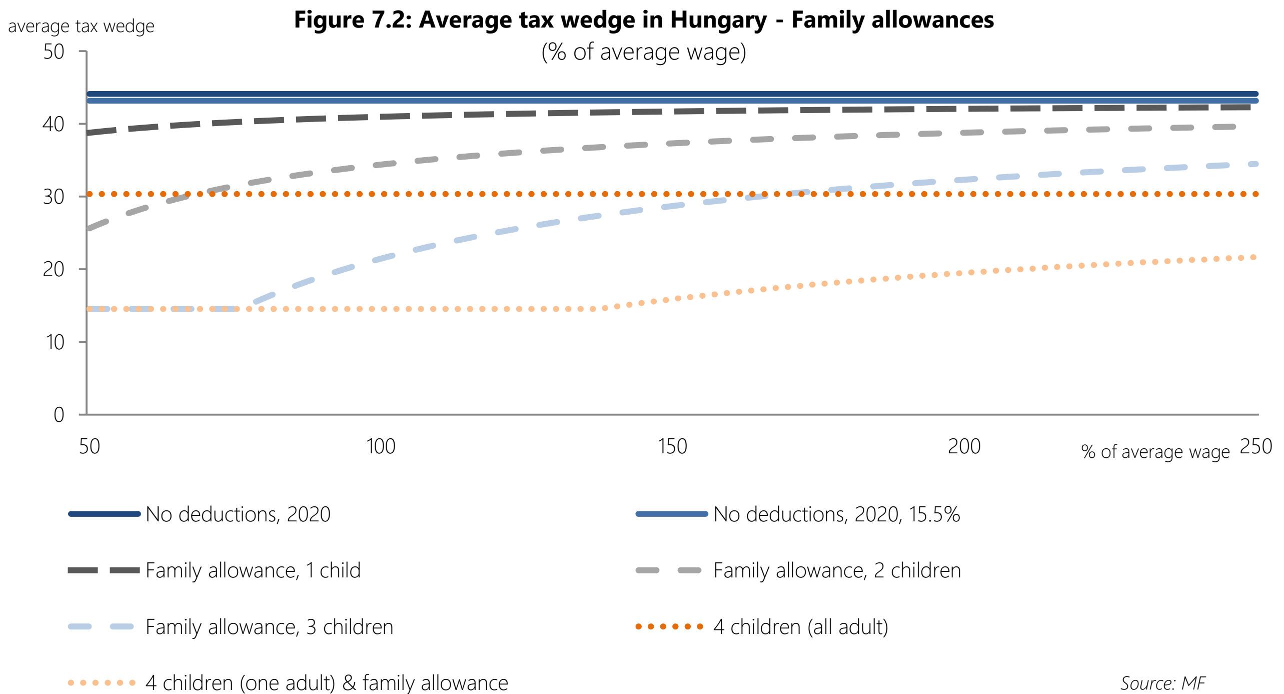
Source:OECD, MF calculation

A family tax credit for children – whereby the tax system takes into account the number of dependants – was introduced from 2011, and tax credits affecting employer taxes from 2013. The family allowance for persons with two children was doubled in four equal steps from 2015 to 2019. From 2015, the family-

friendly tax system was complemented with an allowance provided to couples in their first marriage, available in parallel to the family allowance as of 2017. Under the Family Protection Action Plan, a new measure was introduced to provide unprecedented support to large families: as of 1 January 2020, women who are raising (or had raised) at least four children are fully exempt from paying of personal income tax for the overall length of their working life. The Government continues to consider the support of families and encouragement to have children as a priority in the future.

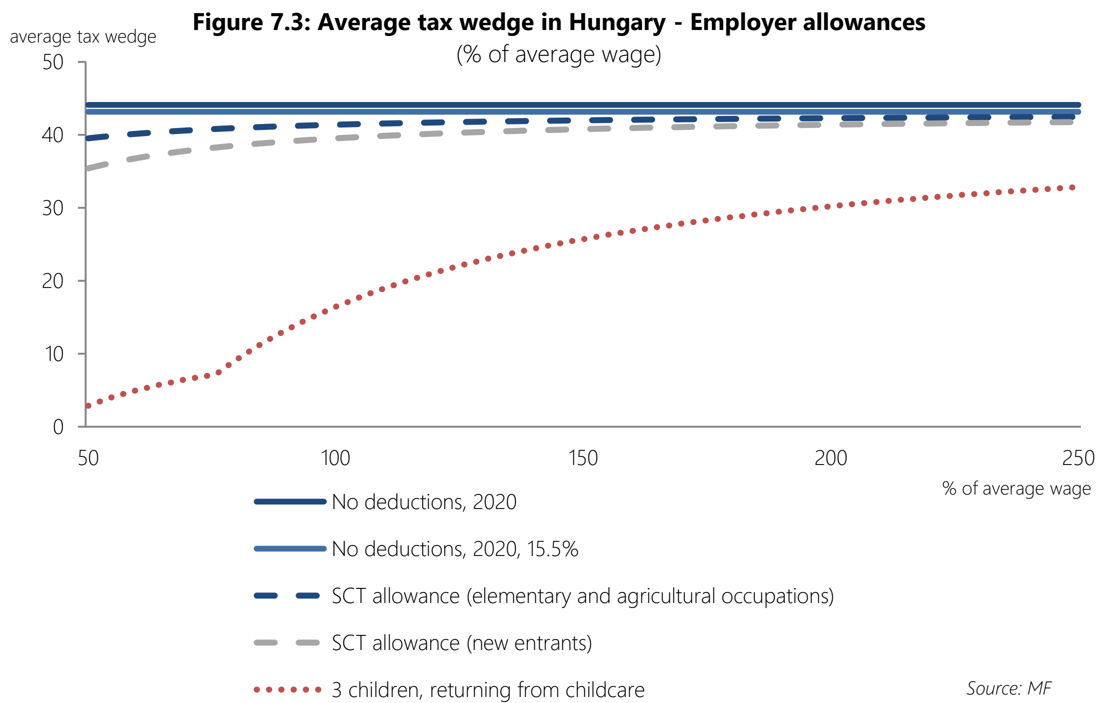
Figure 7.2: Average tax wedge in Hungary - Family allowances

(% of average wage)



Source: MF

Another key element of the tax benefit system is supporting the most disadvantaged groups to find a job and remain in employment. For this purpose, targeted reductions in employer taxes (social contribution tax and small business tax) are available under the Job Protection Action Plan launched in 2013. The objective of the measure was to improve employment indicators for groups whose domestic activity rates lagged behind those of the regional countries. As of 2019, the allowances became better targeted, with the primary objective being to support the employment of new entrants or those who have been permanently absent from the labour market. The upper limit of the allowances was increased from the previous HUF 100,000 to the amount of the current minimum wage. The new entrants' allowance was a significant help for both employers and jobseekers in 2020, and the number of people on the benefit is expected to rise further in 2021, as people who have lost their jobs due to the coronavirus are provided with assistance to re-enter the labour market. In order to support families in purchasing a home, the purchase of new and second-hand apartments will be exempt from tax from 2021 – regardless of the value threshold – if funded from the Family Housing Allowance (CSOK).



Another positive change is that, from July 2020, all forms of work performed by retired persons are exempt from the payment of contributions and social contribution tax, and the minimum contribution base for sole proprietorships and partnerships has been reduced to the amount of the minimum wage, instead of the previous one-and-a-half times the minimum wage.

A number of measures have been implemented over the past two years to simplify the tax system, reduce the number of tax types and minimise administration. As of 1 January 2019, health care contribution merged into the social contribution tax and the regulation of accident tax was integrated with insurance tax. In addition, the cultural tax, the 75% special tax on the termination of employment of private individuals and the special tax on credit institutions have been abolished. As of 1 July 2020, employees' individual contributions have been merged into a single social security contribution, and at the same time the regulation of the basic provisions of social security and contributions have been redefined in a consolidated legislation. The family allowance has also become more favourable, up to the amount of the social insurance contribution (i.e. by 1.5 percentage points.)

In an effort to support young people, from 2022 and onwards, persons under 25 will be exempt from personal income tax, which will typically allow them to earn 22.6% more net income.

The negative impact of the coronavirus pandemic has been affecting the economy since March 2020. In order to protect jobs and the survival of businesses, the Government also gives priority to supporting sectors most severely hit by the pandemic through the tax system. In the months, businesses benefited from tax exemptions of the social contribution tax, the vocational training contribution, the rehabilitation contribution and the small business tax.

Corporate taxes

In corporate taxes, tax policy is primarily aimed at increasing competitiveness and encouraging investment. In this spirit, a uniform reduction of the tax rate to 9 percent was implemented in 2017. The small business tax (KIVA) and the lump-sum tax for small enterprises (KATA) were introduced as optional tax schemes in 2013 to reduce the tax burden on SMEs. In the case of corporate income tax, in order to encourage investment, restrictions on the amount of the development reserve have been lifted in a multi-step process over the past period. In 2020, the 50% limit on the development reserve in proportion to pre-

tax profit was abolished, providing a possibility for using the development reserve up to the full amount of pre-tax profit, taking into account the ten-billion-forint ceiling. This provision was already applicable for the 2019 tax year. The ten-billion-forint ceiling was also abolished, as of 2021, whereby the development reserve can now be unlimitedly applied to the entire profit. Furthermore, in order to encourage investment by smaller businesses, the threshold for the development tax credit for small and medium-sized enterprises will be gradually reduced from HUF 500 million in three steps from 2020.

Starting from 2017, the regulation of small business tax (KIVA) was simplified to a significant extent, with both the entry and exit thresholds for tax liability being raised. In 2021, the sales revenue and balance sheet total threshold for KIVA entry has been increased to HUF 3 billion, and the limit from which this tax payer status cannot be applied has been increased to HUF 6 billion, accordingly. In parallel with the reduction of the social contribution tax burden, the tax rate has gradually decreased over the recent years: In 2017, the tax rate was reduced from 16% to 14%, then by another 1 percentage point in 2018 and another one in 2020, and by 1 percentage point again from 1 January 2021 to 11%, providing an even more favourable tax environment for SMEs. As a result of these measures and the campaigns to promote the tax type, the number of taxpayers has more than tripled since 2016, reaching over 64,000 by the end of February 2021.

To reduce the administrative burden for micro-enterprises and private entrepreneurs, the threshold for the lump-sum tax for small enterprises (KATA) was raised from HUF 6 million to HUF 12 million in 2017. The threshold of value-added tax exemption was increased from HUF 8 million to HUF 12 million as of 2019, in an effort to further reduce the administrative burdens. However, there have been a number of cases of abuse within this tax type through “hidden employment” (outsourcing employment to entrepreneurs) for the purpose of aggressive tax optimisation. This places employers who employ professionals on a traditional employment basis at a serious competitive disadvantage compared to those who outsource the work. Employees may also be affected adversely by this situation, given that, as ‘KATA’ entrepreneurs, they lose their employment protection, and may be granted lower social security benefits in the future. Consequently, from January 2021, the rules on the itemised tax of small businesses have been changed to discourage outsourcing: the part of revenues above HUF 3 million of a small taxpayer originating from the same paying company is now subject to an additional 40% tax imposed on the client company. Despite the changes, the popularity of the KATA scheme continues to grow due to the simplicity of the tax type and the low tax burden, with the number of taxpayers exceeding 428,000 in February 2021.

The tax advance supplement was abolished for central tax types in 2019 and for local business tax in 2020. As from 2021 onwards, the submission of local business tax returns via the NTCA will become mandatory, which will significantly reduce the administrative burden for businesses. A further substantial measure concerning local business tax is that, in respect of 2021, the maximum rate of local business tax for small and medium-sized enterprises with a sales revenue or balance sheet total of less than HUF 4 billion has been set at 1%, and the businesses concerned can already enforce the 50% reduction on their tax advances payable in 2021.

In an effort to re-launch the economy and ensure liquidity for companies, from 2021, the income tax of energy suppliers will also allow for deferral of loss incurred from the 2020 tax year onwards, similarly to the corporate income tax.

In order to replenish the Epidemic Control Fund, a special retail tax was introduced effective from 1 May 2020, the basis for which is the amount of sales revenue from retail activities. Furthermore, a special tax imposed on credit institutions due to the coronavirus pandemic based on the special tax on financial institutions, which provided significant funds for controlling the pandemic in 2020. The amount of the excess contribution paid by credit institutions can be deducted in equal instalments from the current year tax liability of the special tax on financial institutions for five years starting in 2021.

Consumption and turnover taxes

Shifting the focus of taxation towards consumption and turnover taxes continues to be an important element of the Government's tax policy. In line with this, in recent years, the reduction of the value-added tax has been used only as a targeted measure – taking into account the bearing capacity of the budget – in areas where it was justified by the need for sectoral development or to combat the black economy. Thus, VAT rates on a number of basic foodstuffs have been reduced, and VAT rates on internet services and restaurant meals have also been lowered in the past few years.

In an effort to strengthen the competitiveness of domestic tourism, the VAT rate on commercial accommodation services was reduced from 18% to 5% from 2020. At the same time, the 4% tourism development contribution was also extended to the above services; however, in order to mitigate the impact of the coronavirus pandemic, it will not be payable from 1 March 2020 until 31 December 2021, and the tourism tax will not be payable until the end of the state of emergency. Furthermore, until the end of the state of emergency, a 5% VAT rate will apply to takeaway and door-to-door sales of food and drink, which would otherwise be subject to a 5% VAT rate in the framework of restaurant catering services.

In addition, a reduced VAT rate of 5% has been introduced – with entry into force on 22 July 2020 – for the sale of residential property built in so-called brownfield areas with a useful floor area not exceeding 150 square metres. Also, under the Home Creation Action Plan, a 5% VAT rate will again apply to the sale of new housing from 1 January 2021 until 31 December 2022 (with transitional provisions until the end of 2026). In order to get closer to the EU tax minimum on cigarettes, the rate of the excise duty on cigarette and fine cut smoking tobacco gradually increased from September 2018 in three steps (September 2018, January and July 2019), then in further four steps from January 2020 (January 2020, July 2020, January 2021 and April 2021). Furthermore, from 2021, the distillation of spirits for consumption by the households of fruit growers and their guests, up to a certain quantity, will be exempt from tax.

Measures for combatting tax avoidance

In recent years, measures aimed at the whitening of the economy have principally focused on the collection of consumption taxes. In 2014, online cash registers were introduced, which, in 2015, was followed by the implementation of the Electronic Public Road Trade Control System. In order to encourage electronic payments, a POS terminal installation programme was launched in 2016, then online invoice data reporting became mandatory from 1 July 2018, which was extended in two further steps from July 2020 and January 2021 (on both occasions with a 3-month penalty-free period granted by the tax authority).

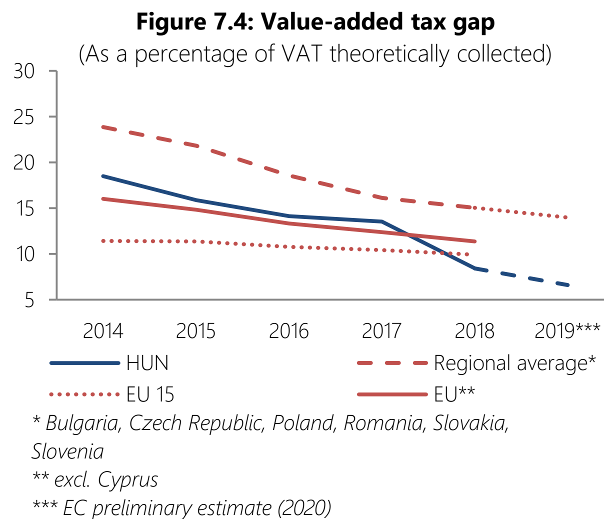
The objective of the online invoice data reporting obligation is to combat VAT fraud with regard to transactions between taxpayers, which is made possible by real-time reporting to the tax authorities. As of January 2021 (or after the penalty-free period), data reporting has become comprehensive, including for invoices issued to non-taxable persons. Given that the reporting obligation now also covers intra-Community sales and exports of products, the entire data flow of practically the entire economic life will be transparent to the NTCA. The extended online invoicing system will also contribute to the introduction of eÁFA as a tax return draft system in the course of 2021.

As a result of the measures implemented in recent years for the purpose of combatting tax avoidance, the rate of uncollected VAT has decreased significantly in Hungary, which is also confirmed by the European Commission's latest study on estimating VAT gap

(European Commission 2020[1]). According to the estimate, the level of domestic VAT in proportion to the VAT theoretically collected reached 21% in 2013. Since then, domestic VAT gap has been on a steady decline, falling from 8.4% in 2018 to below 7% in 2019, according to the Commission's preliminary estimates. The rate of decline in domestic VAT gap has exceeded the average rate for EU countries, placing Hungary among the EU leaders in 2019, ahead of countries such as Germany and Denmark. Although changes in other items affecting the VAT base (household investment, public purchases) may have played a role in the development of the VAT gap, a larger part of it is due to the measures taken to combat tax avoidance.

Figure 7.4: Value-added tax gap

(As a percentage of VAT theoretically collected)



** Bulgaria, Czech Republic, Poland, Romania, Slovakia, Slovenia*

*** excl. Cyprus*

**** EC preliminary estimate (2020)*

Source: European Commission (2020), MF calculation

Hungary continues to be committed to and involved in the international fight against aggressive tax avoidance. In 2018, Hungary amended the rules concerning controlled foreign companies in accordance with the provisions of the European Union's Anti-Tax Avoidance Directive, and implemented the rules for limitations to the deductibility of interest, effective from 2019. Moreover, the other provisions of the Directive, i.e. the rules pertaining to capital withdrawals and the rules against hybrid instruments (tax avoidance as a result of differences in the legal evaluation of the same factual circumstances) have been transposed in 2020. At the beginning of 2021, Hungary ratified the Multilateral Convention on the implementation of tax convention measures for preventing tax base erosion and profit shifting, which provides additional tools to combat aggressive tax planning.

The primary objectives of the tax procedure area include improving tax compliance, strengthening the relationship between the tax authority and taxpayers, as well as encouraging cooperation and voluntary compliance. In this scope, recent years have seen the restructuring of the tax authority’s organisation, and a number of measures have been implemented in order to strengthen the service provider and customer-focused profile of the tax authority. The most significant step has been the introduction of the eSZJA system, which now allows NTCA to prepare draft returns for more than 5 million private individuals, taking over the burden of preparing the personal income tax returns for a significant portion of taxpayers. Relying on experiences acquired through using the eSZJA and due to the gradual integration of data reporting, the tax authority may become able to suggest drafts of tax returns for an increasing number of tax types and for a bigger scope of taxpayers. In

[1]European Commission (2020): Study and Reports on the VAT Gap in the EU-28 Member States: 2020 Final Report, September 2020

2019, the tax authority prepared a draft tax return for private entrepreneurs on the first occasion, and drafts of tax returns were also made available for the excise duty, which concerns an easily definable group of taxpayers. In the medium term, the objective of the Government is to provide even more businesses with pre-completed drafts prepared by the tax authority of tax returns requiring the most burdensome administrative procedures (e.g. VAT) and of the various reporting obligations of employers. From the second half of 2021, the data provided by the extension of the online invoice data reporting will be used as the basis of the VAT return drafts (eÁFA) prepared by the tax authority

8. Institutional characteristics of general government

8.1. Budgetary framework

The framework rules for the preparation of the budget are laid down in the Fundamental Law, in Act CXCIV of 2011 on the Economic Stability of Hungary (Economic Stability Act), Act CXCV of 2011 on Public Finances (Public Finances Act) and Government Decree 368/2011 (XII.31.) on its implementation.

In view of the pandemic situation, the Government has taken a number of legal and economic measures. The state of emergency is one of the special legal orders provided for in the Fundamental Law. In a state of emergency, the Government may take decisions differently from the standard legal orders, to the extent that may be substantiated based on the emergency situation. The escape clause in Article 36(6) of the Fundamental Law is activated at times when a special legal order is applied, under which the requirement to reduce debt may be derogated from to the extent necessary to mitigate the consequences of the circumstances triggering the special legal order, or, in case of an enduring and significant national economic recession, to the extent necessary to restore the balance of the national economy. Similarly, the Act on Disaster Management also provides for a derogation from the public finance rules. In order to mitigate the effects of the coronavirus crisis, the Government passed a decision regarding a faster and more flexible use of budgetary reserves in Government Decree 69/2020, and the rules on reserve under the Budget Act were suspended for 2020. The reserves have been used for disease control and economic protection measures. Government Decree 92/2020 was the legal document that allowed the Government to derogate from the provisions of the Budget Act for 2020. The Government declared a state of emergency for the second time on 3 November 2020. The Parliament is currently discussing the Government's proposal to extend the law on the protection against the coronavirus pandemic until the 15th day of the autumn session of the Parliament.

8.2. Structure of the general government's statistical data reporting

In Hungary, statistics on the government sector are compiled by the Hungarian Central Statistical Office (KSH) and the National Bank of Hungary (MNB). According to the current division of labour, the KSH is responsible for non-financial accounts and the MNB for financial accounts. In the data report provided in the excessive deficit procedure (EDP Notification), the above division of labour applies to the compilation of factual data up to the period preceding the reference year, while the calculation of the expected government balance and debt for the given year is the duty of the Ministry of Finance. The statistical working committee consisting of representatives of the KSH, the MNB and the MF operates at the managerial and expert level. The procedural issues related to data flow, division of labour and methodological judgement are set out in a cooperation agreement updated in 2015. The main source of data for the government sector's statistics is the Public Finance Information System, the annual and interim reports of public finance institutions, complemented by the collection of statistical data on government enterprises and non-profit organisations, and the collection of banking and securities statistics for the government sector as a whole. The notification report will be published by the KSH on its website when issued to Eurostat. After a three-week consultation period with Eurostat, the KSH publishes – together and simultaneously with the Eurostat press release – the EDP Notification Tables approved by Eurostat. It also publishes the methodological description related to its compilation, which is continuously updated by the Hungarian statistical authorities. In the explanatory part of the annual budget and final accounts submitted to Parliament, the Ministry of Finance presents the divergence between the official general government balance and the Maastricht balance and debt indicators in a separate section. The disclosures required by Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States are fully complied with by the Ministry of Finance.

TABLES

Table "A"

Discretionary government measures and assessment of budgetary impact 2020-2023

Measures		ESA code	Effect on the budget (GDP%, compared to previous year)			
			2020	2021	2022	2023
Transitional measures implemented in relation to the pandemic	**Revenue-related measures**					
	Annual VAT return of local governments	D.2	-0.13	0.23	-0.11	0.00
	Suspension of the tourism development contribution from 1 March 2020 to 31 December 2021	D.2	-0.06	-0.02	0.07	0.00
	Measures related to the SZÉP card	D.61	-0.07	-0.01	0.07	0.00
	Capping the local business tax rate at 1%	D.2	-	-0.16	0.05	0.09
	Special tax of credit institutions related to the pandemic situation	D.29; D.4; D.5; D.7; P.52; P.53; K.2; D.8	0.11	-0.13	0.00	0.00
	Reduction of the VAT rate on new housing from 27% to 5%	D.2	-	-0.21	-0.04	-0.03
	Other measures		-0.18	0.03	0.07	0.01
	TOTAL TRANSITIONAL REVENUE MEASURES		**-0.33**	**-0.27**	**0.13**	**0.07**

Continued on next page.

	Measures	ESA code	Effect on the budget (GDP%, compared to previous year)			
			2020	2021	2022	2023
Transitional measures implemented in relation to the pandemic	**Expenditure-related measures**					
	HUF 3 million housing renovation allowance – From 2021, families with children can apply for up to HUF 3 million renovation allowance.	D.9	-	-0.22	-0.04	0.18
	Extension of Child Care Fee (GYED) and Child Care Benefit (GYES) expiring during the state of danger	D.62	-0.02	0.02	0.00	0.00
	Reallocation of EU resources and REACT EU					
	Job protection wage subsidy – 70% of net lost wages paid by the state	D.39	-0.06	0.05	0.00	0.00
	Job creation wage subsidy scheme	D.39	-0.06	0.06	0.00	0.00
	Job protection wage subsidy – 40% wage subsidy for persons working in engineering (R&D) jobs	D.39	-0.03	0.03	0.00	0.00
	SME efficiency-enhancing subsidies	D.92	-0.19	0.18	0.00	0.00
	Structure-changing digital training	D.75	-0.01	0.01	0.00	0.00
	Providing liquidity to companies (MFB working capital loan)	F.4	-0.12	0.11	0.00	0.00
	HUF 10 million Interest-Free Restart Quick Loan for SMEs	D.75	-	-0.19	0.18	0.00
	Sectoral wage subsidy scheme (until the end of the state of emergency)	D.3	-0.06	-0.10	0.14	0.00
	Expenditure of the Epidemic Control Fund					
	Decided expenditure on pandemic control broken down by ESA	D.1	-0.01	0.01	0.00	0.00
		P.2	-0.52	0.48	0.00	0.00
		P.51	-0.46	0.43	0.00	0.00
		P.52	-0.75	0.70	0.00	0.00
		F.8	-0.03	0.02	0.00	0.00
	Expenditure on the increase of the wages of health care professionals and health visitors	D.1	-0.17	0.16	0.00	0.00
	One-off wage supplement per health care employees in 2020 (HUF 500,000/person)	D.1	-0.21	0.20	0.00	0.00
	Expenditure of the Economy Protection Fund broken down by ESA	D.1	-0.03	0.02	0.00	0.00
		D.3	-0.05	0.05	0.00	0.00
		D.75	-0.16	0.02	0.12	0.00
		D.92	-1.14	1.05	0.00	0.00
		D.99	-0.33	0.31	0.00	0.00
		F.5	-0.54	0.50	0.00	0.00
		P.2	-0.09	0.08	0.00	0.00
		P.51	-0.19	0.18	0.00	0.00
	TOTAL TRANSITIONAL EXPENDITURE MEASURES		**-5.25**	**4.16**	**0.40**	**0.18**

Continued on next page.

Measures		ESA code	Effect on the budget (GDP%, compared to previous year)			
			2020	2021	2022	2023
Long-term measures	**Revenue-related measures**					
	Personal income tax exemption for young people from 2022	D.51	-	-	-0.25	0.00
	Reduction of VAT to 5% on Braille displays and printers, edible offal of pork, all types of milk (ESL, UHT), restaurant services, fish, internet services, accommodation services	D.2	-0.07	0.00	0.00	0.00
	A further 1% point reduction in the KIVA tax rate (in line with the reduction in social contribution tax) in 2023	D.51	-	-	-	-0.02
	Introduction of the retail tax	D.214	0.10	0.03	0.02	0.01
	Phased reduction of the employer tax burden 2019-2023	D.61; D.29; D.4; D.5; D.7; P.52; P.53; K.2; D.8	-0.66	-0.33	-0.23	-0.36
	Other	-	-0.10	0.03	-0.02	0.02
	TOTAL LONG-TERM REVENUE MEASURES		**-0.73**	**-0.27**	**-0.47**	**-0.35**
	Expenditure-related measures					
	Gradual restoration of the 13th month pension	D.62	-	-0.15	-0.15	-0.14
	Wage increase in healthcare	D.1	-	-0.69	-0.63	-0.38
	TOTAL LONG-TERM EXPENDITURE MEASURES		**-**	**-0.84**	**-0.77**	**-0.52**
TOTAL DISCRETIONAL MEASURES			**-6.30**	**2.78**	**-0.72**	**-0.61**

Note: Due to rounding, the summed data might differ from the sum of the detailed data.

Table 'B'

State guarantees announced/adopted in connection with the coronavirus crisis

Measure	Maximum amount of conditional commitment (HUF million)
Garantiqa Hitelgarancia Zrt. – Garantiqa Crisis Guarantee Programme	500,000
AVHGA – Crisis Rural Guarantee Programme	100,000
Magyar Export-Import Bank Zrt. - EXIM Compensation Loan Programme	150,000
Magyar Export-Import Bank Zrt. - EXIM Compensation Loan Protection Programme	50,000
MFB Magyar Fejlesztési Bank Zrt. - MFB Force Majeure Guarantee Programme	50,000
MFB Magyar Fejlesztési Bank Zrt. - MFB Crisis Credit Programme	180,000
MFB Magyar Fejlesztési Bank Zrt. - MFB Competitiveness Credit Programme	150,000
Total	1,180,000

Table 'C'

Recovery and Resilience Facility (RRF) support

	RRF support (GDP %)					
	2020	2021	2022	2023	2024	2025
Revenues as projected	-	0.87	0.89	0.99	0.61	0.40
Current expenses	-	0.09	0.12	0.12	0.07	0.05
Gross fixed capital formation	-	0.78	0.77	0.87	0.54	0.35
Expenditures as projected	-	0.87	0.89	0.99	0.61	0.40

Table 1a

Macroeconomic prospects

	ESA-code	2020 HUF billion	2020	2021	2022	2023	2024	2025
					change in %			
1. Real GDP (at constant prices)	**B1g**	45168.3	-5.0	4.3	5.2	4.1	4.0	4.2
2. Nominal GDP	B1g	47743.5	0.5	8.1	9.2	7.9	7.7	7.8
Components of real GDP (at constant prices)								
3. Private consumption expenditure	P.3	22909.6	-2.3	3.2	5.8	3.9	3.9	4.1
4. Government consumption expenditure	P.3	9313.9	-1.0	2.6	-0.8	0.3	0.8	0.8
5. Gross fixed capital formation	P.51	11947.9	-7.3	4.2	7.2	6.1	4.3	4.5
6. Changes in inventories and net acquisition of valuables (% of GDP) [2]	P.52+ P.53	647.0	0.5	0.0	0.0	0.0	0.0	0.0
7. Exports of goods and services	P.6	36,446.4	-6.8	6.4	10.5	7.0	6.7	7.1
8. Imports of goods and services	P.7	36,096.5	-4.4	5.2	10.0	6.7	6.2	6.5
Contribution to real GDP growth (at constant prices)								
9. Final domestic demand		44171.4	-3.4	3.3	4.7	3.7	3.3	3.5
10. Changes in inventories and net acquisition of valuables	P.52+ P.53	647.0	0.5	0.0	0.0	0.0	0.0	0.0
11. External balance of goods and services	B.11	349.9	-2.1	1.0	0.5	0.4	0.7	0.7

[2] The change of stock reflects the work and leap day effect in 2020.

Table 1b

Price developments

	2020	2021	2022	2023	2024	2025
			change in %			
1. GDP deflator	5.7	3.7	3.8	3.7	3.6	3.5
2. Private consumption deflator	3.2	3.6	3.0	3.0	3.0	3.0
3. Harmonised Index of Consumer Prices (HICP)	3.3	3.6	3.0	3.0	3.0	3.0
4. Public consumption deflator	6.1	6.7	2.4	4.3	5.3	5.4
5. Investment deflator	9.3	5.2	4.2	3.9	3.6	3.3
6. Export price index (goods and services)	4.4	3.0	2.5	2.0	2.0	2.0
7. Import price index (goods and services)	2.5	4.6	2.2	1.8	1.8	1.8

Table 1c

Labour market developments

	ESA-code	2020 level	2020	2021	2022	2023	2024	2025
			change in %					
1. Employment, persons (thousands) (15-74)[1]		4603.2	-0.9	0.0	1.1	0.6	0.3	0.2
2. Unemployment rate (%) (15-74)		-	4.1	4.2	3.3	2.9	2.7	2.6
3. Labour productivity, per person		-	-4.1	4.2	4.1	3.5	3.6	4.0
4. Compensation of employees (HUF bn)	D.1	20,546.9	1.4	7.2	8.1	7.2	7.8	8.2
5. Compensation per employee (HUF million)		5.2	7.0	6.2	6.0	6.5	7.5	8.0

[1] *Employment by Labour Force Survey statistics.*

Table 1d

Sectoral balances

	ESA-code	2020	2021	2022	2023	2024	2025
		% of GDP					
1. Net lending/borrowing vis-à-vis the rest of the world	B9.	2.1	3.5	4.1	4.1	4.2	4.5
of which:							
- Balance of goods and services		2.3	1.8	2.4	2.9	3.6	4.2
- Balance of primary incomes and transfers		-1.7	-0.9	-1.2	-1.4	-1.9	-2.3
- Capital account balance		2.0	3.1	3.4	3.0	2.9	3.0
2. Net lending/borrowing of the private sector including statistical discrepancy	B9.	10.2	11.0	10.0	8.0	7.2	6.5
3. Net lending/borrowing of general government	B9.	-8.1	-7.5	-5.9	-3.9	-3.0	-2.0

Table 2a

General government budgetary prospects

	ESA-code	2020 HUF billion	2020	2021	2022	2023	2024	2025
			% of GDP					
Net lending (EDP B.9.)								
1. General government	S.13	-3,869.6	-8.1	-7.5	-5.9	-3.9	-3.0	-2.0
2. Central government	S.1311	-3,469.7	-7.3	-6.3	-5.7	-3.9	-3.2	-2.2
3. State government	S.1312	-	-	-	-	-	-	-
4. Local governments	S.1313	53.0	0.1	-0.3	0.1	0.0	0.1	0.1
5. Social insurance funds	S.1314	-452.9	-0.9	-0.8	-0.2	0.0	0.1	0.1
General government (S.13)								
6. Total revenue	TR	20,774.8	43.5	42.1	41.3	40.6	38.7	37.7
7. Total expenditure	TE	24,644.4	51.6	49.6	47.2	44.5	41.7	39.7
8. Balance	B.9	-3,869.6	-8.1	-7.5	-5.9	-3.9	-3.0	-2.0
9. Interest expenditure	D.41	1,128.0	2.4	2.4	2.4	2.4	2.3	2.1
10. Primary balance		-2,741.6	-5.7	-5.0	-3.5	-1.5	-0.8	0.1
11. One-off and other temporary measures[1]		-	0.0	0.0	0.0	0.0	0.0	0.0
Selected components of revenues								
12. Total taxes (12=12a+12b+12c)		11,952.8	25.0	24.4	24.1	23.8	23.5	23.2
12a. Taxes on production and imports	D.2	8,709.3	18.2	17.6	17.3	16.9	16.5	16.2
12b. Taxes on income and on capital	D.5	3,225.8	6.8	6.8	6.8	6.9	6.9	6.9
12c. Capital taxes	D.91	17.7	0.0	0.0	0.0	0.0	0.0	0.0
13. Social security contributions	D.61	5,379.1	11.3	10.9	10.6	10.2	9.8	9.8
14. Property income	D.4	213.4	0.4	0.4	0.2	0.2	0.2	0.2
15. Other		3,229.5	6.8	6.4	6.3	6.4	5.2	4.5
16.=6. Total revenue	TR	20,774.8	43.5	42.1	41.3	40.6	38.7	37.7
Tax burden[2] (D.2+D.5+D.61+D.91-D.995)		17411.4	36.5	35.5	34.9	34.1	33.4	33.1
Selected components of expenditure								
17. Compensation of employees + intermediate consumption	D.1+P.2	9,038.7	18.9	19.5	17.6	17.0	15.8	14.9
17.a. Compensation of employees	D.1	5,059.1	10.6	10.5	10.1	9.9	9.3	8.8
17.b. Intermediate consumption	P.2	3,979.6	8.3	9.0	7.5	7.1	6.5	6.1
18. Social payments (18=18.a+18.b)		6,098.5	12.8	12.7	12.4	12.0	11.7	11.3
of which: Unemployment benefits[3]		123.0	0.3	0.2	0.2	0.2	0.2	0.1
18.a. Social transfers in kind supplied via market producers	D.6311, D.63121, D.63131	700.5	1.5	1.6	1.6	1.6	1.5	1.5
18.b. Social transfers other than in kind	D.62	5,398.0	11.3	11.1	10.8	10.4	10.2	9.8
19.=9. Interest expenditure	D.41	1,128.0	2.4	2.4	2.4	2.4	2.3	2.1
20. Subsidies	D.3	819.7	1.7	1.4	1.2	1.1	1.0	0.9
21. Gross fixed capital formation	P.51	3,058.8	6.4	6.5	7.1	6.6	6.0	5.2
22. Capital transfers	D.9	2,215.5	4.6	2.5	2.3	2.0	1.8	2.3
23. Other costs		2,285.2	4.8	4.5	4.2	3.3	3.1	2.9
24.=7. Total expenditure	TE	24,644.4	51.6	49.6	47.2	44.5	41.7	39.7

Note: Due to rounding, the summed data might differ from the sum of the detailed data.

[1]: The convergence programme does not include a one-off item to estimate the structural balance. Table 'A' describes the discretionary measures.

[2]: Including revenues collected by the EU

[3]: Cash benefits from the National Employment Fund and certain training grants

Table 2b

No-policy change projections

	2020	2020	2021	2022	2023	2024	2025
	HUF billion	% of GDP					
1. Total revenue at unchanged policies	20,774.8	43.5	42.1	41.3	40.6	38.7	37.7

The table contains revenue projections based on measures taken until 30 April 2021.

Table 2c

Items not included in the expenditure aggregate

	2020	2020	2021	2022	2023	2024	2025
	HUF billion	% of GDP					
1. Expenditure on EU programmes fully matched by EU funds revenue	1190.1	2.5	2.2	2.3	2.6	1.6	1.1
1a. of which investment fully matched by EU funds revenue	807.5	1.7	1.6	1.7	1.9	1.3	0.9
2. Cyclical unemployment benefit expenditure	-2.0	0.0	0.0	0.0	0.0	0.0	0.0
3. Effect of discretionary revenue measures	-503.7	-1.1	-1.5	-1.7	-1.9	-2.1	-2.0
4. Revenue-increasing items	-	-	-	-	-	-	-

Table 3

General government debt developments

	ESA-code	2020	2021	2022	2023	2024	2025
		% of GDP					
1. Gross debt		80.4	79.9	79.3	77.5	75.7	73.1
2. Change in gross debt ratio		14.9	-0.5	-0.6	-1.8	-1.8	-2.6
Contribution to changes in gross debt							
3. Primary balance		-5.7	-5.0	-3.5	-1.5	-0.8	0.1
4. Interest expenditure	D.41	2.4	2.4	2.4	2.4	2.3	2.1
5. Stock-flow adjustment		14.7	-2.0	0.3	0.1	0.7	0.9
Implicit interest rate on debt (%)		3.2	3.2	3.2	3.2	3.1	3.0

Table 4

Cyclical developments

	ESA-code	2020	2021	2022	2023	2024	2025
		% of GDP					
1. GDP at previous year's prices (annual growth rate)		-5.0	4.3	5.2	4.1	4.0	4.2
2. General government balance	B.9	-8.1	-7.5	-5.9	-3.9	-3.0	-2.0
3. Interest expenditure	D.41	2.4	2.4	2.4	2.4	2.3	2.1
4. One-off and other temporary items		0.0	0.0	0.0	0.0	0.0	0.0
of which: on the revenue side: general government		0.0	0.0	0.0	0.0	0.0	0.0
on the expenditure side: general government		0.0	0.0	0.0	0.0	0.0	0.0
5. Potential GDP (%)		1.4	2.3	3.2	3.6	3.8	4.0
components: - labour		-0.1	0.2	0.2	0.1	0.1	0.1
- capital factor		1.1	1.3	1.3	1.3	1.3	1.4
- total factor productivity (TFP)		0.4	0.9	1.7	2.2	2.4	2.5
6. Output gap		-4.5	-2.7	-0.8	-0.4	-0.2	0.0
7. Cyclical budgetary component		-2.1	-1.2	-0.4	-0.2	-0.1	0.0
8. Cyclically adjusted balance (2-7)		-6.0	-6.3	-5.5	-3.8	-2.9	-2.0
9. Cyclically adjusted primary balance (8+3)		-3.6	-3.9	-3.1	-1.4	-0.6	0.1
10. Structural balance (8-4)		-6.0	-6.3	-5.5	-3.8	-2.9	-2.0

Note: Due to rounding, the summed data might differ from the sum of the detailed data.

Table 5.

Divergence from the previous convergence programme

	ESA-code	2020	2021	2022	2023	2024	2025
Real GDP growth (%)							
1. 2020 Convergence Programme		-3.0	4.8	4.6	4.3	4.2	-
2. 2021 Convergence Programme		-5.0	4.3	5.2	4.1	4.0	4.2
3. Difference		-2.0	-0.5	0.6	-0.2	-0.2	-
General government net lending (% of GDP)							
1. 2020 Convergence Programme	EDP B.9	-3.8	-2.7	-2.2	-1.6	-1.0	-
2. 2021 Convergence Programme	B.9	-8.1	-7.5	-5.9	-3.9	-3.0	-2.0
3. Difference		-4.3	-4.8	-3.7	-2.3	-2.0	-
General government gross debt (percent of GDP)							
1. 2020 Convergence Programme		72.6	69.3	66.3	63.2	59.8	-
2. 2021 Convergence Programme		80.4	79.9	79.3	77.5	75.7	73.1
3. Difference		7.8	10.6	13.0	14.3	15.9	-

Table 6

Long-term sustainability of public finances[1]

	2019	2030	2040	2050	2060	2070
	% of GDP					
Pension expenditure	8.3	8.3	9.7	11.2	11.9	12.4
Old-age and early pensions	6.7	7.0	8.5	10.1	10.9	11.3
Other pensions (disability, survivors)	1.6	1.3	1.2	1.1	1.0	1.1
Health, long-term care and education expenditure	8.8	8.7	9.2	9.7	10.1	10.1
Health care expenditures	4.8	5.1	5.3	5.6	5.7	5.6
Long-term care expenditures	0.6	0.6	0.8	0.9	1.1	1.2
Education expenditures	3.4	3.0	3.1	3.2	3.3	3.3
Pension contribution revenue	7.7	7.4	7.4	7.4	7.4	7.4
Assumptions						
Labour productivity growth	2.9	2.3	2.3	2.1	1.8	1.5
Real GDP growth	4.9	2.4	1.4	1.6	1.4	1.3
Participation rate, males (20-64)	85.9	89.8	89.8	90.1	90.2	90.1
Participation rate, females (20-64)	70.0	79.3	79.4	80.1	80.2	80.1
Total participation rate (20-64)	77.9	84.6	84.8	85.3	85.3	85.3
Unemployment rate (20-64)	3.3	4.0	4.0	3.9	3.9	3.9
Population aged 65 + over (%)	19.6	21.7	24.6	27.8	29.5	29.6

[1]*Based on the budgetary and macroeconomic projections prepared for the 2021 Ageing Report, approved by the Economic Policy Council (EPC) in January 2021.*

Table 7

Assumptions on the external economic environment

	2020	2021	2022	2023	2024	2025
Hungary: Short-term interest rate (annual average, %)	0.4	0.9	0.9	0.9	1.0	1.0
Hungary: Long-term interest rate (annual average, %)	2.2	3.2	3.1	3.1	3.3	3.3
HUF/EUR rate	351.2	361.1	360.9	360.9	360.9	360.9
World excluding EU, GDP growth rate	-3.4	5.2	3.8	3.5	3.5	3.4
EU-27 GDP growth rate	-6.3	3.7	3.9	2.5	2.1	2.1
Growth of relevant foreign markets	-8.5	5.4	8.1	4.2	4.1	4.1
World import volumes, excluding EU	-9.4	7.5	4.9	4.4	4.4	4.3
Oil prices (Brent, USD/barrel)	42.0	66.0	61.8	58.9	57.3	56.5

ts