HUNGARY: Recovery with strong downside risks

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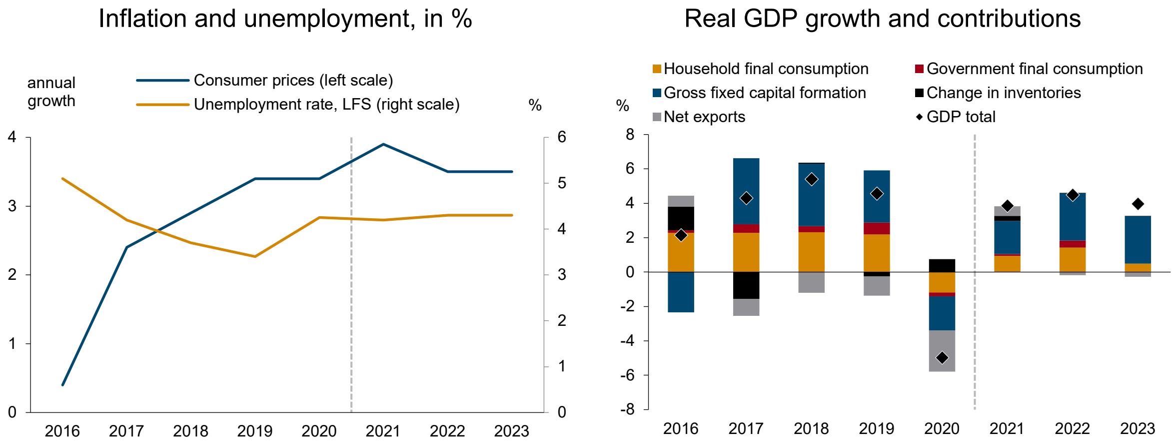
Hungary's GDP dropped by 5% in 2020, due mostly to declining net exports, but also, to a smaller extent, to shrinking investment and household consumption. The key issues for a recovery are the early revitalisation of international value chains in the automotive industry, resilience of the small and medium-sized enterprise (SME) sector and restoration of the pre-crisis spending propensity of households. The political stakes are high in the wake of the government's growing confrontation with the EU and the approaching elections, scheduled for early 2022.

Figure 4.8 / Hungary: Main macroeconomic indicators



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

Hungarian GDP dropped by 5% in 2020, with an abrupt COVID-19-related dive in Q2 and a better-than-expected performance in Q4. On the production side, both industry and services declined overall, but there were big intra-sector differences: in industry, output in the manufacture of transport equipment fell by over 10%, whereas in the computer and electronics industry and in food, output actually increased moderately. Meanwhile, in services, tourism was the hardest hit (-33%), followed by transportation and storage (-16.6%) and, surprisingly, health and social work activities (-10.2%). Despite the crisis, growth was recorded in some sectors: information and communications technology, financial services, wholesale and retail trade, and public administration and defence. Construction shrank by almost 10%, while in agriculture value added declined more than the overall GDP drop. On the distribution side, half of the overall 5% GDP contraction can be attributed to an unfavourable turn of events in net exports, as trade in services collapsed, with exports hit far harder than imports. A quarter of the decline in GDP came from consumption, and another quarter from gross capital formation. Investment declined by 7.3%, but a strong accumulation of inventories helped to curb the shrinkage in gross capital formation.

The principles and practices of COVID-19 crisis management changed over the course of 2020. Until the middle of the year, the main instrument was an (optional) moratorium on credit repayment by both households and businesses, coupled with moderate fiscal measures. In the second half of the year, government spending gradually gained momentum, and in December alone, the fiscal deficit relative to GDP leapt from about 5% to 9%, reflecting a huge one-off outflow of resources. The opacity of official information means that it is hard to gain a clear picture of the actual crisis management. Of the funds earmarked for 'protection of the economy' (amounting to some 7.6% of GDP), only about a quarter seem to have been spent on purposes related to crisis management itself.[17] Most of the resources went on financing re-badged (but already ongoing) investments, as well as on items that will bolster the ruling party's 2022 election campaign – e.g. support for Hungarians who live in those areas of neighbouring countries that once formed part of Hungary (and who are dyed-in-the-wool Fidesz voters), projects that benefit certain religious establishments, etc. Investment in prestige projects also continued, such as sport infrastructure, the preparations for this year's World Hunting Expo, etc.[18]

Ever since 2010, Fidesz has heavily promoted the creation of a 'work-based' society in Hungary. This mindset led to underestimate the significance of partially replacing wages that evaporated because of COVID-19; thus income support has been modest, compared to other countries. In health care, a highly controversial reform was introduced, which led to some personnel leaving the sector in the most critical period of the pandemic.

Behind the scenes of crisis management, a new wave of power centralisation has been set in motion by Prime Minister Orbán, with local governments deprived of important resources.[19] Although they may apply to central government for compensation, applications are not assessed uniformly: Fidesz-led local authorities stand a better chance than those under opposition control.[20] Extreme centralisation has been seen in both the healthcare sector and higher education. Steps taken to bolster the government's political influence – but marketed as 'crisis management' – include investment in public enterprises and government-friendly private businesses (which are informally given the nod in the public procurement process); 'friendly' subsidies and grants; and the use of offshore companies in transactions to hide inexplicable profits.[21] Those sectors and businesses most impacted by this recent wave of Fidesz offensives are: the energy infrastructure, the banking sector, key tourist facilities around Lake Balaton, important software programs for the government, railway development projects and the military industry (imports and production), universities (which are being turned into nominal foundations), facilities for elite sports, agriculture and casinos (which were allowed to remain open, while the catering industry was forced to close its doors).[22]

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17 É. Várhegyi, Veszteségeink, *Élet és Irodalom*, 12 March 2021.

18 Z. Barotányi, interview with György Surányi, former governor of the National Bank of Hungary (*Magyar Narancs*, 24 February 2021).

19 ibid.

20 E. Csendes-Erdei, Kérj kölcsön valakitől!, *Magyar Narancs*, 24 March 2021.

21 A masterpiece of investigative journalism: A. Bódis, Amíg Ön a járványra figyelt, a NER bevette az országot – leltár a „hazavitt" stratégiai ágazatokról, *Válasz online*, 28 January 2021, https://www.valaszonline.hu/2021/01/28/amig-on-a-jarvanyra-figyelt-a-ner-bevette-az-orszagot-leltar-a-hazavitt-strategiai-agazatokrol/

22 ibid.

Orbán's course of confrontation with the EU is gaining momentum. Now that Fidesz has left the European Parliament's European People's Party group (long a moderating influence), Orbán may move towards more extreme positions. Since November 2020, an EU mechanism linking the disbursement of EU funds to a country's respect for the rule of law has been in place, although whether any practical steps could be taken to implement the mechanism within a relatively short space of time (i.e. before the 2022 Hungarian elections) is a moot point. EU transfers – especially those from the 'Next Generation EU' package, which are scheduled to reach recipient countries as early as summer 2021 – will be of crucial importance in lifting the economy out of the COVID-19 recession and restoring a sustainable fiscal position. They could mean a net inflow of grants amounting to 5% of Hungary's GDP on average in 2021-2023 (probably less this year).

There is considerable uncertainty looming over the forecast horizon. The next elections are less than a year away, and recent polls have indicated that the united list of opposition parties is catching up with (or even overtaking) Fidesz. Popular dissatisfaction over the government's crisis management may play an important role. Without rapid economic recovery fostered by the massive inflow of EU transfers, Orbán's victory in the elections is in jeopardy; but the alternative – a retreat in his political confrontation with the EU and greater room for manoeuvre by the opposition – may be no less dangerous for him. Should Fidesz lose the elections, the politically fairly fragmented opposition would have to deal with the entrenched institutional power of Fidesz (the immovable loyalist attorney general, the constitutional court, the vast majority of the electronic and printed media, which are kept firmly in check, etc.) and the rapidly expanding economic empire of Orbán loyalists.[23] This would be an enormously difficult undertaking, with economic risks on top of everything else. If Orbán does win the 2022 elections, Hungary's access to EU transfers could be suspended at some point. An early suspension could be more troublesome than a later one, once the economy has already returned to its pre-crisis growth path.

Our forecast for 2021-2023 is definitely optimistic. We reckon on a substantial influx of EU resources and a fair pace of revitalisation in the business sector, among both large foreign companies and domestically owned SMEs. A moderate recovery in household consumption is also on the cards, assuming a gradual catching-up with pre-crisis spending propensity. Yet the downside risks – both political and economic – are high. Should one or more of them come to pass, then the likely outcome would be significantly slower recovery, or even stagnation.

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23 ibid.

Table 4.8 / Hungary: Selected economic indicators

	2017	2018	2019	2020 1)	2021	2022 Forecast	2023
Population, th pers., average	9,788	9,776	9,771	9,750	9,670	9,620	9,600
Gross domestic product, HUF bn, nom.	39,233	43,347	47,514	47,605	51,000	55,000	59,000
annual change in % (real)	4.3	5.4	4.6	-5.0	3.9	4.5	4.0
GDP/capita (EUR at PPP)	20,230	21,580	22,800	22,620	.	.	.
Consumption of households, HUF bn, nom.	18,961	20,522	22,397	22,527	.	.	.
annual change in % (real)	4.7	4.8	4.6	-2.5	2.0	3.0	3.0
Gross fixed capital form., HUF bn, nom.	8,699	10,742	12,937	13,101	.	.	.
annual change in % (real)	19.7	16.4	12.2	-7.3	7.0	10.0	10.0
Gross industrial production							
annual change in % (real)	4.7	3.5	5.6	-6.2	6.0	6.0	5.0
Gross agricultural production							
annual change in % (real)	-4.1	2.7	0.4	-2.1	.	.	.
Construction industry							
annual change in % (real)	29.7	21.2	20.7	-9.2	.	.	.
Employed persons, LFS, th, average	4,421	4,470	4,512	4,460	4,505	4,550	4,550
annual change in %	1.6	1.1	1.0	-1.1	1.0	1.0	0.0
Unemployed persons, LFS, th, average	192	172	160	198	200	200	200
Unemployment rate, LFS, in %, average	4.2	3.7	3.4	4.3	4.2	4.3	4.3
Reg. unemployment rate, in %, eop 2)	5.6	5.2	5.1	4.5	.	.	.
Average monthly gross wages, HUF 3)	297,017	329,943	367,833	403,616	432,200	460,700	491,100
annual change in % (real, gross)	10.3	8.3	7.7	6.2	3.0	3.0	3.0
Average monthly net wages, HUF 3)	197,516	219,412	244,609	268,405	287,400	306,400	326,600
annual change in % (real, net)	10.3	8.3	7.7	6.2	3.0	3.0	3.0
Consumer prices (HICP), % p.a.	2.4	2.9	3.4	3.4	3.9	3.5	3.5
Producer prices in industry, % p.a.	3.3	5.6	2.1	4.3	3.0	3.0	3.0
General governm.budget, EU-def., % of GDP							
Revenues	44.1	43.8	43.5	41.0	45.0	45.0	45.0
Expenditures	46.5	45.9	45.6	50.0	50.5	48.9	48.5
Net lending (+) / net borrowing (-)	-2.4	-2.1	-2.1	-9.0	-5.5	-3.9	-3.5
General gov.gross debt, EU def., % of GDP	72.2	69.1	65.4	78.0	77.7	75.7	74.3
Stock of loans of non-fin.private sector, % p.a.	5.5	10.5	13.2	13.4	.	.	.
Non-performing loans (NPL), in %, eop 4)	7.5	5.4	4.1	3.9	.	.	.
Central bank policy rate, % p.a., eop 5)	0.90	0.90	0.90	0.60	0.60	0.70	1.20
Current account, EUR m 6)	2,536	408	-659	99	0	0	100
Current account, % of GDP 6)	2.0	0.3	-0.5	0.1	0.0	0.0	0.1
Exports of goods, BOP, EUR m 6)	85,285	88,662	93,054	88,706	94,000	100,600	106,100
annual change in %	8.5	4.0	5.0	-4.7	6.0	7.0	5.5
Imports of goods, BOP, EUR m 6)	83,573	90,346	96,097	89,572	96,700	104,000	110,200
annual change in %	12.0	8.1	6.4	-6.8	8.0	7.5	6.0
Exports of services, BOP, EUR m 6)	23,817	25,359	27,112	19,627	24,900	27,400	30,100
annual change in %	8.9	6.5	6.9	-27.6	27.0	10.0	10.0
Imports of services, BOP, EUR m 6)	16,870	17,671	19,944	15,661	19,100	21,000	23,100
annual change in %	7.1	4.7	12.9	-21.5	22.0	10.0	10.0
FDI liabilities, EUR m 6)	7,024	6,606	2,345	695	.	.	.
FDI assets, EUR m 6)	4,987	3,748	1,419	728	.	.	.
Gross reserves of CB excl. gold, EUR m	23,261	26,273	27,010	32,115	.	.	.
Gross external debt, EUR m 6)	105,523	107,155	104,562	106,742	110,000	110,000	110,000
Gross external debt, % of GDP 6)	83.2	78.8	71.6	78.8	78.7	74.0	69.9
Average exchange rate HUF/EUR	309.19	318.89	325.30	351.25	365	370	375

1) Preliminary and wiiw estimates. - 2) From 2020 unemployed in % of working-age population 15-64 (% of LFS labour force before). - 3) Enterprises with 5 and more employees. From 2018 new source to define the staff categories; from 2019 based on tax administration data, survey data before. - 4) Loans more than 90 days overdue and those unlikely to be paid. - 5) Base rate (two-week CB bill). - 6) Excluding SPE.

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