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I. The global economy

The state of the **global economy** improved somewhat in the last quarter of 2020, despite the worsening of the epidemiological indicators. In 2021 as a whole, global output was dropped 3.4 percent, the largest fall since World War 2. But even so, the fall was less drastic than previously expected, and this applies not just to the global economy but also to most of the regions of the world. The short-term outlook is quite uncertain. A new wave of the pandemic emerged in the first quarter of this year, and it is more widespread than the previous ones, especially in Europe. Nevertheless, the majority of the forecasters assumes that global growth will remain positive throughout the year, and only a few specific regions will face further decline. The present growth is almost universally driven by various fiscal stimulus measures. In the developed countries, private consumption remains subdued while household savings are on the rise. This is why inflation has remained moderate so far, although a mild upturn is already visible, and if fiscal expansion continues inflation may pick up pace soon. Investment activity has also recovered toward the end of 2020, following the strong decline in the first half of the year, thus at an annual average, the investment trend was more favorable than previously expected. Unemployment levels rose only moderately, another consequence of fiscal profligacy and various job saving policy interventions. Still, the crisis is still very much present in some specific areas – food service, hotel services, tourism, air transport, the entertainment sector – and a continuation of pandemic-related movement restrictions may bring about a cascading chain of bankruptcies since no fiscal measure can compensate for a long-lasting hiatus of sales income. So far, the forecasts are surprisingly optimistic: the spring forecast of the OECD projects a global growth rate of 5.6 percent, and the Kiel Institute (Ifw) is even more sanguine: it predicts the global economy to grow by more than 6 percent. This optimism is based on the assumption that the pandemic will abate due to rising levels of vaccination coverage, and life will return to normal by the summer. We think that, due to the bottlenecks in vaccination capacities, normalization is likely to proceed at a slower pace, and the easing of lockdown measures is risky, especially in countries with limited healthcare capacities. The phasing-out of fiscal stimulus measures also poses a downward risk.

Global trade turnover will gradually return to pre-2020 levels, as it has become clear that limiting the flow of goods is unnecessary. On the other hand, the market undergoes a structural change since healthcare products are still prominent in European import, demand for consumer electronics products and computers grew markedly. Furthermore, the states continue to accumulate strategic food reserves, leading to an increase in the trade flow of food products. The trade of services, on the other hand, has not recovered so far, and it is likely to remain subpar for a long time, since international tourism will probably remain restricted even after the economic reopening.

The Brent **oil price** reached record lows in 2020, due to the pandemic, especially in the second quarter with an average price of USD 41.8 per barrel. Prices began to rise toward the end of the year, fueled by the hope for an improvement in 2021, and the oil price has fluctuated steadily above USD 60 since mid-February. It seems likely that in the second half of this year oil prices will reach even higher levels. While the market will remain very volatile in the first half, with the possibility of wild price fluctuations, we expect the yearly average price to reach USD 67 per barrel, that is, a higher level than what we predicted in the autumn of 2020. This, however, depends on the pace of economic normalization. The outlook for the next year is even more uncertain – at present and average oil price of USD 70-72 per barrel seems likely.

Commodity market trends start to become a source of worry. Both food and industrial commodity prices surged by more than 20 percent, a rate not seen in a long time. The price hike is fueled by the gradual recovery of private consumption and the reconfiguration of the global market. The US-China trade war has not eased since the inauguration of the new US president, and the weakening of the dollar in itself poses an upward pressure on prices. Several events in the recent past – for example the incident at the Suez Canal – demonstrated the vulnerability of the commodity market and the growing inflationary pressures.

The **monetary policy** remains accommodative. At its March meeting, the *FED* left the policy rate unchanged, in accordance with the expectations, and continues its asset purchase program. It emphasized again that it would temporarily tolerate even an inflation rate above 2 percent, until a stable recovery is reached. The market players interpreted this as a predictor of low interest rates and continuing quantitative easing in the coming years. The *ECB* announced at its March meeting that it would continue its pandemic emergency purchase program at least until March 2022, with the aim of keeping interest rates low and ensure that the various stimulus programs can be financed. Policy rates will remain unchanged until a substantial change in inflation trends occurs. The British and the Japanese central banks maintain their expansionary policy stance as well. In some other countries, however, the economic conditions have already pressured the central banks into tightening measures. The Russian central bank – reversing its former stance – raised the reference rate by 25 basis points, to 4.5 percent, and indicated further rate hikes in the future.

The euro is still relatively strong vis-à-vis the dollar: the exchange rate has been fluctuating near 1.2 **EUR/USD** in the first months of 2021. It dipped below 1.2 during March but rose again afterwards and came close to 1.21 in the second half of April. We expect that the bilateral exchange rate will remain around 1.2 EUR/USD throughout this year.

In 2020, most developed countries suspended fiscal restraint and introduced large-scale stimulus packages. Since the pandemic keeps exerting a formative impact economic life in the first half of the year and various restrictions remain in effect at least by the end of April, fiscal stimulus tools will remain effective during 2021. What is more, the US government announced a new stimulus package, and the German government declared that the annual fiscal deficit may amount to 4.8 percent of GDP this year. We maintain that such a massive accumulation of fiscal debt may lead to serious consequences in the future, especially in countries with pre-existing structural problems. Eventually the countries will be forced to embark on fiscal consolidation, which will hamper future growth.

Outside the European Union, there are signs of a slow economic turnaround. **US** GDP was down 3.5 percent in 2020, which is less drastic than what analysts expected during the fall of last year. While the pandemic hit the US hard, now the US economy seems likely to be the first developed economy to recover, due to the fast pace of vaccination and the government stimulus. According to estimates, the US economy may expand by as much as 6-7 percent this year, and the 1.9 trillion-dollar Biden stimulus will boost economic growth in 2022 as well. Hence, the US may return to the pre-pandemic growth trajectory before the end of this year and become the main driver of global recovery.

Compared to other Asian countries, the 4.9 percent fall of the **Japanese** economy in 2020 is almost akin to a collapse. At the end of the last year, a new wave of epidemics reached Japan and economic conditions worsened again, especially in the area of person-to-person services. As a result, consumer confidence was rather unfavorable at the beginning of 2021. In February, however, manufacturing output bounced back, and an upward trend began. The Japanese economic growth rate may reach an annual 3-4 percent this year, and growth may continue at a rate of 2 percent in 2020, a pace relatively dynamic by Japanese standards.

China is the only major economy that achieved growth in 2020. According to OECD estimates, GDP grew by 2.3 percent and the growth rate may be as high as 7.8 percent 2021 and 4.9 percent in 2022. It is noteworthy that – the first time in the history of the PRC – absolute growth rate targets are absent not just from the annual plan but also from the new five-year plan that was launched in this March. For this year, the target is a growth rate above 6 percent which should be achieved along with an economic restructuring that significantly reduces the vulnerability of the Chinese economy. China was successful not just in halting the epidemics and preventing a new escalation during the time of the severe global second wave, but also in the fast response in terms of developing the productive capacities to meet the demand newly created by the pandemic. By producing medical equipment, tools and preparations, tools for teleworking, distance learning, equipment and systems that help enduring the lockdown, China overcame the shock caused by the epidemic. After the abatement of the pandemic, the place of China in the global economy will be probably different from the pre-pandemic period. Its role as the "workshop of the world" will doubtlessly weaken, due to the reappraisal and reorganization of global value chains, but its role as an international investor will become more prominent than ever before, both in the area of FDI export and as a financier of countries struggling with fiscal difficulties.

According to the international institutions, the economic contraction in the **developing countries** was less severe than previously expected, their combined GDP probably decreased by about 2.5 percent, and it may grow by 5.7 percent in 2021. The ability of these countries to withstand the crisis heavily depends on which phase of the growth cycle they were in when the crisis arrived. In Africa, the pandemics interrupted a decade-long period of unprecedented dynamic growth, while In Latin-America it compounded the already existing problems of stagnation or economic decline. Among the developing regions, the disciplined way of dealing with the pandemic by the Eastern Asian countries is noteworthy. On average, GDP grew by 1% here in 2020, and it is expected to expand by 6.4 percent this year. It is well known how severely the tourism sector was affected by the epidemics in many developing countries where tourism is almost the only direct and indirect source of income – also, a fast recovery of international tourism is highly unlikely. It is becoming likely that the global economic recovery will by K-shaped, and the urgent need for a worldwide cooperation to alleviate the social and economic consequences of the pandemics is not just a slogan. The illness can be defeated only at a global scale, and a spread of revolts fueled by mass discontent can also be prevented only by global solutions.

Following the dramatic fall in the second quarter, GDP was up 12.5 percent in the third quarter on a quarterly basis in the **eurozone**, but it decreased once again – by a quarter-on-quarter 0.7 percent – in the fourth quarter. On an annual basis, the euro area GDP dropped 6.6 percent in 2020 as a whole. There are large differences between the

individual member states. This year, a mild GDP decrease is expected for the first quarter, due to renewed attack of the epidemic, but during the year as a whole GDP may climb 4.8 percent, provided that fast vaccination makes a gradual EU-wide easing of lockdown measures possible, and that another wave does not enforce a reversal of the reopening in the second half of the year. Under favorable conditions – that is, a continuing retreat of the epidemic – a growth rate of about 4 percent can be expected in the euro area in 2022 as well. It must be noted that there are downward risks to this outlook. *Price trends* remain favorable: the yearly inflation rate was 0.3 percent in the eurozone last year, and while it is expected to rise to about 1.7 percent, this is still below the ECB target. No substantial trend change is expected for 2022, either. The *unemployment rate* may decrease to 8.3 percent in the euro area in 2021 and to about 7 percent in the next year. As for the **EU27**, GDP fell by an average 6.2 percent last year, and the volume of GDP was 4.8 percent below its 2019 level. The EU-wide GDP may expand by 4.7 percent this year, provided that the epidemic remains under check and the eagerly awaited reopening does not backfire.

In **Germany**, GDP decreased by 4.9 percent in 2020, a relatively moderate pace compared to our expectation. Regarding this year, most analysts highlights the danger of a stop-go policy, with lifting and reintroducing lock-down measures as long as the level of vaccination is below the necessary threshold to reopen entirely. Thus, a GDP growth rate of about 3.2 percen seems likely, with downward risks. By March the business sentiment has improved considerably, even amid the introduction of further restrictive measures, but on the other hand one-fifth of firms assess their own position as being close to bankruptcy. The growth rate may gather some speed, to 4-5 percent, in 2021, due to the abatement of the epidemic. Inflation rate may get near 2 percent. Fiscal policy will remain expansive.

The impact of COVID-19 on the **United Kingdom** was particularly severe. The GDP dropped by 9.9 percent last year, and due to the new wave of the epidemic, British analysts have cut their growth forecasts for this year substantially. As of now, an annual growth of 3.4 percent seems likely. The combined cost of the job-saving policy measures and the support to small enterprises amounts to about 4.8 percent of GDP in the 2020-2021 fiscal year. Due to the generous stimulus programs, the public debt-to-GDP rate surged to 99 percent of GDP in 2020, and it may rise further in the coming years, eventually reaching 111 percent of GDP. There are serious downward risks in the forecast period, due to the protracting epidemic, the less-than-expected efficacy of the vaccines, and the fact that the Brexit effect on trade flows is more serious than previously envisaged.

I. New EU member states

Recession continued in the new member states in the last quarter of 2020. On average, GDP was dipped by 3.2 percent, while in 2020 as a whole the rate of GDP decline was 4 percent, roughly in accordance with expectations. The lockdown measures that had been introduced during the autumn remained in effect in the winter months, hence consumption during the Christmas season was less than in the previous years. The GDP is likely to continue in the first quarter of 2021, a combined result of the movement restrictions and the statistical base effect. Considering the calamitous situation in the healthcare systems the 4-percent decline in 2020 is not particularly severe, even if the gross national income may have fallen more steeply, at a rate higher by 1 percentage point. (About the GNP trends in 2020 there will not be data available before this autumn.)

In the last quarter, Croatia suffered the largest fall (7.1%), as tourism, one of the main growth drivers, practically came to a halt. Also, the movement of guest workers was limited. The outcome was similar in Malta (-6.2%) and Slovenia (-5%) as well. On the other end of the spectrum is Lithuania, with a GDP decrease of merely 0.8 percent, defying all expectations. The Lithuanian growth performance is noteworthy considering that in the other to Baltic states the decline was more pronounced (2.7 percent in Estonia, 3.6 percent in Latvia). On a more negative note, Lithuanian unemployment surged more substantially than what seems warranted considering the GDP data. The source of the different growth outcome is not clear since the lockdown measures were similar in magnitude than in anywhere else in Europe, the epidemic was even more virulent than in the other Baltic states (the number of dead per capita in Lithuania was nearly 1.5 times the respective number in Estonia. Still, consumption decreased only moderately and remained stable throughout the year, which, according to independent observers, is a result of the consistent communication on the part of the government and the disciplined behavior of the population. While the Lithuanian economy avoided a deep recession last year, it is not expected to grow at a steep pace this year, either.

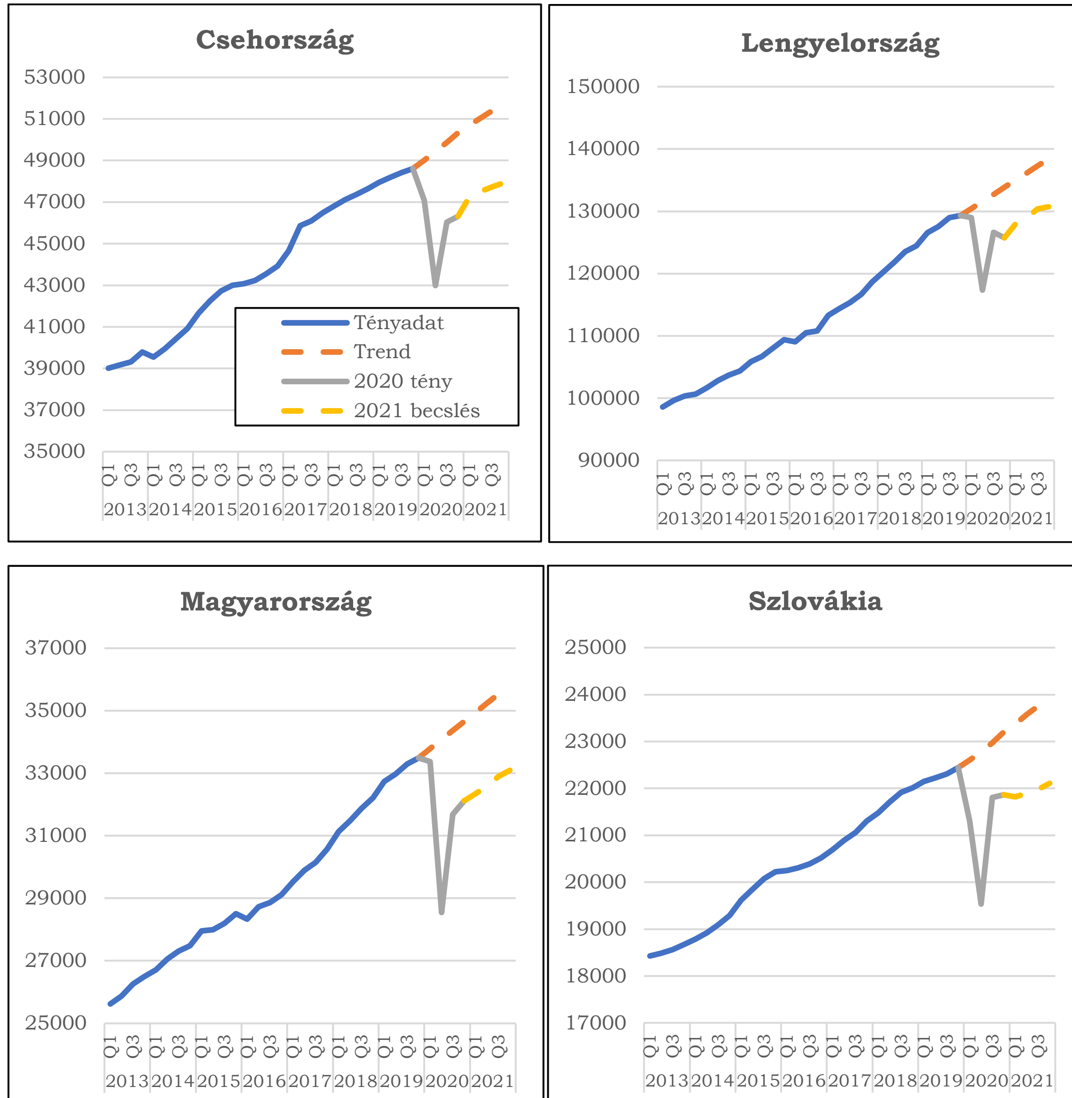
The countries of the region are likely to reach the 2019 level of GDP, similarly to the other EU member states. It is doubtful, however, whether they can ever return to the pre-crisis growth trajectory from which they diverged in 2020. Regarding in the Visegrad countries, we estimate the divergence from the former trend countries as high as 6-8 percent in Czechia, Hungary and Slovakia, and 4-6 percent in Poland. The table below shows the magnitude of the growth in necessary to return to the pre-crisis trajectory in 2021, in comparison with the actual growth forecast for this year.

Divergence from the growth trend in the Visegrad countries

Country	Growth forecast for 2020 at the end of 2019	Actual growth in 2020	Expected growth in 2021	Divergence from the trend in 2021	Growth rate necessary to return to the trend in 2021
Czechia	2,1%	-5,0%	3,8%	7,0%	12,4%
Poland	3,4%	-2,7%	4,5%	5,3%	9,8%
Hungary	3,3%	-5,0%	4,5%	7,0%	13,0%
Slovakia	2,4%	-5,2%	4,3%	7,1%	12,1%
Eurozone	1,2%	-6,6%	4,8%	5,1%	11,0%

Source: Eurostat, Kopint-Tárki, Consensus Economics

Growth trajectories in the V4 countries after 2020
(based on GDP data at constant prices)



Source: Eurostat, Kopint-Tárki

As can be seen from the charts above, the long-term loss amounts to 4-6 percent of GDP, and there is scant hope to win back this loss in the near future. It should be noted that the growth trends are based on the growth rates before 2020, which means that they do not take into account the fact that at the end of 2019 analysts expected an economic slowdown, even before the Covid outbreak.

The epidemic primarily hit household consumption, and even those whose incomes were not affected could not spend as usual due to the lockdown. This was especially painful for the firms during the Christmas season. In the last quarter, consumption grew only in three member states: Lithuania (0.3%), Estonia (0.9%) and Malta (3%). On the other hand, consumption contracted severely in Slovenia (-10.1%), Latvia (-5.2%) and Romania (-466%). The combined result was an overall consumption fall of 2.6 percent in the new member states in the fourth quarter. Investments decreased only by 2.1 percent in the last quarter, still a meager outcome considering the fiscal stimulus measures that poured unprecedented amount of money into the economies.

Due to the massive fiscal stimulus measures, both fiscal deficits and public debt rates increased, on average by 10 percent of GDP, in the region. The average debt-to-GDP rate reached 54 percent in the new member states, the highest level ever recorded. The debt levels in the individual countries vary, however. It is questionable whether such public debt levels are sustainable in the medium term, or whether these economies will be able to grow without fiscal support. Most likely, the fiscal stimulus will not be halted this year, only slightly cut back at most. A problem is that even if the amount of state support in 2021 is only half of the amount spent in 2020, the combined debt-to-GDP ratio may reach 60 percent by the end of this year in the new member states – in some of the individual states,, it may reach 80-85 percent. And the phasing-out of the fiscal programs becomes possibly only when the vaccination is advanced enough to make free movement of the residents and the complete reopening of shops at least within the EU. The tourists from outside the EU will still be sorely missed since they constitute about 10-15 percent of the pre-crisis tourism turnover, and thus affect GDP growth, especially in Hungary, Czechia, Croatia and, to a lesser degree, Slovenia.

Inflation is another source of uncertainty. A rate hike is unlikely in 2021 in every country, which means that only demand can limit the rise of prices. But demand is expected – at least by the more optimistic scenarios – to return to pre-crisis levels in summer, or can even temporarily rise above them, as households catch up with their delayed consumption. This will probably push inflation upward for a short time, especially in countries with particularly prominent tourism sector (Croatia, Slovenia). While this is expected to be a temporary upsurge, it may carry over to 2022.

In a number of countries, prices are already rising at a fast pace. In the first quarter, core inflation stood above 5 percent in Poland, 2.7 percent in the Czech Republic, 2.6 percent in Slovakia and 2 percent in Hungary. Since energy prices decreased in several countries, due to market developments, keeping headline inflation down, but the core inflation rates suggest the presence of a steady inflationary pressure, a fact the exerts pressure on the central banks as well. Real interest rates may be negative in the new member states (as in the core member states), which may lead to a weakening of their currencies and the rising risk of asset bubbles, especially in the housing markets. Inflation rates may remain close to 2.5 percent in the region in both 2021 and 2022, but there are significant upward risks.

The global economic conditions are still unfavorable for economic growth in the region, because export rates in the main Western European trade partners will remain subdued – hence no substantial growth stimulus from the outside can be expected. As a result, the role of domestic consumption and investment – and within investments, the spending of EU-subsidies and the productive use of investment funds – will become more decisive. The statistical base effect will be overwhelming in the second quarter, possibly leading to year-on-year growth rates as high as 14-15 percent. Assuming, that the restrictive measures no longer hamper economic activity in the second half of the year, the new members may post annual growth rates of 4-5 percent in 2021, and similar rates in the next year. This presupposes that the epidemic will no longer limit consumption which includes external tourism.

Table 2/1.

Economic Growth in the EU Member States

(Percentage change of real GDP over the previous year)

	Weight	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021****	**2022****
Germany	20.9	1.7	2.2	2.5	1.5	0.6	-4.9	3.2	4.5
France	14.7	1.1	1.1	2.3	1.7	1.3	-8.1	5.4	3.6
Italy	10.9	0.9	1.1	1.7	0.9	0.3	-8.9	5.2	3.6
Netherlands	4.9	2.0	2.2	2.9	2.6	1.7	-3.8	2.4	2.9
Belgium	2.9	1.7	1.5	1.7	1.4	1.4	-6.4	4.7	3.4
Luxembourg	0.4	3.9	2.4	1.5	2.6	2.3	-1.3	2.7	3.5
Ireland	2.1	25.2	3.7	8.1	8.2	5.5	3.4	2.0	4.4
Greece	1.1	-0.4	-0.2	1.5	1.9	1.9	-8.2	4.1	4.8
Spain	7.6	3.8	3.0	2.9	2.4	2.0	-11.0	7.3	4.2
Portugal	1.3	1.8	1.9	2.8	2.1	2.2	-7.6	5.1	3.8
Austria	2.4	1.0	2.1	2.5	2.4	1.6	-6.6	2.0	4.7
Finland	1.5	0.5	2.8	3.0	1.7	1.0	-2.8	2.2	2.6
Estonia	0.2	1.9	3.5	4.9	3.9	4.3	-2.9	3.0	3.0
Slovakia	0.6	4.2	3.1	3.2	4.1	2.3	-5.2	4.3	4.1
Slovenia	0.3	2.3	3.1	4.9	4.5	2.4	-5.5	4.4	4.0
Cyprus	0.1	2.0	4.8	4.5	3.9	3.2	-5.1	4.0	4.0
Malta	0.1	10.8	5.6	6.8	6.7	4.4	-7.0	5.0	4.5
Latvia	0.2	3.0	2.1	4.6	4.8	2.2	0.0	3.9	4.0
Lithuania	0.3	2.0	2.4	4.1	3.5	3.9	-0.8	3.7	3.3
Euro Area	**72.4**	**2.1**	**1.9**	**2.5**	**1.9**	**1.2**	**-6.6**	**4.8**	**4.2**
United Kingdom	15.3	2.3	1.8	1.8	1.4	1.4	-9.9	3.4	4.0
Denmark	1.9	2.3	2.4	2.3	1.5	2.2	-3.3	2.5	2.2
Sweden	2.9	4.4	2.4	2.4	2.3	1.2	-2.8	3.3	2.8
Hungary	**0.9**	**3.8**	**2.1**	**4.3**	**5.4**	**4.6**	**-5.0**	**4.7**	**5.0**
Czech Republic	1.3	5.3	2.5	4.4	2.9	2.4	-5.6	3.8	4.5
Poland	3.2	3.8	3.1	4.8	5.1	4.1	-2.7	4.5	4.0
Romania	1.4	3.9	4.8	7	4.1	4.1	-3.9	4.0	4.4
Bulgaria	0.4	3.5	3.9	3.8	3.1	3.4	-4.2	3.5	4.0
Croatia	0.3	2.4	3.5	2.9	2.6	2.9	-8.4	4.3	4.6
EU-15	**90.8**	**2.4**	**1.9**	**2.3**	**1.8**	***1.3***	**-7.6**	**4.5**	**4.1**
New EU-13	**9.2**	**3.8**	**3.2**	**4.8**	**4.3**	***3.6***	**-4.0**	**4.2**	**4.2**
EU-28	**100**	**2.3**	**2.0**	**2.6**	**2.0**	***1.5***	**-7.2**	**4.5**	**4.1**
BREXIT	**84.7**		**2.0**	**2.7**	**2.1**	***1.5***	**-6.2**	**4.7**	**4.1**
Memorandum items									
USA		2.5	2.9	1.6	3.0	2.2	-3.5	6.6	4.1
Japan		0.3	1.1	1.0	1.9	0.7	-4.9	3.9	2.2
China		7.3	7.0	6.7	6.8	6.1	2.3	7.8	4.9
Russia		0.7	-2.8	-0.2	2.2	1.3	-3.0	4.0	1.8
South-Eastern Europe									
Serbia		1.7	3.3	2.1	4.3	3.2	-1.8	4.8	3.8
Turkey		6.1	3.2	7.4	2.5	-2.3	-2.5	3.9	4.5

* Kopint-Tárki forecast

EU-15 = Countries that joined the European Union before 2004 (“Old EU Member States”)

New EU-13 = Countries that joined the European Union in 2004, 2007 and 2013 (“New EU Member States”)

Source: Eurostat, national statistical offices, OECD

Table 2/2.

Inflation in the EU Member States

(Harmonized consumer price indices, percentage change over the previous year)

	Weight	2015	2016	2017	2018	2019	2020	2021**	2022**
Germany	19.8	0.1	0.4	1.7	1.9	1.4	0.4	2.5	1.7
France	14.2	0.1	0.3	1.2	2.1	1.3	0.5	1.5	1.4
Italy	12.1	0.1	-0.1	1.3	1.2	0.6	-0.1	1.4	1.2
Netherlands	4.0	0.2	0.1	1.3	1.6	2.7	1.1	1.8	1.6
Belgium	2.7	0.6	1.8	2.2	2.3	1.2	0.4	1.5	1.3
Luxembourg	0.2	0.1	0.0	2.1	2.0	1.6	0.0	0.9	0.8
Ireland	1.2	0.0	-0.2	0.3	0.7	0.9	-0.5	0.2	1.4
Greece	1.4	-1.1	0.0	1.1	0.8	0.5	-1.3	0.4	1.3
Spain	8.0	-0.6	-0.3	2.0	1.7	0.8	-0.3	1.2	1.1
Portugal	1.5	0.5	0.6	1.6	1.5	0.3	-0.1	1.3	1.3
Austria	2.2	0.8	1.0	2.2	2.1	1.5	1.4	1.8	1.8
Finland	1.4	-0.2	0.4	0.8	1.2	1.1	0.4	1.2	1.1
Estonia	0.2	0.1	0.8	3.7	3.4	2.3	-0.6	1.5	2.0
Slovakia	0.6	-0.3	-0.5	1.3	2.5	2.8	2.0	2.0	2.0
Slovenia	0.3	-0.8	-0.2	1.6	1.9	1.7	-0.3	0.7	1.6
Cyprus	0.2	-1.6	-1.2	1.0	0.8	0.5	-1.1	0.9	1.5
Malta	0.1	1.2	0.9	1.3	1.7	1.5	0.8	1.5	1.8
Latvia	0.2	0.2	0.1	2.9	2.6	2.7	0.1	1.4	2.0
Lithuania	0.3	-0.7	0.7	3.8	2.5	2.2	1.1	2.0	2.4
Euro Area	**70.4**	**0.0**	**0.2**	**1.5**	**1.8**	**1.3**	**0.3**	**1.7**	**1.5**
United Kingdom	18.0	0.0	0.7	2.7	2.5	1.8	0.9	1.8	2.3
Denmark	1.6	0.2	0.0	1.1	0.7	0.7	0.3	0.8	1.3
Sweden	2.3	0.7	1.1	1.9	2.0	1.7	0.7	1.2	1.7
Hungary	**0.8**	**0.1**	**0.4**	**2.4**	**2.9**	**3.4**	**3.4**	**4.1**	**3.8**
Czech Republic	1.2	0.2	0.7	2.3	2.0	2.6	3.3	2.4	2.5
Poland	3.4	-0.7	-0.2	1.6	1.2	2.1	3.7	2.6	2.5
Romania	1.6	-0.4	-1.1	1.0	4.1	3.9	2.3	3.0	3.0
Bulgaria	0.4	-1.1	-1.3	1.0	2.6	2.5	1.2	2.0	2.3
Croatia	0.3	-0.3	-0.6	1.3	1.6	0.8	0.0	1.4	2.4
EU-15	**90.6**	**0.1**	**0.4**	**1.7**	**1.9**	***1.4***	**0.5**	**1.7**	**1.6**
New EU-13	**9.4**	**-0.4**	**-0.2**	**1.7**	**2.2**	***2.6***	**2.6**	**2.5**	**2.5**
EU-28	**100.0**	**0.0**	**0.3**	**1.7**	**1.9**	***1.5***	**0.7**	**1.8**	**1.7**
BREXIT	**82.0**		**0.2**	**1.6**	**1.8**	**1.4**	**0.7**	**1.8**	**1.6**
Memorandum items [a]									
USA		1.5	1.6	0.1	1.3	1.5	1.2	2.8	2.3
Japan		0.4	2.7	0.8	0.5	0.5	0.2	1.0	0.8
China		2.6	2.0	1.4	2.0	2.9	1.6	1.6	2.3
Russia [b]		7.8	15.5	7.0	2.9	4.5	3.3	4.7	4.0
South-Eastern Europe									
Serbia		2.3	1.1	3.1	2.0	2.5	1.5	1.7	1.9
Turkey		8.9	7.7	11.0	16.7	13.3	11.9	11.7	9.2

a Non-harmonized consumer price indices
b December/December
* Kopint-Tárki forecast
EU-15 = Countries that joined the European Union before 2004 ("Old EU Member States")
New EU-13 = Countries that joined the European Union in 2004, 2007 and 2013 ("New EU Member States")
Source: Eurostat, national statistical offices, OECD

Table 2/3.

Harmonized Unemployment rates in the EU Member States

(Unemployed as a percentage of the labor force aged 15-74, ILO-Eurostat)

	Weight	2015	2016	2017	2018	2019	2020	2021*	2022*
Germany	17.5	4.6	4.1	3.8	3.4	3.2	4.2	4.4	4.1
France	12.2	10.4	10.1	9.4	9.1	8.5	8.2	9.0	8.0
Italy	10.5	11.9	11.7	11.2	10.6	10.4	9.3	9.6	9.0
Netherlands	3.7	6.9	6.0	4.9	3.8	3.4	3.9	4.2	3.4
Belgium	2.1	8.5	7.8	7.1	5.9	5.6	5.1	5.3	5.1
Luxembourg	0.1	6.5	6.3	5.6	5.3	5.3	6.7	6.4	5.5
Ireland	1.0	10	8.4	6.7	5.8	5.1	6.0	6.8	5.1
Greece	1.9	24.9	23.6	21.5	19.3	17.8	16.6	16.9	15.4
Spain	9.4	22.1	19.6	17.2	15.3	14.0	15.6	15.2	13.8
Portugal	2.1	12.6	11.2	9.0	7.0	6.4	7.1	6.9	6.5
Austria	1.8	5.7	6.0	5.5	4.9	4.7	5.4	5.1	4.8
Finland	1.1	9.4	8.8	8.6	7.4	6.8	7.8	7.7	6.7
Estonia	0.3	6.2	6.8	5.8	5.7	5.5	7.5	8.0	7.0
Slovakia	1.1	11.5	9.7	8.1	6.9	5.8	7.0	8.0	7.0
Slovenia	0.4	9	8.0	6.6	5.6	4.2	5.0	5.0	4.5
Cyprus	0.2	15	13	11.1	8.2	6.5	8.5	8.0	7.0
Malta	0.1	5.4	4.7	4.0	3.9	3.5	5.0	5.0	4.0
Latvia	0.4	9.9	9.6	8.7	7.3	6.5	8.5	8.0	7.5
Lithuania	0.6	9.1	7.9	7.1	6.5	6.1	9.0	8.0	7.0
Euro Area	**66.4**	**10.9**	**10.0**	**9.1**	**8.2**	***7.6***	***8.1***	***8.3***	***7.6***
United Kingdom	13.5	5.3	4.8	4.4	4.0	3.8	5.2	5.9	4.8
Denmark	1.2	6.2	6.2	5.7	5.0	4.9	5.6	5.7	5.0
Sweden	2.2	7.4	6.9	6.7	6.3	6.8	8.3	8.1	6.9
Hungary	**1.9**	**6.6**	**5.0**	**4.1**	**3.6**	**3.3**	**4.1**	**4.0**	**3.7**
Czech Republic	2.2	5.1	4.0	2.9	2.4	2.3	3.0	3.3	3.0
Poland	7.0	7.5	6.2	4.9	3.3	3.8	4.5	5.0	4.0
Romania	3.6	6.8	5.9	4.9	4.3	4.2	6.0	6.5	6.0
Bulgaria	1.3	9.2	7.6	6.2	6.0	4.0	6.0	5.5	5.0
Croatia	0.7	16.1	13.4	11.1	9.1	6.0	8.0	7.5	7.0
EU-15	**80.2**	**9.9**	**9.2**	**8.4**	**7.5**	**7.1**	***7.6***	***7.9***	***7.1***
New EU-13	**19.8**	**7.9**	**6.6**	**5.5**	**4.5**	**4.1**	***5.3***	***5.5***	***4.8***
EU-28	**100.0**	**9.4**	**8.6**	**7.6**	**6.8**	**6.4**	***7.1***	***7.4***	***6.6***
BREXIT	**86.5**		**9.2**	**8.2**	**7.3**	**6.7**	**7.4**	**7.7**	**6.9**
Memorandum items [a]									
USA		6.2	5.3	4.9	3.9	3.7	8.1	5.4	4.1
Japan		3.6	3.4	3.1	2.8	2.4	2.8	2.7	2.5
China [b]		4.7	4.1	4.0	4.0	4.1	4.1	4.1	
Russia [c]		5.1	5.6	5.7	5.4	4.6	6.0	5.9	5.7
South-Eastern Europe									
Serbia [d]		19.2	15.3	13.5	12.7	11.0	9.5	9.5	9.0
Turkey		9.9	10.9	10.9	11.0	14.0	13.7	14.0	14.0

a Non-harmonized unemployment rates
b Urban unemployment
c OECD statistics, unemployment rates for the age group 15-64
d National statistics, unemployment rates for the age group 15-64
* Kopint-Tárki forecast

EU-15 = Countries that joined the European Union before 2004 (“Old EU Member States”)
New EU-13 = Countries that joined the European Union in 2004, 2007 and 2013 (“New EU Member States”)
Source: Eurostat, national statistical offices, OECD

Macroeconomic indicators for Hungary and Kopint-Tárki forecast

(year-on-year change, percentage)

	Data			Forecast		
			2021	2021		2022
	2019	2020	Q1	2020 Dec.	2021 Apr.	2021 Apr.
GDP aggregates, real growth						
GDP total	4.6	-5.0		3.5	**4.7**	**5.0**
Domestic Demand	6.6	-3.0		2.8	**4.5**	**4.7**
Private Consumption	4.6	-2.8		3.0	**3.8**	**3.8**
Public Consumption	5.6	2.8		0.0	**0.0**	**0.0**
Gross Fixed Capital Formation	12.8	-7.3		4.5	**8.0**	**8.5**
Gross Capital Formation	11.3	-5.5		3.3	**8.0**	**8.5**
Export	5.8	-6.8		5.6	**8.6**	**6.7**
Import	8.2	-4.4		4.7	**8.5**	**6.4**
Industrial production	5.6	-6.1	*4.0*	4.5	**10.5**	**5.0**
Consumer Price Index	3.4	3.3	*4.0* [e]	3.0	**4.1**	**3.8**
Employment, earnings						
Number of Employed, growth [a]	0.8	-0.9	*-0.9*	1.0	**1.0**	**0.6**
Employment rate [a]	62.6	62.1	*61.9*	60.6	**62.8**	**63.1**
Unemployment Rate [a]	3.3	4.1	*4.5*	4.0	**4.0**	**3.6**
Unit Labor Costs, in EUR [b]	7.6	1.1		3.4	**1.1**	**1.7**
Gross Nominal Wages	11.4	9.7	*9.7* [f]	6.5	**7.8**	**7.4**
Net Real Wages	7.7	6.2	*6.6* [f]	3.3	**3.6**	**3.5**
Savings Rate, % of GDP [c]	5.0	6.1		5.0	**6.0**	**5.5**
Current and Capital Accounts Balance, % of GDP	1.4	2.1		0.5	**2.5**	**3.0**
General government Fiscal Balance, ESA-2010, % of GDP	-2.0	-8.1		-7.0	**-6.5**	**-5.0**
Gross Government Debt, % of GDP	65.5	80.4		78.4	**81.0**	**80.0**
Short-term Government Yields (3M), eop	-0.01	0.28	*0.39* [g]	0.3	**0.7**	**0.7**
Long-term Government Yields (10Y), eop	2.01	2.08	*2.74* [g]	2.2	**2.6**	**2.6**
External assumptions						
Internat. Trade in Goods and Services [d]	4.0			8.3		
Brent Oil Price ($/bbl, p. avg.)	64.4	41.8	*64.2* [e]	50.0	**67.0**	**70.0**
GDP Real Growth, Eurozone	1.3	-6.6		4.6	**4.8**	**4.2**
GDP Real Growth, New EU Members	3.6	-4.0		4.1	**4.2**	**4.2**
EUR-HUF, period average	325	351	*362* [e]	360	**365**	**365**
EUR-USD, period average	1.12	1.14	*1.20* [e]	1.14	**1.20**	**1.20**

a ILO methodology, period averages, aged 15-74, public workers are counted as employed.
b Manufacturing, based on gross value added and the monthly average compensation of employees in euro, cumulated from the beginning of the year
c At enterprises with at least 5 employees, all budgetary institutions, and major non-profit institutions
d Net lending of households according to the financial accounts statistics, percentage of GDP, four-quarter cumulative data
e February-April
f January-February
g April

II. The Hungarian economy

In the fourth quarter of the last year, the growth performance defied expectations by a long shot, and as a result, the annual economic decline in 2020 as a whole was milder than what could be expected in the time of the first outbreak of the pandemics. The GDP fell by 5 percent in the last year, which was actually similar to what most analysts (the Kopint-Tárki among them) expected toward the end of the second quarter, after the partial but marked rebound of economic activity before the arrival of the second wave.

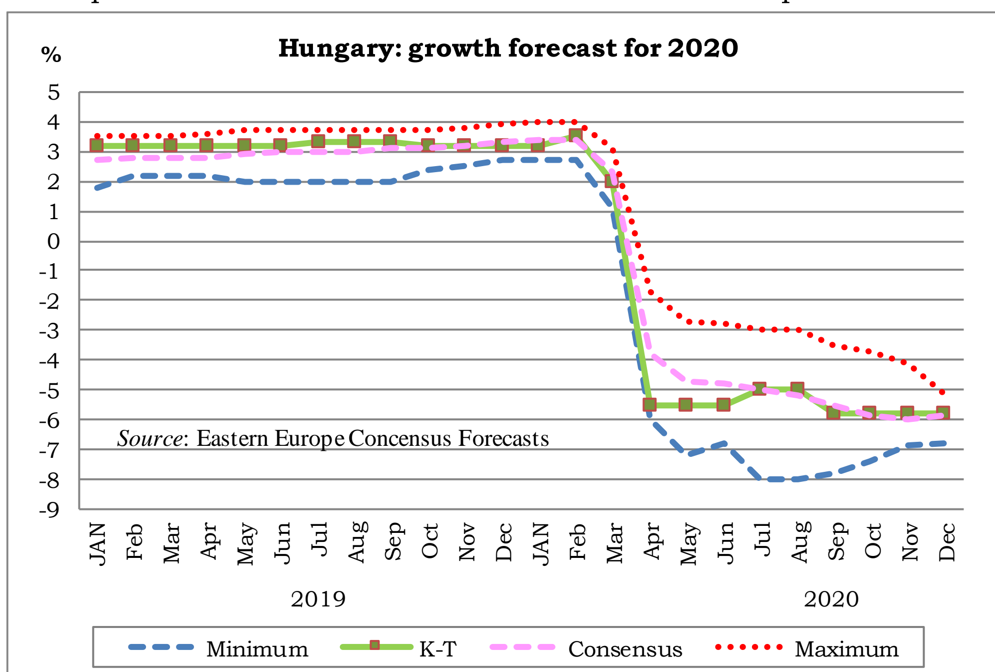
While the year-on-year rate of decrease was higher in the fourth quarter than in the third, the deterioration was relatively mild, and on a quarter-on-quarter basis the GDP even increased somewhat, due to the favorable trends in industry and especially in construction. But even within the services sector, the second wave did not hit every area, and its impact was not overwhelming even in wholesale and retail trade.

This also means that the *initial level* of GDP at the start of this year was higher than previously expected. Hence – if in other respects economic do not drastically diverge from our previous expectations, as presented in our winter report, the annual rate of GDP growth will be also higher in 2021 than the 3-4 percent the Kopint-Tárki assumed at the end of the last year.

According to the expected scenario, the seasonally adjusted GDP level remains approximately unchanged until the effective suppression of the epidemic – which is not expected to happen before the middle of the year – and will start rise markedly afterwards.

But is that scenario still viable, considering what is known about the economic trends in the beginning of the year?

While industrial production was only mildly affected by the second wave of the pandemic, the chip shortage and container shortage – and bottlenecks regarding various industrial commodities – had an impact worldwide, and in Hungary as well. While not directly, these shortages are ultimately the consequences of the epidemic. These shortages dampen the sentiment of economic firms but did not prevent a modest growth



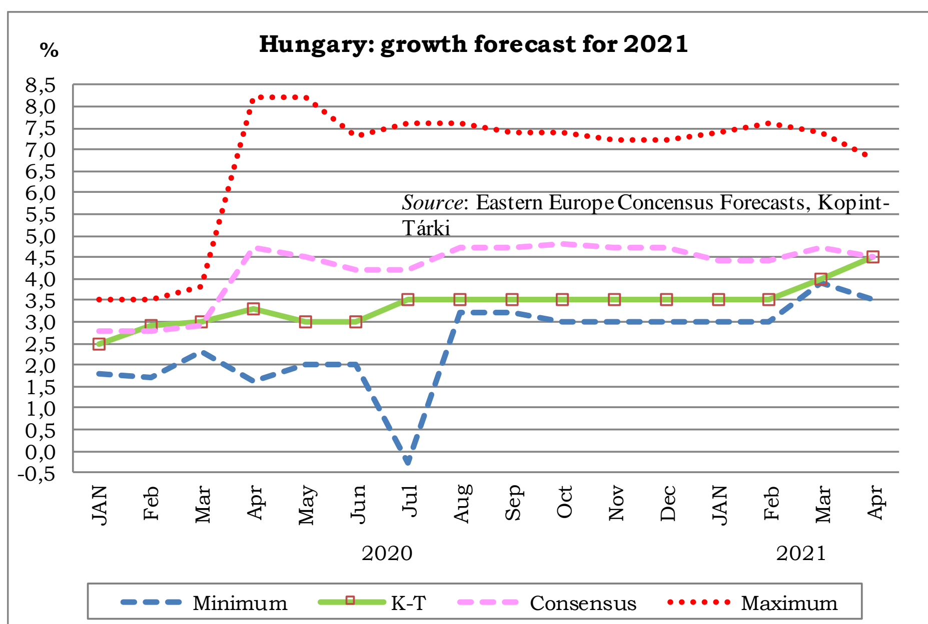
of industrial production in the first two months of 2021. Retail trade turnover was, on the other hand, more visibly affected by the second wave – and even more so by the *third wave* that resulted in further restrictive measures in mid-March. This means that while the volume of output may well increase even in the first quarter in industry, construction and some of the subsectors within services, a marked, if temporary, downturn in consumption may also occur.

On the whole, however, it still seems true that the return of the pandemic puts off the economic recovery but does not result in a sharp worsening of growth rates during the first half of the year, especially considering that in April the government started to relax the lockdown measures in several steps.

In any case, however, *year-on-year growth* will begin in earnest before the middle of the year, during the second quarter, due to the wild swings in the basis period. For the same reason, however, the year-on-year growth of industrial production will markedly decelerate in the second half of the year compared to the second quarter, even though the seasonally adjusted industrial output is expected to really take off during that period.

As for the envisaged upturn in the second half, a point of uncertainty is how *private consumption* will react on the reopening measures. In the last year, the fall of consumption constituted a spectacular divergence from the growth of real wage disbursements, but this is misleading, since wages notwithstanding, household incomes as a whole have likely decreased in 2020, due to a sharp drop in entrepreneurial incomes. But even so, the pandemic generated **significant pent-up consumption during the past year**. On the other hand, household incomes may expand by more than 4 percent in 2021, taking into account the rebound of entrepreneurial incomes.

Despite that, we expect private consumption to grow at a pace somewhat below 4 percent. One reason to this is the hit private consumption suffered in the first quarter of the year. Another reason is that while many will set to catching up with the delayed consumption, others may remain cautious, and also many entrepreneurs are likely to choose to use the return of income flows for financial consolidation, for example,



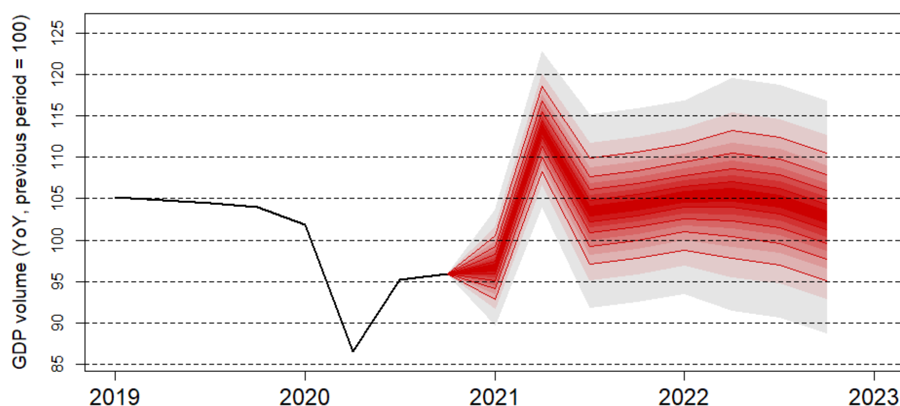
replenishment of their financial reserves. But there is considerable uncertainty regarding the post-crisis behavior of households, hence there are upside risks to our consumption forecast.

The economic restart in the second half of the year partially depends on how many firms will be still standing by the time of the effective reopening – a widespread bankruptcy would reduce the productive capacities and limit economic recovery, at least in the short term. Now, in 2020 there was no surge in the number of bankruptcies – which is somewhat surprising – it is to be seen whether the hardships in the first quarter of the year changes that.

Investments are the component of GDP that is likely to continue to recover unabatedly during the first half of the year. The positive investment growth in the last quarter of 2020 was primarily driven by public and household investments, and public investments are expected to be the dominant driving force in this year as well, as the extreme year-end fiscal spending materializes in newly launched – and in a few cases, completed – investment projects. The role of households is somewhat more uncertain: while the number of housing constructions started will certainly increase, the steep growth in the number of constructions *completed* may come to an end. The state subsidies transferred to enterprises will also have an effect on business investment, but we expect that much of these subsidies will materialize in investments only in the next year.

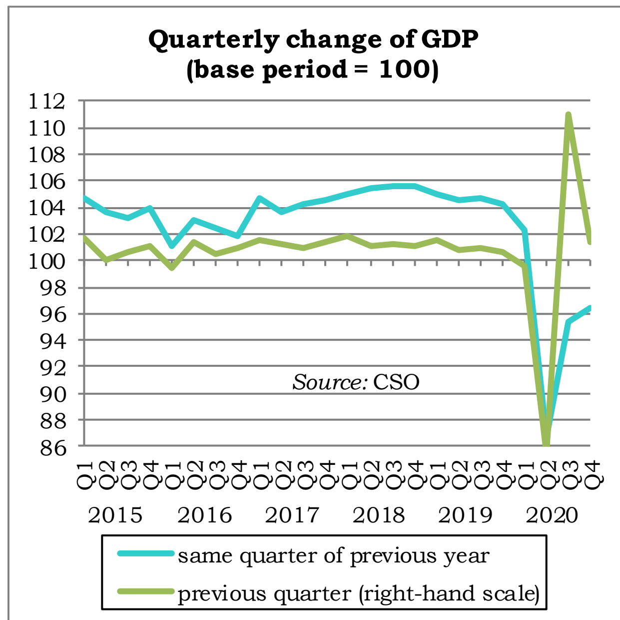
The volume of the *external trade of goods* surged in the last quarter of 2020 and – after a short disruption in January – continued to grow in the first quarter of 2021. The growth contribution of net export is likely to be positive in the first half of the year but may turn into the negative in the second, due to a consumption upsurge. The net export of services is likely to improve, but its positive effect may remain muted – the full recovery of external tourism may take several years.

On the whole, we expect the GDP to grow by 4.7 percent in 2021, and this pace may continue, even increase, in the next year. The longer-term outlook is more uncertain: the ballooning of corporate debt will become a worldwide problem sooner or later, and the international tensions are even more serious now than before the Covid crisis.



The GDP and its components

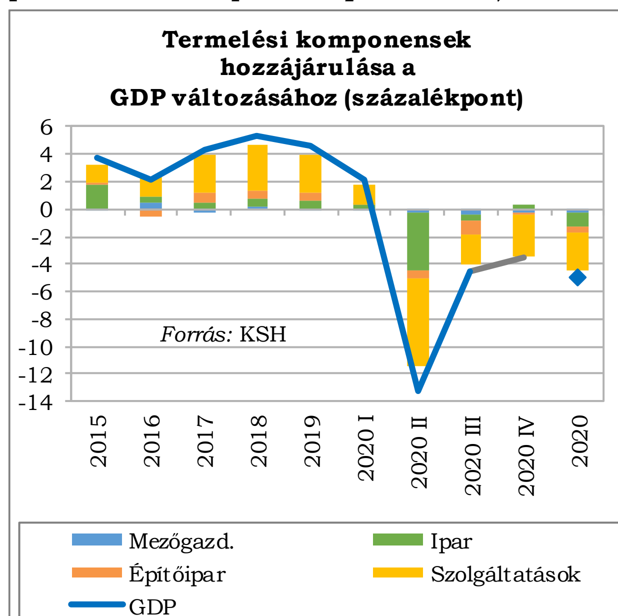
After the marked improvement in the third quarter, a visible deterioration in the fourth quarter was expected, due to the second wave of the epidemic and the related lockdown measures. This deterioration did not materialize, however: the GDP decreased by 3.5 percent year-on-year, after the 4.6 percent in the third quarter. Compared to the *previous quarter*, the GDP even increased, even if much less spectacularly than in the previous quarter.

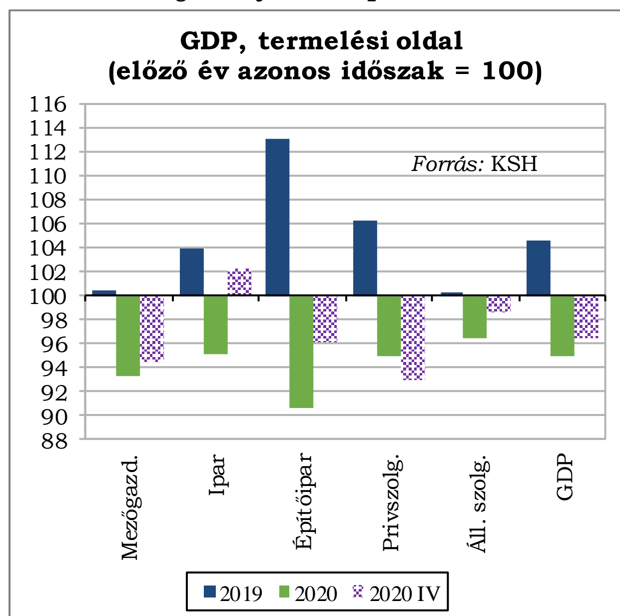


As a result, the annual average fall of GDP was also milder than expected – **5 percent** – in the last year.

On the ***production side***, industrial production was not heavily affected by the second wave, hence the industrial value added grew in the last quarter – after two quarters of decline – primarily due to a year-end surge in the auto industry. Also, construction value added decreased only by 3.9 percent – after a two-digit fall in the third quarter – mostly due to the improvement in the construction of buildings. But the fact that *services*, the sector most directly vulnerable to lockdown measures, did not plunged as hard as expected was also a crucial factor. Although tourism accommodation and food services imploded again, the overall value added of the wholesale and retail trade sector did not decreased, only stagnated, transport declined at a similar pace as in the third quarter, and even the deterioration in the arts and entertainment sector was was mild.

On the ***expenditure side***, the rate of decrease deteriorated by 1.5 percentage points in overall private consumption to 4 percent (more specifically, by 1 percentage point in private consumption *expenditures*). On the other hand, *gross fixed capital accumulation*





unexpectedly turned into positive growth in the fourth quarter, which is notable even if much of this improvement was offset by a negative turn in the change in inventories. Along with the jump in government consumption, this meant that ***domestic final use*** as a whole decreased by 4.7 percent, a pace hardly higher than in the third quarter. ***Net export***, on the other hand, improved spectacularly, mostly due to the upsurge in the export of goods, and that pushed down the overall rate of decrease of GDP below 4 percent in the fourth quarter.

The year **2020 as a whole** was characterized by a moderate decrease of private consumption and a more pronounced fall in fixed capital formation, accompanied by a minimal positive contribution of the net export of goods and a drastic negative contribution of the net export of services. **This year**, we expect a substantial improvement in domestic use and a rebound in both export and import. Private consumption may approximately reach – while fixed capital formation may get close to – pre-crisis levels. Net export, especially the net export of services, is expected to improve. At present **we predict an annual GDP growth of 4.7 percent** for 2021.

3.1. The production of GDP

3.1.1. Industry

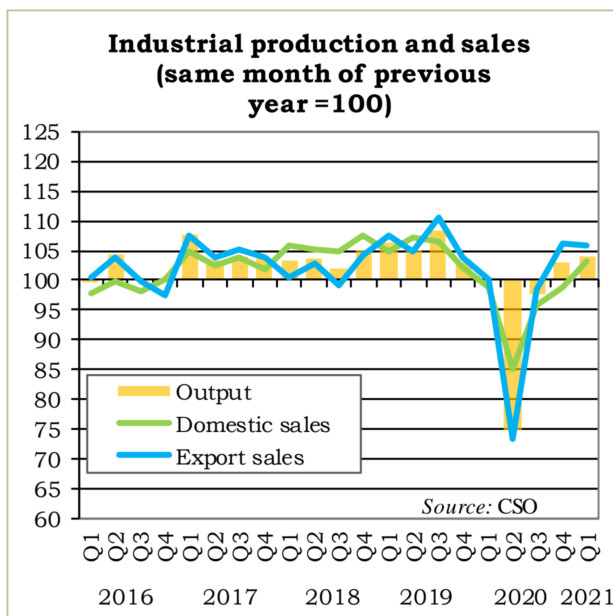
In the last months of 2020, industrial recovery continued: after a moderate decrease of 2.4 percent in the third quarter, the fourth quarter saw an *output growth* of 2.9 percent in the fourth quarter. Just as export sales suffered the most during the spring implosion, the year-end growth was driven by a 6 percent increase in export sales, while import sales continued to decrease, even if at a very slow pace.

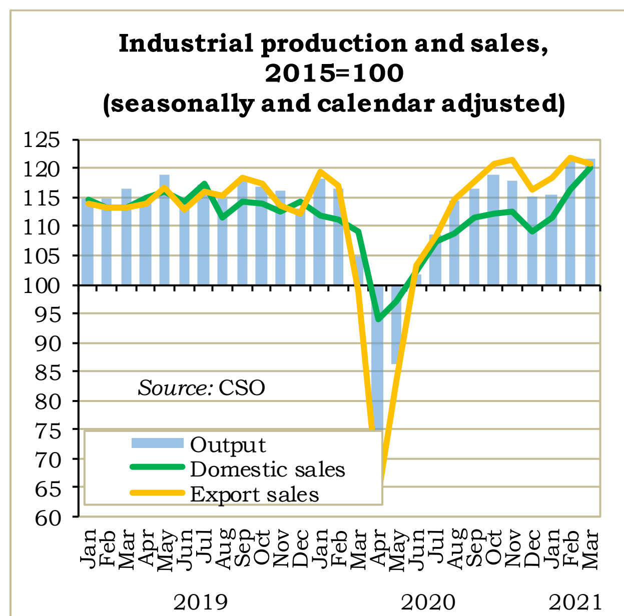
This does not mean that industry remained entirely unaffected by the second wave: as the seasonally adjusted data show, the monthly volume peaked at October and then dipped visible in November-December. But this downward turn remained moderate enough to make the continuation of year-on-year growth possible in the fourth quarter. As a result, in 2020, industrial output dropped by an annual 6.1 percent, a less drastic fall than previously expected.

While many manufacturing branches contributed to the year-end recovery, the fast growth of *automotive industry* was the decisive factor – in the meanwhile, the output continued to slide in more than half of the branches, even if the pace of decrease moderated even in those areas. Growth of export sales was much more broad-based than growth of domestic sales.

In the first months of 2021, industry defied expectations again: the effect of the second wave seemed to abate by February, and the much-touted chip and container shortage failed to put a visible dent on the process of recovery so far. In the first quarter, domestic sales also recovered at a fast pace, despite the new restrictions that were temporarily introduced in early March, due to the third wave of the epidemic. As a result, the average year-on-year growth rate was positive for both domestic and external sales, even if the latter climbed at a faster pace.

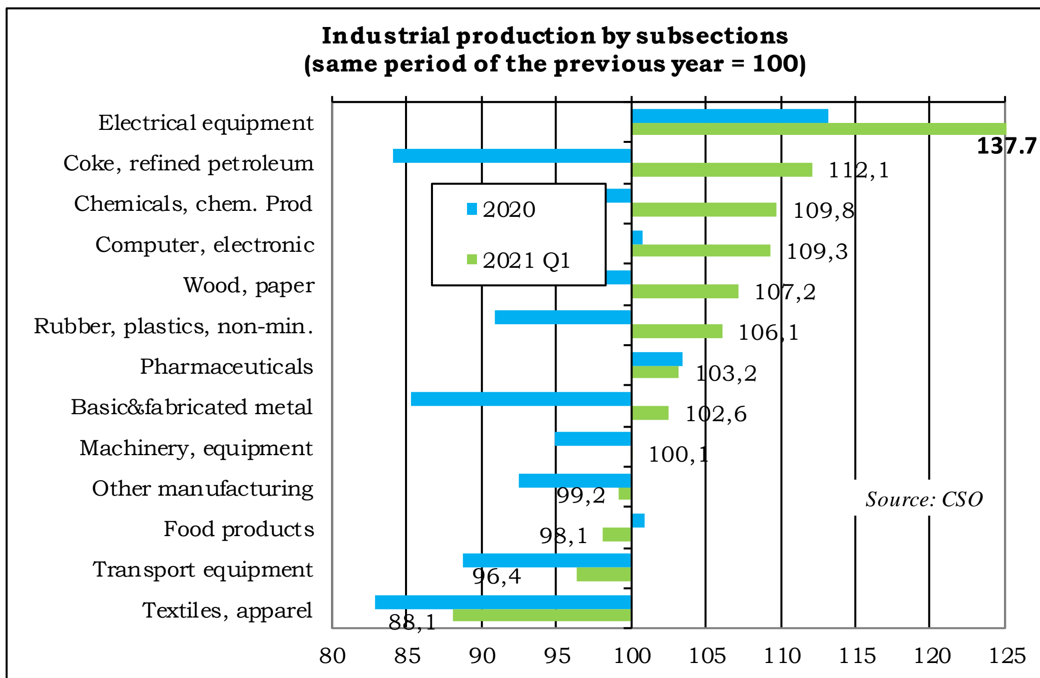
The fact is, however, that there is one important manufacturing branch, the auto industry, that has not yet shaken off the effect of the global chip shortage and the logistical bottlenecks: while the seasonally adjusted output came close to the pre-creases peak in September and October, it fell steeply afterwards and still not reached its pre-





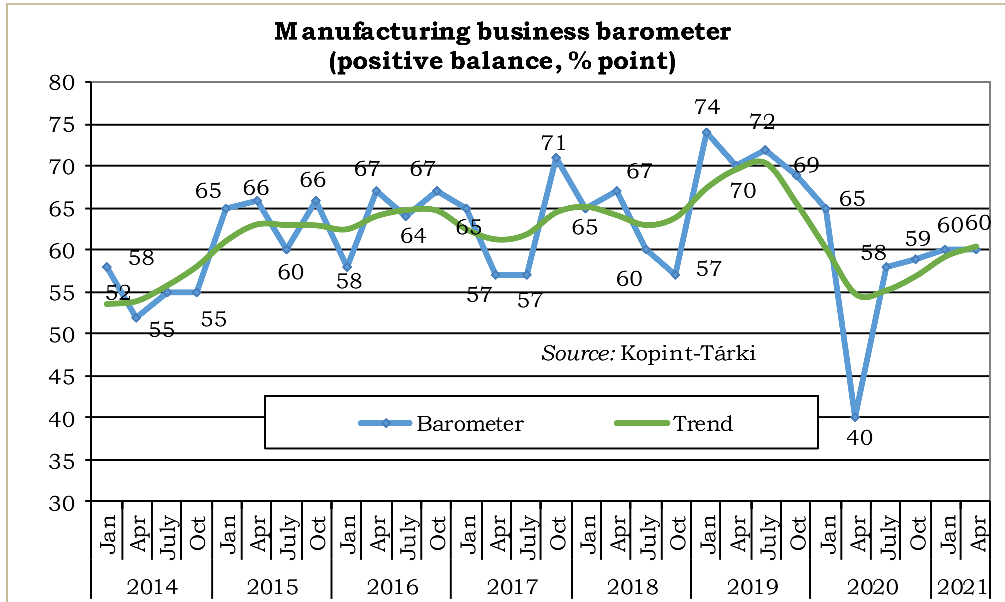
crisis level in March 2021. The opposite is true, on the other hand, in the case of the electronics industry, the rubber, plastic and building material industry, and for manufacturing as a whole.

In the coming months, year-on-year growth will reach sky-high levels, due to the extremely low basis. Apart from this certainty, there are still question marks regarding the future evolution of industrial output. According to industry representatives, the chip shortage has a more severe impact on activity in the second quarter than it had in the first, and it well affect industrial activity in the second half of the year as well. But even so, on the wake of the surprisingly strong first-quarter growth performance in the first quarter, it seems virtually certain that the yearly average growth will reach – or at least come close to – **10 percent** in 2021.

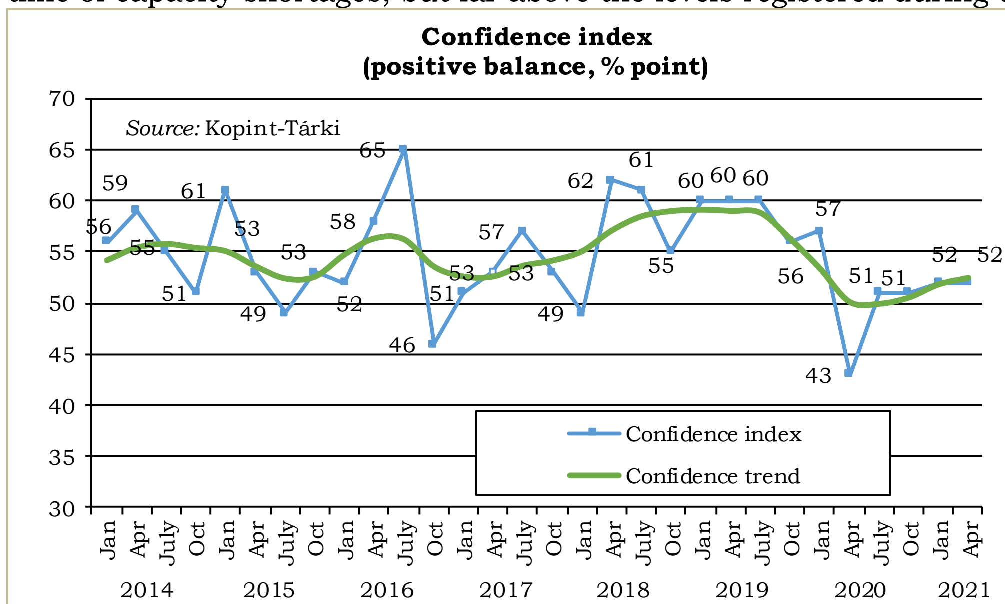


Manufacturing confidence survey

One year ago, right after the announcement of the first regulation on the state of emergency, the manufacturing sentiment indicators plummeted to levels last seen during the global crisis of 2009-2009. Three months later they bounced back but remained well below the 2019 levels, and the trend is a slight rise almost akin to stagnation.



The business barometer that is based on the subjective assessment of firms, has been near 50-60 points since the last summer, which means that the manufacturing firms do not deem their situation favorable – although neither they think it is extremely unfavorable. The future prospects seem to improve continuously but very incrementally. The fluctuation of the epidemiological situation naturally has an effect on the indicators but even the third wave did not disrupt the slightly upward trend, only slowed down the process of recovery. At present, the share of firms in a poor state is 21 percent, which is substantially better than the annual average in 2020. The stocks of orders tend to be at medium level, well below what firms experienced in 2019, in the time of capacity shortages, but far above the levels registered during the global



crisis a decade ago.

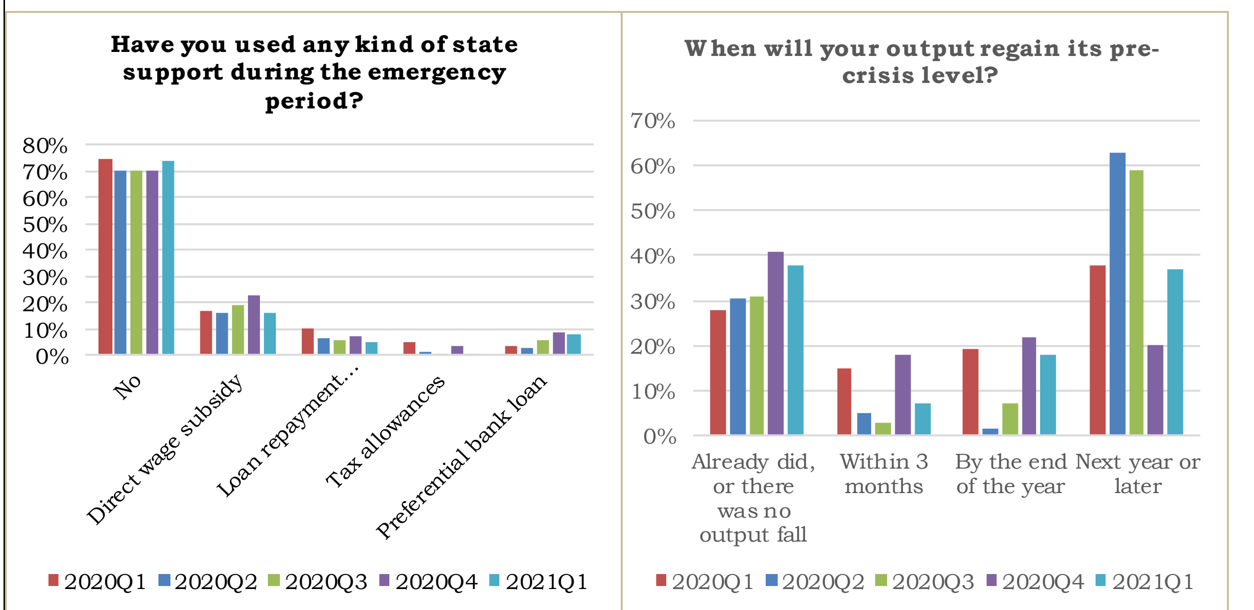
The production outlook is improving step by step – at the moment, it is at 65 points. The capacity utilization ratio is around 70 percent (about 10 percentage points lower than in 2019), and the majority of the firms intends to expand its workforce in the next 6 months. The output stock is quite low, probably because most of the firms already run them down in 2020.

As for the impediments to production, the pressure from demand shortage has eased, although still the number of firms that mentioned this factor is half time greater than two years ago. Labor shortage is climbing upward to become again one of the most important impediments, but still much less prevalent than a couple of years ago. Only a fraction of manufacturing firms reported financing difficulties as an impediment.

The one truly negative aspect of the last survey is the assessment of the state of the Hungarian economy: this index could not return to positive levels since the announcement of the emergency situation. According to the assessment of the manufacturing firms, the service sector keeps struggling even admi the more-or less steady functioning of the industrial sector.

The majority of manufacturing firms has not received any support during the emergency – among the ones that did, benefiting from the wage subsidy was the most prevalent (16%). The number of recipients of wage subsidy kept growing during the last year but this year, the growth halted. About 40 percent of the firms think that they have already recovered the losses from the stoppages in the spring of 2020, and another 40 percent think that this will not happen before 2022 even in the best case. The remaining 20 percent hopes for returning to pre-crisis output levels during this year.

In short, the subjective indicators paint a mixed picture. The confidence index – that synthesizes objective indicators – is also in the same range – at 52 points – as the barometer, and stagnates compared to the previous survey, but the trend is very slowly rising. After one year, the conclusion can be drawn that some firms were unaffected by the epidemic, but about one-fourth or one-fifth of manufacturing firms has been severely hit. If the present conditions last, more and more firms will face serious trouble, and even now it seems to be clear that the recovery will take at least one year even after the wholesale restart.



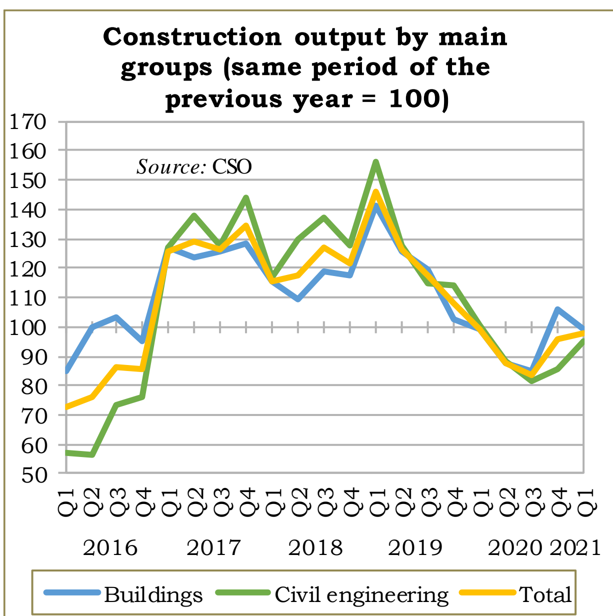
3.1.2. Construction

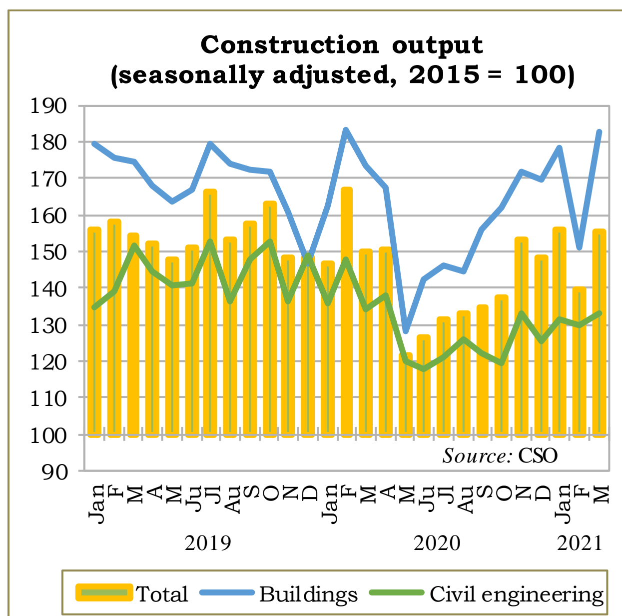
In the last quarter of 2020, the rate of output fall moderated considerably – from 17 percent in the third quarter for 4.3 percent. But this was mostly due to an improvement in the construction of buildings, where the previous two-digit decline turned into a growth of 6 percent. Steep decrease continued in civil engineering in the fourth quarter, and the as the seasonally adjusted data shows, the recovery of civil engineering is relatively drawn-out while the output of the construction of buildings nearly returned to pre-crisis levels by the end of 2020. On the whole, the partial recovery in the fourth quarter meant that the annual average fall of construction output – 9.1 percent – did not reached two-digit territory in 2020.

The recovery process remained ambiguous at the *beginning of this year*, but in a different way: civil construction output continued its gradual recovery while building construction levels fluctuated wildly. As a result, now both main groups posted a year-on-year decrease in the first quarter, even if at a moderate pace.

The recovery of building construction was supported by a steep growth in the number of finished housing construction projects in both the fourth quarter of 2020 and the first quarter of this year, but according to the iBuild database, the picture is different regarding the volume of newly started and the ongoing housing construction projects. The construction of industrial buildings, logistical buildings and (outside Budapest) hotels was strong in the last quarter. In civil engineering, road and utility construction declined while railroad construction activity grew at the end of 2020.

The outlook is uncertain: new orders surged in January but fell in February, and the value of the projects *started* decreased in the last quarter, which is a cause for cautiousness. But the volume of newly started projects is expected to start increasing this year, and from May the low statistical base will support year-on-year growth rates as well. We expect an **annual growth of 8-10 percent** for 2021 in construction.





3.1.3. Housing construction

The steep growth in the number of dwellings built continued in the fourth quarter of the last year – in fact it even accelerated to 41.7 percent. As a result, the annual average growth rate was 33.5 percent, and the number of dwellings built surpassed 28 thousand, a higher number than in any other year in the past decade.

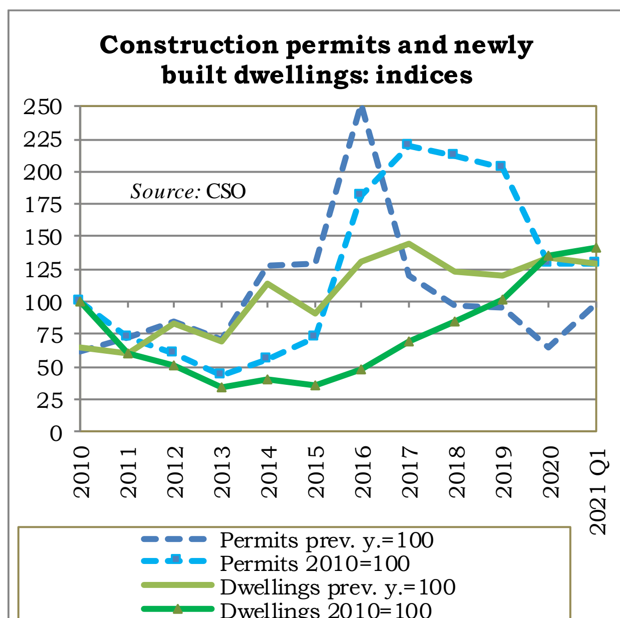
This is impressive, but it does not accurately reflect the trend of overall housing construction activity: According to the iBuild database, the number of housing construction projects *started* was falling drastically, and the number of dwellings under construction declined as well. This means that the jump in the number of finished housing construction projects marks the end of a housing construction wave. This is underlined by the fall in the number of housing building permits (or notifications) in 2020, by as much as 36 percent.

Housing construction activity was adversely affected by the phasing out of the preferential VAT rate on newly built dwellings and by the pandemic. The latter caused an uncertainty that prompted many developers to call of or at least delay housing projects.

But the reintroduction of preferential VAT rate at the start of 2021 (regarding the projects that are given a building permit before the end of 2022 and are completed before the end of 2026) and the launching of a new housing support package creates a new situation. Many suspended projects may be renewed. Also, a new, stricter energy efficiency regulation will enter into force at the end of June, which is likely to give an incentive to builders to accelerate the construction projects so as they are finished before that deadline.

This may be reflected by the fact that the fast rise in the number of dwellings built *continued in the first quarter of 2021*, at a pace of 29.5 percent. The outlook regarding the second half of the year is less clear. On the other hand, it can be taken for granted that the number of housing permits/notifications will rise in 2021, especially in the second half, even though it still declined slightly in the first quarter.

While the ongoing wave of newly finished housing projects increases the number of dwellings on the market, its downward effect on housing prices is hard to estimate. The new housing support program will increase the demand for dwellings and also the number of transactions on the housing market. In the case of newly built dwellings, a decrease of prices may be prevented by the high wage and input cost, rising demand and the more demanding energy efficiency regulation from the middle of the year. The downward effect of the VAT rate cut on prices is expected to be modest at best.



3.2. The final use of GDP

3.2.1. Household income, consumption and savings

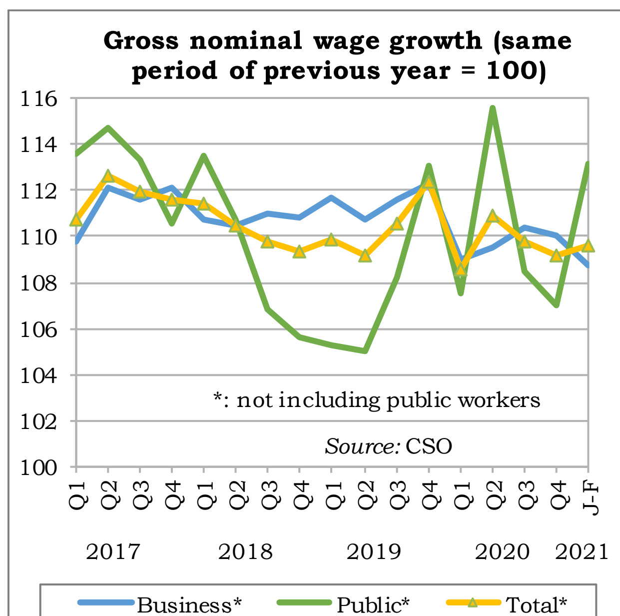
In the fourth quarter of the last year the surprisingly strong wage growth continued, at a pace of 9.4 percent, virtually identical with the rate observed in the third quarter. As a result, the average annual wage growth – *not including public workers* – was 9.6 percent in 2021. While wages rose faster in the public sector than in the business sphere, the difference – on an annual average – was not very substantial. (It should be noted that from now the CSO publishes headline wage data that covers every legally employed full-time workers – in addition to the usual coverage, that is workers at firms with more than 4 employees, public sector employers and major nonprofit employers – although this broader data is not detailed further. According to this new headline number, non-public worker gross wages grew by 9.7 percent, which suggests that officially reported wages grew at a higher pace in the smallest micro firms than the national average.)

With *public workers*, wages were up 9.7 percent for the standard coverage and 9.8 percent for all employees in 2020. The **real wage** of all employees rose by 6.3 percent, a generous rise for a full-blown crisis year.

Some comments are warranted, however. First, the wage number only covers full-time employees: all those who were put into part-time employment during the crisis, and suffered a fall of income as a result, fell out of the statistics. The same is true for those who were put on unpaid leave for more than a month. This distorts the numbers upward, although in the last quarter the number of part-time workers – and the resulting distortion – was much smaller than in the second quarter.

Second, the majority of those who lost their job – or their full-time status – were low earners, thus the fall in the number of employees also distorted the wage index upward. This effect was less prominent in the last quarter than earlier, as well.

Third, the *number of employees* continued to decrease – by more than 2 percent – in the fourth quarter. Hence ***net real wage disbursements*** grew by 4.2 percent in the last quarter, a much less impressive pace than the nominal wage growth rate – although a significant improvement (due to lower inflation and a more moderate pace of employment loss) compared to the previous quarters.



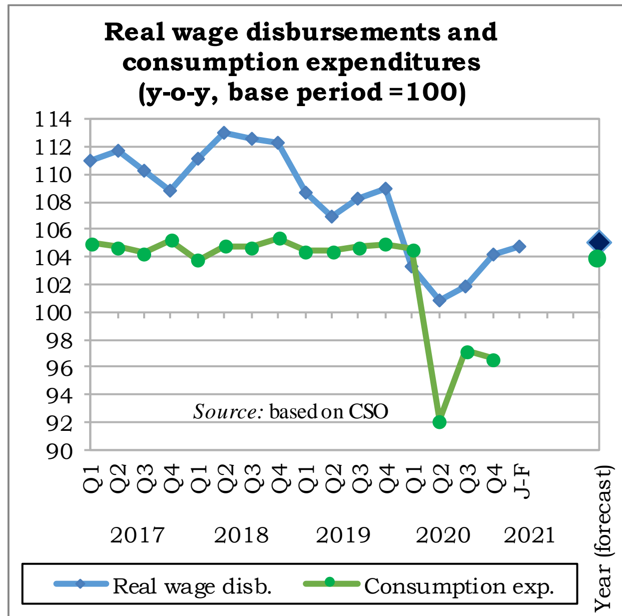
The annual average growth of net real wage disbursements was 0.6 percent in 2020 according to the official statistical data, while in reality the growth rate may have been near zero.

In the first two months of ***2021***, wages continued at a surprisingly high pace, by 9.7 percent for the standard coverage and 9.4 percent for all employees. The observed wage growth defied expectations, especially since this year, both minimum wage and

the guaranteed wage minimum was raised only by 4 percent, half the rate compared to the last year.

Unsurprisingly, *public sector* wages constitute the main driver, with a whopping 13.4 percent growth, primarily a result of the large-scale raise in the wages of physicians. But even business sector wages were up 8.8 percent, which is a real surprise.

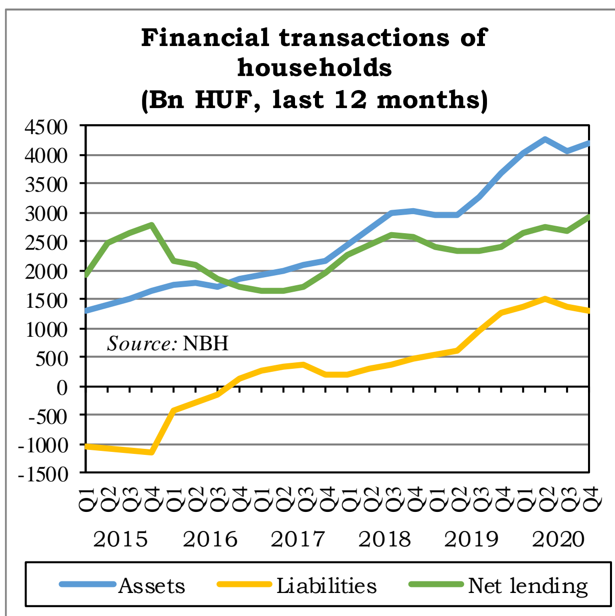
We expect wage growth to moderate over the year, with a yearly rate of 7.5-8 percent in 2021. This may lead to a real wage disbursements growth of about 5 percent, taking into account that the number of employees is expected to rise this year.

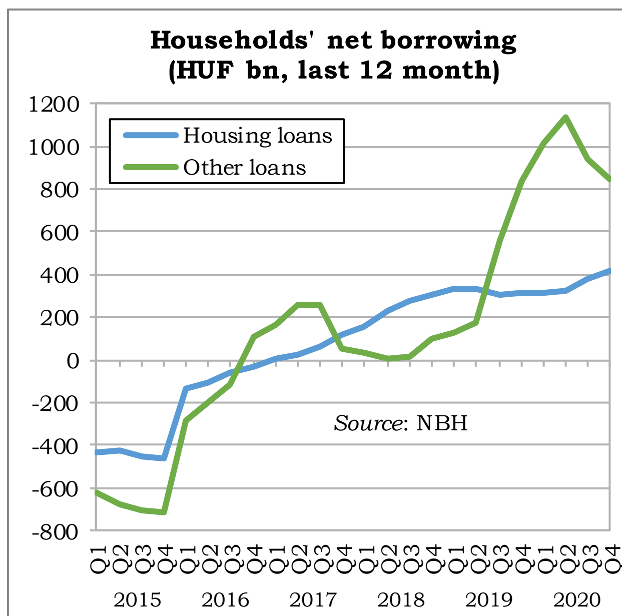


The improving trend of ***household consumption expenditures*** was interrupted by the second wave of the epidemic: after a 2.8 percent in the third quarter, the rate of fall accelerated to 3.4 percent in the last quarter. Since real wage disbursement growth also accelerated at the same time, the gap between wage growth and consumption growth widened. This, on the other hand, may be explained by the steep fall of entrepreneurial income, due to which the volume of overall ***household incomes*** may have decreased even at the end of 2020.

This year, the year-on-year growth rate of consumption will be greatly influenced by the statistical base effect, just as in the case of many other economic indicators. Due to the low base, we expect private consumption to grow by more than 3.5 percent, despite the negative growth rate expected for the first quarter.

The ***net lending*** of households reached record high in the fourth quarter of 2020, and the same is true for the last year as a whole. This is only partially due to growing gross savings – the substantial decrease of net borrowing in the fourth quarter also heavily contributed to the high level of net lending. Net borrowing decreased due to the statistical





base effect, that is, the record level of borrowing in the second half of 2019, a result of the popularity of the then newly launched prenatal baby support loan.

The four-quarter cumulative net savings rate (as a percentage of GDP) climbed upward and reach 6.1 percent by the end of 2020, after the 5 percent in end-2019. In the fourth quarter alone, the savings rate was outstandingly high, 7.8 percent.

3.2.2. Investments

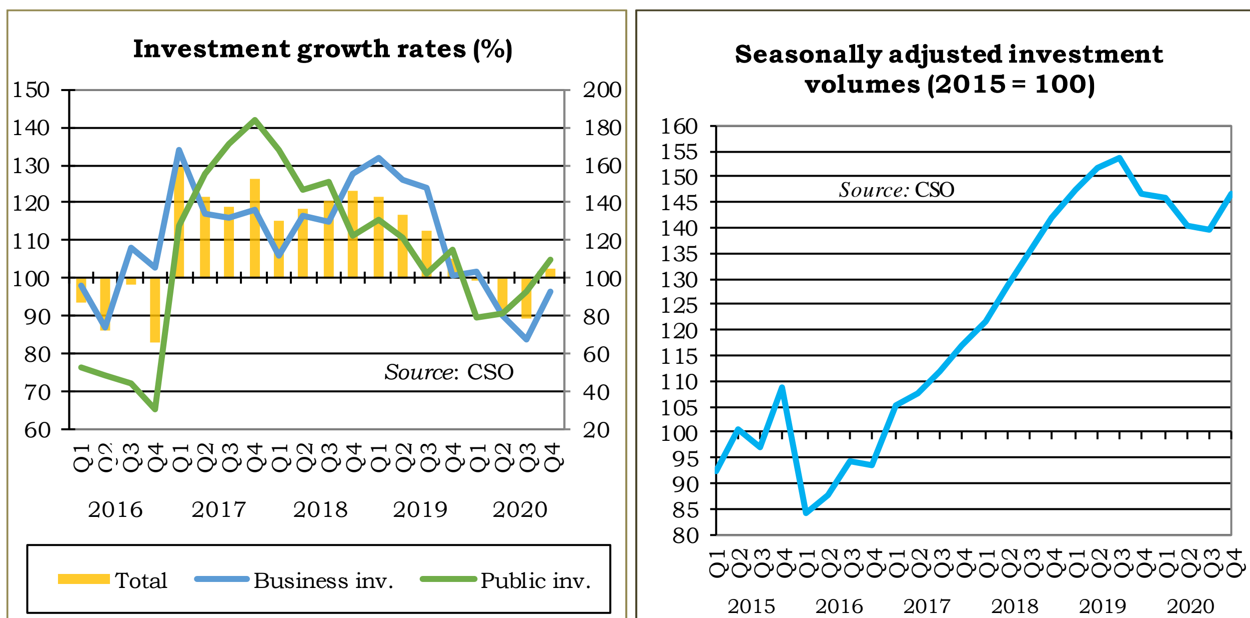
In the last quarter of 2020, a spectacular turnaround of investment trends occurred: investments rose by 2.5 percent, after the two-digit fall in the third quarter. Despite the modest pace of growth, this was a positive surprise. According to the seasonally adjusted data, the volume of investments was virtually the same as in the first quarter – that is, before the outbreak of the crisis. Both investments in buildings and investments in machinery grew in the fourth quarter.

While an improvement was observed in the case of investments of medium and large firms as well – a deceleration of decrease to 3.6 percent – the positive growth was due to a sudden jump in public investments and in the fast growth of household investments. Public investments were up 10.1 percent on an annual basis. Investments in public administration, education, healthcare and arts-entertainment uniformly *at a rate above 20 percent* in the last quarter. The latter is mostly due to investments in competitive sport.

As opposed to soaring investments in the budgetary sector, the picture is mixed in the case of so-called quasi-fiscal sector, for example because of the decline of investment into transport infrastructure – which is due to the phasing-out of the previous development projects and the dearth of newly started projects.

Private business investments began to decrease in the majority of economic branches, including the one with the largest weight, manufacturing. But despite negative growth, the year-on-year indices improved in most branches, and this applies to manufacturing as well, just as the other three major sectors: real estate, transport and storage and wholesale and retail trade.

Within manufacturing, investments continued to fall in a number of sub-branches – including the dominant auto industry – but in some areas (electrical machinery, pharmaceutical industry, food industry) investments started to grow. Real estate investments continuously grew in 2020, but in the fourth quarter the growth rate surpassed 20 percent. According to the CSO, this is due to housing construction, although this is somewhat puzzling: other data sources suggest that only *finished*

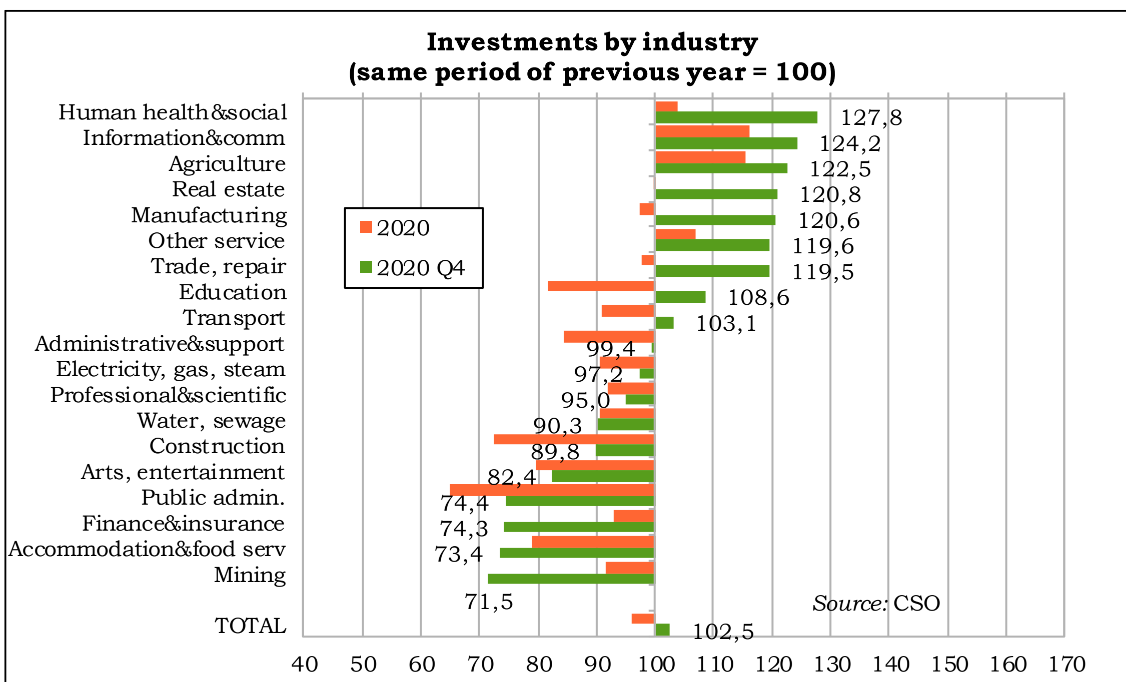


housing projects grew spectacularly, the magnitude of ongoing housing construction did not.

Among the less prominent areas, investments grew drastically in the info-communication sector and in construction but fell steeply in agriculture.

It should be noted that – according to the CSO – business investments continued to decrease due to the passivity of foreign-owned companies. This is somewhat puzzling, considering that these firms are more typically engaged in export activity and the markedly improving external demand conditions should, in theory, give a favorable background for investment.

Due to the positive growth in the fourth quarter, annual investments declined only by 3.8 percent in 2020, much less than originally expected. In **2021**, we expect investments to grow at a good but not outstanding pace – by about 8 percent – with some further acceleration in the next year. Public investments will probably drive this year's investment growth, helped by the improving sentiment in the business sector. In the economic sectors that had been hit heavily by the crisis, investment growth may be dampened by elevated debt levels and the eroded financial standing of many firms, even the immediate effect of these problems is cushioned by the continuation of expansive credit policies.



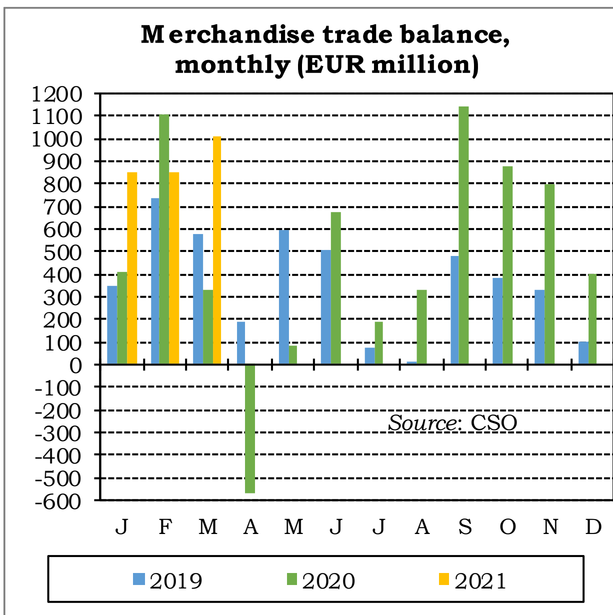
3.2.3. External trade

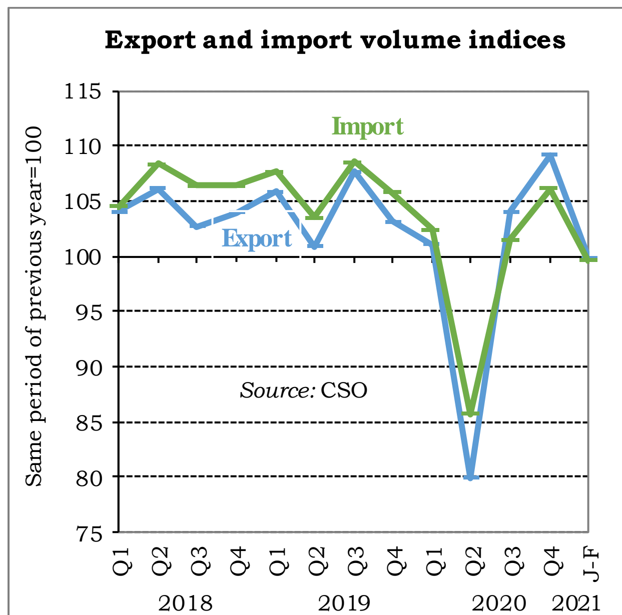
The external trade flows recovered much faster than originally expected, and the export of goods grew by about 4 percent in the third quarter and more spectacularly, by 9.2 percent, in the fourth quarter of 2020. Import recovered, too, although its year-on-year growth rate in the fourth quarter was relatively moderate, 6.1 percent. As a result – while in mid-2020 the threat of a tumultuous fall of net export loomed large – eventually the annual value of the trade surplus in 2020 was EUR 5.8 billion, *34 percent higher* than in the previous year.

While during the first wave of the pandemic the export of machinery and transport equipment was hit the hardest, by the fourth quarter the export of this main group soared at a double-digit rate.

In the first two months of 2021, the volume of both export and import basically stagnated – with great month-to-month fluctuation but probably skyrocketed in March, based on the preliminary data. And this was, in most part, not just a result of the statistical base effect: external trade flows did not really plunge before April 2020. In any case, the first quarter as a whole saw an almost 47 percent growth of external trade surplus in euro terms.

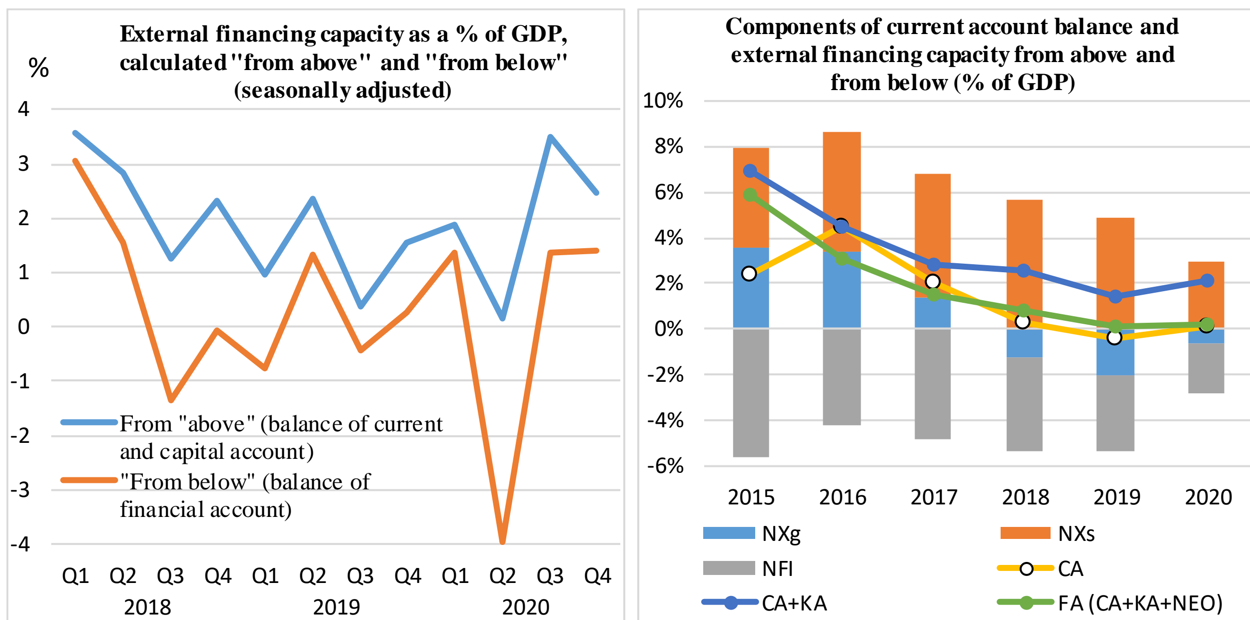
We do not expect this steep growth of trade surplus to continue: with consumption and investment recovering over the year, import growth is expected to catch up to export growth. While in 2021 the euro-denominated net export will probably surpass the level seen in the last year, the annual growth rate is expected to be moderate.





3.2.4. Balance of payments

While there was no major change from 2019 to 2020 in the most important two indicators regarding the external financial position of Hungary – the external financing capacity as a percentage of GDP, calculated "from above" and "from below" (that is, the combined balance of current and capital accounts on the one hand and the balance of the financial balance on the other[1]) – these indicators wildly fluctuated from quarter to quarter. The chart below (based on the seasonally adjusted numbers calculated by the NBH) shows that the modest improvement in the first quarter was followed by drastic deterioration in the second[2], which in turn gave way to an even more spectacular improvement in the third quarter.



Source: NBH

Codes: CA (current account) = NXg (net export of goods) + NXs (net export of services) + NFI (net income); KA: capital account; CA+KA: external financing capacity from above; NEO: net errors and omissions; CA+KA+NEO: external financing capacity from below (financial account balance).

This demonstrates the close correlation between the changes in the external balance and the general economic developments which were decisively affected by the Covid pandemic and the policy response to it.

The relative stability of the annual external financing capacity calculated above in 2019 and 2020, however, was a combined effect of significant shifts in the components of the indicators, as shown in the right-hand chart below.

While the current account returned to balance in 2020 from the moderate deficit in 2019, all of its three components changed considerably. The most striking change is the

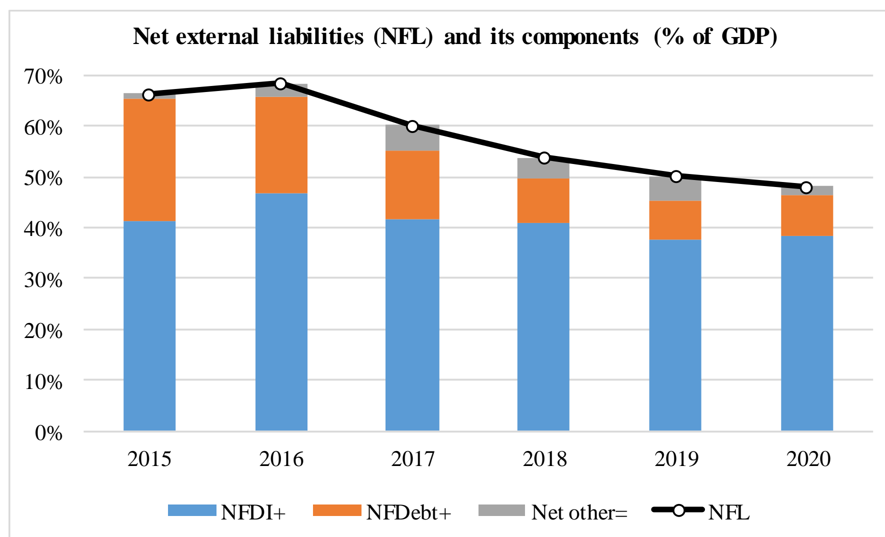
[1] The difference between the financial account – which includes the components of the external financing of the economy – and the combined balance of current and capital accounts is the „net errors and omissions" (that is, the statistical discrepancy).

[2] The terms „improvement" and „deterioration" do not express a value judgement; they are used in the usual descriptive way (the decrease of deficit and increase of surplus is „improvement" while their opposites constitute a „deterioration").

marked decrease in the deficit of incomes that was primarily caused by the fall in the profits of the foreign-owned companies.

The negative balance of goods moderated as well since the fall of import, due to decreasing domestic demand, exceeded the fall of export, a result of decreasing international demand and the bottlenecks along the production chains. The combined balance of incomes and goods improved by 2.5 percentage points, more than offsetting the deterioration of net services (by 2 percentage points), a result of plummeting tourism revenues. The combined result was an improvement in the GDP ratio of current account, by 0.5 percentage point.

Since the capital account balance-to-GDP ratio remained largely unchanged – a surplus of about 2 percentage points – the combined current and capital account balance also rose by 0.5 percentage points, to 2 percent of GDP. Since the negative balance of errors and omissions rose by 0.5 percentage points, however, the financial account balance did not improve in 2020 but remained close to zero, similarly to the current account balance.
Source: NBH
Codes: NFDI: net FDI inflow, NFDebt: net external debt



The *stock* of net external liabilities, as percentage of GDP, remained relatively stable, just as its main components: neither net FDI, nor the stock of net debt changed significantly. Only the stock of “other net liabilities” decreased, which mostly reflected a decrease in the stock of shares, held by foreigners, that represents a holding of less than 10 percent, thus does not qualify as FDI.

Behind the relative stability of the net stocks, however, some substantial shifts took place between the gross components. The gross external debt of Hungary (excluding direct investment debt instruments) soared from 51.5 percent of GDP in 2019 to 58 percent of GDP in 2020, reversing the improving trend that went on uninterrupted from 2009 to 2019. The surge in 2020 was primarily due to the FX bonds issued by the government, while the net external debt could remain almost unchanged because the FX reserves surged almost as much as the stock of gross debt.

In 2021, the combined current and capital account balance is expected to moderately improve, reaching a surplus of 2.5 percent of GDP.

3.2.5. Employment, unemployment

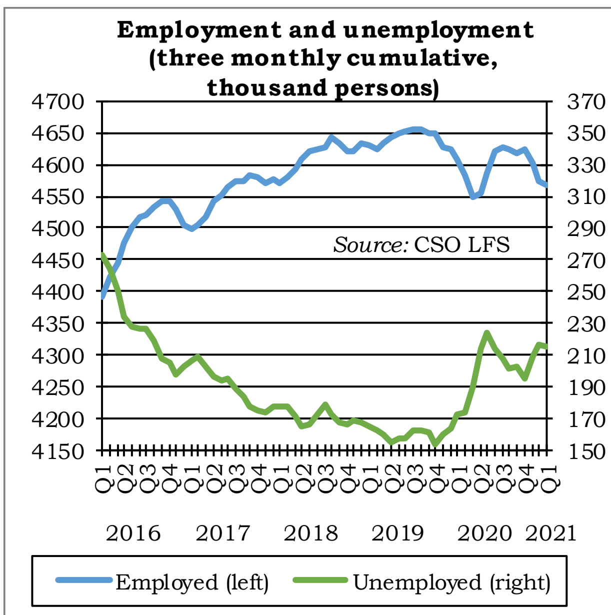
According to the labor force survey (LFS) data, the improving trend of the third quarter of the last year was interrupted in the fourth quarter and was turned into a deterioration in the first quarter of 2021. In both the third and fourth quarter of 2020, the pace of decrease in the number of employed moderated to 0.6 percent, but it accelerated again in the first quarter of this year, to 0.9 percent.

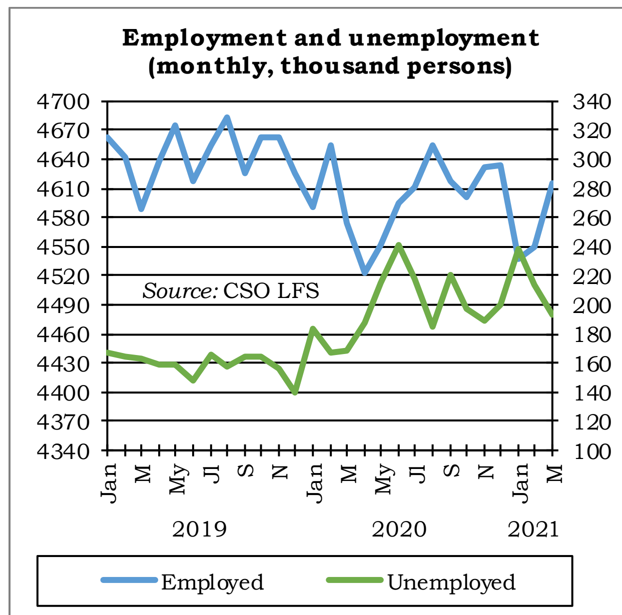
The monthly data shows more clearly the changing dynamics in the recent months: by January, the number of employed dipped to a level close to the low point registered during the first wave but recovered in March. The changes in the number of unemployed were approximately mirrored the changes in employment. This suggests that the negative employment effect of the second wave was significant but relatively short-lived. Interestingly, there is no indication of the third wave and the additional lockdown measures introduced around mid-March in the March employment data.

The *unemployment rate* rose back to 5 percent in January but decreased afterward, to 4 percent in March.

It can be seen from the data that both in the last quarter of the last year and the first quarter of 2021, the year-on-year decrease in the number of employed was due to the decrease in the number of workers employed abroad and public workers. This implies that, surprisingly, the domestic labor market remained virtually unaffected by the second wave of the pandemic, while a significant part of people working abroad lost their jobs.

In any case, we expect that joblessness remains a problem in the coming month but year-on-year indicators will improve, due to the lower employment levels in the basis period from April, and also due to the fact that the government started reopening the economy in mid-April. Still, we expect the number of employed to climb by less than 1 percent in 2021, while the annual unemployment rate may decrease to 4 percent (from the 4.1 percent seen in 2020).





3.3. Fiscal, monetary and financial developments

3.3.1. Fiscal developments

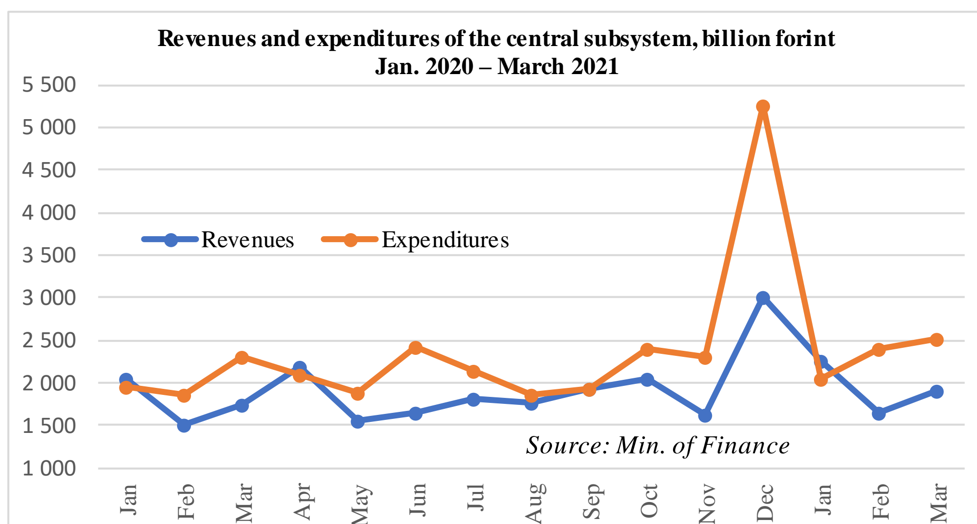
The 2020 budget

Due to the restrictions introduced as a response to the Covid epidemic, the seasonally and calendar adjusted Hungarian GDP fell by 4.8 percent in the third quarter and by 4.1 percent in the fourth. After the temporary easing of the epidemic during the summer a second wave arrived in the autumn and a third in early in March 2021. The great uncertainty regarding the trajectory and the impact of the epidemic was – and still is – reflected in fiscal developments and economic policy as well. The worldwide phenomenon of fiscal policy becoming more prominent, due to the declining efficacy of monetary measures, can be observed in Hungary as well.

According to the data published by the Hungarian Treasury, the cash-flow deficit of the central budget increased by a factor of 4.5, to HUF 4594 billion, by the end of 2020. Taking into account the surplus of the extrabudgetary funds (HUF 47 billion) and the deficit of the social security funds (HUF 462 billion), the combined deficit of the central subsystem was HUF 5549 billion in 2020, which is 15 times the original target, 1.5 times of the modified target announced in last August, and amounted to 11.7 percent of GDP.

On a monthly basis, the balance of the central subsystem fluctuated widely. There was a surplus in January and April, a minimal deficit almost akin to equilibrium in September and a slight deficit in August, which was in accordance to the numbers seen in the preceding years. In the other months until November, the deficit fluctuated between HUF 324 and 786 billion. But in December, the deficit soared to unprecedented high, HUF 2250 billion, which alone amounted to 40 percent of the annual deficit. According to the Hungarian Official Gazette, the government distributed HUF 860 billion, for a wide variety of purposes, from the central budget in 24 December alone.

As for the components of the fiscal balance, central budget revenues grew in nominal terms by 7 percent in 2020, while real GDP fell by 5 percent (nominal GDP remained approximately the same). Within the payments of enterprises, the revenue growth was primarily due to the corporate tax and the surtax on financial institutions, but the surtax on energy suppliers, the gambling tax and the tax on small corporations yielded



increased revenue inflow as well. Revenues from VAT, the largest item within taxes on consumption, increased by 3 percent. Regarding the payments of households, PIT revenues were up 4.3 percent. Besides, the increase of revenues from EU programs was significant. On the other hand, revenues decreased in the case of simplified business tax, mining allowance and contribution to tourism development, due to government measures aiming at cushioning the effects of the crisis. The monthly breakdown of revenues suggests that by the last quarter of 2020, firms largely adjusted their operation to the crisis.

Part of the increase in VAT revenues was due to the unexpected surge in inflation. The 2020 budget was originally calibrated to an inflation of 2.8 percent, but the actual outcome was an inflation of 3.3 percent. PIT incomes got a boost from the 9.8 percent hike of the wages of full-time employees. Corporate income revenues rose due to the good results in 2019. The fluctuation from month to month, and the changes in the related regulation obscure the picture. Revenues from the EU got a boost from the weakening of the forint against the euro. The original budget envisaged an exchange rate of 320 EUR/HUF, but instead, the actual outcome was 351.2 EUR/HUF.

All this suggests that the jump in the deficit is not due to a drop in revenues. Corporate tax revenues may drop, however, this year, since the profitability of firms deteriorated in 2020.

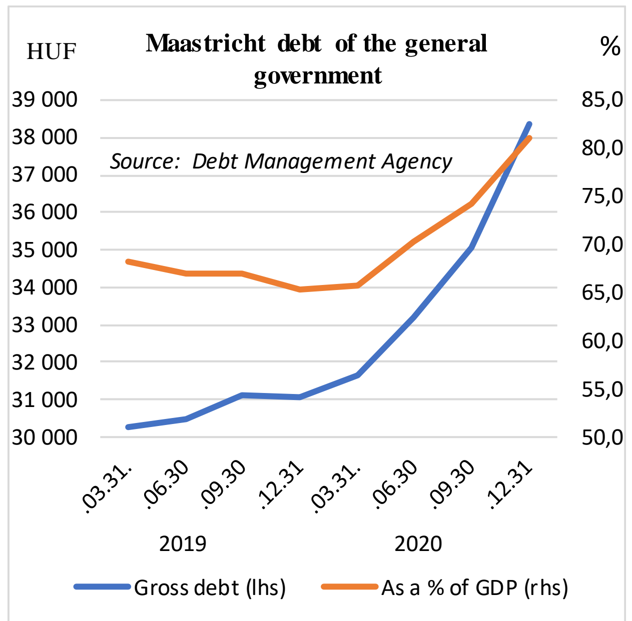
The expenditures of the central budget were up 31.7 percent and exceeded the original target by 41 percent. In April 2020, the government launched the economic protection fund with a budget of HUF 923 billion that was later increased several times, reaching HUF 3944 billion by the end of December. Much of this, however, was not new funding: many formerly existing items, with different original name, was included in this new fund as well. The actual spending directly on crisis management amounted to HUF 409 billion, in the form of investment subsidy for large enterprises, guarantee program, job saving support schemes, help for the food sector. It is doubtful, however, whether the HUF 240-250 billion spent on sport-related investments (stadium and gym hall building projects, etc.) and the HUF 82 billion spent on the Budapest-Belgrade railway line is an effective tool in combating the crisis.

Regarding the outlook for this year, data on the first quarter is available. In January-March, the central subsystem posted a deficit of HUF 1144 billion, which is 77 percent of the annual target. A significant part of the deficit is due to the fact that the HUF 151 billion revenue related to EU programs is nowhere near to the HUF 616 billion expenditures related to the EU programs. The bulk of these expenditures was spent on the operative programs of the 2014-2020 period. Also, the first step of reintroducing the 13th-month pension, a sum proportional to one week, was transferred in February. In addition, HUF 68.2 billion was spent on measures aimed at countering the coronavirus epidemic.

According to the annual financing document of the Hungarian Debt Management Agency (ÁKK), published in December 2020, the cash-flow deficit of the central subsystem is envisaged to reach HUF 3332 billion in 2021, and the debt-to-GDP ratio is to stand at 6.8 percent of GDP.

But the actually relevant indicator is not the cash-flow deficit but the accrual-based deficit of the general government, calculated according to the EU methodology

(ESA2010). Due to the crisis, the EU institutions suspended for an indefinite period the rule that the deficit cannot exceed 3 percent of GDP. According to the CSO, the accrual-based deficit of the general government was HUF 3870 billion, 8.1 percent of GDP in 2020, as opposed to the 2.1 percent seen in 2019. This exceeds the EU average by more than 1 percentage point. The Ministry of Finance predicts a deficit of 6.5 percent for this year. (The deficit of local governments, as a percentage of GDP, is marginal.) In its March inflation report, the NBH predicted a deficit of 6.5-7 percent. The European Commission's forecast in October 2020 predicted a smaller deficit amounting to 5.4 percent of GDP.



Apart from the more substantial reduction of expenditures and a more moderate reduction of revenues, the strong positive growth of GDP (3.5 percent according to the government projection) is expected to be the main factor behind the decrease of deficit-to-GDP ratio in 2021. The reduction of the nominal deficit will be secondary. The fiscal projections are based on the fiscal measures known so far. Further fiscal steps may naturally alter the fiscal outlook.

The possibility of a more dynamic GDP growth poses a positive risk regarding the deficit-to-GDP ratio. (By the way, the 2021 budget envisaged a GDP growth of 4.8 percent, which is more optimistic than the present government projection.) This, however, is uncertain, considering the additional lockdown measures introduced as a response to the third wave of the epidemic. Another positive risk is the inflow of the EU funds. It is not still known how much Hungary will receive in 2021 from the EU under the aegis of the 2021-2027 programming period and under the Next Generation EU program, particularly from the recovery and resilience facility. Even under a positive scenario, disbursements will not begin before the second half of 2021, hence their effect on the fiscal trends will be limited. The nonrefundable grants amount to EUR 6.27 billion, which approximately equals HUF 2200 billion. The disbursements are conditional, hence the negative risk that the EU institutions do not accept the projects forwarded by the government, resulting in a decrease in the funds available or the postponement of their availability, exists as well.

Fiscal debt

According to the data of the Hungarian National Bank, the gross consolidated nominal government debt was HUF 38.408 billion at the end of last December – that is, 80.4 percent of GDP – if the debt of Eximbank is included. This constitutes a growth of 15 percentage points compared to the 65.4 percent registered at the end of 2019. This growth, a result of the large public deficit and the evolution of nominal GDP on the one hand, and an increase of the liquid reserves of the government and the revaluation of the stock of debt on the other, is about halfway between the average of the developed

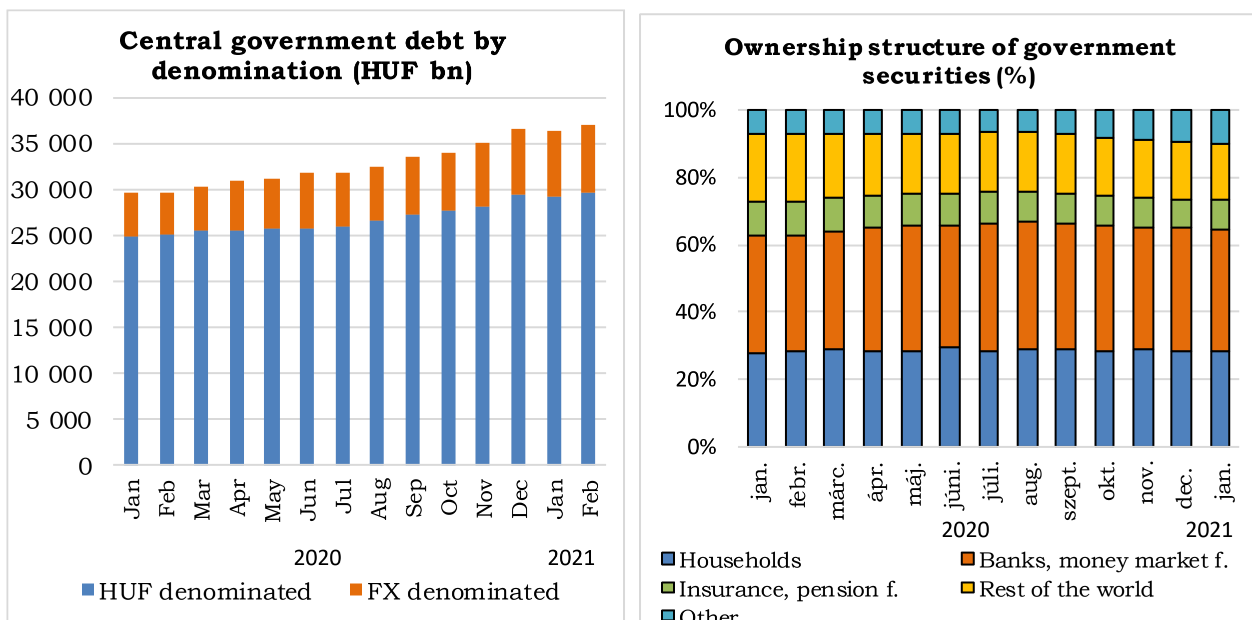
countries and the developing countries, according to the IMF data. Due to the coronavirus crisis, the debt ratio, that was on the decrease since 2010-2011, changed direction in 2020.

Hungary's credit rating has been in the low-medium category since 25 September 2020, in terms of both FX and HUF debt, in the ranking of all three major rating agencies, with a stable outlook in the case of Standard & Poor's and Fitch Ratings, and a positive outlook in the case of Moody's regarding HUF debt. In its forecast published in 12 February, S&P predicted a GDP growth of 4.6 percent in 2021, while Fitch predicts 4.9 percent. But the sanguine growth projections notwithstanding, neither has amended either Hungary's rating or the outlook. Although the agencies continually evalue the debt of each country, neither upgrade nor downgrade is likely in the short run.

In 2020, the former trend of increasing role of households, the sector which the government deems the most stable buyers/investors, reversed course: their share in central budget debt decreased from 31.1 percent in end-January to 25.7 percent in end-December. Much of this was due to the expiration of retail government securities that were held by other institutional investors. The Hungarian Government Security Plus, one of the retail securities with the highest yield, attracted most of the retail security purchases.

The trend of decreasing share of FX debt halted at the end of February 2020, at 15.3 percent, and the share rose to almost 20 percent by the end of December. In end-March 2021, it stood at 18.5 percent. FX debt was increased by a HUF 353.6 billion issue of euro bonds with a maturity of 6 years in April 2020, the issue of the first Hungarian green bond (HUF 518.4 billion) in June, a HUF 180.3 billion issue of yen-denominated Samurai bonds in September, and the issue of two types of pre-financing bonds with maturities of 10 and 30 years, to a total amount of HUF 895.2 billion. Also, the government issued euro bonds for domestic buyers to the amount of HUF 50.2 billion and drew down a FX loan of HUF 547 billion. At the same time, the repayment of HUF 1158 billion of existing FX loans reduced the stock of FX debt.

We estimate that public debt is likely to remain around 81 percent of GDP in 2021. The interest rate cost amounted to 2.6 percent of GDP in 2020, making debt relatively cheap.



Assuming that the present low-interest and low-inflation environment remains, the cost of debt financing will remain relatively low, which makes it possible to postpone resolute fiscal consolidation measures. In any case, the rise of domestic government yields poses a negative risk too debt financing.

Taking into account debt maturities, repayments and pre-financing, the December 2020 publication of the Government Debt Management Agency (ÁKK) envisages a gross sovereign debt issuance of HUF 8965 billion in 2021, which amounts to 17.2 percent of GDP. Forint-denominated securities will make up 94 percent of this amount, leaving a 6 percent share to FX securities. According to the plan, retail securities will make up nearly 40 percent, which means that the ÁKK intends to finance the debt from domestic sources, primarily from household savings. Also, ÁKK seeks to increase the average maturity of government securities, the planned issuance of green bonds is a means to achieve this aim. There is no plan to issue international FX bonds – FX financing will consist of drawing down EUR 1 billion worth FX loan while other FX borrowing (for example, FX-denominated retail bonds) will amount to EUR 0.5 billion. 36 percent of the drawdown has already been implemented in the first quarter of 2021.

According to the of the ÁKK plan, the net financing requirement of the central government is HUF 3332 billion. The government continues to rely on households and plans to issue at least HUF 1000 billion of retail government securities. The aim to increase the stock of retail securities to HUF 11 billion by 2023 is still valid. At the end of February 2021, the level of retail securities stood at HUF 9355 billion. The sales of bonds at switch auction program is planned to be expanded to HUF 1500 billion in 2021, to, expand the average maturity of the existing debt, and the issuance of a new green bond from the second half of 2021. The ÁKK aims at gradually increasing the maturity and smoothing the maturity structure. 37 percent of the yearly primary issuance target has already been fulfilled. Liquidity reserves amounted to about 5.5 percent of GDP at the end of March 2021.

A possible drawback of forint-denominated financing compared to FX financing is the higher cost. Under the present favorable conditions, the FX bonds could be sometimes issued at a lower interest rate than forint HUF bonds. But a depreciation of the forint can easily cancel out the interest cost saving. The higher interest cost is a price of the reduction of exposure to shocks from the world economy.

The same applies to financing the public debt by issuing retail bonds. The higher interest rate offered to households increases the cost of this mode of financing, and also makes the financial market more fragmented, reduces the efficiency of the banking system due to the large interest rate and yield differences.

Finally, the evolution of household savings is a possible point of risk. A surge in consumption during the recovery from the crisis may reduce household savings.

3.3.2. Inflation

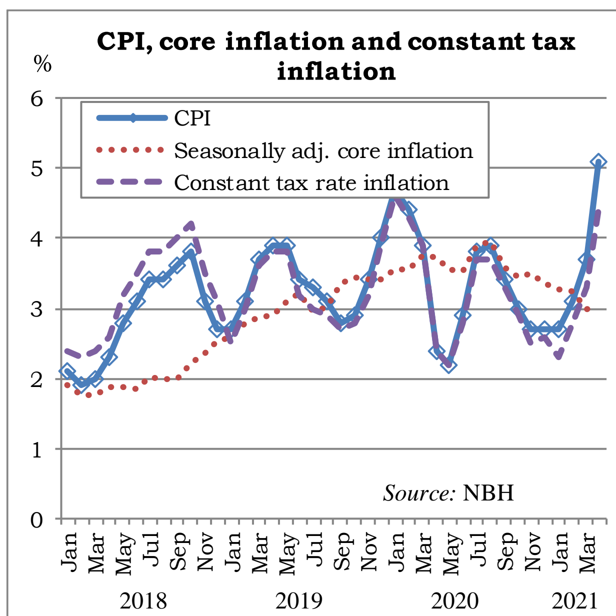
In 2020, consumer prices rose by 3.3 percent, in accordance with our winter forecast. But this made the Hungarian annual rate the highest in the European Union, slightly ahead of Czechia. While Romanian inflation was formerly high as well, in 2020 the annual rate was only 2.3 percent.

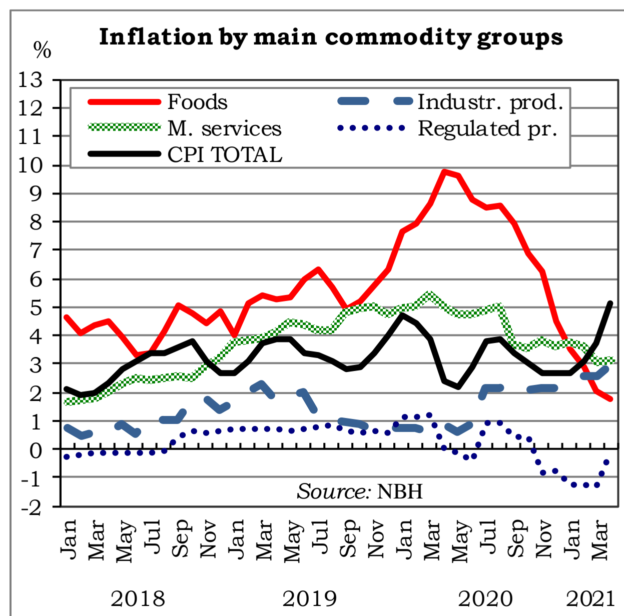
From last November, the inflation rate dipped below 3 percent and remained there until January 2021. In February, however, it rose above 3 percent again, and after continuing acceleration it reached 5.1 percent in April. It may moderate afterwards, possibly below 4 percent, but by the end of the year it will reach 4.6-4.8 percent again. As a result, we predict an **annual inflation rate of 4.1 percent in 2021**. The upward risk is significant, however – an annual rate above 4 percent cannot be ruled out, even if at present we do not deem this the most likely scenario.

In 2020, *food prices* were the foremost driver of inflation, with a price index of 7.3 percent. Food price inflation peaked in April at 9.8 percent and gradually eased afterwards. The towering food price indices in the late spring and early summer was partly due to particularly unfavorable weather conditions and weak fruit yields, but the temporarily decreasing price sensitivity of household during the first months of the lockdown measures – due to the fears of a disruption of food supply – probably played a role as well. Such a drop in price sensitivity is certainly not in the cards this year, as households have already established their alternative ways to acquire food, the home delivery supply can also put a cap on food price surges.

Tobacco and alcoholic beverages, on the other hand, may become an important inflationary factor, due to the repeated raise of the tax component of the prices of these goods.

Fuel prices are another major driving force. In the first four months, fuel prices, fueled by rising global oil prices, had an outstanding role in the inflationary surge. Since we do not expect further significant oil price hikes, the upward pressure from fuel prices is likely to ease in the remainder of the year.

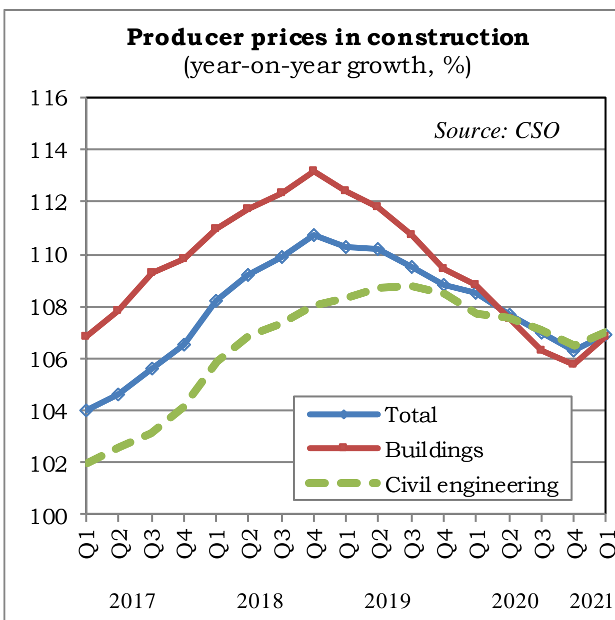


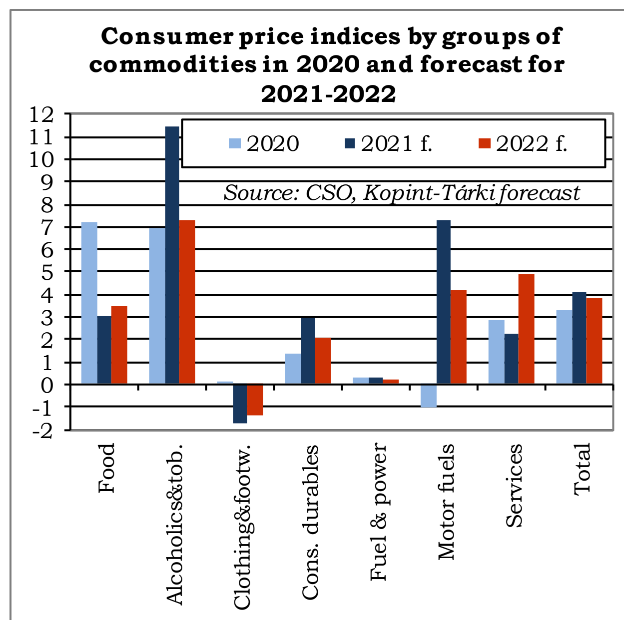


The prices of *consumer durables* began to accelerate from the autumn of 2020, mostly because of the weakening of the forint. While the continuous weakening trend interestingly failed to affect consumer durable prices for a relatively long time, it began exerting a pressure on durable prices from last fall. As a result, by February the price index of consumer durables reached 3.8 percent, although it moderated somewhat afterwards. Our inflation forecast assumes that the upward pressure from consumer durables remains moderate, but in case of another weakening spell this assumption may prove false. This possibility poses an upward risk.

It is hard to give a forecast regarding the prices of *market services*. It is unclear how the easing of restrictions will affect demand for consumer services, and how this change in demand will affect the prices of services. On the one hand, it is possible that service providers try to compensate for their losses suffered in the past year by raising prices. On the other hand, it is not yet known how households will respond to the reappearance of various consumer options that were not available during the crisis. In all likelihood, an element of sudden appearance of delayed consumption demand will be seen, but caution among the households shaken by the crisis will probably keep influencing consumer behavior as well. Another question is whether the government reintroduces the parking fee, suspended in April 2020, before the end of this year. If it does then that may raise the annual inflation rate by a couple of tenths of a percentage point.

In 2022 we expect the inflation rate to decrease to 3.8 percent.





3.3.3. Financial and capital markets

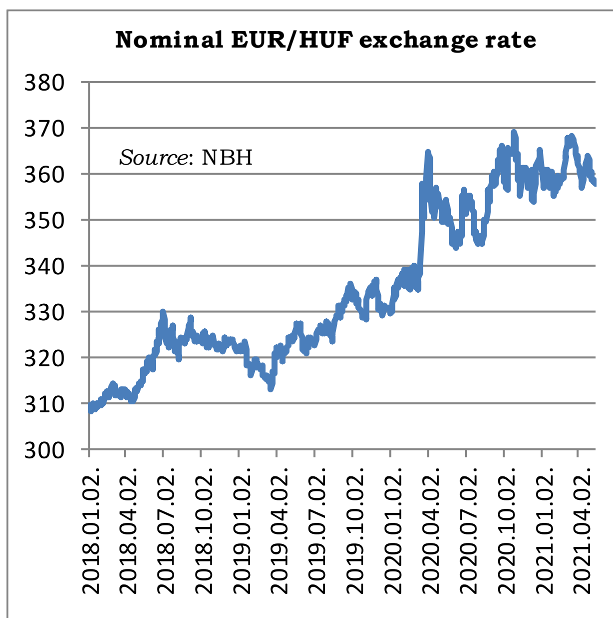
Exchange rate

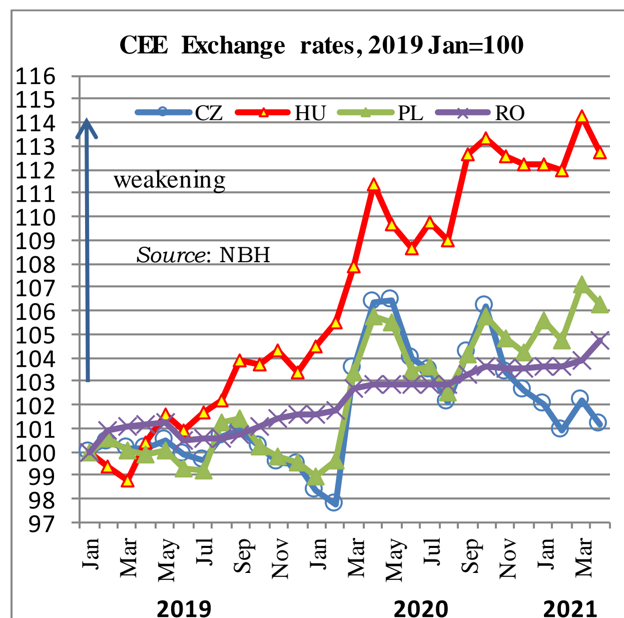
The forint has been on a weakening trajectory against the euro for years, to varying degree, due to external and internal factors. The most important external factors are: global fears regarding the pandemic and its economic consequences, changes in the EUR/USD exchange rate, the global expectations regarding inflation, interest rate policies, financial and capital market yields. As for the internal factors, the comparatively lax monetary policy stance and the relatively high inflation should be mentioned.

Compared to January 2020, the monthly average EUR/HUF rate weakened by 7.9 percent by April 2021. This is comparable to the weakening of the Polish zloty during the same period (7.4%) but much more drastic than in the case of the Czech koruna and the Romanian leu (2.9% and 3%, respectively). While the general trend was similar, at least until late 2020, in the region, the differences in the degree of depreciation may reflect the effect of internal factors. In March, the monthly average EUR/HUF rate weakened to a new record level (365.6), but partially recovered afterwards.

In the short run, the NBH has various means at its disposal to stabilize or strengthen the forint exchange rate (one-week deposit rate hike, swap tools, etc.). While the NBH does not have a declared exchange rate target, it monitors the exchange rate tendencies. While a definite prediction is not possible, we do not deem it likely that the NBH lets the annual average exchange rate against the euro rise above 370 EUR/HUF, a line that can be considered as a psychological boundary beyond which the behavior of domestic and foreign players becomes more unpredictable. An exceedingly weak forint would hinder the NBH in achieving its inflation target as well. The question is, which level of reference rate would be optimal for both the exchange rate and the inflation rate on the one hand and conducive for economic recovery as well on the other.

The normalization of the global economic environment – assuming that the various risks do not seriously disrupt it – can be a stabilizing external factor regarding the forint exchange rate. As for the internal factors, the forint may benefit from the expected improvement in the current account balance and the inflow of significant EU





funds that improves the external financing capacity and boosts the stock of international currency reserves, Through rising reserves, the EU funds protect from speculation against the forint as well.

Government bond yields

Government yields were shaped by changes in the “risk appetite” of investors and the response of major central banks to the economic consequences of the coronavirus pandemic, and the domestic monetary policy responses. The monthly average yields increased between January and December 2020, but this trend was accompanied by wide monthly fluctuations. Short-term movements were especially hectic on the short end of the yield curve. For example, the yield of 3-month government securities rose from 0.03 percent in January 2020 to 0.28 percent in December, but between the two dates, the yield stood as high as at 0.95 percent in April or as low as at 0.18 percent in June.

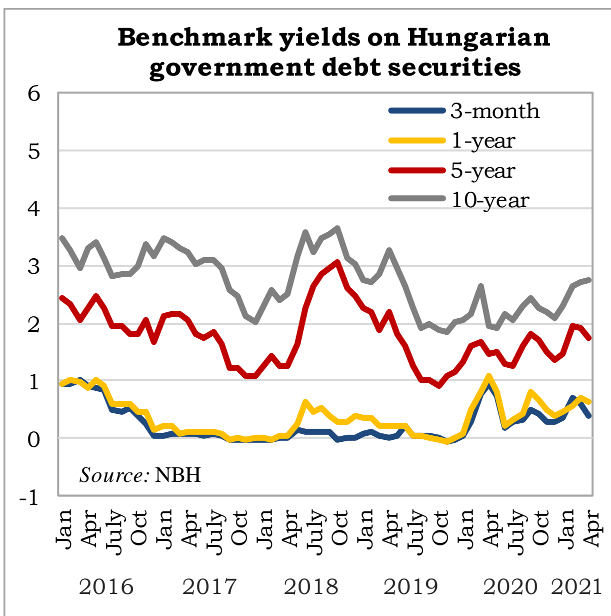
The rising trend continued in the first months of 2021: between December and April, the 3-month yield rose to 0.39 percent in April, while the 10-year yield rose to 2.74 percent. According to the NBH communication, the asset purchase program will be continued as long as it is warranted in the light of the economic and financial reverberations of the pandemic. Through strengthening the monetary transmission, this program serves as a kind of safety net on the government security market.

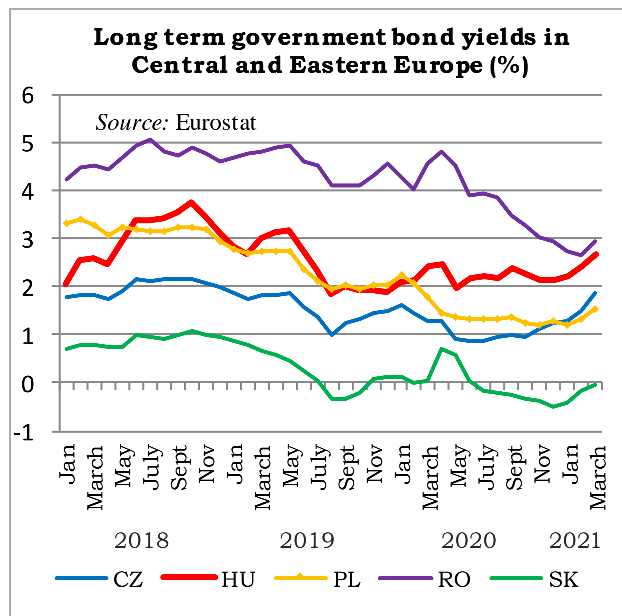
In the region, the 10-year yields – according to the EU convergence criterion – rose between last November and April 2021, with the exception of Romania. The Hungarian long yield continued to be higher than the respective yield in Czechia, Poland and Slovakia. What is more, after the rise in recent months, the Hungarian yield came close to the traditionally higher Romanian yield.

3.3.4. Corporate and household lending

Corporate lending

The restrictive measures aiming at countering the epidemic and the uncertainties regarding the economic prospects markedly affected corporate lending in 2020.





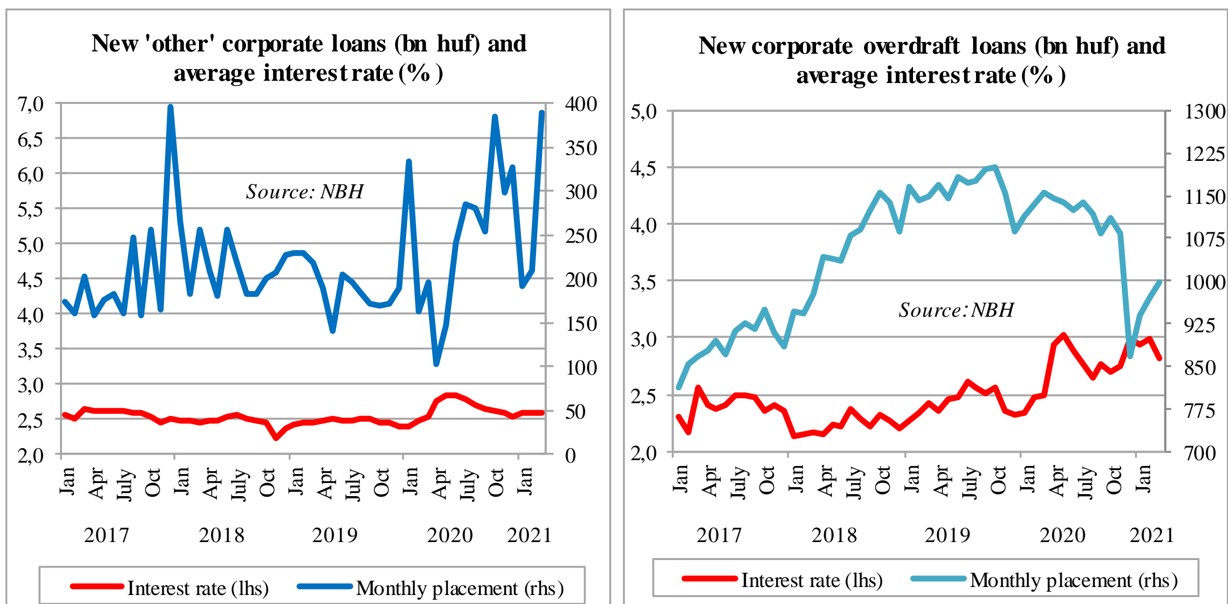
According to the NBH statistics, the total value of outstanding corporate loans dipped by HUF 166.5 billion in the second quarter of 2020 as a combined effect of the provision of new loans and repayment of existing loans, with an even higher fall in FX loans and a slight increase in HUF-denominated loans. In the second half of the last year, on the other hand, forint loans recovered and increased at a good pace while the stock of outstanding FX loans decreased.

Apparently, the enterprise sector adapted to the new conditions in the second half of the year, after the initial shock of the second quarter, hence corporate lending could recover. The stock of corporate loans provided by monetary institutions was 12.8 percent higher in December 2020 than at the end of 2019, a slight acceleration of year-on-year growth compared to the previous year. On the other hand, the structure of outstanding loans changed, the share of FX loans decreased to 38 percent (from 45 percent in end-2019), which was probably a result, at least in part, of the weakening of the forint against the euro.

The epidemic-induced cyclical fluctuations within the year had an impact on new loans as well. In April and May 2020, the monthly value of HUF-denominated “other” loans – that is, non-overdraft loans – dipped to almost HUF 100 billion, from the formerly typical level of HUF 180-200 billion, and despite the spectacular rebound in June-July, the quarterly level of new loans was 17 percent lower in the second quarter of 2020 than in the same period of the previous year. In the second half of the last year, new lending stabilized around a monthly average of HUF 290 billion.

The monthly sum of overdraft loans has been on the decrease since the peak level of HUF 1154 billion in March 2020. A possible reason for that is that the cost of overdraft loans is somewhat higher than the cost of other loans. In 2020, the cumulative sum of new overdraft loan taken by non-financial enterprises was 5.3 percent lower than in the previous year.

NHP Go!, a program newly launched by the NBH in April 2020, played a role in maintaining corporate borrowing activity: until the end of March 2021, more than 31 thousand micro-, small and medium enterprises have concluded loan or leasing contracts to the amount of HUF 2040 billion. During the months before March 2021, more than half of all new business loans and about 90 percent of new SME-loans were



provided under the NHP GO! program, according to the March inflation report by the NBH.

On the whole, the NBH expects a deceleration in the growth rate of outstanding corporate loans to about 6 percent by the end of 2022 (from about 9 percent in last December) and a subsequent gradual reacceleration to about 10 percent in the following years.

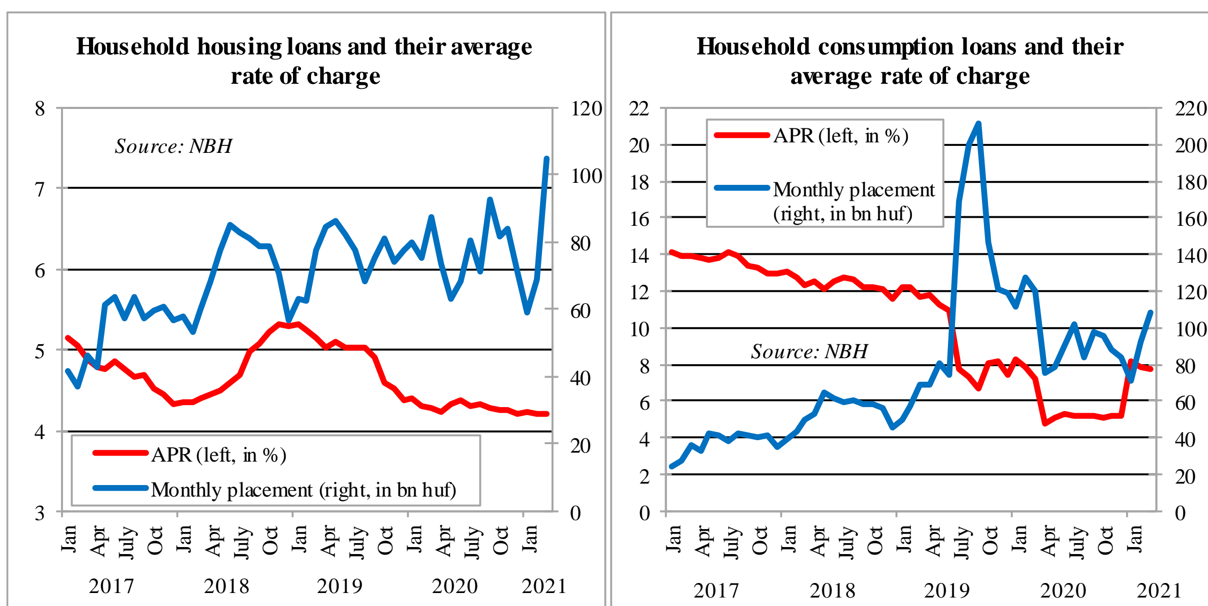
After the jump in the interest rates of "other" corporate loans in April 2020, some downward correction has taken place. After peaking at 2.83 percent in last June, the average interest rate moderated to 2.57 percent by January 2021 and remained largely stable afterwards. The fact that the loans under the NHP GO! program are granted by the commercial banks at interest rates hardly above 2.5 percent probably significantly contributed to this moderation.

Household lending

While the emergence of the pandemic affected considerable household lending, but the fall in the demand for loans was mitigated by the carryover effect of the introduction of the wildly popular prenatal baby support loan in mid-2019. Also, the loan repayment moratorium decelerated the amortization of existing loans. The combined effect of these contradictory factors was that the stock of loans kept growing in 2020 and was 14 percent higher in the fourth quarter of 2020 than one year earlier. Without the moratorium, the year-on-year growth would have been only 8 percent.

The pandemic had a more spectacular effect on the new loan contracts. Compared to the previous year, the value of new housing and consumption loans dipped by 9 percent in 2020. This is, however, entirely due to consumption loans: the latter fell by 15.6 percent while the value of new housing loans was up 1.8 percent. The monthly magnitudes of consumption loans fluctuated in accordance with the ebbs and flows of the epidemic while the trajectory of housing loans was more balanced. Within the new housing loans, the share of state-supported loans decreased to 10.6 percent by January 2021 from the 21 percent in January 2019.

This, year, the main point of risk regarding household lending is the ending of the repayment moratorium at the end of June 2021.



Economic Indicators 2012-2019 Forecast 2020-2021 (percentage change)

	2013	2014	2015	2016	2017	2018	2019	2020	2021*	2022*
GDP AGGREGATES, ANNUAL REAL GROWTH										
GDP total	1.9	4.2	3.8	2.1	4.3	5.4	4.6	-5.0	4.7	5.0
Domestic Demand	1.8	5.3	2.4	1.6	5.8	7.1	6.6	-3.0	4.5	4.7
Private Consumption	-0.1	2.1	3.6	4.1	3.8	4.1	4.6	-2.8	3.8	3.8
Public Consumption	6.0	9.8	1.1	0.3	7.5	4.1	5.6	2.8	0.0	0.0
Gross Capital Formation	6.1	12.9	-0.1	-4.1	10.8	16.2	11.3	-5.5	8.0	8.5
of which: Fixed Capital Formation	9.8	12.2	4.9	-10.6	19.7	16.4	12.8	-7.3	8.0	8.5
Export	4.1	9.2	7.4	3.8	6.5	5.0	5.8	-6.8	8.6	6.7
Import	4.3	11.0	6.0	3.4	8.5	7.0	8.2	-4.4	8.5	6.4
PRODUCTION INDICES										
Agricultural Production (gross)	12.5	11.4	-2.4	9.3	-4.1	2.7	0.4	-2.2	0.0	0.0
Industrial Production	1.1	7.7	7.4	0.9	4.6	3.5	5.6	-6.1	10.0	5.0
Retail Trade Volume	1.8	5.2	5.8	4.8	5.6	6.7	6.3	-0.2	3.7	3.8
EMPLOYMENT, EARNINGS										
Number of Employed	1.8	4.8	2.7	3.4	1.5	1.3	0.8	-0.9	1.0	0.6
Unemployment Rate	9.8	7.5	6.6	5.0	4.0	3.6	3.3	4.1	4.0	3.6
Gross Nominal Wages	3.4	3.0	4.3	6.2	12.9	11.3	11.4	9.7	7.8	7.4
Net Real Wages	3.1	3.2	4.4	7.4	10.3	8.3	7.7	6.2	3.6	3.5
PRICES, EXCHANGE RATES										
Consumer Price Index	1.7	-0.2	-0.1	0.4	2.4	2.8	3.4	3.3	4.1	3.8
EUR/HUF Exchange Rate (annual average)	297	309	310	311	309	319	325	351	365	365
EUR/USD Exchange Rate (annual average)	1.33	1.33	1.11	1.11	1.13	1.18	1.12	1.14	1.20	1.20
Short-term Interest Rates (3M), eop	2.86	1.43	0.80	0.06	-0.01	0.00	-0.01	0.28	0.7	0.7
Long-term Interest Rates (10Y), eop	5.61	3.60	3.33	3.16	2.02	3.01	2.01	2.08	2.6	2.6
BALANCE OF PAYMENTS										
Current and Capital Accounts, % of GDP	7.3	4.9	6.9	4.5	2.8	2.5	1.4	2.1	2.5	3.0
GOVERNMENT BUDGET										
General Government Balance, ESA-95, % of GDP	-2.6	-2.8	-2.0	-1.8	-2.5	-2.1	-2.0	-8.1	-6.5	-5.0
Gross Government Debt, % of GDP [a]	77.4	76.7	75.8	74.9	72.2	69.1	65.5	80.4	81.0	80.0

a Including the balance sheet of Eximbank

* Kopint-Tárki forecast

Source: CSO, NBH

ECONOMIC TRENDS IN EASTERN EUROPE

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