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I. The global economy

The **world economic situation** improved in the first half of the year: both the growth indices and the confidence indicators showed an upward trend. The pandemic-related restrictions primarily affected the service sector, while industrial production and world trade are riding a conjunctural wave. There are bottlenecks, primarily in the area of the supply of raw materials and parts and components, which may hinder output growth. The capacity constraints and the sudden upturn of demand for industrial products pushed upward the prices of raw materials – in this segment, and unprecedented price hike has taken place recently that is bound to appear, sooner or later, in consumer prices as well. Nevertheless, monetary policy remains accommodative and, in most countries, fiscal policy is expected to keep giving growth impulses to the economy as well. At the time of writing, the trends are encouraging: the OECD predicts a global growth of 5.8 percent for this year – after the 3.5 percent fall in 2020 – and the continuation of growth at a pace of 4.4 percent in 2022. Growing inflation and the possibility of monetary tightening poses a downward risk to growths expectations, along with a renewed assault of the pandemic. Both risks are real, but neither is expected to get out of control, according to most analysts. Another risk comes, in the longer term, from the extreme debt levels accumulated by governments and firms. This can become a problem especially later, when interest rate hikes generate a less accommodating financial environment.

The stimulus programs were launched simultaneously worldwide, which gave a large boost to **world trade** and opened the possibility to return to the growth trend interrupted in 2019. The only obstacle to this is the still subdued flow of the trade of services. But the trade of goods is already under full steam, making logistical centers operating at maximum capacity and causing delays in the shipping of goods. The bottlenecks are not expected to be resolved before the end of this year and they are likely to be resolved only partially in 2022. As a result, the volume of world trade is likely to expand by 8.5 percent in 2021 and at a pace of 6-7 percent in the next year.

Commodity markets have made a turnaround too: the latest report of the IEA was upbeat, predicting a growth of global **oil** demand by as much as 5.4 barrel/day, with a further growth by 3.1 barrel/day in 2022. Thus, global oil demand may reach pre-pandemic levels by the end of 2022. The price of Brent oil rose above USD 75 dollars per barrel in late June and has remained there afterward. Demand is likely to grow further in July, followed by a proportionate growth of supply. On the whole, oil prices will probably continue to rise at least till the end of the third quarter. At an annual average, oil prices may reach 66-68 USD/barrel in 2021 and remain within the 65-70 band in 2020 – prices may actually decrease slightly in the next year in the case of a substantial upturn in oil supply. For now, analysts do not expect oil prices to rise further drastically since ample reserve capacities are available in the area of extraction and an extreme growth of oil demand is unlikely.

In the **non-energy commodity** markets, prices rose to unprecedented highs, especially in the case of materials that are necessary for infrastructure investments, like iron ore and copper. Food prices rose at a fast pace as well and, due to the growing demand for biofuels, a new supercycle seems to be forming. Supply cannot catch up with demand in almost any segment, primarily due to China where, in the name of decarbonization, polluting power plants are closed en masse and the resulting output gap is filled by an upsurge of import. Even speculators try to ride this wave, hence Beijing seeks to cool the market by release great quantities of strategic reserves into the market. Nevertheless, high prices will almost certainly remain until the end of the year, and in a few cases highly relevant for Hungary – like microchips – the cycle may even last till the end of 2022.

While **monetary policy** remains expansive for now, some signs of future tightening are already becoming visible. In the case of the *FED*, the tone of its communications became stricter and that led to a strengthening of the dollar. Since within the FED monetary council there are noises of the need to raise interest rates, a restrictive turn of US monetary policy can be expected, in 2022 at the latest, which will have global reverberations. A great deal will depend on how lasting the upsurge of inflation will be and how labor market indicators evolve. The *ECB* confirmed at its June session that – for the time being – it will maintain its lax monetary policy stance and considers the inflationary upsurge in the euro area a clearly temporary phenomenon, therefore not a reason to reverse gears. The *British* and *Japanese* central banks stick to monetary easing as well – even if some tightening in the next year may take place in the case of the former, it is not in the cards in Japan. On the other hand, a gradual raising of policy rates has already begun in a few other countries (Russia, Hungary, Czechia.

The economic upturn can be felt in the **international environment of the European Union** as well. According to the OECD, GDP will grow by 6.9 percent this year, with a subsequent deceleration to 3-4 percent in 2022. Government stimuli play a decisive role in the dynamic growth this year. The US fiscal stimulus is estimated to amount to 8.5 percent of GDP and much of it will be spent in 2021. The stimulation of demand is hoped to stabilize both the labor market and private consumption. The flip side is that the gross fiscal debt will reach 140 percent of GDP, which can cause problems later, especially amid tightening interest rate conditions.

In **Japan**, the economy is expected to grow by 2.6 percent this year, followed by some slowdown in the next. As a result, the level of GDP will not reach its pre-pandemic level by the end of 2022. Export will be the main driver of growth – it may expand by 11.5 percent in 2021, according to the OECD, roughly canceling out the plunge in the last year. Just as in the US, expansive fiscal policies have a great role in achieving positive growth.

The **Chinese** GDP is expected to climb 8.5 percent this year, with a slight slowdown to 6 percent in the next. The forms of state intervention are in a flux. China primarily concentrates on measures aiming at fending off or alleviating the threats on financial stability. The new five-year plan, launched this year, implements a strategy called duel circulation, of which a crucial part is to make domestic consumption the key driver of growth. Net export is another important growth component since China adapted to the new, pandemic-related global needs very fast: it very substantially expanded its production and export of healthcare equipment, tools and preparations. China's influence both as an FDI exporter and as a financer of states struggling with fiscal difficulties is to grow further in the future.

More and more **developing countries** seem to be condemned to another "lost decade": due to their failure to handle the epidemic efficiently, they will need about ten years to reach the pre-pandemic level of their GDP. South Asia, Sub-Saharan Africa, Latin America and many countries of the Caribbean are unable to overcome the epidemic, but they lack the necessary resources to help those in need and to restart economic activity as well. The epidemic-related lockdowns hit workers in the informal economy – most prominently women – the most, and they make up a very large part of the workforce of the developing economies. From this group of countries, the outlook is the least bleak in East Asia, especially those which – as in South Korea, Taiwan and Malaysia – have been constitutive parts of the production and development chains of electronic products, and whose population could contribute to minimalize the spread of the epidemic through disciplined behavior.

The GDP of the **euro area** fell by 1.3 percent in the first quarter year-on-year, due to another wave of the pandemics and by 0.3 percent on a quarterly basis. From the second quarter, however, dynamic growth is expected since – counting on the rising levels of vaccination – the restrictive measures are eased everywhere and tourism is starting to revive, along with personal services. On a yearly average, EU-19 GDP may expand by 5 percent in 2021 and 4.6 percent in 2022. The level of GDP is expected to reach pre-pandemic levels before the end of this year. Differences in growth rates will remain significant. Fiscal measures will continue to have a major role this year. The phasing-out of the various stimulus measures is likely to take place, depending on growth performance, in either the second half of the year or in the next year. Private consumption decreased by a year-on-year rate of 5.4 percent in the first quarter. Depending on the suspension of restrictions of movement, private consumption may get a boost from the second quarter, and the annual rate of consumption growth may reach 3 percent. Gross fixed capital formation also declined by 2 percent on an annual basis, in the first quarter, and it is also expected to regain positive growth in the second quarter, with 6-7 percent annual growth in 2021. Government consumption expenditures grew by 3 percent in the first quarter and a similar pace of growth is expected for the whole year as well, an indication of the continuing stimulating role of fiscal expenditures. The *price conditions*, on the other hand, are changing. The annual inflation rate was 0.3 percent in the last year in the eurozone, but the rate has been rising since January. In May, eurozone inflation reached 2 percent – the ECB target – followed by 1.9 percent in June. The yearly inflation rate is likely reach approximately 2 percent, with a decrease to 1.7 percent in 2022, but the upward risks are considerable.

In the **EU-27**, the GDP contracted by an average 6.1 percent in the last year. We expect an economic growth rate of 4.9 percent for 2021, provided that the new waves of the epidemic do not make reintroducing restrictions unavoidable again. Inflation will accelerate in the EU-27 as well, with particularly severe price hikes in a number of countries, and the yearly rate is expected to reach 2.1 percent in 2021 and 1.8 percent in 2022 after the 0.7 percent seen in the last year. Upward risks abound, however. The unemployment rate may dip below 7 percent if the economic upturn remains stable.

In **Germany**, optimism is spreading in the business sector: The IPO index rose considerably in May and June, mostly a reflection of improving business confidence. An annual growth rate of 3.6 percent is expected for this year, with some further acceleration to 4 percent in the next. Manufacturing firms are still sorely affected by the various bottlenecks in the supply chain but expect improvement in the second half of the year. Both private consumption and investments are likely to expand sharply in the summer months. With a rebounding of demand, prices began to edge upward as well – the prices of transport services, raw materials and intermediate goods rose at a particularly steep pace – and that will have a spillover effect on consumer prices, too.

Inflation is expected to climb to 2.6 percent in 2021 and remain near 2 percent in 2022 as well.

The **British** economy may grow by 6 percent this year, a higher rate than previously expected, even though the detrimental effects of Brexit are still present. The pre-pandemic level of GDP is not likely to be reached sooner than the end of 2022. One factor behind the British upturn is the extremely generous fiscal policy that sought to compensate the losses of both the business sector and households. A part of these stimulus measures will remain in effect during this year, contributing to the stability of the labor market. But they pose serious risks for the future because it is unclear how many of the subsidized firms remains viable after the phasing-out of the subsidies and preferential loans. Inflation is surging, reaching 2.1 percent in May and 2.5 percent in June, exceeding the target level (2%) set by the BOE. Still, the central bank limits itself to verbal tightening so far. Due to the expansive fiscal policy, the public debt may climb to 145 percent of GDP by the end of the year.

II. New EU member states

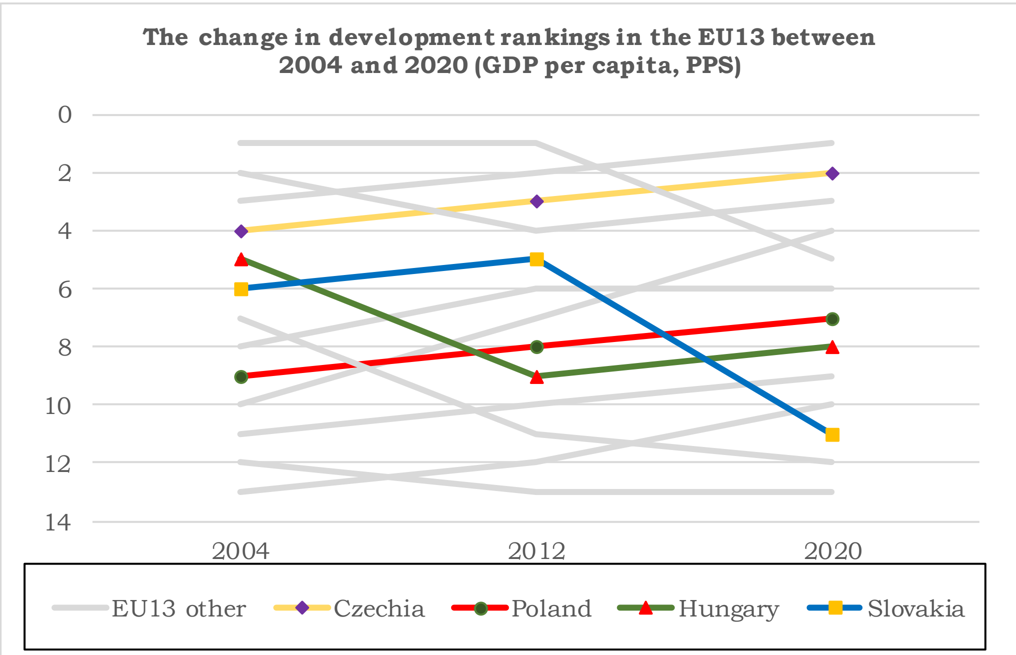
The first quarter of 2021 was the last one the basis period of which was not affected in its entirety by the coronavirus pandemics. Although there were already disruptions in shippings from China in March 2020, the restrictive measures to counter the epidemic were only introduced in the second half of March in the region. In addition, in the winter and spring months of this year many restrictions were in effect again, primarily those that limit the access to services. As a result, the EU13 GDP contracted by 0.9 percent in the first quarter which, by the way, is not a very unfavorable outcome compared to the EU as a whole. Only 4 of the 13 countries posted positive growth, one economy (Romania) stagnated and recession continued in the rest of the countries within the region.

One country, Estonia had an outstanding growth (5,4%) – it must be added that in this country GDP decreased (by 1.1 percent) in the basis period as well. The low statistical base is not the whole story, however: some of the other EU13 countries fared worse in the first quarter of 2020. Mainly two factors contributed to the good growth performance: first, the Estonian fiscal situation was very good at the beginning of the coronavirus crisis, second, the IT firms operating in the country, mostly oriented toward the Baltic and Scandinavian markets, could expand fast during the lockdown period, providing significant tax revenues for the state budget. As a result, the government, whose fiscal wiggling room was large enough to begin with, had the opportunity to provide almost fully compensation to the most heavily affected sectors for their losses without a dangerous loss of fiscal equilibrium.

In the first quarter of 2021, Slovenian GDP was up 1.6 percent (seasonally and calendar adjusted), while Lithuania and Slovakia posted growth rates of 1.5 and 0.2 percent, respectively. Due to the small weight of these latter countries, however, their positive contribution to the regional growth rate was minimal. While Romania basically stagnated, growth rates remained negative in the other 8 countries. Due to the unfavorable growth rates in Poland, Hungary and Czechia (-1.4, -2.1, and -2.6 percent, respectively), these countries had a sizeable negative contribution to the regional growth performance. In Poland, the negative change in net export (the growth rate of import was much higher than that of export) kept GDP growth in negative territory while private consumption and investments slightly expanded. In Czechia, where the epidemiological situation was arguably the worst, consumption and fixed investments contracted by 4 and 3 percent, respectively and net export contributed negatively to growth as well. In this regard, Hungary fared better and could improve its net export, but fixed capital formation and overall consumption decreased somewhat.

Investments failed to recover significantly: the regional growth rate was only 2.7 percent in the first quarter, of which 1.5 percentage points were due to the very steep growth rate (54,6%) in Estonia (mostly a result of statistical base effect). Investments were disappointing in the Visegrad countries: according to the seasonally and calendar adjusted data, fixed capital formation decreased by 10 percent in Slovakia, -3 percent in Czechia and -0.1 percent in Hungary, and it climbed only 0.9 percent in Poland. The dramatic decline in Slovakia was due to the disturbances in the auto industry that could not operate at full capacity amid the input shortages, and various plants were forced to halt production for several weeks, which affected export and investments. Due to the disruptions in input supply, even make-to-stock became unfeasible. The Czech and Hungarian industrial firms face similar problems while in Poland the greater weight of food industry helped compensate for the output fall in other manufacturing branches. In countries with less exposure to automotive supply chain disturbances, investments grew by 5-6 percent on average.

Due to its global magnitude, the crisis did not halt the real convergence trend in the region, since the developed countries suffered recession too. In 2020, the PPS-based real GDP per capita of the EU13 amounted to 78.8 percent of the EU27 average. Over the 16 years since the EU accession, the convergence achieved was 17 percentage points, which is not very impressive considering that Montenegro, with much less transfers from the EU, achieved 16 percentage points and Serbia achieved 13 percentage points. Lithuania and Romania boast the largest relative development, with 37 percentage point convergence of GDP per capita. Cyprus, Malta and Slovenia, the most developed economies within the EU13, still could not surpass the EU average. The convergence in Croatia, Hungary and Slovakia was also disappointing, with an average of 10 percentage points – as a result, Hungary was 8. in the ranking by development within the EU13, as opposed the year 2004 when Hungary ranked the third. Growth rates are likely to be high in both 2021 and 2022 but they will be accompanied by high inflation rates as well, especially in countries outside the Eurozone. The resulting weakening of currencies may undermine the convergence achieved by high growth rates. Nevertheless, no significant change in the ranking is expected in the forecast period.



Two different inflation patterns can be identified in the region. In the non-euro member states, the average inflation is above 3 percent while the euro area members post inflation rates around 1-1.5 percent. The net result is an average inflation rate of 2.9 percent in the first months of this year in the EU13. Several factors influence the price trends: first, the reopening of the economy (the service sector) generated enormous demand that outpaces supply and second, the global shortage of raw materials brought about a surge in the prices of raw materials and intermediate goods, which eventually had a spillover effect on consumer prices as well. Hence in some segments a price hike of 100 percent or even more has been registered, an extreme example of which is real estate prices. As early as in the spring months, catering services suffered from labor shortage again, leading to wage pressures and – eventually – higher consumer prices. In addition, the measured inflation rate may be lower than the perceived rate since consumer spending patterns changed significantly during the epidemic: formerly marginal goods and services gained prominence and vice versa.

The majority of the central banks deem the inflationary pressure temporary and explains citing the logistical bottlenecks and pent-up consumption demand. 2020 saw a leap in savings in every EU13 country although to different degrees. In the Baltic states the growth exceeded 10 percent, in Poland it exceeded 30 percent while in Hungary it was only 10 percent. The Hungarian central bank has already started tightening, and the other central banks will probably follow suit to suppress the inflationary pressure. Still, harsh rate hikes are not likely because the economic growth is not yet robust enough, hence every move toward tightening may hinder economic recovery. The most likely scenario is that the central banks will seek to prevent inflation to get out of control but will let it rise to levels much higher than the average of the previous years, even to 4-5 percent. This, however, exacerbate social inequalities that could be alleviate by additional redistribution measures which, on its turn, would hinder growth.

Due to the low statistical base, high annual growth rates (4.5-5.5 percent) will be achieved this year throughout the region. As for the 2022 outlook, much depends on inflation. Imported inflation will probably remain high until the end of the year. It is also possible that the prices of raw materials stop rising but do not decrease, or only minimally. The productive units of the Central Eastern European countries tend to occupy the end points of the value chains, their production is mostly based on the heavy import of basic materials and intermediate products. What is more, the region is resource-poor. High import prices will hold back growth, hence the evolution of global commodity markets crucial for these countries. The government stimulus measures are likely to remain in effect and the inflow of EU funds will help economic growth. Hence, we expect an average growth rate of 4-4.5 percent for 2022, which is enough to return to the 2019 levels. The return to the pre-pandemic growth trajectory, on the other hand, will probably prove impossible.

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	25.0	1.7	2.2	2.5	1.5	0.6	-4.9	3.6	4.7
France	17.3	1.1	1.1	2.3	1.7	1.3	-8.1	5.7	3.6
Italy	12.4	0.9	1.1	1.7	0.9	0.3	-8.9	4.5	4.1
Netherlands	6.0	2.0	2.2	2.9	2.6	1.7	-3.8	2.4	3.2
Belgium	3.4	1.7	1.5	1.7	1.4	1.4	-6.4	4.8	3.5
Luxembourg	0.5	3.9	2.4	1.5	2.6	2.3	-1.3	4.4	2.7
Ireland	2.7	25.2	3.7	8.1	8.2	5.5	3.4	8.7	6.9
Greece	1.2	-0.4	-0.2	1.5	1.9	1.9	-8.2	4.1	4.8
Spain	8.4	3.8	3.0	2.9	2.4	2.0	-11.0	5.9	5.0
Portugal	1.5	1.8	1.9	2.8	2.1	2.2	-7.6	3.9	4.5
Austria	2.8	1.0	2.1	2.5	2.4	1.6	-6.6	4.0	5.0
Finland	1.8	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	5.5	4.0
Slovakia	0.7	4.2	3.1	3.2	4.1	2.3	-5.2	4.3	4.5
Slovenia	0.3	2.3	3.1	4.9	4.5	2.4	-5.5	4.5	4.3
Cyprus	0.2	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	4.5	5.5
Latvia	0.2	3.0	2.1	4.6	4.8	2.2	0.0	3.9	4.5
Lithuania	0.4	2.0	2.4	4.1	3.5	3.9	-0.8	3.9	3.5
Euro Area	**85.1**	**2.0**	**1.9**	**2.6**	**1.9**	**1.3**	**-6.5**	**5.0**	**4.6**
Denmark	2.3	2.3	2.4	2.3	1.5	2.2	-3.3	2.5	2.7
Sweden	3.6	4.4	2.4	2.4	2.3	1.2	-2.8	4.3	3.3
Hungary	1.0	**3.8**	**2.1**	**4.3**	**5.4**	**4.6**	**-5.0**	**5.2**	**5.0**
Czech Republic	1.6	5.3	2.5	4.4	2.9	2.4	-5.6	3.8	4.5
Poland	3.9	3.8	3.1	4.8	5.1	4.1	-2.7	4.6	4.0
Romania	1.6	3.9	4.8	7	4.1	4.1	-3.9	5.9	4.5
Bulgaria	0.5	3.5	3.9	3.8	3.1	3.4	-4.2	3.7	4.0
Croatia	0.4	2.4	3.5	2.9	2.6	2.9	-8.4	5.0	4.1
EU14	***88.9***	**2.4**	**1.9**	**2.3**	**1.8**	**1.3**	**-6.9**	**5.0**	***4.5***
New EU13	**11.1**	**3.8**	**3.2**	**4.8**	**4.3**	**3.6**	**-4.0**	**4.7**	**4.3**
EU27	**100**	**2.3**	**2.0**	**2.6**	**2.0**	**1.6**	**-6.1**	**4.9**	**4.4**
Memorandum items									
USA		2.5	2.9	1.6	3.0	2.2	-3.5	6.9	3.6
Japan		0.3	1.1	1.0	1.9	0.7	-4.7	2.6	2.0
United Kingdom		2.4	1.7	1.7	1.3	1.4	-9.9	6.8	4.6
China		7.3	7.0	6.7	6.8	6.1	2.3	8.5	5.8
Russia		0.7	-2.8	-0.2	2.2	1.3	-2.6	2.7	2.0
South-Eastern Europe									
Serbia		1.7	3.3	2.1	4.3	3.2	-1.8	5.2	4.0
Turkey		6.1	3.2	7.4	2.5	-2.3	-2.5	5.2	4.2

* Kopint-Tárki forecast
EU14 = Countries that joined the European Union before 2004 ("Old EU Member States")
New EU13 = 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	24.6	0.1	0.4	1.7	1.9	1.4	0.4	2.6	1.9
France	17.4	0.1	0.3	1.2	2.1	1.3	0.5	1.7	1.4
Italy	14.1	0.1	-0.1	1.3	1.2	0.6	-0.1	1.4	1.3
Netherlands	4.9	0.2	0.1	1.3	1.6	2.7	1.1	2.1	1.9
Belgium	3.3	0.6	1.8	2.2	2.3	1.2	0.4	1.9	1.5
Luxembourg	0.2	0.1	0.0	2.1	2.0	1.6	0.0	2.6	2.0
Ireland	1.4	0.0	-0.2	0.3	0.7	0.9	-0.5	1.2	1.7
Greece	1.7	-1.1	0.0	1.1	0.8	0.5	-1.3	0.5	1.7
Spain	9.1	-0.6	-0.3	2.0	1.7	0.8	-0.3	2.0	1.8
Portugal	1.9	0.5	0.6	1.6	1.5	0.3	-0.1	1.2	1.7
Austria	2.7	0.8	1.0	2.2	2.1	1.5	1.4	2.2	2.0
Finland	1.7	-0.2	0.4	0.8	1.2	1.1	0.4	1.9	1.7
Estonia	0.2	0.1	0.8	3.7	3.4	2.3	-0.6	2.0	2.0
Slovakia	0.8	-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	1.5	2.0
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	1.1	1.5
Latvia	0.2	0.2	0.1	2.9	2.6	2.7	0.1	2.0	2.0
Lithuania	0.4	-0.7	0.7	3.8	2.5	2.2	1.1	2.0	2.4
Euro Area	**85.3**	**0.0**	**0.2**	**1.5**	**1.8**	**1.3**	**0.3**	**2.0**	**1.7**
Denmark	2.0	0.2	0.0	1.1	0.7	0.7	0.3	1.5	1.3
Sweden	3.0	0.7	1.1	1.9	2.0	1.7	0.7	2.1	1.6
Hungary	1.0	**0.1**	**0.4**	**2.4**	**2.9**	**3.4**	**3.4**	**4.2**	**3.9**
Czech Republic	1.5	0.2	0.7	2.3	2.0	2.6	3.3	2.9	2.5
Poland	4.3	-0.7	-0.2	1.6	1.2	2.1	3.7	3.8	3.0
Romania	1.9	-0.4	-1.1	1.0	4.1	3.9	2.3	4.0	3.0
Bulgaria	0.5	-1.1	-1.3	1.0	2.6	2.5	1.2	2.0	2.3
Croatia	0.4	-0.3	-0.6	1.3	1.6	0.8	0.0	1.8	2.4
EU14	**88.1**	**0.1**	**0.4**	**1.7**	**1.9**	***1.4***	**0.5**	**2.0**	**1.7**
New EU13	**11.9**	**-0.4**	**-0.2**	**1.7**	**2.2**	***2.6***	**2.6**	**3.2**	**2.8**
EU27	**100.0**	**0.0**	**0.3**	**1.7**	**1.9**	***1.5***	**0.7**	**2.1**	**1.8**
Memorandum items [a]									
USA		1.5	1.6	0.1	1.3	1.5	1.2	2.9	2.6
Japan		0.4	2.7	0.8	0.5	0.5	0.0	0.1	0.6
United Kingdom		0.0	0.7	2.7	2.5	1.8	0.9	1.9	1.7
China		2.6	2.0	1.4	2.0	2.9	2.5	1.5	2.5
Russia [b]		7.8	15.5	7.0	2.9	4.5	3.6	4.7	4.0
South-Eastern Europe									
Serbia		2.3	1.1	3.1	2.0	2.5	1.5	2.5	2.1
Turkey		8.9	7.7	11.0	16.7	13.3	11.9	15.7	12.5

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	20.3	4.6	4.1	3.8	3.4	3.1	3.8	4.4	3.7
France	14.0	10.4	10.1	9.4	9.0	8.4	8.0	8.0	7.6
Italy	12.1	11.9	11.7	11.2	10.6	10.0	9.2	10.3	9.7
Netherlands	4.3	6.9	6.0	4.9	3.8	3.4	3.8	3.8	3.4
Belgium	2.4	8.5	7.8	7.1	6.0	5.4	5.6	5.6	5.0
Luxembourg	0.1	6.7	6.3	5.5	5.6	5.6	6.8	6.4	5.5
Ireland	1.1	10.0	8.4	6.7	5.8	5.0	5.7	5.6	4.9
Greece	2.2	24.9	23.6	21.5	19.3	17.3	16.3	16.1	15.4
Spain	10.9	22.1	19.6	17.2	15.3	14.1	15.5	15.5	13.8
Portugal	2.4	12.6	11.2	9.0	7.1	6.5	6.9	6.9	6.5
Austria	2.1	5.7	6.0	5.5	4.9	4.5	5.4	5.2	4.8
Finland	1.3	9.4	8.8	8.6	7.4	6.4	7.8	7.7	6.7
Estonia	0.3	6.2	6.8	5.8	5.4	4.4	6.8	8.0	7.0
Slovakia	1.3	11.5	9.7	8.1	6.5	5.8	6.7	8.0	7.0
Slovenia	0.5	9.0	8.0	6.6	5.1	4.5	5.0	5.0	4.5
Cyprus	0.2	15.0	13.0	11.1	8.4	7.1	7.6	8.0	7.0
Malta	0.1	5.4	4.7	4.0	3.7	3.6	4.3	5.0	4.0
Latvia	0.4	9.9	9.6	8.7	7.4	6.3	8.1	8.0	7.5
Lithuania	0.7	9.1	7.9	7.1	6.2	6.3	8.5	8.0	7.0
Euro Area	**76.8**	**10.9**	**10.0**	**9.1**	**8.2**	***7.6***	***8.1***	**8.2**	**7.5**
Denmark	1.4	6.3	6.0	5.8	5.1	5.0	5.6	5.6	5.0
Sweden	2.5	7.4	6.9	6.7	6.4	6.8	8.3	8.5	7.2
Hungary	2.2	**6.6**	**5.0**	**4.1**	**3.6**	**3.3**	**4.1**	**3.9**	**3.6**
Czech Republic	2.5	5.1	4.0	2.9	2.2	2.0	2.6	3.3	3.0
Poland	8.0	7.5	6.2	4.9	3.9	3.3	3.2	5.0	4.0
Romania	4.2	6.8	5.9	4.9	4.2	3.9	5.0	6.5	6.0
Bulgaria	1.6	9.2	7.6	6.2	5.2	4.2	5.1	5.5	5.0
Croatia	0.8	16.2	13.1	11.2	8.5	6.6	7.5	7.5	7.0
EU-14	**77.2**	**9.9**	**9.2**	**8.4**	**7.5**	**7.1**	***7.6***	**8.2**	**7.5**
New EU13	**22.8**	**7.9**	**6.6**	**5.5**	**4.5**	**4.1**	***5.3***	**5.5**	**4.8**
EU27	**100.0**	**10.0**	**9.1**	**8.1**	**7.2**	**6.7**	**7.0**	**7.6**	**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
United Kingdom		5.3	4.8	4.4	4.1	3.8	4.5	5.4	5.8
China [b]		4.7	4.1	4.0	4.0	4.1	3.8	3.6	3.6
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	9.0	9.3	8.5
Törökország		9.9	10.9	10.9	11.0	14.0	13.2	13.6	14.2

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

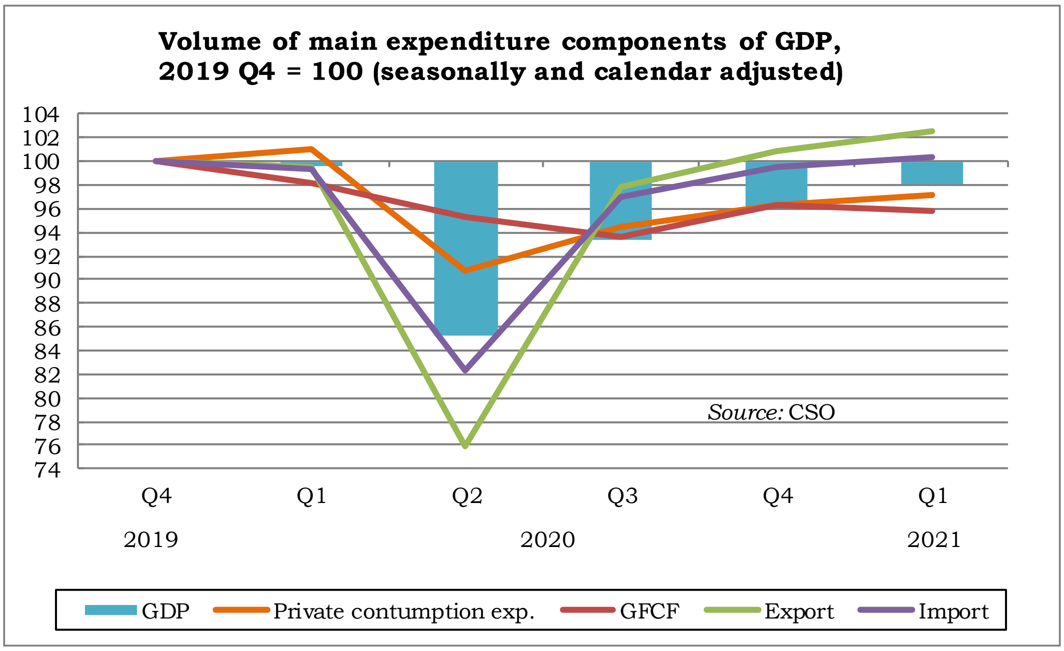
(year-on-year change, percentage)

	Data				Forecast		
			2021		2021		2022
	2019	2020	Q1	Q2	2021 May	2021 July	2021 July
GDP aggregates, real growth							
GDP total	4.6	-5.0	*-2.1*		4.7	**5.2**	**5.0**
Domestic Demand	6.6	-3.0	*-4.3*		4.5	**4.0**	**4.9**
Private Consumption	4.6	-2.8	*-3.7*		3.8	**4.1**	**4.3**
Public Consumption	5.6	2.8	*10.4*		0.0	**2.7**	**0.0**
Gross Fixed Capital Formation	12.8	-7.3	*-0.1*		8.0	**6.4**	**8.0**
Gross Capital Formation	11.3	-5.5	*-12.4*		8.0	**4.3**	**8.0**
Export	5.8	-6.8	*3.3*		8.6	**10.8**	**6.7**
Import	8.2	-4.4	*1.1*		8.5	**9.0**	**6.6**
Industrial production	5.6	-6.1	*4.0*	*37.7*	10.5	**12.0**	**6.0**
Consumer Price Index	3.4	3.3	*3.2*	*5.1*	4.1	**4.7**	**4.4**
Employment, earnings							
Number of Employed, growth [a]	0.8	-0.9	*-0.9*	*1.4*	1.0	**0.9**	**0.5**
Employment rate [a]	62.6	62.1	*61.9*	*62.8*	62.8	**62.9**	**63.5**
Unemployment Rate [a]	3.3	4.1	*4.5*	*4.1*	4.0	**3.8**	**3.4**
Unit Labor Costs, in EUR [b]	7.6	1.1	*-3.3*		1.1	**1.4**	**2.9**
Gross Nominal Wages	11.4	9.7	*9.4*	*9.4* [e]	7.8	**8.5**	**8.0**
Net Real Wages	7.7	6.2	*6.0*	*4.1* [e]	3.6	**3.6**	**3.4**
Savings Rate, % of GDP [c]	5.0	6.1	*6.7*		6.0	**6.2**	**5.7**
Current and Capital Accounts Balance, % of GDP	1.4	1.9	*3.2* [f]		2.5	**2.5**	**3.0**
General government Fiscal Balance, ESA-2010, % of GDP	-2.0	-8.1	*-6.1*		-6.5	**-7.5**	**-5.9**
Gross Government Debt, % of GDP	65.5	80.4	*81.0*		81.0	**81.7**	**80.0**
Short-term Government Yields (3M), eop	-0.01	0.28	*0.61*	*0.45* [g]	0.7	**1.5**	**1.8**
Long-term Government Yields (10Y), eop	2.01	2.08	*2.71*	*2.83* [g]	2.6	**3.0**	**3.0**
External assumptions							
Internat. Trade in Goods and Services [d]	4.0					**8.4**	**6.5**
Brent Oil Price ($/bbl, p. avg.)	64.4	41.8	*61.0*	*68.7*	67.0	**68.0**	**70.0**
GDP Real Growth, Eurozone	1.3	-6.5	*-1.3*		4.8	**5.0**	**4.6**
GDP Real Growth, New EU Members	3.6	-4.0	*-0.9*		4.2	**4.6**	**4.3**
EUR-HUF, period average	325	351	*361.1*	*354.8*	365	**353**	**353**
EUR-USD, period average	1.12	1.14	*1.21*	*1.21*	1.20	**1.21**	**1.21**

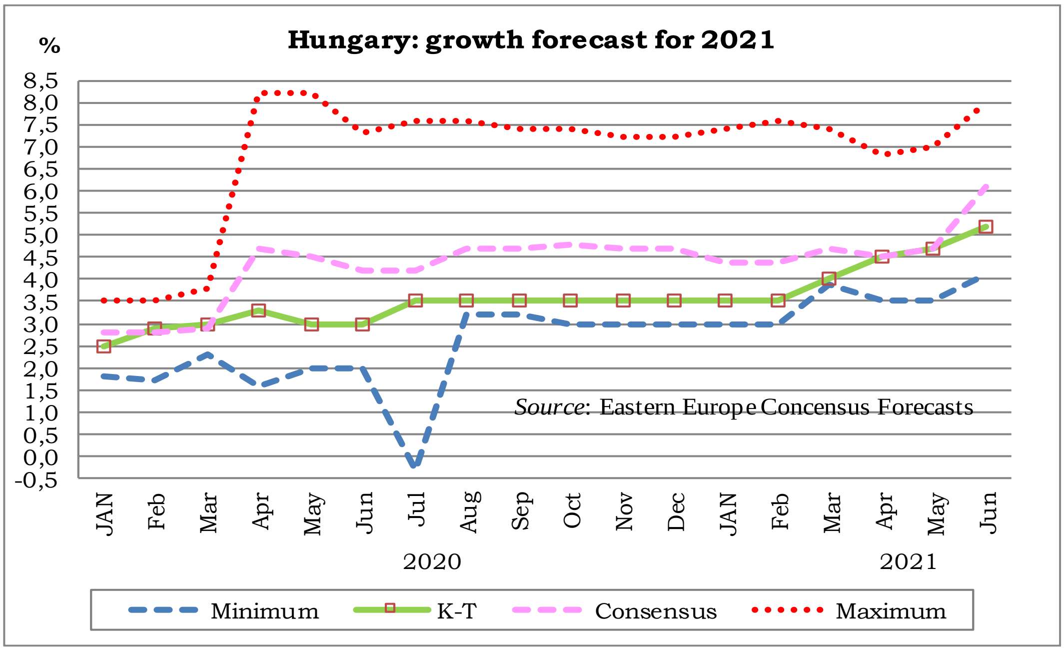
a ILO methodology, period averages, aged 15-74, public workers are counted as employed.
b Manufacturing, based on gross value added and the monthly average compensation of employees in euro, cumulated from the beginning of the year
c At enterprises with at least 5 employees, all budgetary institutions,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

III. The Hungarian economy

The economic developments of the past couple of quarters suggest that the Hungarian economy was more resilient against the second wave of the epidemic than previously expected. Although the picture shown by the non-adjusted year-on-year figures is mixed – for example, it indicates a deterioration in the case of private consumption – the seasonally and calendar adjusted quarter-on-quarter data shows that the recovery continued – at a slower pace – after the partial rebound in the third quarter of 2020. In



the last quarter of 2020 and the first quarter of 2021, improvement continued in all four economic industries on the production side and in all the main components – save fixed capital formation – of the expenditure side. This is why the seasonally adjusted volume of GDP in the first quarter fell short of the volume seen in the last quarter of 2019 only by 2 percent.



The fact that – according to the first-quarter GDP data – the Hungarian economy weathered the reverberations of the second wave of the end of the last year the third wave in the first quarter without substantial worsening resulted in a wave of drastic upward revisions of growth forecasts among analysts. In June, the mean of growth forecasts surpassed 6 percent within the Consensus Economics survey while it did not even reach 5 percent one month earlier. In our opinion, however, there is reason to remain cautious.

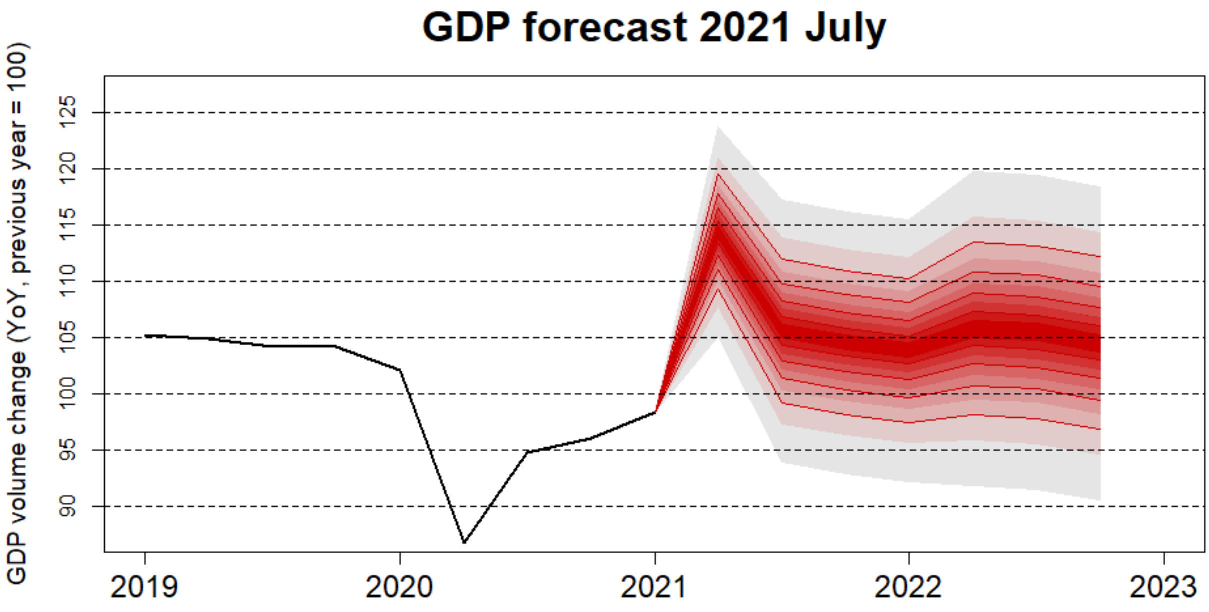
True, the generally expansive policy stance among the developed economies (where optimism is also fueled by the relatively high level of vaccination and the hope that the additional waves of the epidemic will not cause as much disruption than the past ones) creates a favorable international environment for Hungarian economic recovery. But on the other hand, it is becoming apparent that the global logistical bottlenecks, chip shortage, shortage of raw materials and commodity price boom that caused growing problems from the beginning of this year will not go away soon. These problems did not affect spectacularly the industrial recovery in the first quarter, but that may change in the second quarter, at least in the auto industry which is a key sector of the Hungarian economy.

This is why we predict an industrial growth rate of *12 percent for 2021*, a rate somewhat lower than the majority of other forecasters. This also implies that we probably expect a somewhat more modest positive growth contribution by net export than the other analysts.

Another question is how much *household consumption* can expand this year. A number of factors suggest a very sharp growth: the mediocre growth of real wages will be accompanied by improving employment levels, and real wage disbursement are likely to grow at a good pace as a result. This, along with the growth of entrepreneurial incomes, point toward a substantial household income growth in 2021. Furthermore, much of the fall of private consumption in 2020 was due to delayed consumption, which makes it possible that the lifting of virus-related restrictions is followed by an avalanche of pent-up consumption.

This is a real possibility – indeed, it will unavoidably happen to a degree. From the middle of the year, retail trade turnover may rebound to its pre-pandemic level while the hotel and restaurant sector may also post substantial year-on-year growth – even if turnover by *foreign tourists* remains a fraction of what it was in 2019. Still, we do not expect consumption growth to substantially surpass income growth in 2021: our prediction is a consumption growth rate of about *4 percent*.

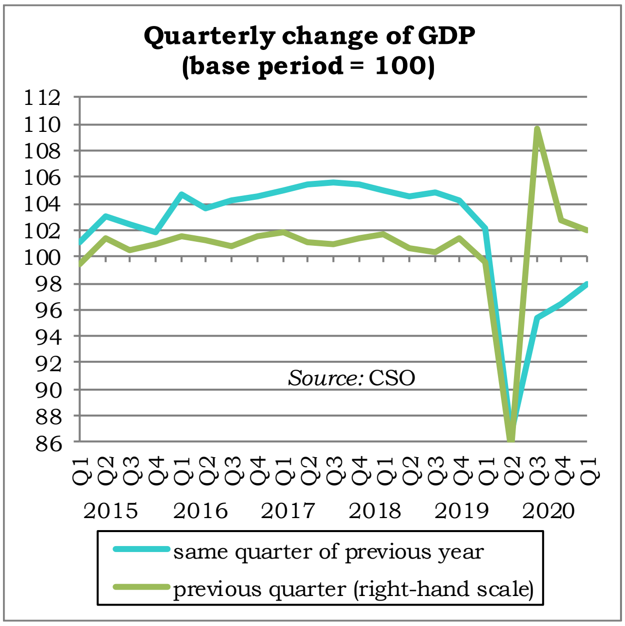
Based on these considerations, we expect an ***annual growth rate of about 5.5 percent*** in 2021, Although a good pace, this growth forecast is conservative compared to the (quite sanguine) predictions of the majority of the other analysts. The growth will be fueled by household consumption, state, household and business investments (even if the latter still decreased on an annual basis in the first quarter), and dynamic export that is helped by the revival of global growth but somewhat held back by supple-side and logistical problems. Our expectation has mostly upward risks. (The possibility of a new, vaccine-resistant virus variant poses a downward risk but the probability of such a scenario is hard to estimate.)

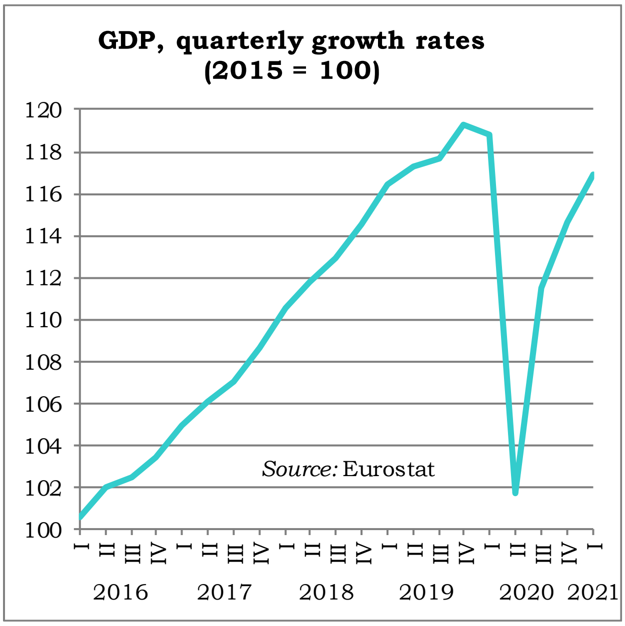


We expect economic growth to continue in 2022 at a pace only slightly slower – 5 percent – but this forecast is subject to both upward and downward risks. The present global inflationary wave may prove lasting, the high headline inflation rates may lead to a sharp acceleration of core inflation, the that may provoke monetary tightening measures that can be detrimental to economic growth. Another issue is the high level of state and corporate debt, the high number of "zombie firms" – not just in Hungary, but on a global scale – and the resulting danger of a wave of bankruptcies generated, for example, by a monetary tightening cycle. In Hungary – due to the apparently arising conflict between the fiscal and the monetary policy stance – this may become a real problem earlier than in other countries. Finally, the stimulating effect of the stimulus measures will eventually peter out, contributing to the flattening of the growth rate.

The GDP and its components

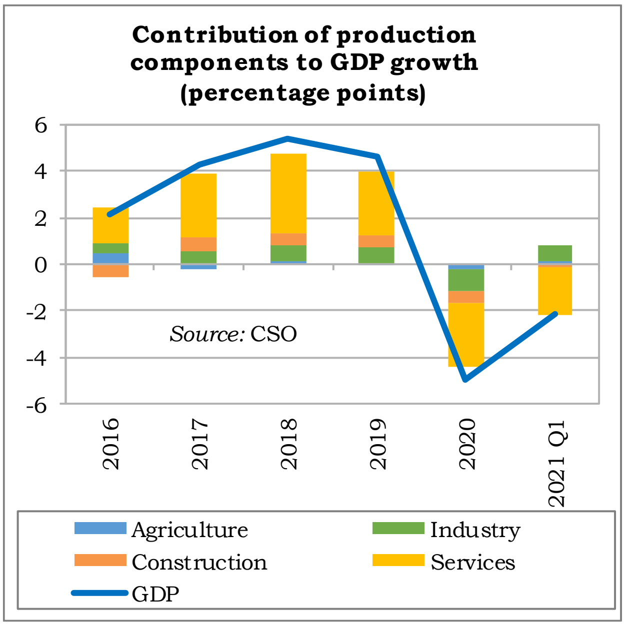
Just as the last quarter of 2020, the first quarter of this year positively surprised analysts: neither the reverberations of the second wave, nor the third wave (that led to new restrictive measures in March) could not interrupt the ongoing recovery. Although the year-on-year GDP growth rate was still negative (showing 2.1 percent decline), the seasonally and calendar adjusted volume continued to rise compared to the previous quarter (by 2 percent). The level of quarterly GDP fell short by only 2 percent compared to the level at the end of 2019.

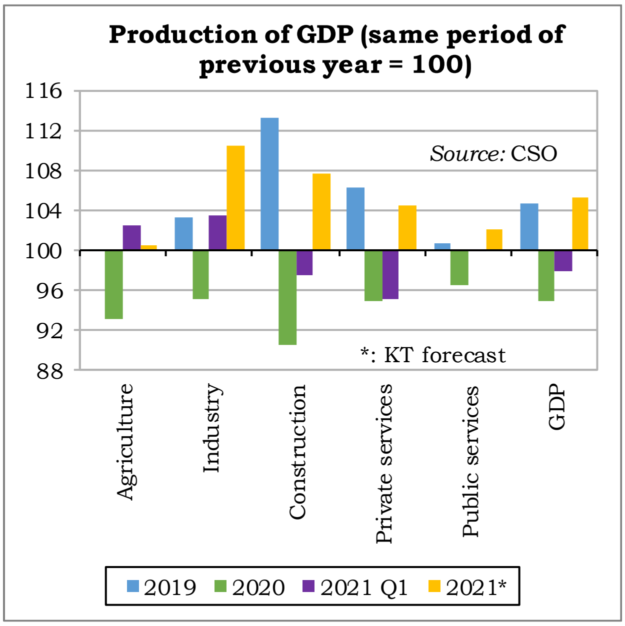




The seasonally and calendar adjusted year-on-year growth rate was 1.6 percent, somewhat softer than the unadjusted rate, in the first quarter.

On the ***production side***, primarily *services* (and, to a lesser degree, construction) kept the overall growth rate on the negative side. This is not surprising as the services sector suffered the most from the counter-epidemic measures. But the situation was improving even here: the year-on-year rate of decline was 3.5 percent, less than in any quarter





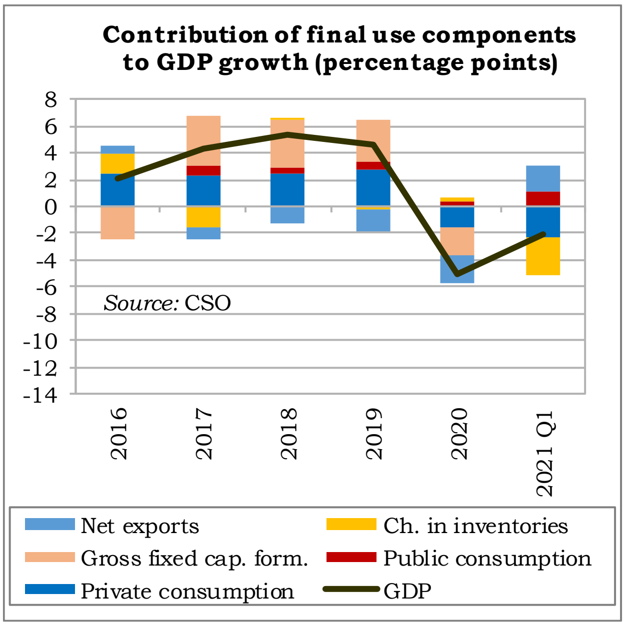
since the start of the pandemic. While still only two segments within services – finance and information and communication – achieved positive growth, the rate of decline softened in the majority of the service areas. As expected, the two exception was the hotel and restaurant sector, and the arts, entertainment and recreation sector, which were hit again by the second and third wave of the epidemic.

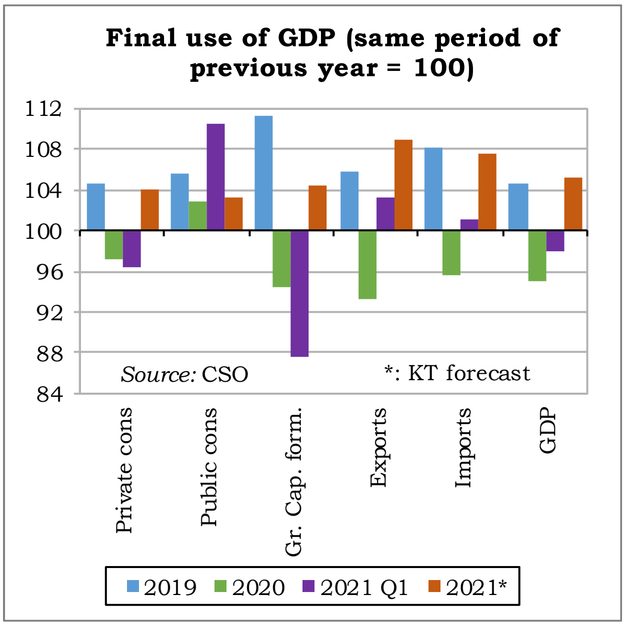
The pace of year-on-year decline slowed down in construction as well – building construction basically stagnated. The positive growth stimulus, on the other hand, came from agriculture on the one hand, and – more importantly – from the slightly accelerating industrial sector on the other. This does not mean that the global chip shortage and shipping bottlenecks did not affect Hungarian industry at all, but their impact remained limited in the first quarter as a whole. The impact became more substantial in April, according to the industrial statistics.

It is important to note that compared to the *previous quarter*, all four economic industries grew, to a greater or lesser extent, just as in the last quarter of 2020. In this sense, the continuation of economic recovery encompassed the whole economy.

On the ***expenditure side***, the rate of decline of *private consumption* eased minimally in the first quarter, to 3.7 percent, but that was due to a growth in social transfers in kind. The *consumption expenditures of households* decreased at an accelerating rate, by 4.8, in the first quarter, on an annual basis. This, however, is apparently a result of the high statistical base, because private consumption expenditures slightly increased compared to the previous quarter. Things are different, however, in the case of *fixed capital formation* that went from a slight growth in the last quarter of 2020 to a "negative stagnation" in the first quarter, on annual and on quarterly basis as well, due to an acceleration of decline of corporate investments. That was compounded by a very strong negative effect of the change in inventories – due to the latter, total ***final domestic use*** decreased not just by one or two percent but by as much as 4 percent in the first quarter.

Fortunately, ***net export*** – more specifically, the net export of goods – could, even more than previously, offset much of the negative growth contribution of domestic use components. As a result, GDP decreased only by about 2 percent on an annual basis. The export of goods increased by 10 percent, amid a much less steep growth of the import





of goods – and that made external trade as a whole a positive contributor to growth, despite the still negative contribution of the external trade of services.

We expect net export to remain an important factor of growth in 2021 as a whole, even if the positive gap between export and import growth rates will decrease or even close in the second half of the year. At the same time, consumption and fixed capital formation will, due to the ongoing recovery and the low statistical base, turn into positive growth during the rest of the year. We expect the annual growth of private consumption in 2021 surpass the annual decline in the last year, due to the continuing wage growth and rising employment levels, and as a result, the 2021 level of consumption will slightly surpass its 2019 level. Fixed capital formation may get close to its 2019 level, too, as corporate investments are expected to start expanding during the year. We predict the **GDP growth rate of 5.5 percent** in 2021.

3.1. The production of GDP

3.1.1. Industry

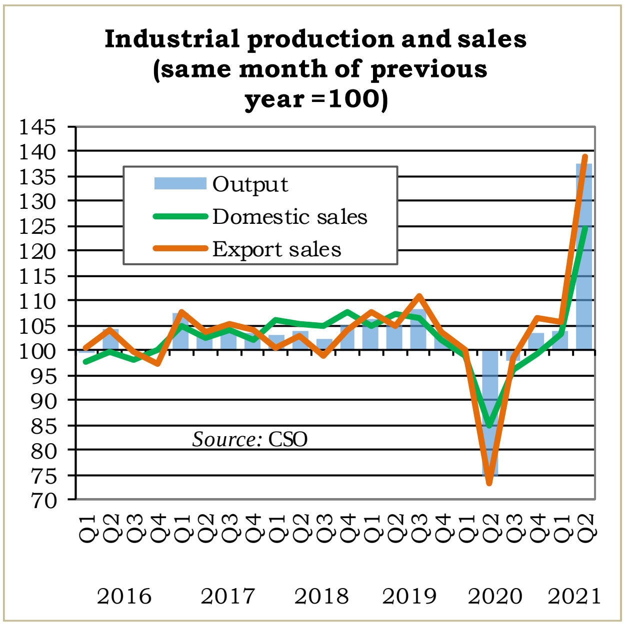
Industry continued to recover in the first quarter: its seasonally and calendar adjusted output was 1.5 percent higher than in the previous quarter. The *year-on-year* growth rate jumped to 4 percent, but this is partly a result of the statistical base effect: in March 2020, industry was already hardly hit by the first wave of the epidemic, even though not as hardly as in the subsequent month. In any case, the first-quarter performance of industry was a positive surprise – the ship shortage and the global logistical problems did not yet cause any visible break in the revival of overall industrial production.

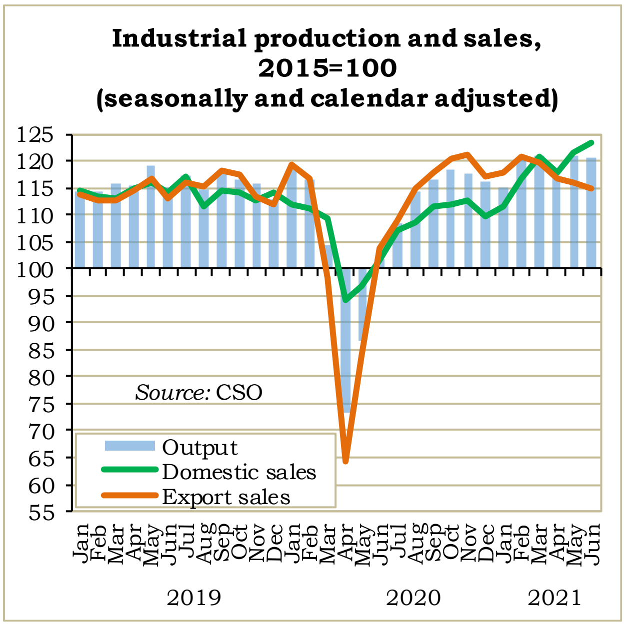
In April, the situation seemed to change: the seasonally and calendar adjusted output dipped – although not drastically – from its record levels in February-March, but also compared to the previous record high in last October. In May and June, the output jumped back to its former level, but even so, the monthly seasonally adjusted volumes suggest not so much a stable trend of growth but rather an almost directionless fluctuation in the first half.

The year-on-year growth rate was 37.7 percent in the second quarter, but this was clearly a reflection of the collapse of output in the same months of the previous year. In any case, the average growth rate in January-May was very high, 18.8 percent, on an annual basis.

In April the ongoing global problems and – to a lesser degree – the new temporary lockdown measures due to the third wave – were probably compounded by the reverberations of the six-day-long Suez Canal obstruction in late March. The main victim of the April decrease – and generally, the branch that takes the largest hit from the chip and logistical problems – was the auto industry, while many other industrial branches display a clear upward trend. Especially strong is the rising trend was the electrical industry.

Compared to the same period of 2020, export sales grew more dynamically than domestic sales – 20 percent versus 17.5 percent – which is also a result of the statistical base

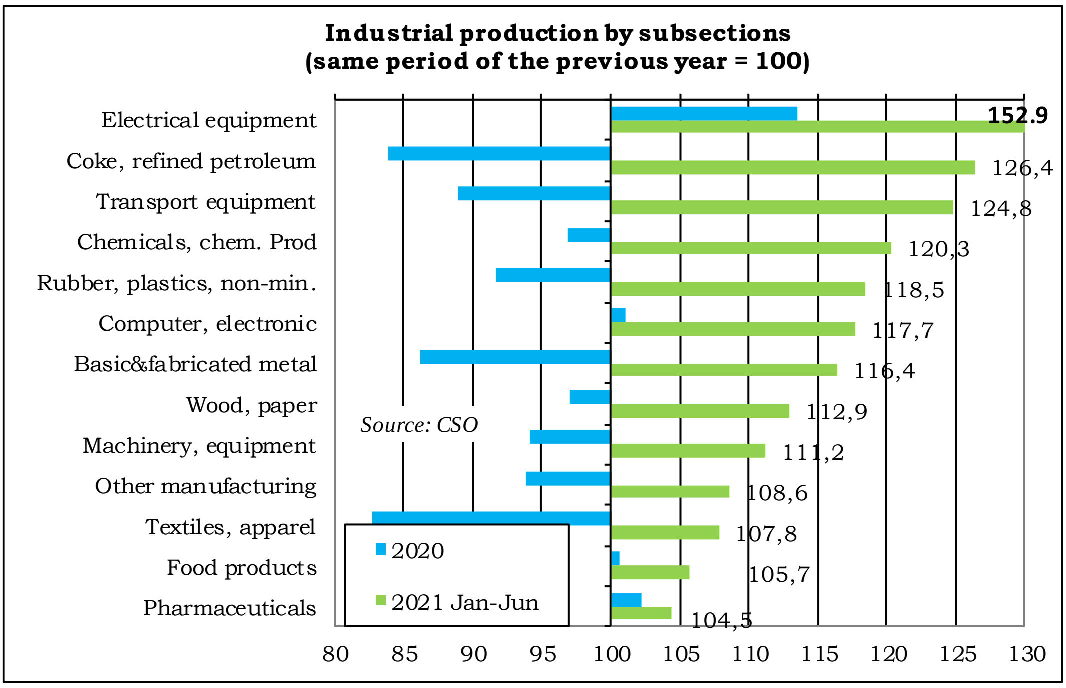




effect, since export sales were disrupted by the first wave of the pandemic much more dramatically than domestic sales.

While overall industrial output reached – in February-March it even surpassed – the pre-pandemic level, the picture is quite mixed in the individual industrial branches. Pre-crisis levels are surpassed in rubber- plastic and building material industry, electrical industry, or in chemical industry. But the largest branch, the auto industry, initially seemed to recover in last autumn but was pulled under again afterwards by the shortage of chips and other inputs. These supply-side problems even cause recurring temporary stoppages of production at various manufacturers.

This is now the main source of uncertainty regarding industrial perspectives. The coming spectacular year-on-year growth rates caused by the statistical base effect notwithstanding, the question is whether the near-stagnation of seasonally adjusted volumes will end and how steep the subsequent rising trend will be. The domestic manufacturing PMI, and especially the evolution of the stock of orders, suggests a very



gradual rise instead of a dramatic upturn, while on the other hand, the latest Kopint-Tárki manufacturing survey results suggest more robust optimism among manufacturing firms. For now, we expect a strong decrease in year-on-year indexes in the last third of the year and an **annual industrial growth rate of about 12 percent**. This will be followed, due to the higher statistical basis, by substantial deceleration in 2022.

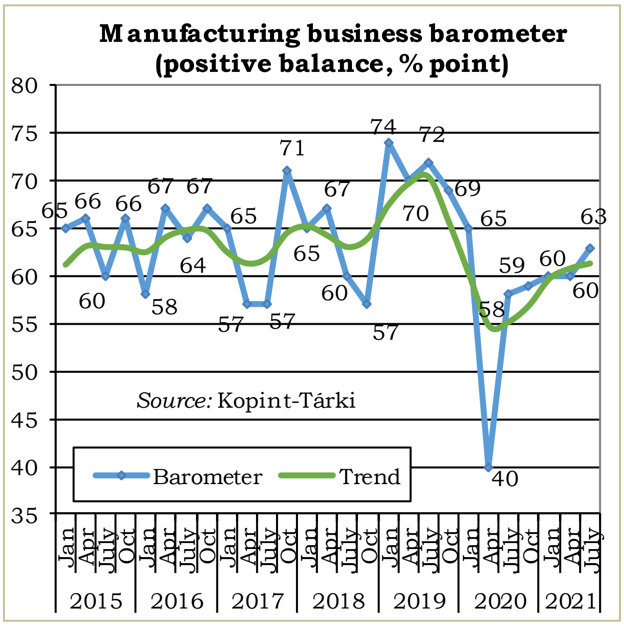
Manufacturing confidence survey

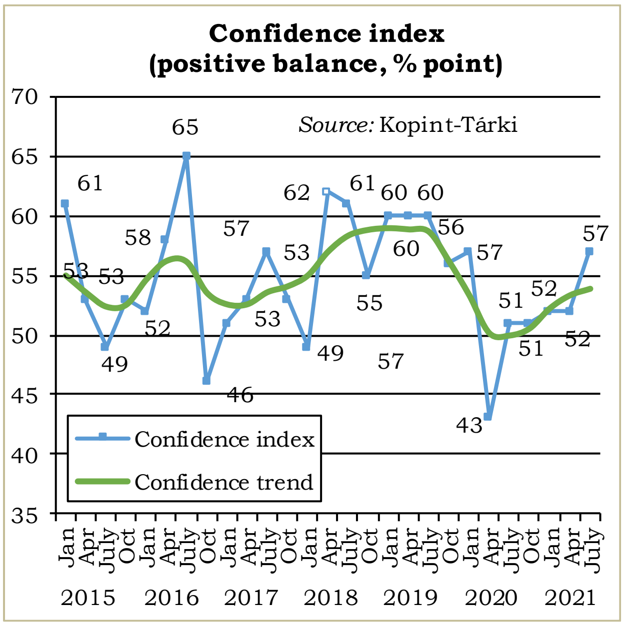
Our latest survey results from the second quarter of 2021 show a continuation of improvement in business sentiment and a robust recovery. While the new lockdown measures in the spring somewhat slowed down the rise of indexes, they could not halt the upward trend. The business barometer is at 63 points, very close to the pre-pandemic level of 65 in January 2020 (that was followed by a plunge to 40 points). The confidence index reached 57 points, exactly the same level as 15 months ago. The euphory from the lifting of most restrictive measures will probably elevate the indexes to even higher levels in the summer.

The respondents assess very positively not just their own situation but the short-term perspectives of the Hungarian economy as well. The macroeconomic outlook index stood at 65 points, the highest in the last 17 years. (This score was surpassed only once, in 2004, just before the EU accession.) Even though the assessment of the respondents' own situation still trails its 2019 levels, the trend is favorable: the assessment of outlook for the next 6 months is on par with its pre-pandemic levels. The number of respondents that deem their own present position bad keeps decreasing and was only 7 percent in the second quarter (from 36 percent in last autumn). At the same time, the firms assessing their present situation favorably do not expect a negative turn in the near future.

The respondents' production forecast score stood at 65 points, the same as in the previous quarter. The capacity utilization is at 75 percent, the highest since the start of the pandemic. Among the hindering factors, insufficient demand lost further prominence and labor shortage is the primary impediment once again. While only 10 percent of respondents cited shortage of imported inputs as an impediment, this is more than double of the 4 percent in the previous quarter. This ratio was 15 percent in the spring of 2020, but then it was due to physical movement restrictions while now it is due to excessive demand. This is why the shortage of imported inputs is likely to become one of the most important hindering factors by the end of this year.

During the pandemic we have been following the share of respondents that made use of the various support schemes created by the state. The results continue to suggest that





only about one-fourth of the firms applied for any of the schemes. Wage subsidy schemes remained the most popular (16%). Only 8 percent of the respondents implemented any layoffs, and the layoffs were usually small-scale. 85 percent of the firms left their capacities unchanged. Furthermore, half of the participants said their output reached its pre-pandemic level, and the ratio of firms that do not expect to achieve full recovery befor 2022 decreased further, to 30 percent.

In sum, the manufacturing firms are gradually emerging from the shock of the pandemic and the recovery seems robust. The shortage of imported raw materials and parts and components may cause problems, however, and not just the shortages but the price hikes may hinder the continuation of recovery. In addition, firms need to brace themselves for the return of labor shortage – possibly more severe than before the crisis since state accelerators are running at full speed throughout Europe, exacerbating the draining effect.

3.1.2. Construction

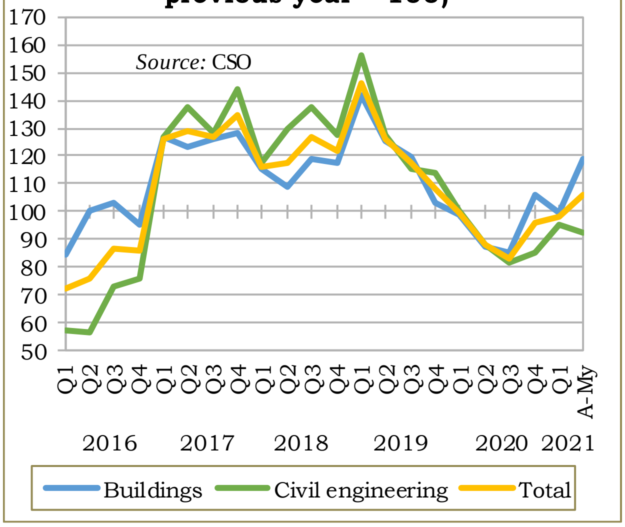
In 2021, year-on-year indexes have continued to improve so far: output decreased mildly, by 2 percent, in the first quarter, and grew by 5.8 percent in April-May. But the growth performance of the individual main groups of construction fluctuated widely. The output of the construction of buildings in the first quarter, after the expansion posted in the fourth quarter of 2020, only to expand by a whopping 18.9 percent in April-May. As for civil engineering, the rate of decline eased to 5 percent in the first quarter but deteriorated again to nearly 8 percent in April-May. The seasonally adjusted data shows that the average monthly output of building construction is already relatively close to its pre-pandemic levels while the output of civil engineering got basically stuck at a low level.

On a five-month average, the production of the construction of buildings grew by 6.6 percent on an annual basis while civil engineering was down 6.3 percent.

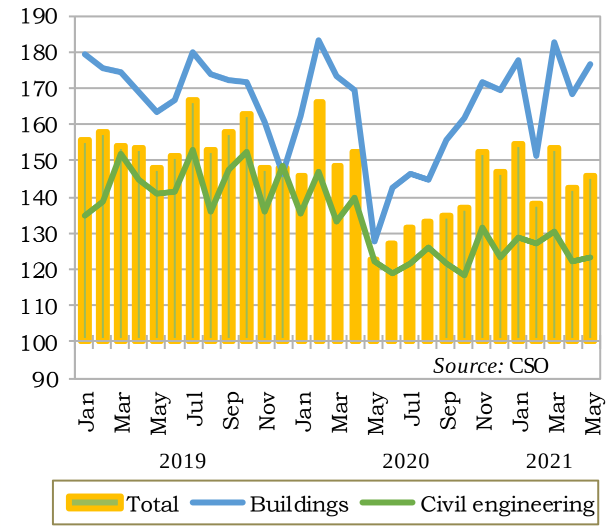
According to the iBuild database, building construction is affected by the decrease in the volume of ongoing housing construction projects on the one hand, and by the expansion of non-residential building activity (industrial and logistical buildings) on the other. Civil engineering was hit by a decline in road and utility construction projects while railroad development activities were still on the rise.

According to the CSO, the volume of outstanding orders was more than 10 percent higher than on year earlier in four months out of five in 2021, an encouraging fact. The growth rate was usually above 20 percent in the case of building construction but the very mild year-on-year growth in the case of civil engineering is also a favorable change compared to the steep fall in the past couple of years. The positive change in the dynamics of orders in civil engineering is due to the new (for example, railroad-related) orders in civil engineering, while in the case of building construction, the low level of new orders was offset by the even slower phasing-out of the existing orders. The latter may be partially a result of the pandemic that delayed the completion of many building construction projects. More recently, the input price hike and the input shortage pose a serious problem for the construction sector.

Construction output by main groups (same period of the previous year = 100)



Construction output (seasonally adjusted, 2015 = 100)



A less than encouraging sign is that, according the iBuild database, the value of *newly started* projects is far from suggesting an upturn of activity in the future. The value of newly started projects decreased by 33 percent on an annual basis in the case of building construction and by 45 percent in the case of civil engineering. In building construction, the decrease is due to the low volume of non-residential projects – the very area where the level of *current activity* is still on the rise.

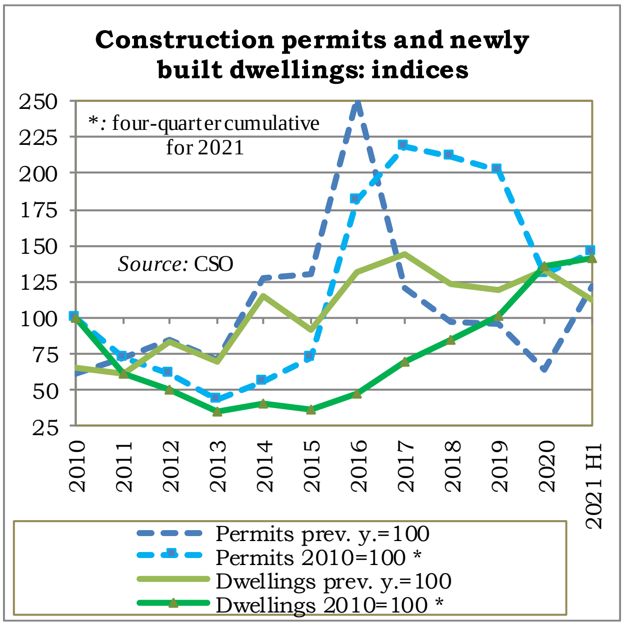
In any case, year-on-year production indexes will be positive from May on, due to the low statistical base. Also, the lifting of the lockdown measures may lead to an upturn in new orders. The **annual growth rate**, however, is likely to remain well below 10 percent in 2021.

3.1.3. Housing construction

The steep year-on-year growth of the number of dwellings built continued in the first quarter (at a rate of 28.9%) but reversed in the second (-6.9%). The negative turn is not entirely unexpected since the volume of the *ongoing* housing construction activity has been heading downward for a while, according to the iBuild database. This is mostly because the previous conjuncture cycle reached its downward phase, but the pandemic somewhat hindered the ongoing construction activity as well. Still, the first half of the year saw a growth of 12.8 percent in the number of dwellings built.

The same is true for the value of *newly started* housing projects, even though here the year-on-year decrease is partly due to the high statistical base. Since the number of *housing permits/notifications* finally began to rise in the second quarter (by 63%), a positive turn in the volume of newly started housing projects may take place in the near future as well.

The reintroduction of the preferential VAT rate (5%) for housing construction projects that receive building permit between the start of 2021 and the end of 2022 and completed before the end of 2026 on the one hand, and the new housing support package on the other, changed the underlying conditions for the housing construction sector. As a result, we can expect an upturn in the volume of newly started construction projects soon. As for the number of dwellings completed, it will remain high but probably continue to slide on an annual basis in the second half of the year.



3.2. The final use of GDP

3.2.1. Household income, consumption and savings

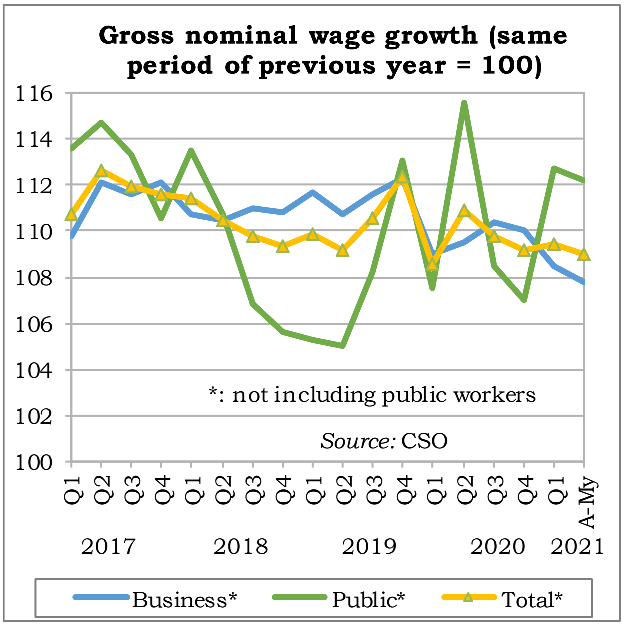
In 2021 wages keep growing at a relatively fast pace: In January-May, the average growth rate was 9.5 percent (9.3 percent if firms with a staff less than 5 employees are excluded). This is noteworthy in the light of the fact that both types of minimum wages were raised only by 4 percent. Wage growth was more dynamic in the public sector (12.4%) than in the business sector (8.4%). Public sector wage growth was primarily driven by the drastic raise of physician wages but wages in the education sector also rose by more than 10 percent as well. The rate of business sector wage growth is still substantial, too, but its pace is the lowest since 2017.

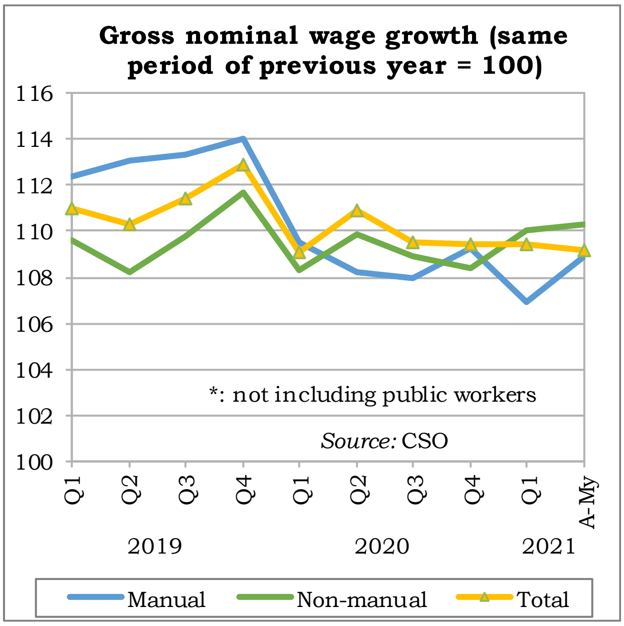
The wages of manual workers still grow at a slower pace than non-manual wages but accelerated from 6.9 percent in the first quarter to 8.9 percent in April-May. This is partially a result of the lower statistical base – the wages of manual workers took a larger hit in the spring of 2020 than non-manual wages – but it can be also partially a reflection of the return of labor shortage.

Real wages were up 5.4 percent in the first five months of the year, showing a slow deceleration. On the other hand, the number of employees began growing in March and surged in April-May, due to the low statistical base, pushing the ***net real wage disbursement*** index upward. The cumulative index, calculated only for full-time employees, was 8.8 percent in January-May, as opposed to the decline seen in 2020.

Wage growth is likely to slow down somewhat during the rest of the year, with an annual average of roughly 8.3 percent. This, along with the fast rise of the number of employees, is likely to result in a dynamic annual growth of real wage disbursements, at a pace near 8 percent.

The year-on-year decline of ***private consumption expenditures*** accelerated to 4.8 percent (from 3.7 percent in the previous quarter), while total private consumption decreased at a lesser pace, by 3.7 percent. Since at the same time real wage disbursement growth gathered pace, the trends of real wage incomes and consumption diverged again. From the second quarter, not just wages but entrepreneurial incomes



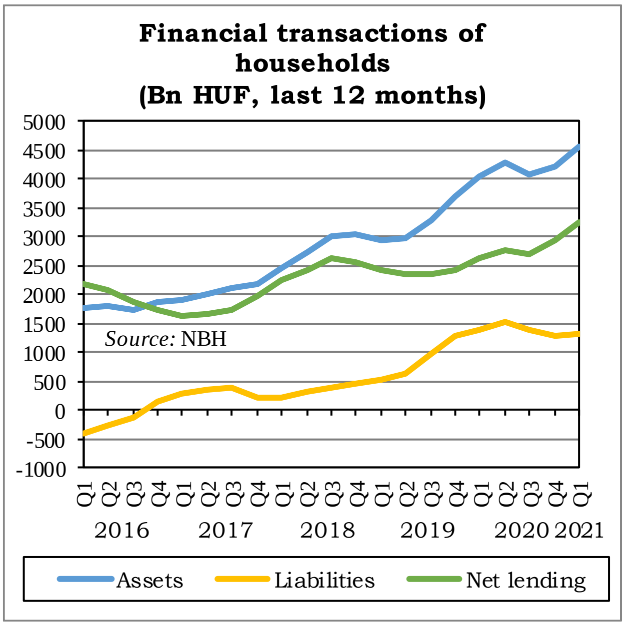


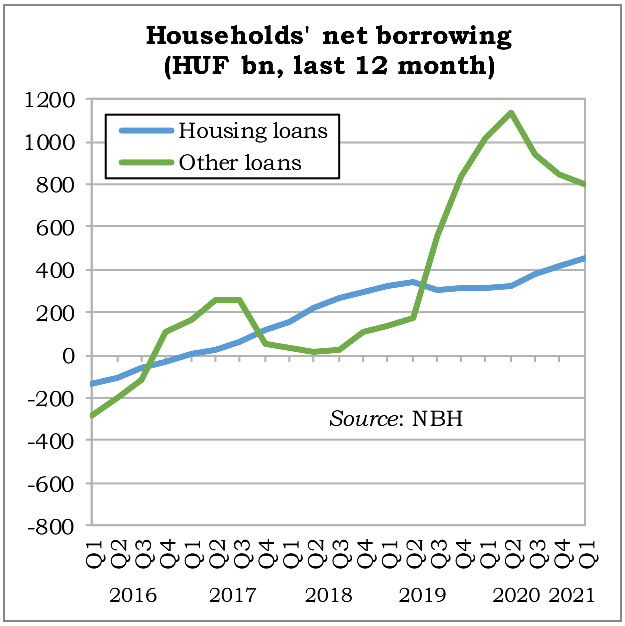
expand as well, giving a further boost to overall household incomes, enabling a substantial growth of household consumption.

As a result, we expect private consumption to expand at a rate somewhat **above 4 percent**, despite the negative in the first quarter.

The nominal value of households' ***net financial capacity*** was up about 48 percent on an annual basis, resulting in a new cumulative four-quarter record high. This a result of both the rise in gross financial savings, and the fact that the previous upward trend of net borrowing that halted in mid-2020 has not returned yet. Gross savings grew primarily due to the inflow into current accounts and mutual fund shares. As for net borrowing, it virtually stagnated because of the high statistical base (surge of "baby loans" in the basis period, but on the other hand, the rising trend continued in the case of housing loans. The first factor prevailed because the weight of non-housing borrowing is still higher, as it has been since the introduction of baby loans in 2019.

The four-quarter cumulative saving rate climbed to 6.7 percent of GDP in the first quarter, from 6.1 percent at the end of the last year. The savings rate in the first quarter alone was unusually high, 8.5 percent – it will decrease later in the year as consumption gathers momentum.





3.2.2. Investments

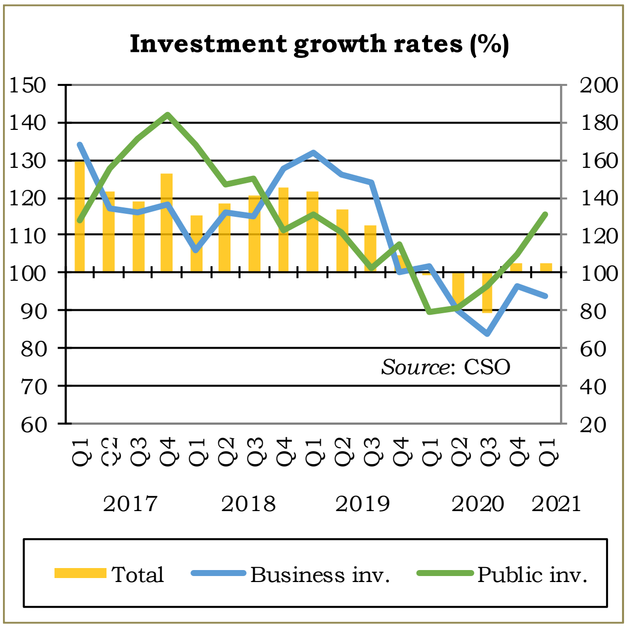
In the first quarter, investments grew by 2.5 percent, the same as the annual rate in 2020. This is not an especially favorable: investments failed gain additional momentum and also its structure worsened. The fall of corporate investments accelerated (to 6.3 percent), hence the modest growth is entirely due to the revving up of state investments and household investments. The seasonally data show that the level of investments almost stagnated compared to the last quarter of 2020: the post-shock upturn almost halted.

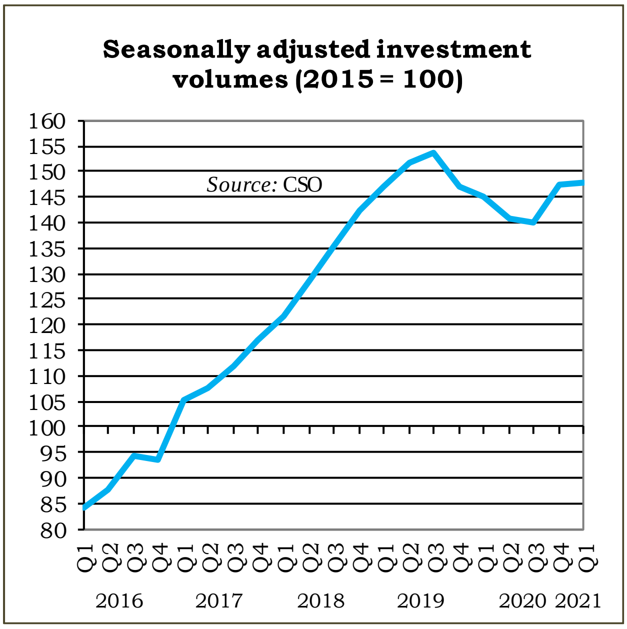
The 30.6 percent growth of state investments basically achieved a return to the level seen in the first quarter of 2019. Public administration and education investments expanded at rates above 30 percent while healthcare and social sector investments at a rate above 45 percent, from very low basis levels. Unlike the investments of central public administration bodies, the investments of local governments declined.

Corporate investments decreased primarily due to the weakening investment activity of *foreign-owned* firms. Accordingly, *manufacturing* investments dropped by 10.1 percent on an annual basis, and the decrease was widespread among manufacturing branches. This may be related by the concentration of resources toward the corporate headquarters in the home country after the financially draining crisis.

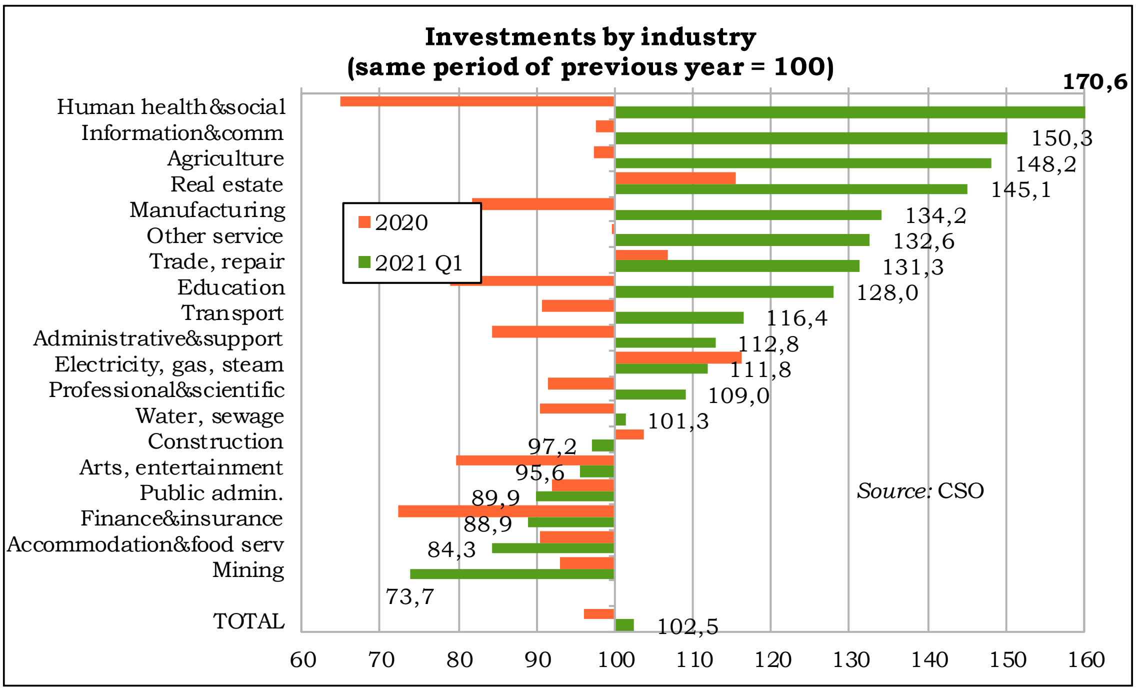
Investments fell not just at private firms but also in the state-linked quasi-fiscal sector: transport and storage investments were down by 16 percent due to the completion of many previous infrastructure projects. Besides, agricultural investments fell steeply, by about 26 percent.

But even so, investment did grow – in most cases, at a two-digit rate – in the majority of economic industries. This did not turn the overall growth rate to the positive because the areas that achieved the most spectacular growth rates (arts-entertainment, construction, other services) are relatively small. while at the same time the two largest industries (manufacturing, transport) decreased drastically. Out of the more prominent areas, real estate investments grow in the first quarter (due to the still rising number of dwellings completed) and domestic trade (due to the development of retail stores).





We expect an upturn of investments during the rest of the year: the average annual growth rate may reach 6-7 percent. State investments will support growth for much of the year while the return of optimism among firms will lead to a recovery in corporate investments. Also, from the second quarter, the low statistical base in itself will raise the year-on-year indexes. Households will rev up their housing investment activity further. There are also reasons not to become too sanguine, however: the financial standing of many firms deteriorated sharply during the long pandemic, and the NBH *started a rate hike cycle*, due to surging inflation and wrapped up its popular FGS Go! preferential credit scheme. These developments will eventually lead to rising financing costs, even though the government tries to prevent this by launching its own new credit package under the aegis of the Széchenyi card program.

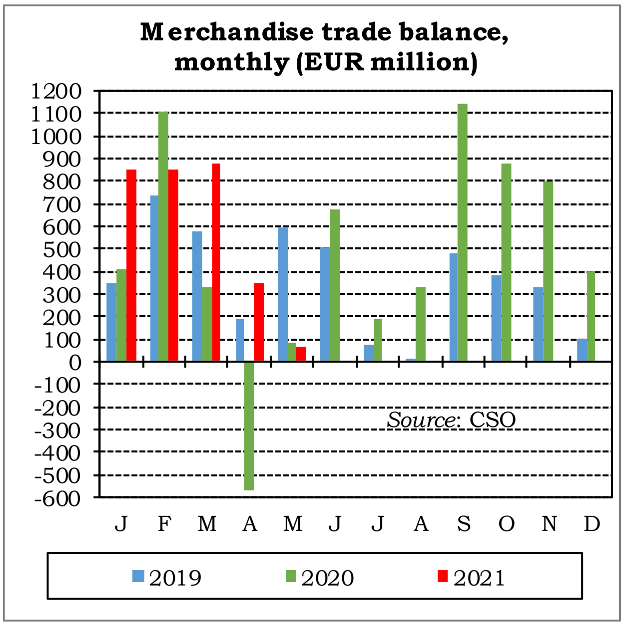


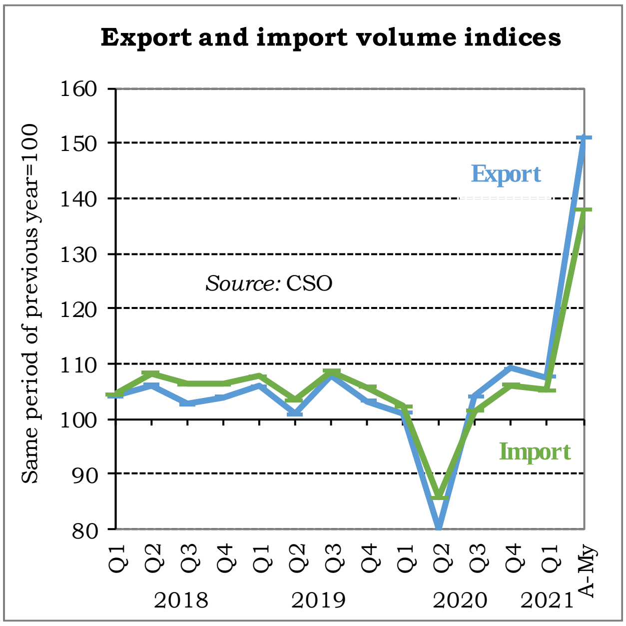
3.2.3. External trade

After the first shock of the pandemic, the external trade turnover recovered much faster than expected, and by the last couple of months of 2020, both export and import surpassed the levels registered one year earlier. The turnover turned into decrease for a short while in January, due to industrial disturbances caused by the chip shortage but returned to growth afterwards and accelerated from April when the statistical base plunged. From February onward, export and especially import volumes are steadily above pre-pandemic levels.

In addition, in four out of the first five months of 2021, export rose at a higher year-on-year rate than import. On a weighted average, the volume of export grew at a pace nearly 5 percentage points higher than that of import. As a result, the cumulative five-month trade surplus amounted to EUR 3 billion, **more than twice** the surplus in the same period of the previous year.

During the rest of the year, a trend change will likely occur. As both consumption and investments gather momentum around the middle of the year, import growth rates are expected to catch up with export growth rates, especially if logistical problems and shortages keep industrial export from taking off. But even so, the annual trade surplus will probably surpass the last year's surplus spectacularly.





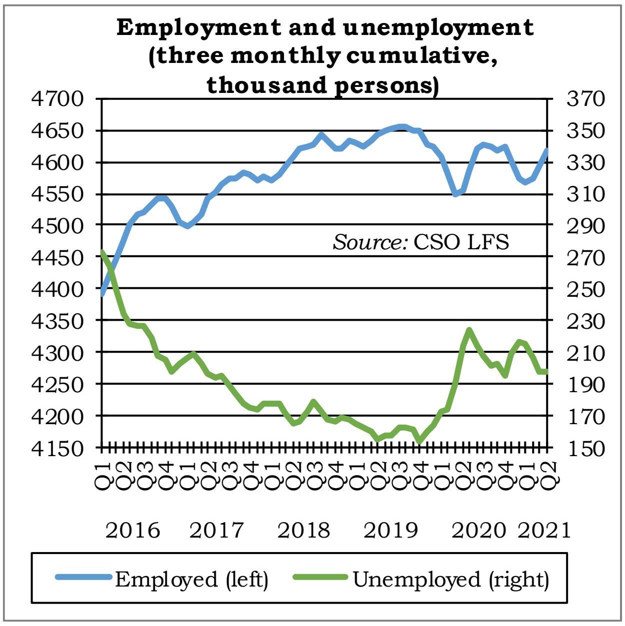
3.3. Employment, unemployment

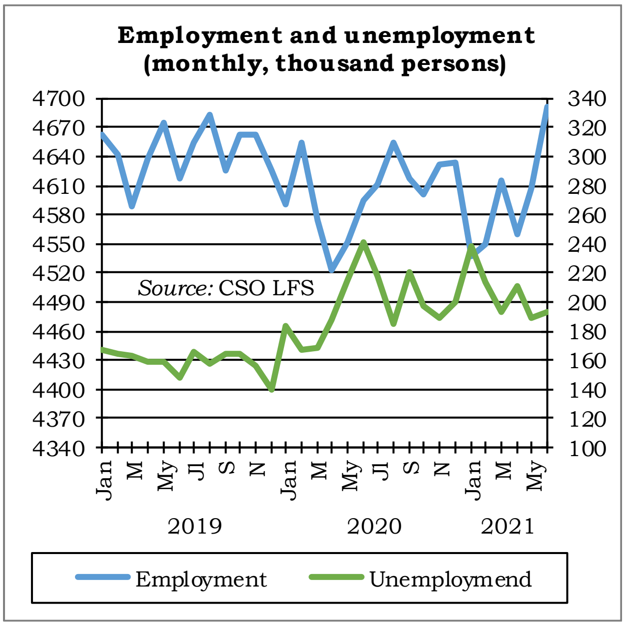
According to the LFS data, the employment situation improved again from the spring after a temporary relapse at the end of last year, due to the second wave of the epidemic. As the monthly data shows, June was the first month when the level of employment was akin to pre-pandemic levels. While the *number of employed* decreased on an annual level – by 0.9 percent – in the first quarter, it increased by 1.4 percent in the second. Apparently, the negative impact of the third wave was even more fleeting than that of the second. A similar pace of growth can be expected for much of the rest of the year.

The *unemployment rate* was 4 percent in June, down from 5 percent in January, but this is still almost identical with the annual rate in 2020.

A favorable aspect of employment growth is that much of it happens in the *primary domestic labor market*: the number of employed abroad decreased even in the second quarter. Also, the contribution of public works employment to overall employment growth was negligible. Less favorable is the fact that the number of *employees* decreased in the first quarter – only the number of individual entrepreneurs grew – and even in the second quarter, the number of employees grew at a below-average pace. The fast growth in the number of entrepreneurs may indicate that still many former employees have difficulties in getting a "normal" employment contract.

The employment situation is likely to improve further in the second half of the year, the number of employed may be close to pre-pandemic peak levels. The unemployment rate seems stickier, but still, the annual rate is likely to decrease somewhat from its 2020 level of 4.1 percent.





3.4. Fiscal, monetary and financial developments

3.4.1. Fiscal developments

Fiscal trends in 2021

Fiscal policy has remained procyclical: a high fiscal deficit is envisaged despite the rapid economic growth. The frequent change of deficit targets makes the analysis and forecasting of fiscal changes difficult.

With the easing of the coronavirus pandemic, economic conditions gradually improve, with a deceleration of GDP fall in the first quarter (and the return to growth afterwards). This alleviates the pressure on fiscal policy while trying to overcome the damage caused by the crisis. On the other hand, the start of monetary tightening poses a challenge to fiscal policy.

The central subsystem of the general government posted a cumulative revenue of HUF 11,641 billion and a cumulative expenditure of HUF 13,345 billion. The fiscal balance amounted to HUF 1,705 billion.

The cumulative deficit of the first half of the year exceeded the original fiscal target by more than 20 percent. On May 26, the deficit target was revised upward, to 7.5 percent of GDP. The EU has temporarily lifted the Maastrich deficit rule – to make it easier for governments to stimulate economic recovery – hence the deficit target does not infringe EU regulation currently in effect. According to the amended deficit target, the cash-flow deficit is envisaged to reach HUF 2,288 billion, 74 percent of which was reached by the end of June. The accrual-based, ESA-compliant deficit target (7.5 percent of GDP) amounts to about HUF 3,900 billion.

The changing of the deficit target makes it harder to analyze fiscal developments, not to mention predict fiscal outcomes. Notably, both the Fiscal Council and the central bank says, in the light of the favorable growth trajectory, that a lower fiscal deficit would be warranted.

In the first half of the year, nominal revenues grew by 9 percent and expenditures by 6.6 percent – thus, the cumulative deficit was somewhat below the deficit in the same period of the previous year. It should be noted that in June, expenditures uncharacteristically decreased on an annual level, which will be certainly a temporary phenomenon.

Regarding the main budgetary items, revenue grew in the case of corporate income tax (by 85 percent), itemized tax on minor taxpayers, VAT, personal income tax, payments of local governments and the pension and health security funds. The large growth from corporate tax is due to the fact that in 2020, amid the acute crisis, the deadline of declaring and paying tax liabilities was deferred to September while this year, the usual deadline – in May – was again in effect. That is, much of the growth was the result of an administrative change, instead of changes in the real economy, including business profitability. The inflow from the itemized tax on minor taxpayers rose due to an expansion in the number of minor taxpayers. Payments of local governments grew because of the government measures to divert various items of revenues from the local governments toward the central government. Personal income tax revenue growth, on the other hand, was mostly driven by rising wage disbursements, due to wage and employment growth.

On the other hand, revenues from the social contribution tax almost stagnated (due to the epidemic-related exemption given to employers and the reduction of the social contribution tax rate from 17.5 to 15.5 percent), while revenues related to state property, interest revenues and revenues from EU programs almost halved in January-June.

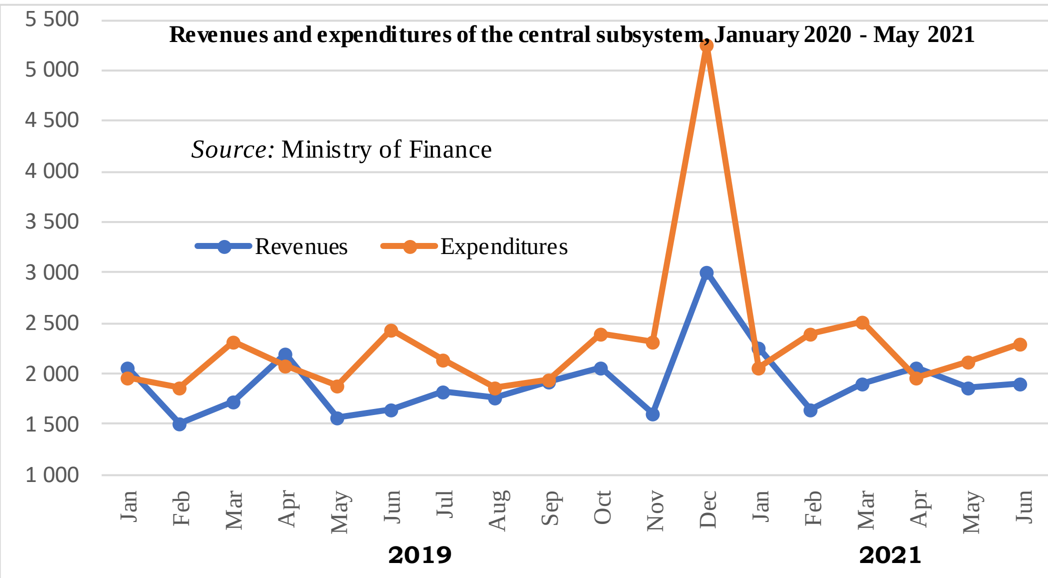
On the other hand, expenditures grew in the case of the pension and health funds, financing of EU programs, extrabudgetary funds (tenfold growth in the case of central nuclear fund), guarantee and contribution to social security funds' expenditures, transfer to local government, expenditures related to state property (threefold growth), family benefits and social allowances, and expenditures related to state property. The expenditure on EU programs amounted to HUF 987 billion in January-June.

According to an April communication of the Ministry of Finance, much of the growth of expenditures is due to the items related to the economic restart. About HUF 400 billion was spent on counter-epidemic measures in January-April. The sector-specific wage subsidy was extended again. In addition, the communication highlighted spending on support to enhance competitiveness (HUF 86 bn), railway development (HUF 60 bn) transport sector related programs (HUF 59 bn), road development (HUF 58 bn), the "modern cities" program (HUF 42 bn) and tourism development programs (HUF 38 bn).

The monthly balances fluctuate widely: just as in the previous years, surpluses were posted in January and April and deficits in the other months. Fluctuating monthly revenue sums and changing rules regarding revenues make hard to assess the trends.

The 24 percent growth in VAT revenues may have been partly due to the unexpectedly high inflation. The latest convergence program, published in April, envisaged a growth rate of 4.8 percent and an inflation rate of 3 percent. (The latter corresponds with the medium-term target of the NBH.) By contrast, the average inflation rate was 4.2 percent in January-June while GDP still decreased on an annual basis in the first quarter. The NBH expects an annual inflation rate of 4.1 percent for 2021, while we expect an even higher rate of 4.4 percent.

The fiscal developments will be shaped, besides government measures and inflation trends, by economic growth rates in the coming quarters. The possibility of a higher



than predicted growth rate constitutes an upward risk for our deficit forecast. The convergence program envisages a growth rate of 4.3 percent in 2021, as opposed to the 6.2 percent posited by the NHB. A stronger-than-expected wage growth rate (outside the budgetary sector) would also have a positive impact on fiscal revenues. Furthermore, if the EU and Hungary agrees upon the Hungarian recovery plan, the EU may transfer 13 percent of the resources allocated to Hungary before the end of the year.

Fiscal debt

Due to the procyclical fiscal policy, the debt-to-GDP ratio decreases, albeit at a symbolic pace. Debt financing will remain manageable, due to the low-yield environment. Should the fiscal trends diverge from the trajectory envisaged by the government, that may provoke a negative response from the major rating agencies.

During the first six months of this year, the central government debt rose by HUF 731 billion, to a total of HUF 37,415 billion. Forint-denominated debt expanded by HUF 1437, entirely due to publicly issued government securities. More specifically, the stock of bonds and retail securities rose while the stock of discount T-bills decreased. On Earth Day (April 22), a new fixed-rate bond was issued with a thirty-year maturity, under the name of Green Hungarian Government Bond. The aim was to develop the domestic sustainable capital market, increase diversification and lengthen the average maturity of Hungarian government debt. A total of HUF 30 billion was sold, amid substantial excess demand. At the end of June, 79.2 percent of the central government debt was financed by HUF-denominated government securities, as opposed to 76.8 percent at the end of December 2020.

At the same time, FX-denominated debt decreased by HUF 707 billion, partially due to the net repayment amounting to HUF 441 billion. The last time the Hungarian Government Debt Management Agency issued international bonds was in November 2020. As a result, the weight of FX debt within overall debt decreased to 17.7 percent by June from the 20 percent at the end of December 2020.

Central government gross debt

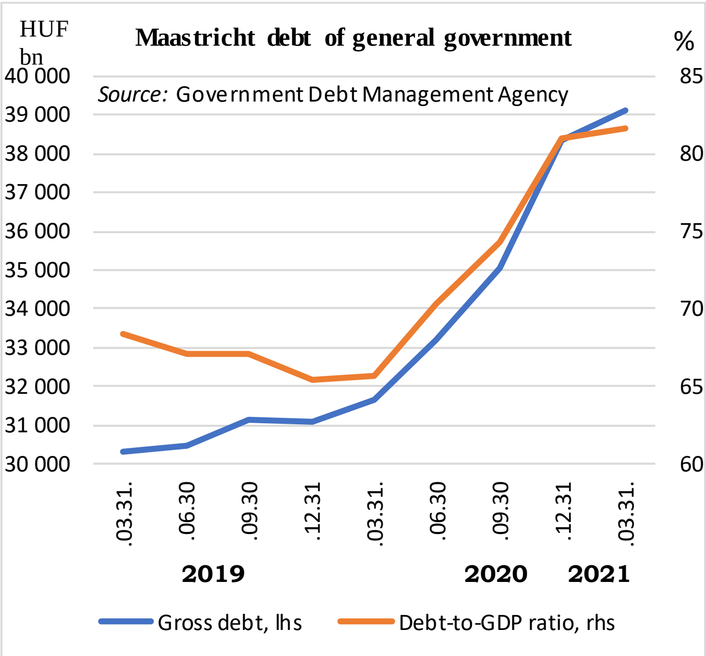
	2020		**2021**		**Change**	
(HUF bn)	**Dec 31**	**%**	**May 31**	**%**	**HUF bn**	**%**
Forint denominated	29 237	79.7	30 665	82.0	1 427	4.9
Loans	1 162	3.2	1 157	3.1	-5	-0.4
Bonds	18 246	49.7	19 285	51.5	1 078	5.9
T-bills	658	25.0	565	1.5	-93	-14.1
Retail securities	9 172	1.8	9 618	25.7	447	4.9
FX denominated	***7 318***	***19.9***	***6 611***	***17.7***	***-707***	***-9.7***
Total	***36 555***	***99.6***	***37 276***	***99.6***	***720***	***2.0***
Other debt	129	0.4	140	0.4	11	8.3
Total central gov. debt	***36 684***	***100.0***	***17 415***	***100.1***	***731***	***2.0***

Source: Government Debt Management Agency

The appreciation of the forint against the euro, cross-currency changes and the decrease of the sum deposited at the Government Debt Management Agency as cover had a downward effect on central government debt level.

According to the NBH data, the total debt of the general government – including the debt of the Eximbank – rose to HUF 39,110 billion (81.7 percent of GDP) at the end of the first quarter from HUF 38,408 billion (80.4 percent of GDP) at the end of 2020, that is, both the nominal sum and the GDP ratio of the fiscal debt continued to grow, even if at a much slower pace than in 2020. In its latest convergence program, the government envisaged a debt-to-GDP ratio of 79.9 percent by the end of 2021. The objective of slightly reducing the relative debt level during the coming quarters is probably informed by the wish to comply with the relevant criterium set by the Hungarian stability act. It is questionable, however, whether the amended deficit target is consistent with the plan to reduce the fiscal debt, however slightly.

The Hungarian debt targets for 2021 and 2022 do not violate any EU rules since in the light of the coronavirus pandemic and the resulting economic crisis, the EU temporarily suspended the fiscal deficit and debt rules until 2023.



Hungary's credit rating – regarding both the forint and FX denominated fiscal debt – has been unchanged since last September and is classified in the lower medium category, with stable outlook at Standard & Poor's and Fitch but – in the case of HUF denominated debt – positive outlook at Moody's. The new convergence program, published in April, envisages a less favorable fiscal trajectory than what the rating agencies expected (the fiscal expansion will continue for a while, instead of being strictly temporary). Yet, neither downgrading, nor upgrading is likely in the short term. Downgrading may take place if the fiscal trends prove even less favorable than the latest government projection.

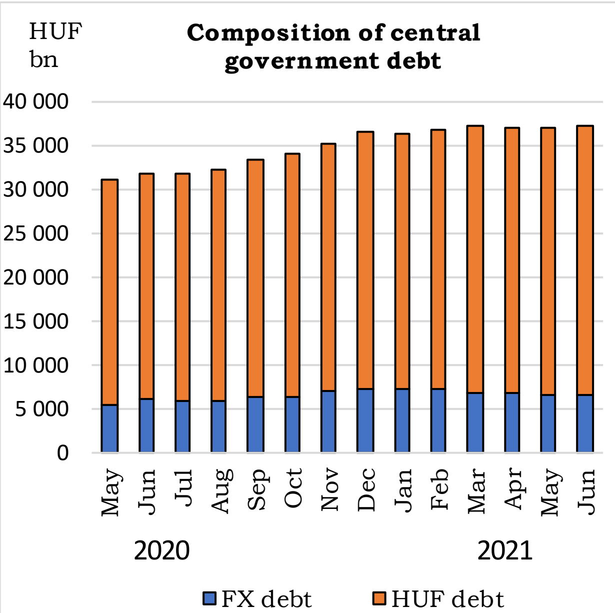
In terms of ownership structure, the share of households – the most reliable buyers/investors according to the government – was somewhat above 28 percent in January-May. The share of foreigners was 15.6 percent at the end of May, down from 17.1 percent in last December.

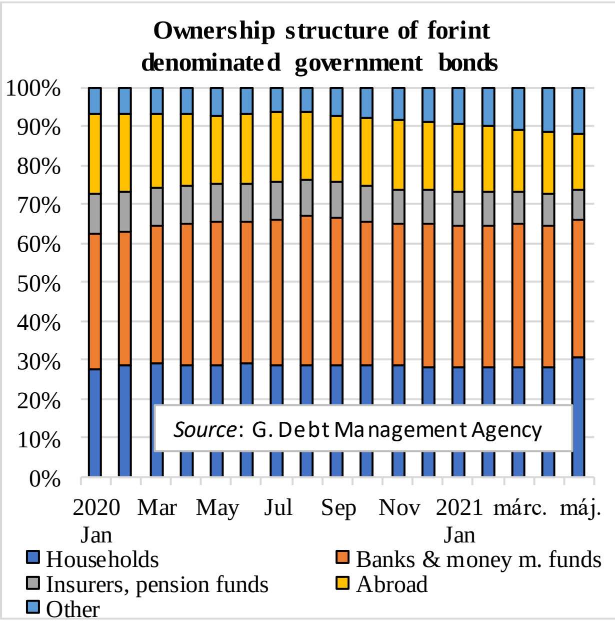
In the first half of the year, 58 percent of the modified primary issue plan of the Debt Management Agency was fulfilled. Within that, 48 percent of the gross HUF retail market issuance plan was fulfilled while the respective ratio for the institutional market HUF bond issuance plan was 76 percent At the end of the first quarter of 2021, the liquidity reserves of the state amounted to 5.5 percent of GDP.

The Government Debt Management Agency, following the amendment of the yearly deficit target in May, revised its own financing plan. The long-term plan is still the lengthening of the average maturity of government debt and the smoothing of the maturity structure. 10-year bonds constitute the bulk of new issuances.

The financing of debt through HUF denominated liabilities has the drawback of being more costly than the FX denominated debt financing. In the present favorable international low-yield environment, debt could be financed through FX bonds at lower interest rates than HUF bonds. (The Government Debt Agency Management sold 10-year and 30-year euro bonds at market yields of 0.64 and 1.66 percent, respectively.) This, however, has a condition, namely the stability – or even strengthening – of the forint against the euro. The price that must be paid for the reduction of exposure of external impacts.

The situation is similar regarding financing the state debt through retail securities. The higher yield offered to households makes this solution costlier and exacerbates the fragmentation of the financial market. The large interest rate and yield premium compared to deposit interest rates divert household savings from banks toward the government securities market, weakening the efficiency of the banking system. In addition, a redistribution of incomes takes place between taxpayers with no savings – consequently, with no security holdings either – and the more well-off households with substantial savings that buy the government securities. The strengthening of the forint against the euro may be a positive risk factor because it can reduce the debt-to-GDP ratio. Finally, savings may create an additional risk. With the ongoing recovery consumption gains momentum and may lead to a decrease of savings, including demand for government securities – unless the saving propensity or a change in the preference regarding the allocation of savings occurs at the same time.





3.4.2. Inflation

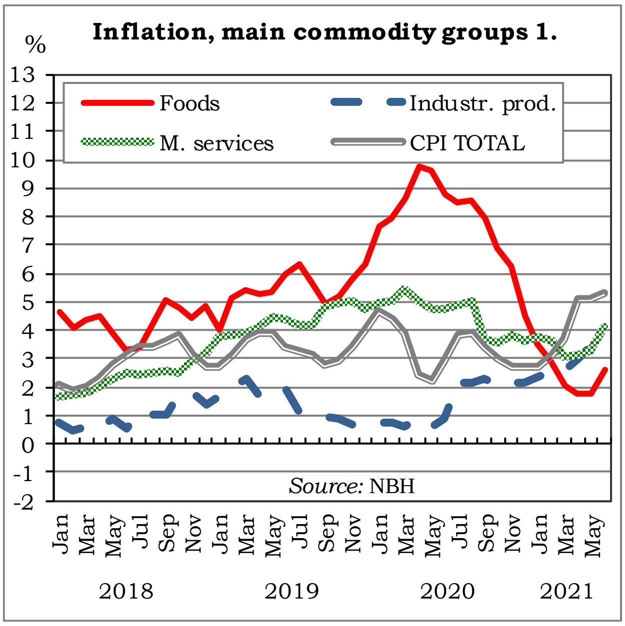
In the first six months of 2021, the average inflation rate was 4.2 percent. Hungarian inflation was the highest within the EU in the first half, ahead of Poland, Romania and Czechia. Notably the V4 countries and Romania are in the negative "forefront" of the EU in terms of inflation, except of Slovakia. The other Eastern European countries (Baltic and Southern European member states) are usually among the countries with moderate inflation rates.

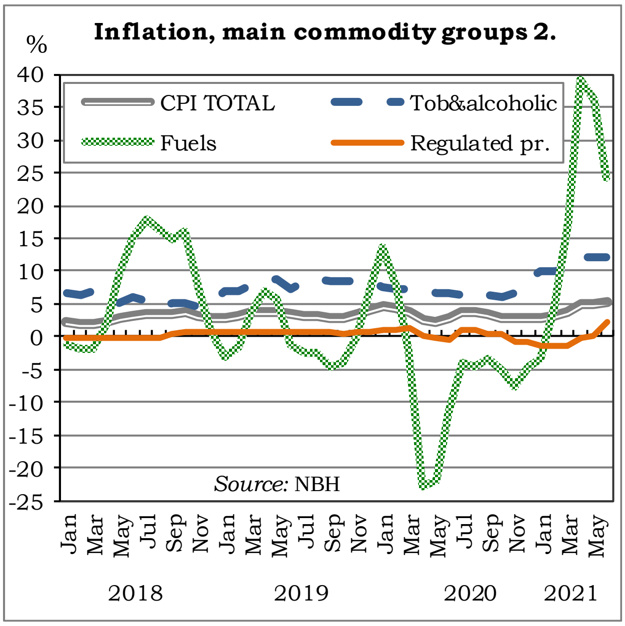
The Hungarian price index was steadily rising from 2.7 percent in January to 5.3 in June. The monthly rates are likely to moderate from July but may rise again to (or near) 5 percent in the last months, mostly due to the statistical base effect.

Unlike in the last year, now inflation is not so much driven by food prices but rather the global oil price hike that led to skyrocketing fuel prices. As opposed to the 8-9 percent monthly food price hikes in much of 2020 (according to NBH data), the food price index has remained below 3 percent from this February.

By contrast, fuel prices plunged in April 2020, due to the pandemic, but surged by almost 40 percent in April, and the year-on-year index moderated only to 24 percent in June. These hectic fluctuations, largely driven by statistical base effect, had a substantial moderating effect on overall inflation in 2020 but have the opposite impact in mid-2021. Since no further significant global oil price surge is expected by experts, this particular factor probably will not drastically push the overall price index upward during the rest of the year.

The other important inflationary factor, the prices of tobacco and alcoholic products, have been rising consistently at an above-average pace in the recent year, courtesy of the constant raising of the excise tax rate. (In June, tobacco and alcoholic prices were up 11.1 percent.) Besides, the prices of consumer durables also began to rise from the middle of 2020, due to the steady weakening of the forint. From February on, the price index of consumer durable hovered around 3.5 percent, the highest pace since 2017. The weakening trend temporarily reversed in May, then began to rise again afterwards but has not weakened to the levels seen in March-April. This may have a moderating effect on consumer durable prices, but this effect can only become manifest with a





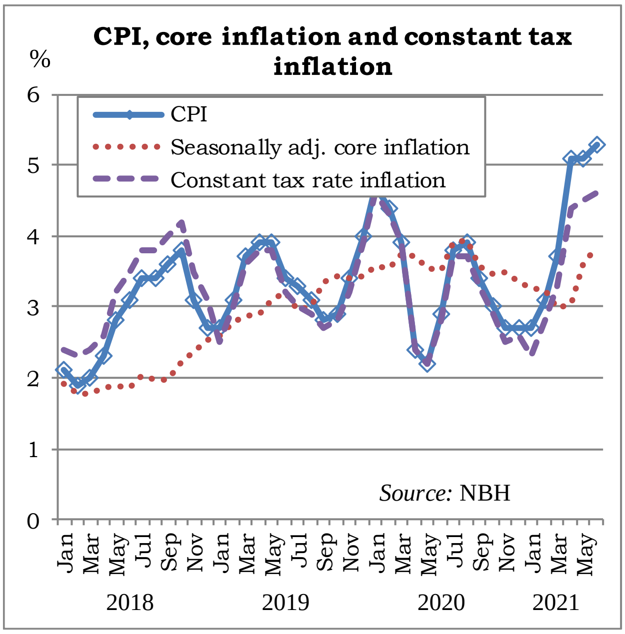
delay, just as the previous weakening spell manifested itself in consumer durable prices with a delay from mid-2020.

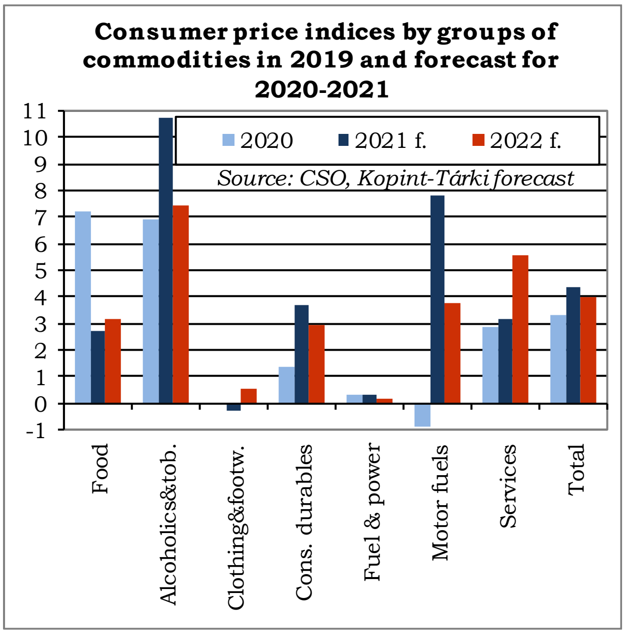
The price indices of *market services* remained moderate in the first five months of the year, even trailing expectations. Strong wage growth was largely prevented too be translated into higher services prices, due to the cautious consumer behavior regarding personal services and the brittle financial standing of certain consumer segments during the pandemic. The question is, how much this situation will change with the elimination of virtually all restrictions during the summer. In any case, an upward inflationary pressure is expected – some of it already could be seen in June when the price index of market services rose slightly above 4 percent.

Core inflation is still way below headline inflation, which highlights the crucial role of early-season vegetables and raw materials in the rise of the price index. Still, monthly core inflation rates began rising as well toward the middle of the year.

The constant tax rate inflation rate was 0.7 percentage point higher in June than the headline rate, which means that tax hikes caused additional price rises to that degree.

The inflation forecast of Kopint-Tárki for 2021 has been revised since our previous report, from 4.1 to **4.7** percent. Seeing inflation to exceed the tolerance band, the NBH raised the policy rate by 30 basis points in both June and July, reaching 1.2 percent in July. The central bank has clearly communicated that this is the beginning of a new cycle of rate hikes that will last as long as it is necessary for the inflation outlook to sustainably return into the target range. In June, the NBH expected this to happen around the middle of 2022, while we expect that to happen later, around the end of the next year.





3.4.3. Financial and capital markets

Exchange rate

The June rate hike by the central bank marked a turning point in monetary policy that largely canceled out a previous weakening spell of the forint against the euro. As a result, the annual average EUR/HUF exchange rate may well fall between the 345-355 band in 2021.

The weakening trend was fueled by various external and internal factors with differing intensity over time. The forint weakened in February-March but gained strength in May, resulting in a monthly average exchange rate that was 1.5 percent stronger against the euro than in January. A slightly more pronounced appreciation in Czechia and a somewhat less pronounced appreciation in Romania took place at the same time. During this period, the regional exchange rates largely moved together, without significant divergence.

The weakening trend was first countered by a change in the communication of the NBH that began to prepare the markets to the impending rate hike, after monetary policy-makers revised their former stance and assessed the spring surge in price indexes more than fleeting (the 5.1 percent year-on-year inflation rate in April was a 8-year high), pointing to the presence of longer-term inflationary risks. Notably the FED, unlike the Hungarian central bank, intends to keep the expansionary stance until 2023 and the ECB does not plan tightening in the short term either. The external monetary environment notwithstanding, the NBH (and the Fiscal Council) highlighted the danger of overheating the Hungarian economy in which the expansive fiscal policy has a great role. This is what the higher policy rates are intended to counter.

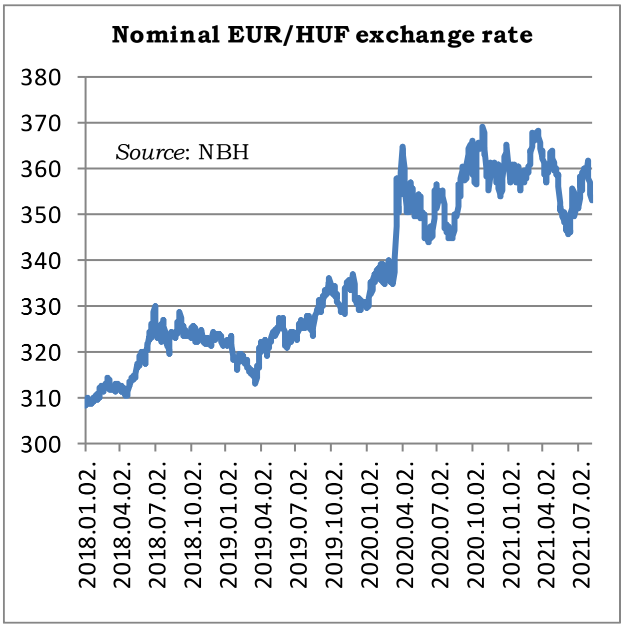
In accordance with the prior communication, the NBH raised its reference rate from 0.6 to 0.9 percent in June and 1.2 percent in September, starting a "data-driven" tightening cycle, which does not automatically mean a rate hike every month but a monthly deliberation based on the most recent data. The rate hike cycle will continue until the inflation rate moderates to the target level, 3 percent. Besides, the NBH announced that it would stop expanding its balance sheet, or it may even reduce it, which is akin to a quantitative tightening. The Funding for Growth Scheme Go!, a preferential lending program for small for medium firms, was discontinued. On the other hand, the NBH continues its corporate bond purchase program, saying that the long-term aim of the latter is the strengthening of the capital market. The interest rate of the 1-week deposit instrument is adjusted to the same level as the reference rate. These measures aim at normalizing the monetary conditions through the ending of the period of monetary easing. The markets largely factored in the rate hike, which led to a moderate (and temporary) strengthening of the forint. In any case, the rate hikes eliminate one of the country specific causes of the weakening of the forint and improve the sovereign risk perception.

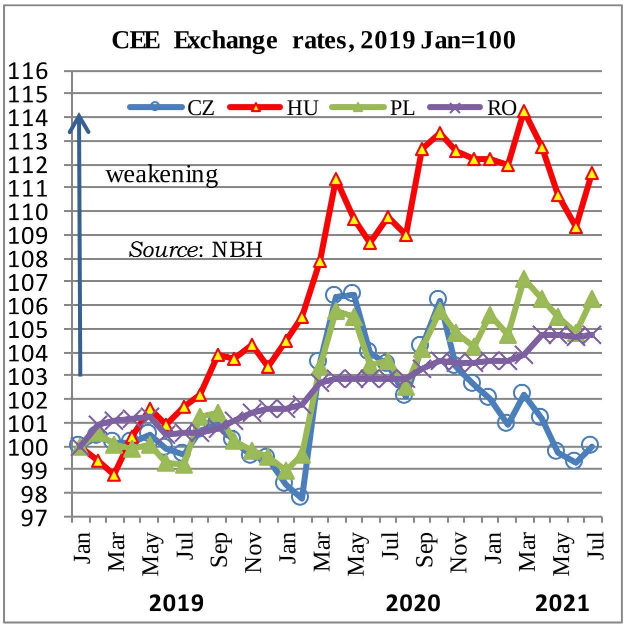
The EUR/HUF exchange rate is shaped by numerous factors, one of them only is the reference rate. The NBH does not have an explicit exchange rate target but it monitors exchange rate changes and steps up if the weakening of the forint jeopardizes the inflation target. A weakening also causes, other things equal, a rise in the debt-to-GDP ratio as well. It follows that the central bank decision about the interest rate was made due to consideration about the inflation, not the exchange rate. On the other hand, a stronger forint may also cool the overheating of the economy. By the way, the NBH has a wide range of options to influence the short-term changes of the exchange rate. The strengthening of the forint against the euro may be an intended side effect of the monetary tightening, thus contributing to the reduction of the vulnerability of the forint.

Another potential stabilizing strengthening influence is the normalization of the world economy (although negative risks abound in this regard). High public debt-to-GDP ratio, a deterioration of the current account and the external financing capacity of the Hungarian economy, a weakening of trust of external actors regarding the Hungarian political sphere and economic policy (due to, among others, the pressure governmental circles exert to buy out the property of certain foreign firms – these are the downward risks regarding the exchange rate.

Considering all these factors, the average EUR/HUF exchange rate is likely to be within the 345-350 range in 2021. A drastic weakening (to 370-380) is unlikely unless the global economic climate suddenly and dramatically worsens (stock prices collapse) and/or a resulting mass capital exodus occurs.

Among Hungary's regional competitors outside the euro area, the Czech central bank raised the policy rate in June while the Polish and the Romanian central bank left the rates unchanged, despite the mounting inflationary pressure. Compared to them, the Hungarian policy rate is the highest. Assuming other things remain unchanged, the forint is likely to fare well in the second half of the year in regional comparison.





Government yields

The new tightening cycle started by the NBH in June puts an end to the low-yield environment, which may prompt bond funds to amend their strategy.

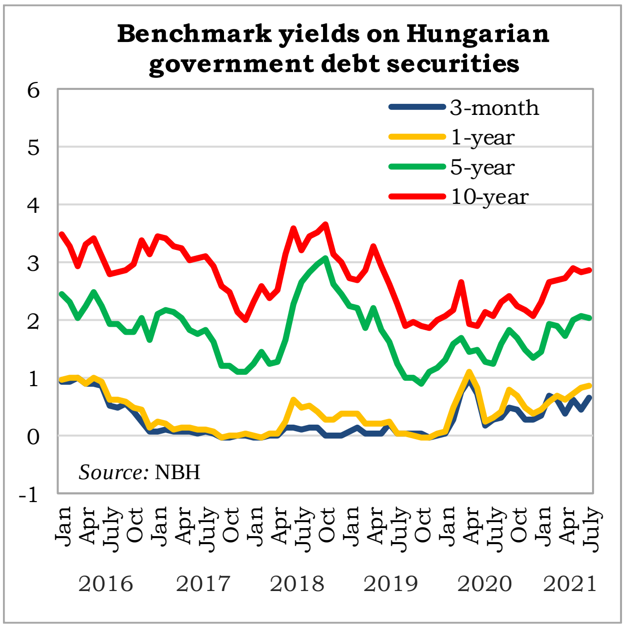
While 3-month and 1-year yields remained almost unchanged in the first seven months of the year, the yield of bonds with longer maturities rose more visibly at the same time, most substantially in the case of 3-year and 5-year yields. The 5-year yield rose from 1.45% in January to 2.04% in July, while the 10-year yield was 2.86% in July, up from 2.31% in January.

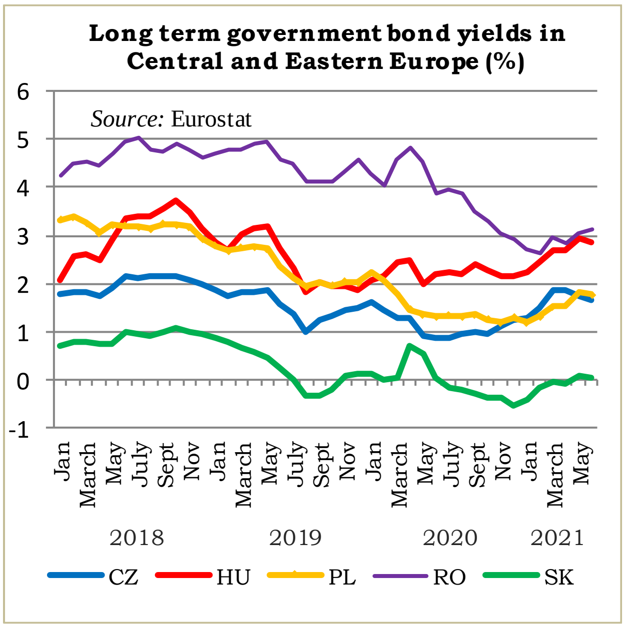
Rising yields led to a decrease in bond fund yields – the decrease was more pronounced in the case of funds that invest in bonds with longer maturities. From now, bond funds have to operate in an environment of rising government yields and will need to adjust their investment policies accordingly.

In May, the government security market was affected by the NBH communication about the future rate hikes. The NBH continues its policy of purchasing government securities to serve as a kind of safety net on the government security market through improving the monetary transmission.

This year, the external impacts have been less prominent but not negligible. According to the Eurostat, the formerly negative yields of the euro area central bank bonds became less negative in the case of bonds with 1-12 years of maturity and became positive in the case of 12-30 years of maturity between January and May. The yield of ten-year bonds rose from -0.18% in January to 0.17% in June. The movement of Hungarian yields was largely in line with this European trend.

To compare the Hungarian developments with the Visegrad countries and Romania: from January to June, the long yield soared from 1.28% to 1.67% in Chechia, from 2.22% to 2.85% in Hungary, from 1.19% to 1.78% in Poland, from 2.72% to 3.11% in Romania and from -0.43% to 0.03% in Slovakia. From this it follows that Hungary still finances the long-maturity debt at lower cost than Romania but at higher cost than the other Visegrad countries.





3.4.4. Corporate and household lending and interest rates

Corporate lending

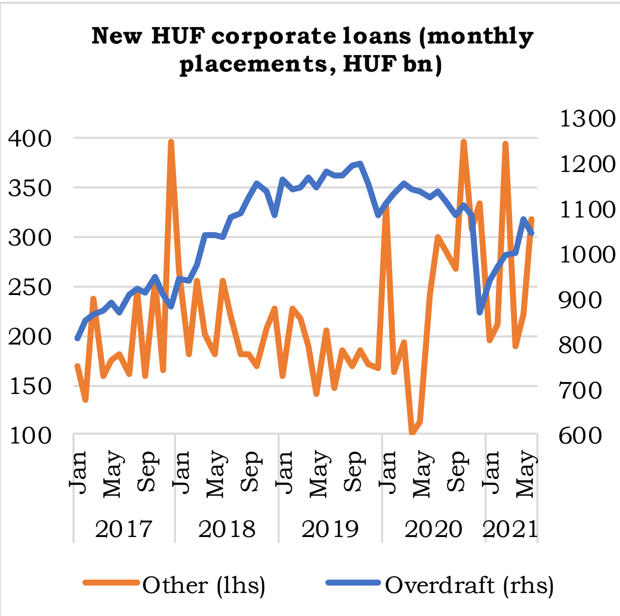
Compared to the same period of the last year, corporate *overdraft lending* lost momentum while *other lending* picked up in the first half of 2021. The discontinuation of the loan repayment moratorium and the preferential lending schemes affects business lending substantially, the less accommodative interest rate environment less so.

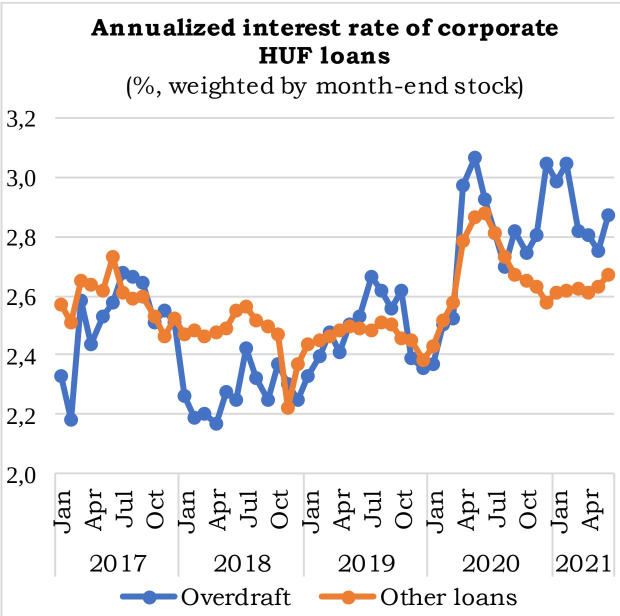
In the first six months, new overdraft loans amounted to HUF 6,035 billion, 11 percent below the amount registered one year earlier. Overdraft borrowing depends on business turnover and the firms may expect lower turnover this year and in 2020. Another possible explanation is the part of the overdraft borrowing was crowded out by the FGS Go! program. The amount of new other loans was HUF 1,531 billion in January-June, more than 30 percent higher than in the same period of the previous year.

The interest rate of overdraft loans was higher in the first half than one year earlier – partly due to a base effect – while the interest rate of other loans, on the other hand, slightly decreased on an annual basis (*entirely* due to a base effect). In the case of other loans, the average interest rate may have been kept relatively low by the FGS Go! scheme under which loans were provided at a rate barely higher than 2.5 percent.

At the same time, euro-denominated new overdraft loans are on the decrease while there are virtually no euro-denominated new other loans. This is in accordance with the policy to phase out euro borrowing as much as possible. While the interest rates of euro loans are significantly lower than the interest rate of forint loans, this is offset by the exchange rate risk. Apparently, only firms engaged in FX-denominated transactions to significant degree need euro-denominated overdraft loans.

According to the June inflation report by the NBH, the stock of business loans provided by the system of financial intermediaries rose by HUF 187 billion in the first quarter of the year. SME loans grew most dynamically, mostly due to new loans provided by the FGS Go! program (to the amount of HUF 580 billion).





Thanks to the FGS Go, more than HUF 1,800 billion was lent among more than 28 thousand SMEs, under preferential conditions, until the end of the first quarter. The repayment moratorium also contributed to the expansion of the stock of outstanding business loans.

Credit conditions are expected to become less favorable, primarily due to the planned discontinuation of the repayment moratorium at the end of September and the rate hike cycle recently launched by the NBH.

In December 2020, roughly 60 thousand firms made use of the possibility to suspend debt service (the payment of interest and principal), which affected about 44 percent of the stock of business loans. As of now, about 30 thousand firms are still benefits from the repayment moratorium. According to the NBH, about 12 percent of the business loan stock is vulnerable to the discontinuation of the moratorium. Vulnerability does not mean that all the loans involved will become nonperforming – it only means that there is an elevated risk of becoming nonperforming.

The fixing of interest rates is prevalent in the case of longer-term business loans, but less usual in the case of short-term loans. The interest rate risk is usually covered by interest rate swaps in the case of the loans to large firms. Much of the SME loans is fixed-rate loan, not to the least due to the FGS program.

The discontinuation of FGS Go! will contribute to a rise of average interest rate levels, which might be partially offset by the launching of other preferential loan schemes.

Household lending

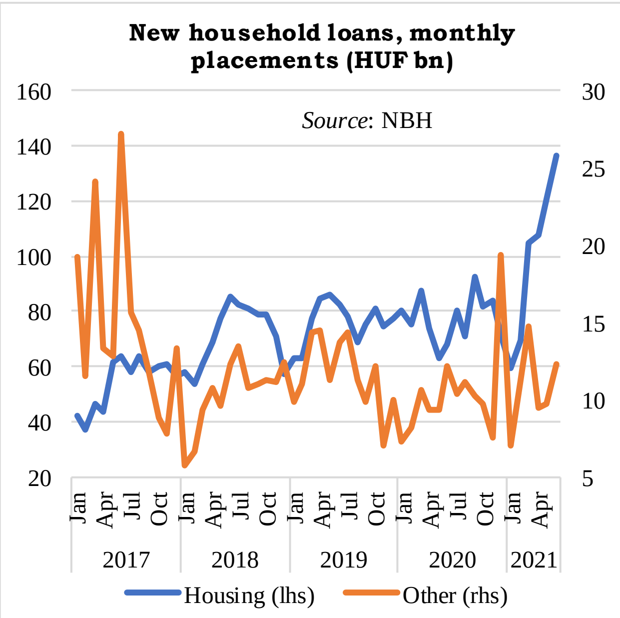
In the first half of 2021, household lending expanded significantly – housing lending has shot up spectacularly since March. The discontinuation of the loan repayment moratorium will affect household lending substantially, the less accommodative interest rate environment less so.

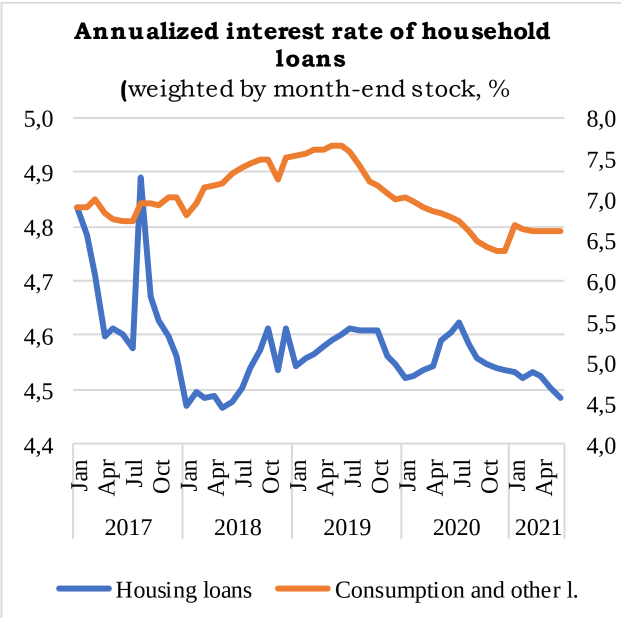
New housing loans amounted to HUF 597 billion in January-June while the respective sum was HUF 64 billion in the case of other loans. This resulted in a year-on-year growth rate of 34 and 13 percent, respectively. The trend shows upward in the case of both types of loans, although the tendency is less spectacular in the case of other loans. The annualized interest rate decreased slightly (from 6.9 to 6.6 percent) in the case of other loans and symbolically (from 4.6 to 4.5 percent) in the case of housing loans.

According to the June inflation report by the NBH, the stock of household loans provided by the system of financial intermediaries rose by HUF 226 billion in the first quarter of the year. In this quarter alone, newly disbursed housing loans decreased by 4 percent, while personal loans plummeted by 29 percent. The skyrocketing of housing loans from March on was partly induced by the fact that certain housing support measures entered into force at the start of this year – many households delayed their housing-related plans in the last year to become eligible for these support schemes this year. Also, the growth in the stock of outstanding housing loans was helped by the repayment moratorium. This effect will be active until the end of September, the amended deadline of the moratorium. 14 percent of the outstanding household debts toward the financial sector is made up by "baby loans".

The recently launched tightening cycle by the NBH has only a limited effect on household lending. The rate hike has an immediate effect only on the loans with floating rates, primarily the newly acquired loans. Based on past experience, the higher policy rates are likely to become visible in the debt service installments of household loans with a delay of 3-6 months. In any case, the NBH can have an impact primarily on the short end of the yield curve – on the long end, not so much.

Now, the share of floating-rate loans is negligible within the new mortgage loans, which means that here the higher reference rate will not have a direct and immediate impact.





A part of student loans is no-interest or fixed-interest loan as well, and the same is true for the great majority of the personal loans, too.

On the other hand, a significant part of mortgage loans (48 percent in terms of the number of loans, 41 percent in terms of total value of loans) has an interest rate fixed only up to 12 months. These loans will be affected adversely by higher interest rate levels.

The most important risk factor of household lending, and especially housing lending, is the phasing out of the repayment moratorium on September 30, 2021. It is likely that those who apply for it will be able to receive another extension of the grace period with a new deadline after the elections next year. According to an NBH estimate, 12 percent of the outstanding household loans carries a risk regarding the end of the moratorium. According to a survey by the GKI Economic Research Co., conducted on a sample of 1000 debtors, 15-20 percent of the total stock of housing loans may become problematic.

Economic Indicators 2013-2020 Forecast 2021-2022 (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	5.5	5.0
Domestic Demand	1.8	5.3	2.4	1.6	5.8	7.1	6.6	-3.0	4.0	4.9
Private Consumption	-0.1	2.1	3.6	4.1	3.8	4.1	4.6	-2.8	4.1	4.3
Public Consumption	6.0	9.8	1.1	0.3	7.5	4.1	5.6	2.8	2.7	0.0
Gross Capital Formation	6.1	12.9	-0.1	-4.1	10.8	16.2	11.3	-5.5	4.3	8.0
of which: Fixed Capital Formation	9.8	12.2	4.9	-10.6	19.7	16.4	12.8	-7.3	6.4	8.0
Export	4.1	9.2	7.4	3.8	6.5	5.0	5.8	-6.8	10.8	6.7
Import	4.3	11.0	6.0	3.4	8.5	7.0	8.2	-4.4	9.0	6.6
PRODUCTION INDICES										
Agricultural Production (gross)	12.5	11.4	-2.4	9.3	-4.1	2.7	0.4	-2.2	0.5	0.0
Industrial Production	1.1	7.7	7.4	0.9	4.6	3.5	5.6	-6.1	12.0	6.0
Retail Trade Volume	1.8	5.2	5.8	4.8	5.6	6.7	6.3	-0.4	3.8	4.2
EMPLOYMENT, EARNINGS										
Number of Employed	1.8	4.8	2.7	3.4	1.5	1.3	0.8	-0.9	0.9	0.5
Unemployment Rate	9.8	7.5	6.6	5.0	4.0	3.6	3.3	4.1	3.8	3.4
Gross Nominal Wages	3.4	3.0	4.3	6.2	12.9	11.3	11.4	9.7	8.5	8.0
Net Real Wages	3.1	3.2	4.4	7.4	10.3	8.3	7.7	6.2	3.6	3.4
PRICES, EXCHANGE RATES										
Consumer Price Index	1.7	-0.2	-0.1	0.4	2.4	2.8	3.4	3.3	4.7	4.4
EUR/HUF Exchange Rate (annual average)	297	309	310	311	309	319	325	351	353	353
EUR/USD Exchange Rate (annual average)	1.33	1.33	1.11	1.11	1.13	1.18	1.12	1.14	1.21	1.21
Short-term Interest Rates (3M), eop	2.86	1.43	0.80	0.06	-0.01	0.00	-0.01	0.28	1.5	1.8
Long-term Interest Rates (10Y), eop	5.61	3.60	3.33	3.16	2.02	3.01	2.01	2.08	3.0	3.0
BALANCE OF PAYMENTS										
Current and Capital Accounts, % of GDP	7.3	4.9	6.9	4.5	2.8	2.5	1.4	1.9	2.5	3.0
GOVERNMENT BUDGET										
General Government Balance, ESA-95, % of GDP	-2.6	-2.8	-2.0	-1.8	-2.4	-2.1	-2.1	-8.1	-7.5	-5.9
Gross Government Debt, % of GDP [a]	77.4	76.7	75.8	74.9	72.2	69.1	65.5	80.4	81.7	80.0

a Including the balance sheet of Eximbank
* Kopint-Tárki forecast

Source: CSO, NBH

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