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I. The World Economy

After the favorable **global economic growth** performance in the second quarter of 2021, dynamism may abate somewhat in the third quarter while the existing rists are becoming more prominent. To varying degrees in the various countries, a new wave of the pandemic is underway, and besides, the logistical bottlenecks, skyrocketing energy and commodity prices, the shortages of various products (like electronic chips) and their impact on several economic branches (e.g. automotive industry) – these complications all cause uncertainty among both firms and consumers. According to the latest forecast of the OECD, global economic growth will be 5.7 percent in 2021, followed by a slowdown to 4.5 percent in the next year. This projection is a downward revision compared to the spring forecast of the OECD and highlights the risks concerning a deceleration in the second half of this year. The growth rates differ significantly among the regions and individual countries.

The spectacular inflationary wave poses a downward risk to growth prospects, and it is still unclear whether or not it is a temporary phenomenon. The price hike is due to the shortages of materials and half-products, a result of the supply-side and logistical bottlenecks mentioned above, and also due to the rise in energy prices. Since the value chains have not yet recovered from the hit taken due to the Covid pandemic, producers cannot meet the ballooned demand entirely, partly due to the logistical problems which pushes shipping prices upward as well. These factors are being built in the prices, the expectations point toward the acceleration of inflation, and in the majority of countries the core inflation has begun to rise, too. The simultaneous acceleration of economic growth and inflation will soon compel the leading central banks to respond, and the first signs of a monetary tightening will become visible in the second half of this year in the case of both the FED and the ECB. In most countries, fiscal policy will remain accommodative and much of the present growth is based on fiscal stimulus measures.

The **global trade** of goods and services are expected to expand by at least 9 percent in 2021, due to the strong first half-year and the low base level. In the next year, the growth rate will inevitably slow down, due to the shortage of basic materials and the Chinese measures, but still it will be much higher than in 2019, since the global demand stimulus are likely to continue until 2023. In the short term, the trajectory of global trade is primarily moved by China since its recovery plan envisages an expansion of output, which in turn necessitates the expansion of Chinese import – the import of raw materials, first of all. Despite the dynamic year-on-year growth, the tapering of global trade expansion is already noticeable in the quarter-on-quarter growth rates, even in the case of export and import flows of the very dynamic emerging economies. One factor behind the deceleration is the deterioration of shortage of basic materials to a point where a new wave of temporary halt of production became inevitable in various plants, primarily among those firms in the transport vehicle and machinery sectors whose operation is based on global value chains. The world's largest suppliers cannot produce enough parts and components: in India, the pandemic still disrupts production, China faces energy supply difficulties, while in Brazil a drought not seen in a long time hinders the harvest in agricultural products.

Due to the revival of demand, the price of **crude oil** began to rise, reaching 75 USD/barrel by the second half of June, approaching 80 USD/barrel in late July and temporarily subsiding afterward, due to a halt in demand. Another round of price hike began in August, and the oil price surpassed 80 USD/barrel in October, a growth of about 65 percent compared to the start of the year. The OPEC+ countries decided to expand oil extraction in July. At an annual average, oil price may reach 68-80 USD/barrel in 2021, with some further rise in the next year. The prices of the **other energy commodities** soared significantly as well. Indeed, an actual global energy crisis has been forming, with a steep rise of the prices of several important energy sources (coal, natural gas) and of electricity itself. All this is due to factors like demand growth in Asia, shipping bottlenecks, and the rise of carbon prices within the EU Emission Trading Scheme (ETS). Energy prices will probably remain highly volatile in the near future.

Although the prices of several **non-energy commodities** went through a downward correction in the past months, the period of market overheating is far from over: on average, prices were 10-30 percent higher in the first eight months of this year than one year earlier. The situation is especially concerning on the global food market, with a price hike of 30 percent compared to the start of this year. The food price hits developing countries especially hard – according to the UN, famines may occur in these countries, especially if the weather conditions are unfavorable. The prices of industrial metals rose particularly dramatically, by 58 percent, in August on an annual basis, especially in segments that provide construction materials (aluminum, iron ore). The fact that China has halted the operation of its several coal-fired power plants, to lower its carbon emission, only exacerbated the situation – the resulting energy shortage led to a halt in the production of basic materials and a rise in basic material prices.

Even though **monetary policy** is to remain generally accommodative in 2021, the signs of a trend change are already here. While the *FED* considers the inflation hike a temporary phenomenon and revised its US growth forecast downward, it also hints in its communication that the planning of the phasing out of its asset purchase program may begin before the end of this year, and a rate hike cycle may start before the end of the next year. In late September, the ECB president called the recovery atypical, because the fast growth is accompanied by supply-side disturbances, and, as a result, accelerating inflation. According to the ECB, this should not be taken overly seriously, because the present inflationary drive was preceded by a long-lasting deflationary spell, and the inflation is fueled by the economic restart and the fast-growing demand that temporarily surpasses supply. The green transition will also affect consumer and producer prices. The ECB maintains its 2 percent inflation target, yet it does not intend to change its monetary stance, for now. The ECB is expected to make its plans regarding its EUR 1850 billion pandemic-related asset purchase program, which is now envisaged to end in March 2022. The British and the Japanese central banks still stick to their accommodative monetary stance – in the case of the latter, no tightening is expected in the foreseeable future. In some other countries (Czechia, Hungary, Poland, Romania, Norway, Brazil, etc.) steps toward monetary tightening are already well underway.

During the past quarter, economic growth gathered momentum in the **international environment of the EU** as well. In the **US**, economic growth was dynamic in the first half of the year, and the level of GDP has already reached its pre-crisis level. The same is true of private consumption and investments, while export still lags behind its 2019 level. US manufacturing is overheated, and its further acceleration is only hindered by the shortage of parts and components. The stock of unmet orders is at record levels and final output prices are also rising at a pace not seen in the last 15 years. As a result, growth may slow down in the third quarter. Rising consumer prices and the revival of the pandemic may reduce consumer optimism in the US – the July data already shows a slight decrease of private consumption and a rise in the savings rate, and retail trade turnover also started do decrease in August. The latest growth forecasts envisage an annual growth of 5.7-5.9 percent in 2021, a slight downward revision compared to the earlier expectations. In the next year, economic growth may be somewhere above 4 percent, depending on how monetary policy changes, to what degree inflation moderates and how the external environment evolves. Inflation is still high, as well as inflation expectations. The annual inflation rate is likely to reach 4.3 percent in 2021, well above the 1.2 percent in the last year. The pace of inflation may moderate somewhat in 2022.

After the 4.7 percent fall in 2020, **Japanese** GDP is expected to grow by 2.1 percent this year, a slower rate than in the majority of developed countries. The growth revival in the spring was moderate and became even more anemic afterward. In the first quarter, the GDP decreased by 0.9 percent against the previous quarter and rose by only 0.3 percent in the second. Private consumption and private investments grew faster but public investments decreased and much of the domestic demand was met from imports, instead of domestic production. The Olympic games in July-August did not give significant boost to economic growth while significantly contributed to the worsening of the pandemic that forced the authorities to introduce further movement restrictions. The August PMI and the business sentiment indexes suggest that the economic performance remains underwhelming in the third quarter.

Despite the recent inflow of worrying news, the international organizations have not revised their predictions regarding **Chinese** economic growth so far. The OECD expects the Chinese GDP to grow by 8.5 percent and the UNCTAD by 8.3 percent in 2021, with respective growth rates of 5.8 and 5.3 percent in 2022. The Chinese places the keeping the Covid epidemic under check by any means necessary to the first place in its priority list. The closures, as well as the overzealous efforts to close the coal-fired power plants, lead to problems in production, transport, energy supply in many areas, which led some media observers to envision the imminent collapse of the Chinese economy. This, however, is unlikely, as is the chance of the insolvency of the real estate developer Evergrande to turn into a worldwide financial crisis, because the Chinese state is the only on these days that has the material and organizational resources to keep these problems under check. One of the cornerstones of the latest five-year plan, launched this year and based on the so-called dual circulation strategy, is to make domestic consumption into the decisive driver of economic growth. Another important objective is to overcome the high level of environmental pollution, the implementation of the climate targets accepted at the international forums and stimulating green innovation.

It is becoming more and more obvious that the growth prospects of the **developing countries** are mostly determined by their access to the vaccines. Even the relatively optimistic scenarios do not expect these countries to achieve a 50 percent level of vaccination of their populations by the end of this year. According to the calculations of experts at the UNCTAD, the economic damage caused by the Covid-19 pandemics exceeds by far the damage caused by the great recession of 2009 in the developing countries. Within the developing world, the prospects of the Eastern Asian economies are the most encouraging, especially of those countries that have been participating organically in the value chains producing and developing electronical products – like South Korea, Taiwan, Singapore and Malaysia – and that were able to minimalize the spread of the epidemic, due to the disciplined conduct of their populations. The disturbances of Chinese electricity provision will probably result in a sudden growth in the manufacturing output and export of the countries of Indochina. The record issue of SDRs by the IMF in August is likely to alleviate the liquidity problems of the heavily indebted developing countries and will also slightly improve their access to credit.

Due to the new wave of the pandemic, the GDP of the **euro area** decreased in the first quarter by 1.2 percent on an annual basis and by 0.3 percent compared to the previous quarter. By contrast, the second quarter saw a dynamic correction: the GDP grew by 14.8 percent compared to the same quarter of the previous year, in great part due to the statistical base effect. Private consumption managed to offset the fall in the first quarter by a year-on-year growth of 12.6 percent in the second quarter, but still trails its pre-crisis level. The volume of services also fell far short of the levels seen before the crisis. Depending on the extent of the easing and retightening of restrictions and the evolution of the epidemic, on the whole we expect private consumption to grow by 3.4 percent in 2021. Gross fixed investments dropped by 6.6 percent in the first quarter in the eurozone but was up 18.8 percent in the second on a year-on-year basis, and they may grow by an annual 5-6 percent in 2021. Government consumption expenditures rose by 2.9 percent in the first quarter and 7 percent in the second – their annual average growth rate may reach 3-4 percent, which indicates that government consumption still supports economic growth. In the last year, the export of goods and services fell by 9.3 percent. The positive scenario is that overall export growth by 10 percent in 2021, assuming that the external demand expands more dynamically than that of the euro area. But the fact that the supply chains still have not been restored and transport and logistical capacities still cannot meet demand poses a sizeable risk regarding export and, more generally, economic growth. The rising costs increasingly spill over to consumer prices and may weaken consumer demand. In sum, we expect the growth rate to abate in the second half of the year compared to the pace seen in the second quarter, but growth will continue. The euro area GDP is expected to grow by 5 percent in 2021 and 4-5 percent in the next year, but both the external and the internal downward risks are considerable.

In the **EU27**, GDP dropped by an average 5.9 percent in 2020. For this year, we expect an annual growth rate above 5 percent, provided that the new virus variation do not force new restrictive measures EU-wide and also the supply-side bottlenecks ease somewhat. Inflation began to rise in the EU27 as well (especially in a few countries like Hungary, Romania and Poland): following the 0.7 percent in the last year, an average inflation of 2.4 percent is expected in 2021. Inflation is likely to ease in 2022 but probably remains above 2 percent, and there are upward risks. Unemployment may remain just above 7 percent in 2021 but may dip further in the next year if the recovery continues.

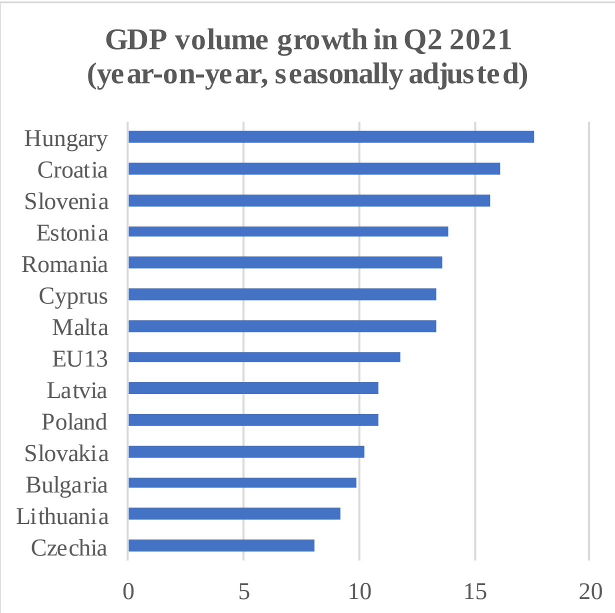
In **Germany**, the earlier growth forecast for 2021 (3.6 percent) was revised downward in the autumn to 2.6 percent, with a possible acceleration to about 5 percent in the next year. The pessimism is warranted, in addition to the supply-side bottlenecks, by the fears regarding the new wave of the epidemic. Along with the revival of demand, prices began to rise as well, especially transport, raw material and half-product prices, which is slowly spilling over to consumer prices as well. Hence an inflation rate of 2.9 percent is expected for this year, and inflation may remain above 2 percent in 2022, too. Fiscal policy remains markedly expansive in 2021. Besides business subsidies and social transfers, connected to the epidemic, a subsidy of about EUR 11 billion went into various environmental programs, water management, railway development, etc. In the meantime, the result of the elections ensures that the greens and the FDP will become participants in the new government, irrespective of whether it is led by the SPD or the CDU/CSU. As a result, economic policy certainly will change, but the degree and direction of change will be decided by the coalition agreement, the finalization of which will probably take considerable time.

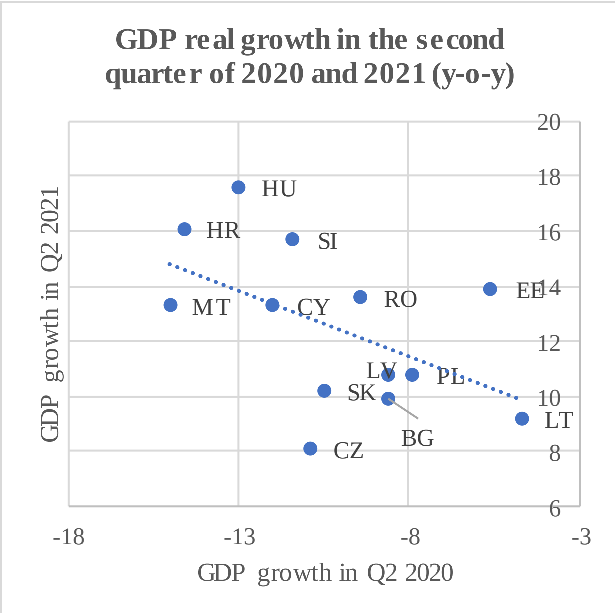
The **UK** economy rose at a steep rate of 4.8 percent in the second quarter, compared to the previous quarter, after a 1.6 percent quarter-on-quarter decline in the first quarter. The volume of GDP is still below its pre-crisis level. The growth was primarily driven by the service sector and construction, while the further recovery of manufacturing was (still is) hindered by the shortage of workers and raw materials. Regarding the final use of GDP, private consumption (7.3 percent) and government consumption (6.1 percent) were the primary drivers of growth. Investments kept declining while export managed to grow (on a quarterly basis) by 3 percent but it is still below its pre-crisis level by 20 percent. The government lifted all restrictions in the summer, citing the high level of vaccination, despite the fact that the new wave of the epidemic led to a resurgence in the number of infected. In 2021, we expect the GDP to grow at a rate above 6 percent in the United Kingdom, with a deceleration to 4 percent in the next year. The Brexit still has – the favorable growth numbers notwithstanding – a negative effect on economic conditions.

II. New EU member states

The second quarter of 2021 saw unprecedented high rates – on an annual basis – in the new member states, due to the extremely low statistical base. With a growth rate above 17 percent, Hungary was the growth leader within the region, but even the lowest rate (in the Czech Republic) was about 8 percent. On average, GDP was up 11.6 percent in the second quarter in the EU13. Apart from the Czech Republic, already mentioned, Poland and Slovakia posted below-average growth rates (10.8 and 9.6 percent, respectively), while the Romanian growth rate (13 percent) surpassed the average. Croatia deserves special mention: due to the successful tourist season – successful, at least, compared to the virtual hiatus of a tourist season in the previous year – Croatian GDP grew by 16.1 percent in the second quarter, an outstanding rate within the region.

In most countries, export was the main driver of growth and – even though higher export naturally means higher input import as well – net export contributed positively to economic growth in the majority of countries. The other leg of growth was provided by private consumption that expanded by 10 percent or even more in much of the region. Investments tended to grow at a double-digit pace, but its growth contribution was limited by its smaller weight. Estonia is a special case: here, investments were up 60 percent. Estonia was already one of the most dynamic countries in the first quarter, and that trend continued. The financial sources for the fast recovery are available thanks to the outstandingly prudent Estonian economic policy that characterized the country throughout the past decades. Now, the country launched sizeable green investments but other areas of the economy (start-up subsidies) and other social spheres get significant development financing. Based on all this, Estonia has a good chance to become the first country of the region which can return to a better growth trajectory than the one that what was interrupted by the epidemic.





As for the future, the Eastern Central European member states face various threats. The global shortage of raw materials can precipitate further production stoppages, primarily in the auto industry where firms **are struggling with overflowing output stocks and a dearth of inputs at the same time**. In the meanwhile, the stock of orders exceeds the existing production capacities by a factor of several times and the time of delivery lengthened by several months. At the same time, firms are hit by labor shortage once again, and a wave of wage hikes started in the region as well. The latter is not just a result of the former but also due to the mounting inflationary pressures.

The price hike has started in most new member states (the exception is Malta where the average inflation index was 0.2 percent in January-September). At present, soaring energy prices – that is, imported inflation – poses the largest threat to price stability since energy prices rose at double-digit rate in several countries. To be sure, the base level is extremely low because the oil price fell to historic lows in the second quarter of the previous year. This component of the inflationary pressure is temporary indeed, but core inflation rates are also around 3 percent which represents more serious risk. There is a worrying possibility that the inflation-generated wage hike starts a spiral that results in a lasting period with significantly higher inflation rates than what was normally seen in the past year.

The Hungarian central bank has already made the first steps toward monetary tightening and the Czech and the Romanian central banks has begun slowly rising the policy rates as well. The Polish monetary council gave up its former wait-and-see stance too, raising from 0.1 to 0.5 percent the reference rate in October, surprising observers. The rate hikes are generally cautious since the economy is still heavily reliant on central bank financing, and the governments keep accumulating debt. This poses a risk because it is becoming more and more likely that the developed countries take the path of resolute monetary tightening, which would drastically raise the financing costs for the emerging economies.

The low interest rates led to rising real estate prices, which can be favorable in the short term because high demand incentivizes investments in productive capacities in the construction sector. But problems may arise in the medium term, especially if wages grow at a lesser pace than housing prices, because that would reduce the ability of households to buy their own dwellings, inflaming social tensions. The low interest rates may increase the attractiveness of housing purchases compared to renting but also may start a vicious circle where households hurry to buy dwellings to outrun housing prices, leading to a faster rise of housing prices. This is compounded by the galloping inflation of the global prices of construction materials (steel, timber, brick, etc.) and the labor shortage. Amid such conditions, the government subsidies aiming at supporting housing purchases tend provoke a further housing price hike. Compared to its 2015 level, the growth of housing prices and rent prices was the highest in Hungary. Due to the regional housing market divergences, observable in every country of the region, the rise of housing prices was probably even steeper in the large cities.

Housing price and rent in the Eastern European new EU member states in 2021

	2021 Q2			2021 Q1
	Housing price	Housing rent		Housing rent/disposable income
	2015=100			
Bulgaria	145.15	n/a		n/a
Czech Republic	166.83	115.82		126.4
Estonia	143.61	124.25		104.6
Latvia	150.54	106.5		105.6
Lithuania	153.51	131.11		96.3
Hungary	184.94	130.73		129.4
Poland	141	123.44		101
Romania	130.94	n/a		n/a
Slovenia	142.76	114.4		109.4
Slovakia	145.88	103.66		115.4

Source: OECD

The growth prospects of the region for this year are still favorable – the regional GDP may grow by more than 5 percent, even though the various shortages are likely to hinder growth, especially in countries which are heavily involved in the global auto industry supply chains. In 2022, the growth rate is likely to decelerate but may remain within the 4%-5% band. In the next year, primarily inflation, and secondarily the debt problem will demand adequate policy responses – both of them may lead to slower growth. The debt consolidation may start in 2022 but it will be a long process because the economies are still extremely vulnerable.

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	1.5	2.2	2.7	1.1	1.1	-4.6	2.6	5.0
France	17.3	1.1	1.1	2.3	1.9	1.8	-7.9	5.9	3.6
Italy	12.4	0.8	1.3	1.7	0.9	0.4	-8.9	5.8	4.1
Netherlands	6.0	2.0	2.2	2.9	2.4	2.0	-3.8	3.4	2.9
Belgium	3.4	2.0	1.3	1.6	1.8	1.8	-6.3	5.0	3.2
Luxembourg	0.5	2.3	5.0	1.3	2.0	3.3	-1.8	6.1	1.8
Ireland	2.7	25.2	2.0	8.9	9.0	4.9	5.9	13.9	3.9
Greece	1.2	-0.4	-0.5	1.3	1.6	1.9	-8.2	8.0	3.9
Spain	8.4	3.8	3.0	3.0	2.3	2.1	-10.8	6.0	5.8
Portugal	1.5	1.8	2.0	3.5	2.8	2.7	-8.4	4.4	5.0
Austria	2.8	1.0	2.0	2.3	2.5	1.5	-6.7	3.6	3.4
Finland	1.8	0.5	2.8	3.2	1.1	1.3	-2.9	3.6	2.7
Estonia	0.2	1.9	3.2	5.8	4.1	4.1	-3.0	8.0	4.5
Slovakia	0.7	5.2	1.9	3.0	3.8	2.6	-4.4	4.3	4.5
Slovenia	0.3	2.2	3.2	4.8	4.4	3.3	-4.2	5.5	4.3
Cyprus	0.2	3.4	6.5	5.9	5.7	5.3	-5.2	4.0	4.0
Malta	0.1	9.6	3.8	11.0	6.1	5.7	-8.3	4.5	5.5
Latvia	0.2	4.0	2.4	3.3	4.0	2.0	-3.6	4.0	4.8
Lithuania	0.4	2.0	2.5	4.3	3.9	4.3	-0.9	4.0	3.5
Euro Area	**85.1**	**2.0**	**1.9**	**2.6**	**1.9**	**1.5**	**-6.3**	**5.4**	**4.6**
Denmark	2.3	2.3	3.2	2.8	2.0	2.1	-2.1	3.9	3.9
Sweden	3.6	4.5	2.1	2.6	2.0	2.0	-2.8	4.0	4.0
Hungary	1.0	**3.7**	**2.2**	**4.3**	**5.4**	**4.6**	**-4.7**	**6.8**	**5.0**
Czech Republic	1.6	5.4	2.5	5.2	3.2	3.0	-5.8	3.8	4.8
Poland	3.9	4.2	3.1	4.8	5.4	4.7	-2.7	5.0	5.0
Romania	1.6	3.0	4.7	7.3	4.5	4.1	-3.9	7.0	4.5
Bulgaria	0.5	4.0	3.8	3.5	3.1	3.7	-4.2	4.2	4.0
Croatia	0.4	2.4	3.5	3.4	2.8	2.9	-8.0	7.0	4.5
EU-14	***88.9***	**2.4**	**1.9**	**2.3**	**1.8**	**1.3**	**-6.8**	**5.3**	**4.5**
New EU13	**11.1**	**3.8**	**3.2**	**4.8**	**4.3**	**3.6**	**-4.0**	**5.3**	**4.7**
EU27	**100**	**2.3**	**2.0**	**2.8**	**2.1**	**1.8**	**-5.9**	**5.3**	**4.6**
Memorandum items									
USA		2.5	2.9	1.6	3.0	2.2	-3.4	5.7	4.9
Japan		0.3	1.1	1.0	1.9	0.7	-4.7	2.1	2.5
United Kingdom		2.4	1.7	1.7	1.3	1.4	-9.8	6.3	4.3
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	4.7	3.3
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
EU-14 = Countries that joined the European Union before 2004 (“Old EU Member States”)
Új EU-13 = Countries that joined the European Union in 2004, 2007 and 2013 (“New EU Member States”)
Source: Eurostat, national statistical offices, OECD

Table 2/2.

Inflation in the EU Member States

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

	Weight	2015	2016	2017	2018	2019	2020	2021*	2022*
Germany	24.6	0.1	0.4	1.7	1.9	1.4	0.4	2.9	2.5
France	17.4	0.1	0.3	1.2	2.1	1.3	0.5	2.0	1.7
Italy	14.1	0.1	-0.1	1.3	1.2	0.6	-0.1	1.6	1.3
Netherlands	4.9	0.2	0.1	1.3	1.6	2.7	1.1	1.9	1.9
Belgium	3.3	0.6	1.8	2.2	2.3	1.2	0.4	1.9	1.8
Luxembourg	0.2	0.1	0.0	2.1	2.0	1.6	0.0	2.8	2.3
Ireland	1.4	0.0	-0.2	0.3	0.7	0.9	-0.5	1.5	1.6
Greece	1.7	-1.1	0.0	1.1	0.8	0.5	-1.3	0.5	2.3
Spain	9.1	-0.6	-0.3	2.0	1.7	0.8	-0.3	2.4	1.8
Portugal	1.9	0.5	0.6	1.6	1.5	0.3	-0.1	1.2	2.0
Austria	2.7	0.8	1.0	2.2	2.1	1.5	1.4	2.6	2.0
Finland	1.7	-0.2	0.4	0.8	1.2	1.1	0.4	1.8	1.7
Estonia	0.2	0.1	0.8	3.7	3.4	2.3	-0.6	3.0	3.0
Slovakia	0.8	-0.3	-0.5	1.3	2.5	2.8	2.0	2.3	2.5
Slovenia	0.3	-0.8	-0.2	1.6	1.9	1.7	-0.3	1.7	2.2
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	2.5	2.5
Lithuania	0.4	-0.7	0.7	3.8	2.5	2.2	1.1	3.5	3.0
Euro Area	**85.3**	**0.2**	**0.2**	**1.5**	**1.8**	**1.2**	**0.3**	**2.3**	**2.0**
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	2.0	1.5
Hungary	1.0	**0.1**	**0.4**	**2.4**	**2.9**	**3.4**	**3.4**	**5.0**	**5.5**
Czech Republic	1.5	0.2	0.7	2.3	2.0	2.6	3.3	3.0	3.0
Poland	4.3	-0.7	-0.2	1.6	1.2	2.1	3.7	4.5	4.0
Romania	1.9	-0.4	-1.1	1.0	4.1	3.9	2.3	4.5	3.7
Bulgaria	0.5	-1.1	-1.3	1.0	2.6	2.5	1.2	2.5	2.5
Croatia	0.4	-0.3	-0.6	1.3	1.6	0.8	0.0	2.0	2.4
EU14	**88.1**	**0.1**	**0.4**	**1.7**	**1.9**	***1.4***	**0.5**	**2.2**	**2.0**
New EU13	**11.9**	**-0.4**	**-0.2**	**1.7**	**2.2**	***2.6***	**2.6**	**3.8**	**3.5**
EU27	**100.0**	**0.1**	**0.2**	**1.6**	**1.8**	***1.4***	**0.7**	**2.4**	**2.1**
Memorandum items [a]									
USA		1.5	1.6	0.1	1.3	1.5	1.2	4.3	3.2
Japan		0.4	2.7	0.8	0.5	0.5	0.0	-0.2	1.3
United Kingdom		0.0	0.7	2.7	2.5	1.8	0.9	2.4	1.7
China		2.6	2.0	1.4	2.0	2.9	2.5	1.2	2.2
Russia [b]		7.8	15.5	7.0	2.9	4.5	2.6	5.9	4.9
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-14 = 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	3.6	3.1
France	14.0	10.4	10.1	9.4	9.0	8.4	8.0	7.9	7.6
Italy	12.1	11.9	11.7	11.2	10.6	10.0	9.2	9.6	9.0
Netherlands	4.3	6.9	6.0	4.9	3.8	3.4	3.8	3.2	3
Belgium	2.4	8.5	7.8	7.1	6.0	5.4	5.6	6.0	5.0
Luxembourg	0.1	6.7	6.3	5.5	5.6	5.6	6.8	6.0	5.5
Ireland	1.1	10.0	8.4	6.7	5.8	5.0	5.7	6.4	5.0
Greece	2.2	24.9	23.6	21.5	19.3	17.3	16.3	16.0	15.4
Spain	10.9	22.1	19.6	17.2	15.3	14.1	15.5	14.9	13.0
Portugal	2.4	12.6	11.2	9.0	7.1	6.5	6.9	6.9	6.2
Austria	2.1	5.7	6.0	5.5	4.9	4.5	5.4	6.3	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***	***7.9***	**7.8**	**7.1**
Denmark	1.4	6.3	6.0	5.8	5.1	5.0	5.6	4.9	4.3
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**	**4.0**	**3.6**	**3.3**	**4.1**	**4.0**	**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***	**7.8**	**7.0**
New EU13	**22.8**	**7.9**	**6.6**	**5.5**	**4.5**	**4.1**	***5.3***	**5.5**	**4.8**
EU27	**100.0**	**10.1**	**9.1**	**8.2**	**7.3**	**6.7**	**7.1**	**7.3**	**6.5**
Memorandum items [a]									
USA		6.2	5.3	4.9	3.9	3.7	8.1	5.5	4.3
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	4.8	4.5
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-14 = 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

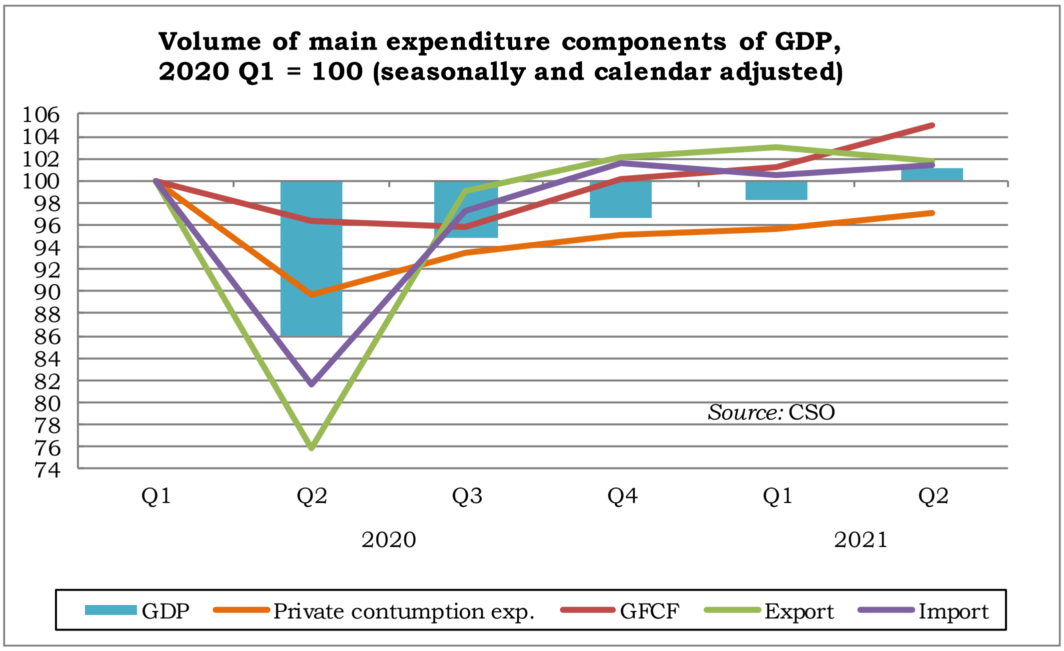
(year-on-year change, percentage)

	Data					Forecast		
			2021			2021		2022
	2019	2020	Q1	Q2	July-August	2021 July	2021 Nov.	2021 Nov.
GDP aggregates, real growth								
GDP total	4.6	-4.7	*-2.0*	*17.8*		5.2	**6.8**	**5.0**
Domestic Demand	6.8	-2.7	*-4.7*	*11.1*		4.1	**4.7**	**5.0**
Private Consumption	4.5	-2.0	*-4.3*	*8.3*		4.1	**3.9**	**4.8**
Public Consumption	6.4	5.2	*7.5*	*0.6*		3.2	**3.2**	**0.0**
Gross Fixed Capital Formation	12.8	-6.9	*3.0*	*11.7*		7.0	**7.4**	**7.3**
Gross Capital Formation	12.1	-7.0	*-11.6*	*22.5*		4.5	**6.8**	**7.3**
Export	5.4	-5.9	*3.4*	*34.2*		8.9	**10.9**	**6.6**
Import	8.2	-3.5	*0.5*	*24.3*		7.6	**8.3**	**6.6**
Industrial production	5.6	-6.0	*4.0*	*37.7*	*5.3*	11.0	**11.0**	**6.0**
Consumer Price Index	3.4	3.3	*3.2*	*5.1*	*5.0* [e]	4.2	**5.0**	**5.5**
Employment, earnings								
Number of Employed, growth [a]	0.8	-0.9	*-0.9*	*1.4*	*0.9* [e]	0.9	**0.9**	**0.5**
Employment rate [a]	62.6	62.1	*61.9*	*62.8*	*63.4* [e]	62.7	**62.7**	**63.0**
Unemployment Rate [b]	3.3	4.1	*4.5*	*4.1*	*4.1* [e]	3.9	**4.0**	**3.6**
Unit Labor Costs, in EUR [b]	7.6	1.1	*-3.3*	*-10.5*		-0.6	**-2.0**	**3.3**
Gross Nominal Wages [c]	11.4	9.7	*9.4*	*7.2*	*7.5*	8.2	**8.2**	**9.6**
Net Real Wages	7.7	6.2	*6.0*	*2.0*	*2.8*	3.8	**3.0**	**3.9**
Savings Rate, % of GDP [d]	5.1	6.4	*7.1*	*5.9*		6.2	**5.8**	**5.4**
Current and Capital Accounts Balance, % of GDP	1.4	1.9	*1.6* [g]	*-0.9* [g]		2.5	**0.5**	**1.0**
General government Fiscal Balance, ESA-2010, % of GDP	-2.1	-8.0	*-6.0*	*-2.5*		-7.5	**-7.5**	**-5.9**
Gross Government Debt, % of GDP	65.5	80.1	*80.8*	*77.4*		81.7	**79.9**	**79.0**
Short-term Government Yields (3M), eop	-0.01	0.28	*0.61*	*0.45*	*1.01* [e]	1.0	**1.0**	**1.3**
Long-term Government Yields (10Y), eop	2.01	2.08	*2.71*	*2.83*	*3.23* [e]	3.0	**3.0**	**3.0**
External assumptions								
Internat. Trade in Goods and Services [d]	3.9	0.9				8.4	**9.7**	**7.0**
Brent Oil Price ($/bbl, p. avg.)	64.4	41.8	*61.0*	*68.7*	*73.5* [e]	68.0	**69.0**	**70.0**
GDP Real Growth, Eurozone	1.5	-6.3	*-1.2*	*14.8*		5.0	**5.4**	**4.6**
GDP Real Growth, New EU Members	3.6	-4.0	*-1.0*	*11.6*		4.6	**5.3**	**4.7**
EUR-HUF, period average	325	351	*361.1*	*354.8*	*353.9* [e]	353	**356**	**356**
EUR-USD, period average	1.12	1.14	*1.21*	*1.21*	*1.18* [e]	1.21	**1.21**	**1.20**

a ILO methodology, period averages, aged 15-74, public workers are counted as employed.
b Manufacturing, based on gross value added and the monthly average compensation of employees in euro, cumulated from the beginning of the year
c 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 Q3
g Seasonally adjusted data published by the NBH

III. The Hungarian economy

As the data of the recent quarters show, the Hungarian economy defied expectations regarding resilience in the face of the second and third waves of the pandemic. In the first two quarters of this year, the seasonally and calendar adjusted volume of GDP steadily grew – what is more, it grew at a good pace. Thus, while the year-on-year indexes fluctuated in accordance with the changing statistical base levels, the whole first half of 2021 can be assessed as a positive surprise. In the second quarter, the volume of GDP – and within that, the volume of fixed capital formation and both the export and import of goods – was above the level registered in the first quarter of 2020, the last quarter preceding the outbreak of the epidemic. On the production side, the services sector was the only sector where the volume of value added fell short of its pre-crisis level in the second quarter of this year.



Among the analysts a sudden wave of optimism was generated by the first-quarter growth data, with a jump in average growth forecasts by more than one percentage point, to a level above 6 percent. At that time, the Kopint-Tárki remained cautious, partly because of the supply-side difficulties already discerned in the industrial sector, and partly due to the doubts regarding how significant the jump in consumption would be.

But the situation changed after the arrival of the second-quarter growth data: by the middle of the year, the volume of GDP rose to a level at which even a stagnation in the second half of the year would result in an annual growth rate above 6.5 percent. This is why at present we predict an annual growth rate **of 6.8 percent** in 2021.

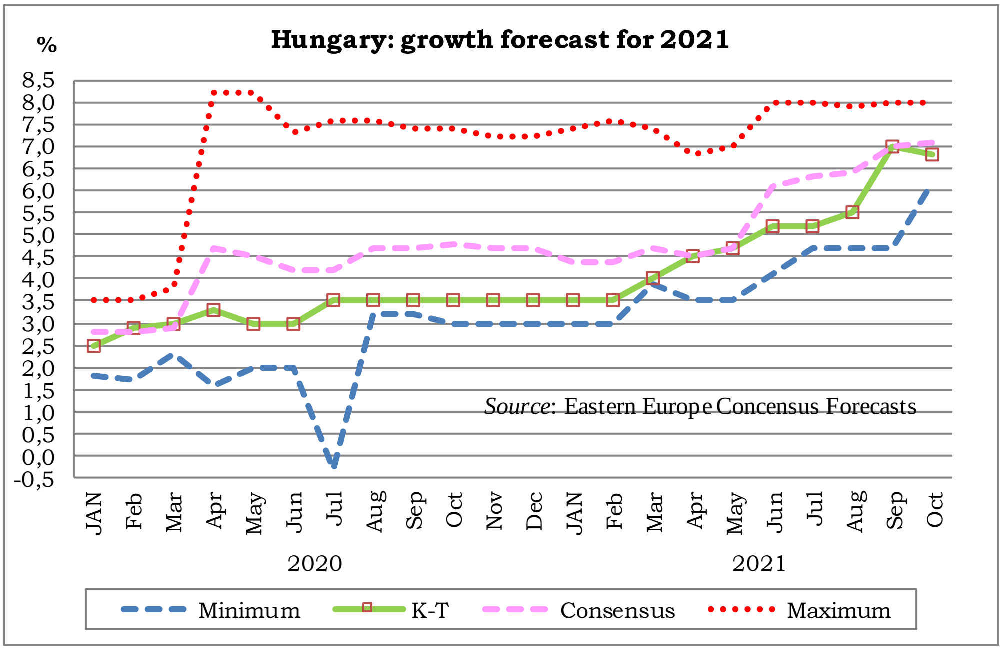
In the second quarter, investment growth significantly surpassed expectations, which was accompanied by a strong positive growth contribution of the change of inventories. Private consumption also grew at a good pace, primarily due to a jump in the consumption of *services*. (On the other hand, this jump was mostly due to the statistical base effect.) In any case, the growth rate of private consumption expenditures reached, the first time for years, the growth rate of real wage disbursements.

Regarding investments, a favorable change in the second quarter that the growth was driven by the business sector, as opposed to the state-driven growth in the first quarter.

The improvement in the net export position also surpassed expectations in the second quarter, primarily because the positive difference between the export and import of *services* widened to record magnitude. Tourism and transport services played the main role – in the case of the former, the steep rise in the export of tourism services was accompanied by a continuing decline of the import of tourism services.

Regarding future prospects, some optimism is warranted due to the still largely expansive economic policy of the developed countries, and it can be still hoped that the ongoing wave of the epidemic will not cause severe economic disturbances. On the other hand, It can be already seen that in various world regions (for example, in China) local outbreaks cause new stoppages and bottlenecks in the global supply chains, and the chip shortage is still acute. So far, the weaker growth performance of the Hungarian auto industry did not prevent the generally upward trend of industrial recovery, but the quite unfavorable August data may be a harbinger of trend change. Still, industrial output is still expected to continue to grow in the second half, but only at a single-digit pace.

Projections for Hungary's economic growth in 2021 (%)



The continuing wage growth and improving employment is likely to help further consumption growth, but the question is whether the new outbreak of the epidemic – and the accompanying (but so far very mild) restrictive measures cause major disturbances on that front. Investment growth is expected to continue at a medium pace, mostly due to business investment activity.

But there is no doubt that the fast quarter-on-quarter growth of GDP (2-3 percent in the first half of the year) will not continue. In the third quarter, growth may even halt on a quarterly basis, which will affect year-on-year growth rates as well. This is why we expect an annual growth rate of 6.5-7 percent for the year as a whole.

For *2022,* we predict a significantly lower growth rate of about 5 percent. Besides higher base levels, the global inflationary surge may prove lasting, high headline inflation rates may eventually lead to a surge in core inflation, thereby provoking growth-hindering countermeasures.

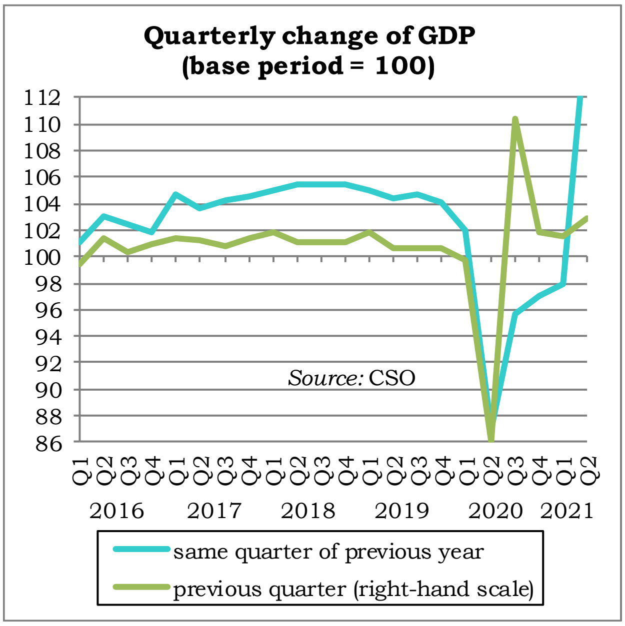
At present, we deem inflation as the biggest threat to balanced growth. The inflationary pressure is fueled not just by domestic demand, rising wages and expansive and pro-cyclical fiscal policy, but also by the globally rising raw material prices and surging inflation in the trade partner countries as well – that is, imported inflation. The rate hike cycle, started by the NBH in June, can have only a limited and delayed effect, thus we expect inflation to exceed the target band even in 2022, which may partially erode the implemented wage raises and may bring about a wage-price spiral.

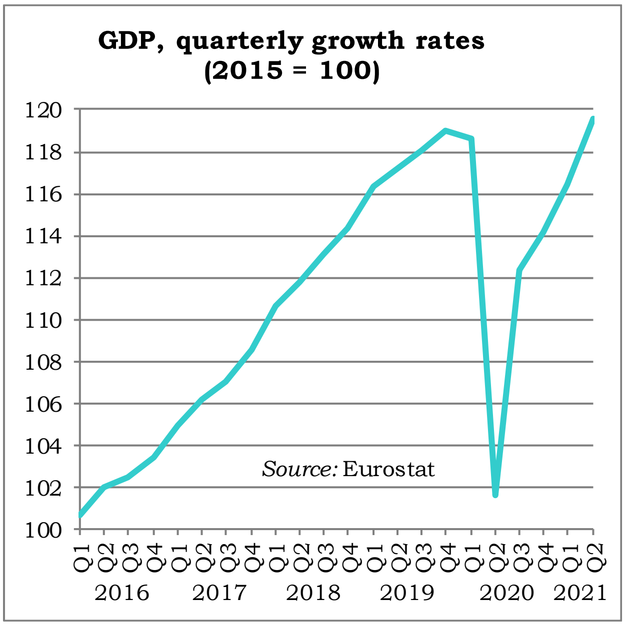
Another question is when the extremely high levels of business and state debt, the presence of a multitude of “zombie firms”, both in Hungary and globally, will backfire, when a wave of bankruptcies will begin, partly due to the rate hike and partly because of the complete phasing out of the credit moratorium. In Hungary, the bifurcation of the fiscal and monetary policy lines, which will become detrimental by the end of this year or, at the latest, in the next year. The stimulative effect of the fiscal measures will taper off worldwide in the next year. In Hungary, a number of new stimulus measures have been announced (tax rebate for families with children, tax exemption for taxpayers under the age of 25) will provide a counterbalance to a degree, but on the other hand they will burn a hole in the budget.

The fast growth of fiscal expenditures will beyond doubt overheat the economy, thereby giving a further boost to inflation. Besides, the burden of servicing the growing debt may become more severe, due to the globally rising yield expectations and interest rates. The debt-to-GDP ratio will decrease in 2021 since nominal GDP will grow at a double-digit rate (due to the real growth of almost 7 percent and the high GDP deflator (5-6 percent). But even so, there is no doubt that the time has come for a reconsideration of fiscal policy.

The GDP and its components

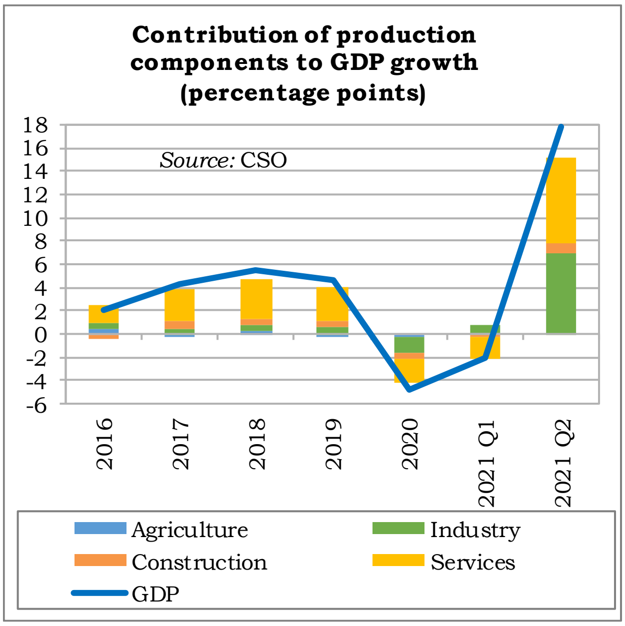
Just like the first quarter, the second quarter was a positive surprise as well: neither the aftershock of the second wave, nor the third wave of the epidemic halted the recovery process. The seasonally and calendar adjusted GDP volume continued to rise, by 1.6 percent in the first quarter and by 2.9 percent in the second. On an annual basis, the mild decrease of 2 percent in the first quarter was followed by a 17.8 percent jump in the second quarter. By the middle of the year, the level of real GDP was 0.5 percent higher than before the crisis, in the fourth quarter of 2019.

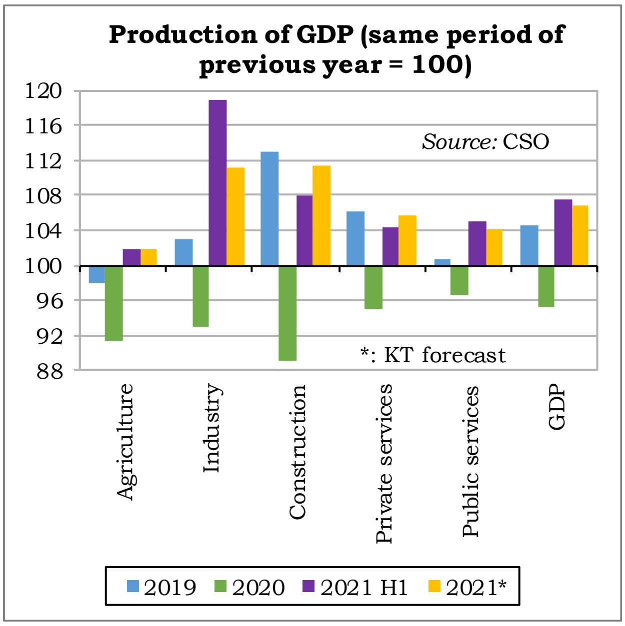




As a result, the Hungarian year-on-year growth rate was the fourth highest within the EU27 in the second quarter.

On the ***production side*** of GDP, all economic areas but agriculture (which is largely influenced by non-conjunctural factors) achieved uninterrupted positive quarter-on-quarter growth in the first half of 2021. This implies that the double-digit growth rates in industry, construction and the services sector were not just due to the statistical base





effect caused by the implosion in the second quarter of 2020. Even *services* were up 12.6 percent, an absolute record. The dynamism of services was supported by the drastic year-on-year jump in tourism accommodation and food service (by more than 70 percent), but trade, transport, info-communication, professional and scientific activities, health and social work activities and the arts-entertainment-recreation sector posted double-digit growth rates as well.

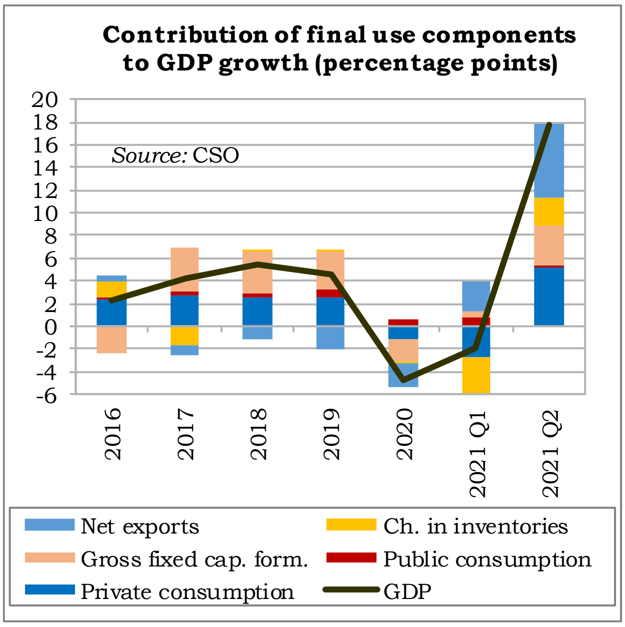
The highest year-on-year growth rate (36.6 percent) was achieved in *industry*, a natural consequence of the fact that industry was hit the most drastically by the first wave of the pandemic. The volume of the industrial value added already surpassed pre-crisis levels in the first quarter, but – according to the industrial statistics data – the largest industrial branch, the auto industry failed to recover completely, mostly due to the chip shortage. In *construction*, primarily the construction of buildings drove growth in the second quarter: civil engineering saw the first signs of a major resurgence only in June.

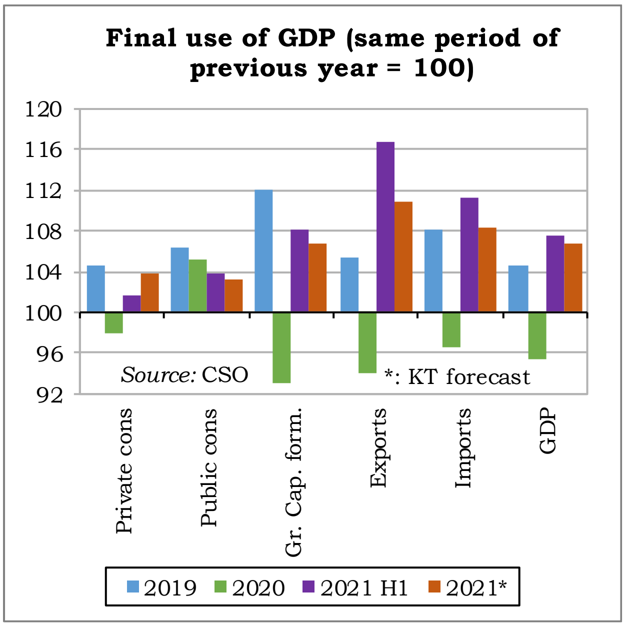
On the ***expenditure side***, the steady quarter-on-quarter growth is less universal: in the second quarter, the volume of the export of goods decreased, along with the collective consumption of the government, compared to the previous quarter. But even so, the year-on-year growth of goods export was dramatic, due to the statistical base effect.

Domestic use grew by 11.1 percent in the second quarter, due to the nearly 8 percent growth of private consumption, and nearly 12 percent growth of fixed capital formation and the drastic upward push coming from the change in inventories (a correction after the strong impact of inventories in the opposite direction in the first quarter).

In the case of external trade, steep improvement was strongly supported by the trade of services as well, as the drastic year-on-year growth of services export was accompanied by an approximate year-on-year stagnation of the import of services.

The prospects of the second half of the year are more subdued, due to the higher base levels and the less sanguine global economic climate. But – assuming a continuation of consumption and investment growth at a relatively good pace and the still slightly positive growth contribution of net export – we expect an **annual growth rate of 6.8 percent in 2021**, which is somewhat below the average pace during the first half of the year.





3.1. The production side of GDP

3.1.1. Industry

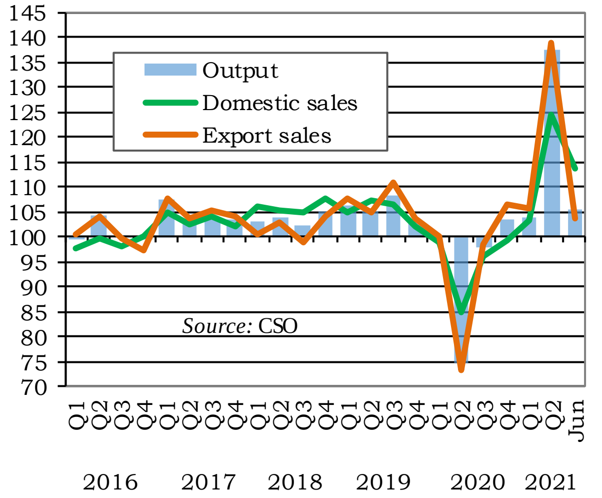
While in the first quarter the industrial output surpassed that in the fourth quarter of 2020, the second quarter saw a slowdown in the recovery process almost to a halt, according to the gross output data from industrial statistics, due to the mounting chip shortage, in addition to other factors like the Suez Canal obstruction. (Interestingly, the GDP statistics tells another story, with a continuation of strong quarter-on-quarter growth in industry.) The near-stagnation continued in July but turned to a marked downturn in August, because of the even more acute chip shortage that hit the auto industry and the electronic industry especially hard. The *year-on-year* growth rate jumped to 37.7 percent in the second quarter, but mostly due to the statistical base effect. The average growth rate in the subsequent two months was only 5.3 percent.

On an annual basis, industrial output was up 15.3 percent in January-August, but only about one-third of the individual branches achieved growth rates above 15 percent. The electrical industry was the growth leader, with a growth rate of about 52 percent, while the auto industry and the electronic industry were up 12-13 percent in the first eight months.

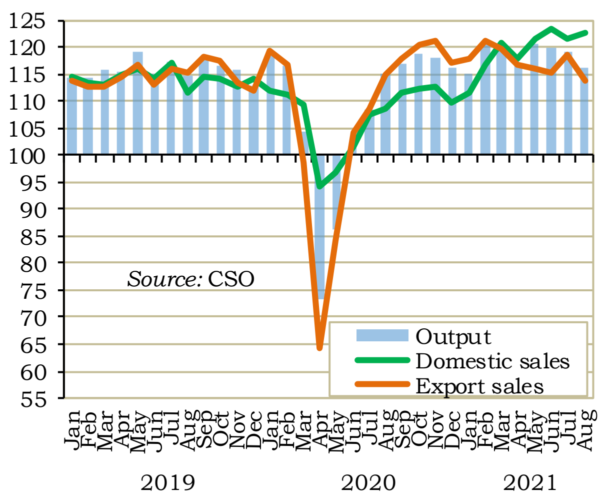
But much of this is because the statistical base effect. According to the seasonally adjusted data, the recovery was basically over in the majority of industrial branches by the middle of the year. The most spectacular exception is the auto industry: its output has been steadily below pre-crisis levels throughout this year, with a further deterioration in July-August.

It is also noteworthy that while on average, export sales grew at a slightly higher pace than domestic sales in January-August, due to the statistical base effect, the difference between the two relations changed dramatically in June-August. Actually, the weak growth performance in the recent months was due to the export sales while domestic sales were riding high during the summer. This means that export sales are the main victim of the supply-side complications while domestic sales have been only slightly affected for now.

Industrial production and sales (same month of previous year =100)



Industrial production and sales, 2015=100 (seasonally and calendar adjusted)



The August downturn underlines the uncertainties regarding the further evolution of industrial activity. We still expect the continuation of growth in the second half on an annual basis, at a modest pace, but the quarter-on-quarter growth will completely halt in the third quarter and probably restart only at a very anemic pace in the last quarter. At present we predict a **growth rate of approximately 11 percent of industrial production in 2021**, with downward risks.

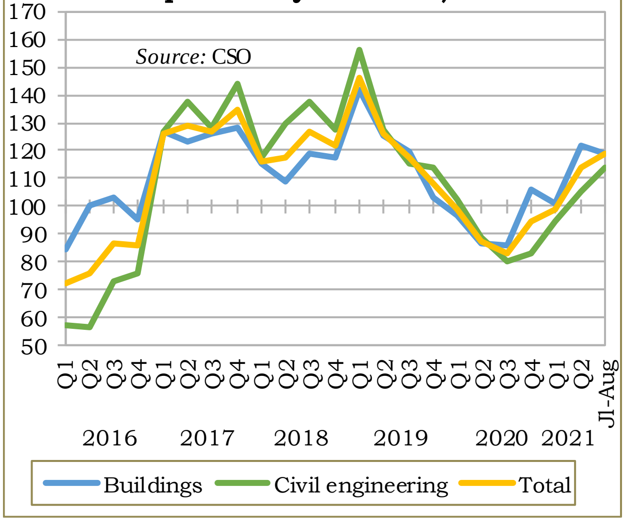
3.1.2. Construction

Despite the wild monthly fluctuations, gradual improvement was the general trend in construction in the first half of the year. On an annual basis, output slightly decreased in the first quarter, grew by 14 percent in the second and leaped by almost 19 percent in July-August. Until June, the improvement was mostly driven by building construction – civil engineering showed signs of a marked upturn only from the end of the second quarter. The seasonally adjusted output is already around pre-crisis levels in the case of the construction of buildings but still falls way short in the case of civil engineering. As a whole, construction output only surpassed its average 2019 level in two months out of the eight so far: in June and in July. In August a negative correction occurred a spectacular July but that may be temporary.

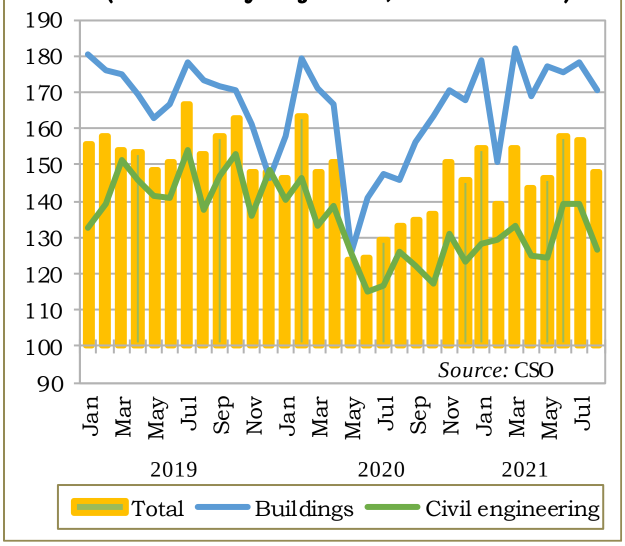
It is a good sign that according to the CSO, the stock of orders are higher by more than 20 percent than one year ago (in August) in both main groups of construction. In the case of civil engineering, the growth comes from new (primarily railway-related) contracts. It should be noted that the high level of orders in building construction is partly due to the fact that the pandemic – and lately the shortage of raw materials as well – hindered the completion of existing orders. While the volume of projects *started* was underwhelming in the first quarter according to the iBuild database, the second quarter saw an upturn in non-residential building construction project starts and also in civil engineering project starts.

Year-on-year growth rates are expected to moderate in the last third of the year, but not drastically. On the whole, construction output is likely to expand **at a rate of about 10 percent in 2021**.

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



Construction output (seasonally adjusted, 2015 = 100)

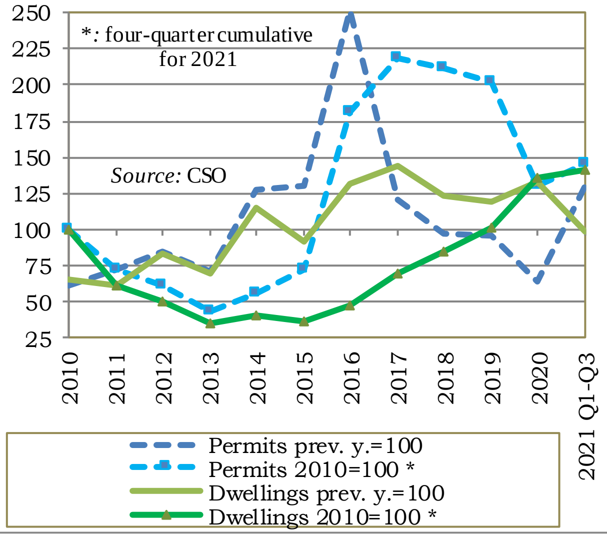


3.1.3. Housing construction

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%) and the fall became drastic in the third quarter (-31.9%). While in the second quarter only the number of dwellings built by natural persons decreased, the third quarter a fall in the number of dwellings built by firms as well. Apparently the shortage of materials and the soaring price of the said materials threw a spanner in the works – the recent numbers of the iBuild database suggest that the fall is due to the supply-side constraints, not to the decreasing number of housing construction projects which need to be completed.

According to the same database, the number of housing construction projects decreased in the second quarter, but this is a temporary lull: the number of *building permits issued* is on the rise (by 49 percent in the third quarter). The households' interest in buying new dwellings got a boost from the reduction of VAT rate on newly constructed dwellings and the new housing support measures announced by the government in late 2020. In autumn, a new support scheme, the Green Housing Home Program, was introduced by the NBH, and the connected Green Home Purchase Subsidy Scheme for Families, introduced by the government. It simply takes time for the newly issued building permits to materialize in actual construction activity.

Construction permits and newly built dwellings: indices



In sum, the number of building permits issued will continue to grow, and – in a few quarters – this will be reflected in the renewed growth in the number of housing construction projects started. The evolution of the number of projects completed depends on whether the supply-side constraints will ease – based on a slight moderation of prices in October, an uptick in completed construction projects may take place in the fourth quarter.

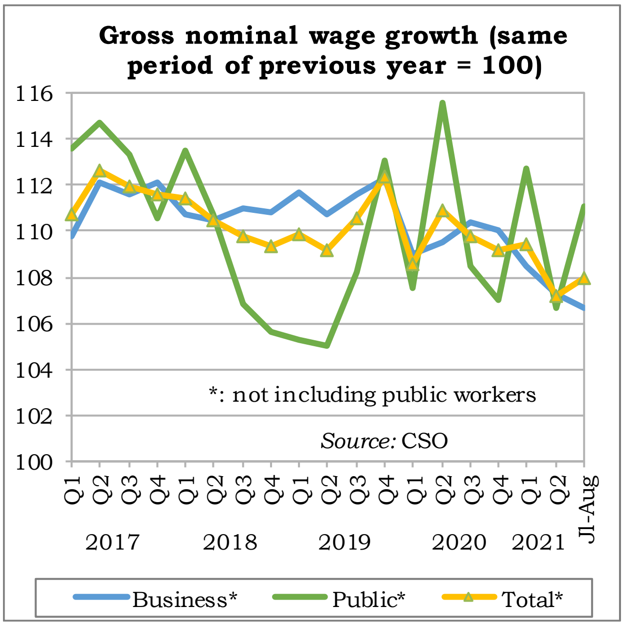
3.2. Final use of GDP

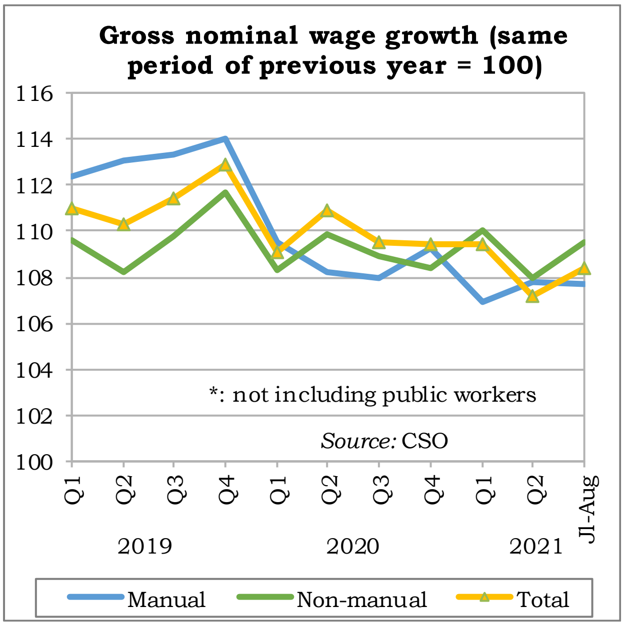
3.2.1. Household income, consumption and saving

Wages continue to grow at a good pace: in January-August, the average growth rate was 8.4 percent (8.4 percent if if firms with a staff of less than 5 employees are excluded), despite the fact that both types of minimum wages were raised only by 4 percent in 2021. Some deceleration of average growth rate can be observed in the business sector, but this is mostly due to a composition effect: low-wage earners who were laid off or put into part-time position in 2020 now become full-time employees again. Wage growth is faster-than-average in the public sector, but this is mostly a result of the drastic raise of the wages of medical doctors – the wages many other categories of public sector employees grow at a relatively modest pace.

Real wages were up 4.1 percent in January-August, but ***net real wage disbursements*** grew more spectacularly, by an average 7.4 percent, due to the rise in the number of employees on payroll.

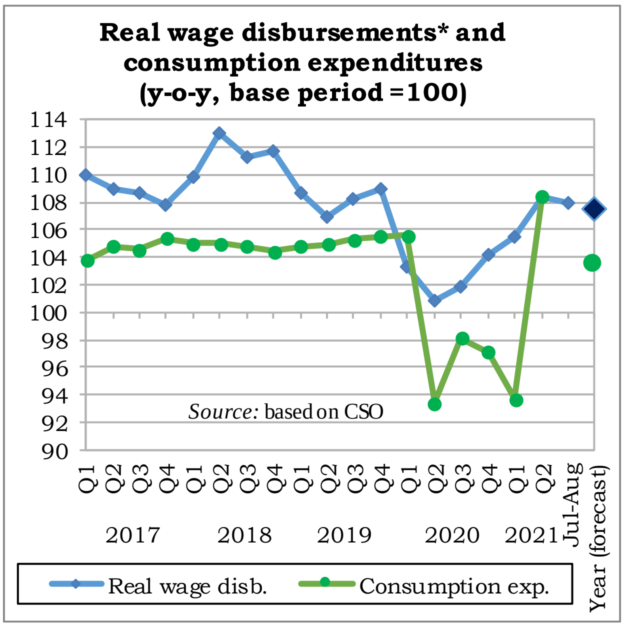
During the rest of the year, wage growth may moderate somewhat further, but the annual average growth rate will remain above 8 percent. Thanks to the growing number of employees, the annual pace of real wage disbursement growth may get close to 8 percent.





While ***household consumption expenditures*** fell markedly in the first quarter on an annual basis, they expanded by 8.5 percent in the second quarter. (Overall private consumption was up 8.3 percent.) This means that the pace of consumption growth caught up – even if only temporarily – with the pace of real wage disbursement growth.

Household consumption growth is fueled by growing household incomes – not just wage disbursements but also entrepreneurial incomes. But due to the year-on-year fall in the first quarter, the average growth of private consumption only amounted to 1.7 percent in the first half of the year. As a result, we expect the annual rate of private consumption growth to remain **below 4 percent in 2021**, even if consumption is likely to grow at a relatively good pace in the second half of the year.

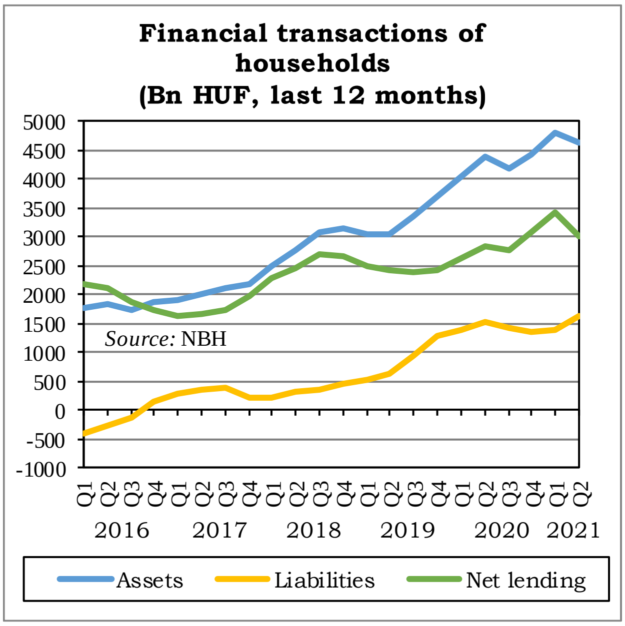


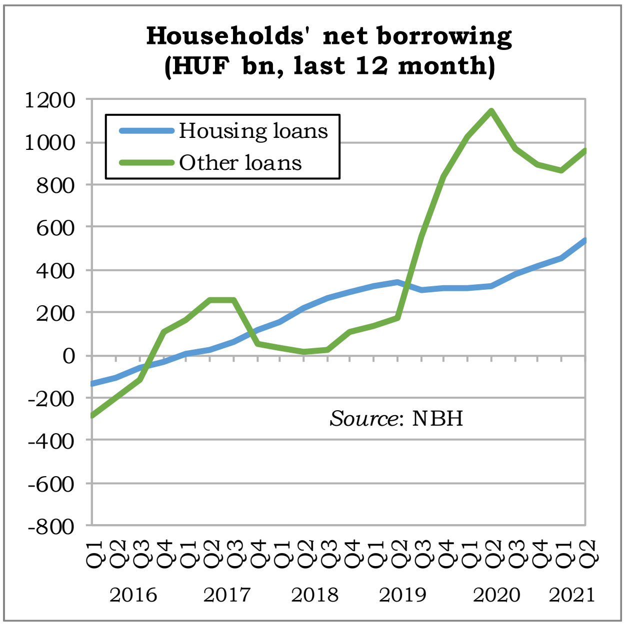
Household ***net lending*** reached record levels in the first quarter, but the rising trend changed direction in the second quarter. The four-quarter cumulative level of gross savings decreased compared to the previous quarter while the level of net borrowing rose to an all-time high (in nominal terms). As a result, cumulative net lending decreased sharply against the first quarter even if it was still higher than in the second quarter of the last year.

A part of it is the statistical base effect: the households' cash and on-demand account holdings suddenly ballooned during the first wave of the pandemic. But even non-cumulative gross savings decreased compared to the previous quarter, which is unusual in the second quarter. On quarter-on-quarter terms, cash, terms deposits and savings into government securities was hit the most. Apparently, funds formerly channeled into savings now were used for consumption.

As for net borrowing, housing borrowing kept rising but this time, the balance of other borrowing increased significantly, too. This is another reflection of the consumption revival.

The four-quarter cumulative savings rate first rose to 6.7 percent of GDP in the first quarter but dipped to 5.9 percent in the second. The non-cumulative savings rate was much lower 3.3 percent, in the second quarter.



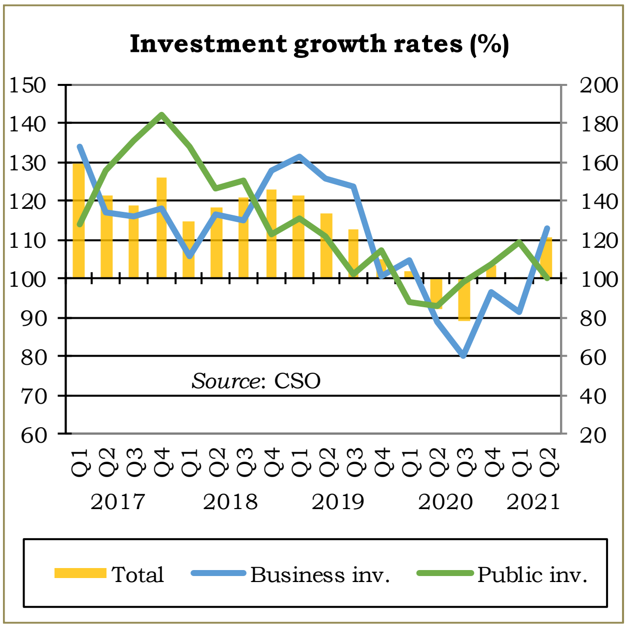


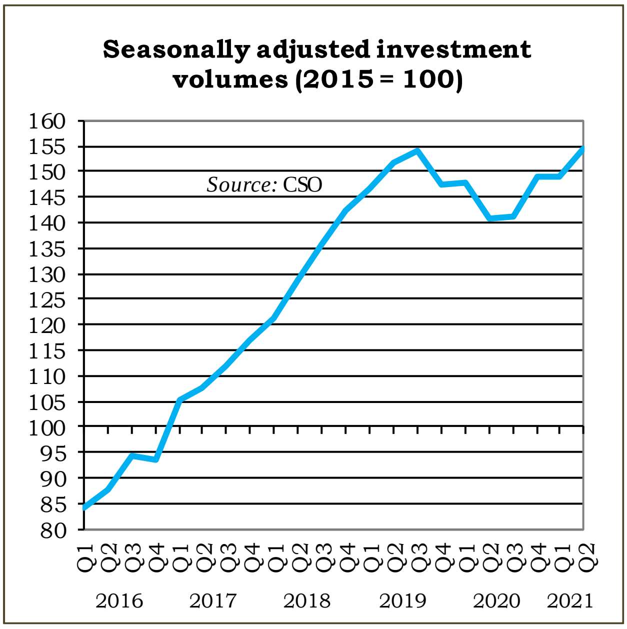
3.2.2. Investments

After the near-stagnation in the first quarter, investments were up 10.8 percent in the second quarter. In addition, now business investments were the main contributor to investment growth with a year-on-year growth rate of 13 percent, while state investments, the former growth drivers, virtually stagnated. According to the seasonally adjusted data, investment volume stopped rising in the first quarter (compared to the previous quarter) but with the resurgence of growth the investment volume surpassed the pre-crisis record level. In both quarters, investments in machinery and equipment were the growth driver. After steep growth in the first quarter, healthcare and public administration investments fell drastically in the second quarter, while investments in education continued to grow and investments into the partially state-related sector of arts and entertainment saw a whopping growth rate of 67 percent, from a very low base. According to CSO information, central government investments kept growing in the second quarter but most of that was offset by the decline of investments by local governments.

The main driver of business investment growth was *manufacturing* investments in the second quarter, just as manufacturing was the main hindering factor in the previous quarter. But investments grew at a good pace in wholesale and retail trade and in accommodation and food service as well. The revival of the investments of the so-called quasi-fiscal sector is shown by the resurgence of road and railroad investments.

Investment growth is expected to continue during the rest of the year: the **annual growth rate is likely to reach or surpass 7 percent in 2021**. The business sector's generally optimistic sentiment and the government support programs are likely to induce business investments to expand – the SME sector seems especially keen to invest, according to a recent survey. The households' housing investment activity will gather further momentum. The rate hike cycle, started by the NBH, and the ending of the FGS Go! program, again by the NBH, may become a hindering factor, however, by raising lending costs and limiting access to financing.





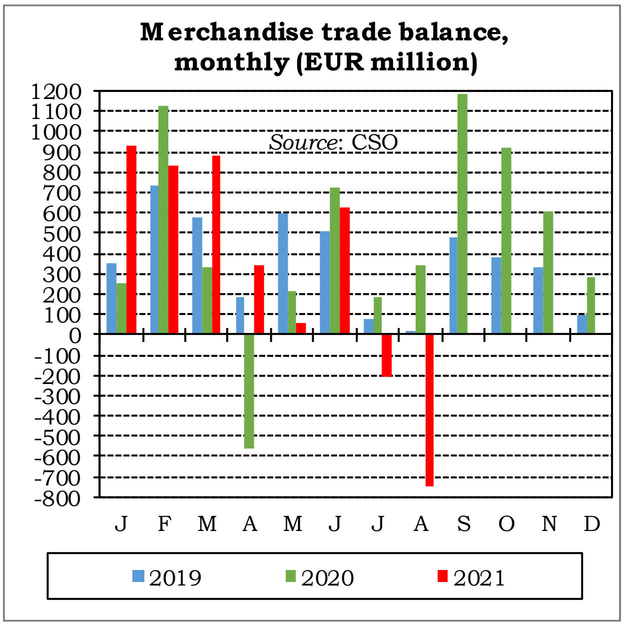
3.2.3. External trade

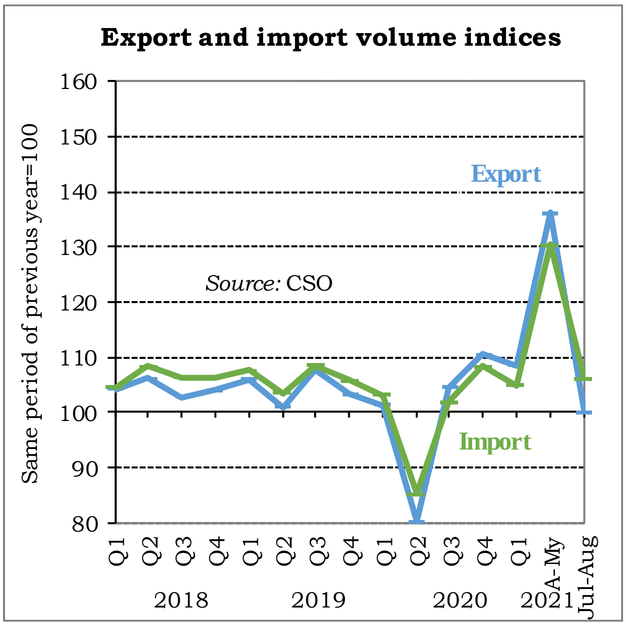
In the first quarter, export grew at a good pace even amid the chip shortage, and the growth rate became dramatic in the second quarter against the very low base level. In much of the first half, the volume of export expanded at a higher pace than import volume, and as a result, the cumulative trade surplus almost reached EUR 3.7 billion in January-June, which amounts to 75 percent growth on an annual basis.

But a negative turn occurred in the subsequent two months: the volume of export stagnated in July-August while the import volume continued to grow by about 6 percent, a reflection of the expansion of domestic demand. Even though the unfavorable export growth rates are partly due to the statistical base effect – a rapid relative export recovery in July and August 2020 – the month-on-month decline in the seasonally adjusted export volume in August is not a good sign. The main cause is probably the culmination of chip shortage, along with mounting the shortage of other materials and rising costs due to disturbance in global energy supply.

As a result, the trade surplus turned into trade deficit in both July and August. The cumulative trade surplus of January-February was only EUR 2.7 billion, *just 3.3 percent higher than in the same period of the last year*.

All this puts a question mark over the external trade prospects for the year as a whole. In the third quarter, merchandise export will certainly grow at a lesser pace the import, while the respective growth rates may level off in the last quarter. We still expect the annual trade surplus get close to **EUR 6 billion**, but this is not a certainty: at this point it cannot be taken for granted that the yearly trade surplus surpasses the surplus of the last year at all.

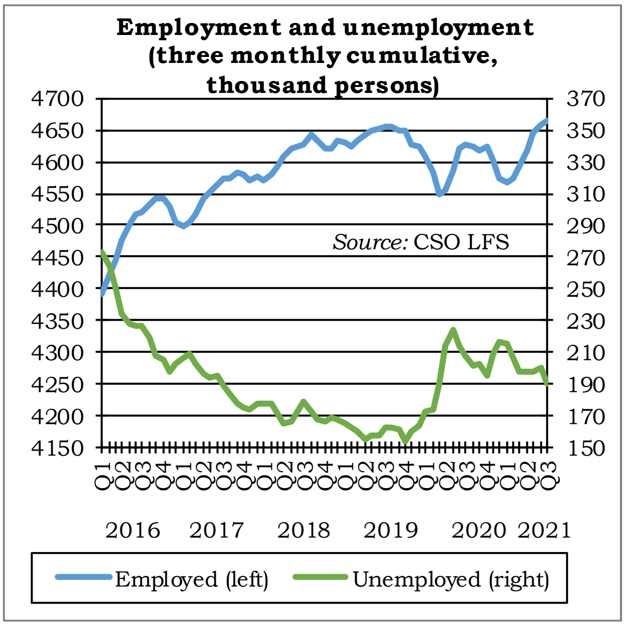


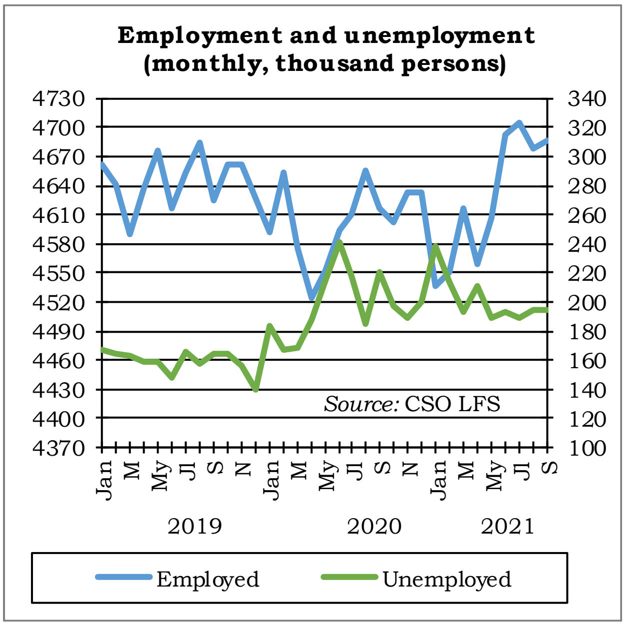


3.3. Employment, unemployment

After a weak year-start, the employment situation started improving again in much of this year, according to the LFS data. From June, the monthly *number of employed* surpassed pre-crisis record levels in the majority of months. The pace of the year-on-year increase in the number of employed first accelerated to about 2 percent June but somewhat subsided afterward. The improvement from May was obviously a result of the suspension of restrictions. After a surge in the first quarter, the *unemployment rate* decreased to 4.1 percent again in the second quarter and to 3.9 percent in the third.

It is good news that most of the improvement in the second and the third quarter can be attributed to the *primary labor market*: the number of the employed who work abroad decreased on an annual basis in both quarters, while the number of public workers has been changing only by a couple of thousand persons. On a more negative note, the growth in the number of *employees* – as opposed to the number of the self-employed – is still not a consistent trend – according to the LFS data, at least. (The payroll data tells a different story.)





The labor market situation is expected to keep improving, but the annual employment growth rate will remain below 1 percent. Due to the temporary high level in the first quarter, the annual unemployment rate will only decrease to 4 percent, at best, from the 4.1 percent in 2020.

3.4. Fiscal, monetary and financial developments

3.4.1. Fiscal developments

Fiscal trends in 2021

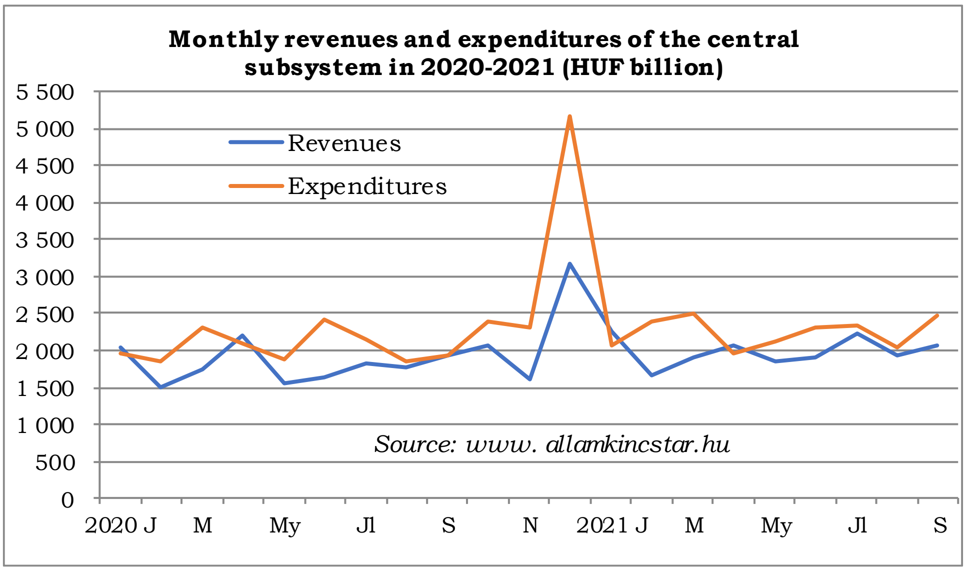
The government still pursues a procyclical fiscal policy and envisages a high deficit-to-GDP ratio, despite dynamic economic growth. The frequent changes in the deficit target and its discretionary spending decisions that ignore any spending ceilings make the analysis and prediction of fiscal trends quite difficult. Strong economic growth can partially offset the pressure on fiscal policy that is exerted by the epidemic-related costs. On the other hand, the tightening of monetary policy and the ongoing deterioration of global economic climate and the epidemic situation may lead to increased fiscal tensions.

According to the official data, the central subsystem of the general government saw a revenue rise of 10.5 percent in January-September, as opposed to the 9.3 percent growth in expenditures. The cumulative cash flow deficit of the central subsystem was HUF 2292 billion in January-September, which is roughly equivalent to the annual target and represents a year-on-year *growth* of about 1 percent compared to the same period of the year. This deterioration – despite the economic recovery – was due to a jump of expenditures in September: in the first eight months, the cumulative deficit was smaller than on year earlier.

Revenues from corporate taxes, VAT, personal income tax and social security tax increased at a good pace while revenues from the social contribution tax, from payments related to state property, interest revenues and revenues from EU programs decreased.

On the expenditure side, expenditures of professional chapter-administered appropriations, transfers to local government, expenditures from state property and expenditures related to pensions and curative provisions grew. On the other hand, a decrease was observed in the case of special and normative subsidies, expenditures of central budgetary institutions and EU-related expenditures.

The Ministry of Finance highlights road development (HUF 172.9 billion), sectoral transport programs (HUF 143.5), the Hungarian Village Program (HUF 134.5 billion), spending on special tasks of higher education (HUF 108 billion), highway availability fee (HUF 101.9 billion) and the Covid-related subsidies to enhance competitiveness (HUF 94.7 billion) as noteworthy items.



According to the accrual-based EU methodology, the general government deficit stood at 4.2 percent of GDP in the first half of this year, while the four-quarter cumulative rate was 7.6 percent. The modified deficit target for 2021 is 7.5 percent of GDP. The most recent EDP-report by the CSO in September raised the nominal GDP target – a reflection of the government's discretionary spending decisions – but also raised its nominal GDP projection, thus the envisaged GDP-ratio is unchanged. Considering the favorable conjunctural conditions, the high target is a reflection of a procyclical policy stance. The May forecast of the EU Commission predicted a deficit of 6.8 percent while the OECD country report in July adopted the government deficit target.

The positive risk regarding the deficit is related to the possibility that the growth rate and inflation rate surpass expectations. Originally, the budget projection was a growth rate of 4.3 percent and an inflation rate of 3 percent. The April convergence program raised the inflation expectation to 3.8 percent. But now the GDP growth is about to reach 6-7-8 percent with an inflation rate of about 5 percent. (The September Inflation Report of the NBH envisages a growth rate of 6.5-7 percent and an inflation rate of 4.6-4.7 percent.) The faster-than-expected wage growth can also add to the tax and contribution revenues of the budget. Also, the forint-denominated value of Inflows from the EU may be raised by the further depreciation of the forint.

The higher growth and inflation rates may add HUF 600-800 billion to fiscal revenues. The growth rate, however, may be dampened by worsening international conditions, with an US monetary tightening, the damage from the fourth Covid wave, a possible strong negative correction of the stock and cryptocurrency markets.

The main negative risk is coming from the rise of fiscal expenditures. Apparently, the government intends to spend all the extra revenues coming from the high growth and inflation rates, mostly discretionally, instead of using them to reduce the public debt. The most prominent additional item in expenditures comes is the higher pension outlay (pension raise, supplementary pension raise, the reintroduction of the 13th month pension). New bits of information appear almost every week about additional expenditures and reallocations within the budget. The preparation for the coming elections may entail another surge of fiscal expenditures in the fourth quarter as well.

The uncertainty around the inflow of EU funds is another point of risk. The EU Commission did not make a final verdict regarding the Hungarian Recovery and Resilience Program until the original deadline, the end of September, and extended the negotiation period indefinitely. Therefore, the first chunk of the EUR 7.2 billion allocated for Hungary (1 billion euro) can only arrive at the end of the year, at earliest, but there is a good chance that it will be transferred only in mid-2022, after the elections. This in itself does not affect the accrual-based fiscal balance but heavily affects the cash-flow balance if the Hungarian government advances the funding of the EU projects.

To bridge the gap, the government created a HUF 450 billion strong National Recovery Fund. (No payments from this Fund has been made so far.) Also, the final adoption of the partnership agreement necessary for starting to transfer the first chunks of the funds available under the 2021-2027 multiannual financial framework is still pending.

In sum: if the agreements with the EU bodies are delayed further than the annual negative gap between the EU-related advance payments by the government and the inward transfers from the EU may balloon to HUF 1100-1200 billion in 2021, as opposed to the HUF 482 billion target.[1] Until the arrival of these transfers, these spending items increase the cash flow deficit.

One possible response on the part of the government is to delay the pre-financing of the EU projects. In the light of the government declarations, this seems unlikely – actually, a speed-up of payments is quite possible. The EU Commission will refinance the payments on the projects only if the national recovery and resilience plan is accepted. This poses the negative risk that the Commission eventually does not accept the pre-financed projects, which would increase the (accrual based) EDP deficit and debt. Another possible response is that the government pre-finances the additional expenditures from the budgetary reserves or from the liquidity reserves parked on the single treasury account. Eventually, there is no practical impediment to the issuance of additional FX bonds to fill the budgetary gap.

Based on the dynamic GDP growth, both the Fiscal Council and the NBH preferred a lower fiscal deficit, for good reason. The Court of Auditors has also opined that the government should use the additional revenues to reduce the public debt – an assessment one can fully agree with.

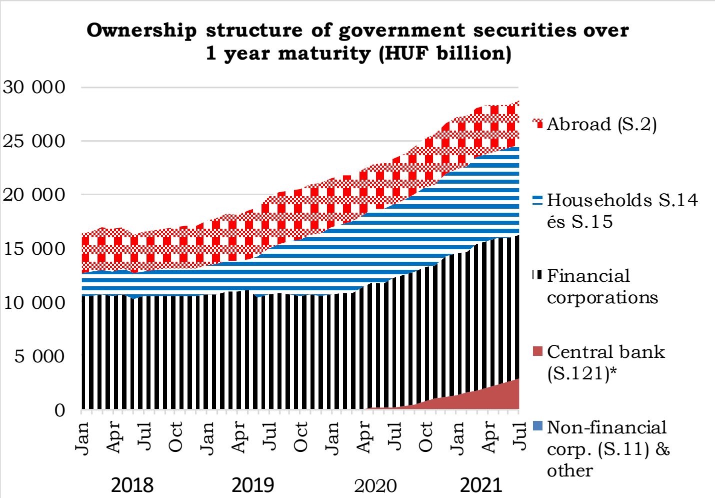
[1] Weinhardt, Attila: Rengeteg pénzt küldött Brüsszel a kormánynak az új vita kirobbanása óta – Ez hogyan lehetséges és mi várható? https://www.portfolio.hu/unios-forrasok/20210821/rengeteg-penzt-kuldott-brusszel-a-kormanynak-az-uj-vita-kirobbanasa-ota-ez-hogyan-lehetseges-es-mi-varhato-497286

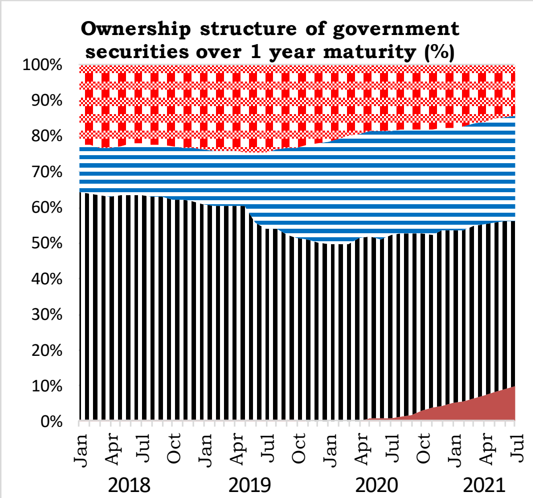
Fiscal debt

According to the Government Debt Management Agency (ÁKK), the nominal debt of the central government rose to HUF 40,060 billion by the end of September, up 9.2 percent compared to its level at the end of the last year. and FX debt by HUF 1025 billion. The growth came from transactions (new debt issuance of HUF 9542 billion and debt redemption of HUF 6129 billion). The net valuation effect slightly reduced the value of debt over the past nine months.

Forint denominated debt rose by HUF 2314 billion – the stock of retail securities was up HUF 605 billion while the stock of discount T-bills decreased by HUF 99 billion. Within the category of retail securities, the Hungarian Government Security Plus and the Premium Hungarian Government Security attracted the largest demand.

In terms of ownership structure, the share of households – the sector which is deemed the most stable investor category – within the HUF-denominated bonds was 23 percent at the end of July, as opposed to the 25 percent at the end of 2021.





The appearance of the NBH on the government securities market is a relatively new development. The NBH started its government security purchase program on May 4, 2020, initially with only small-scale purchases. But in 2021, the NBH was already buying securities on a monthly magnitude of HUF 210-270 billion on the secondary market; its stock of government bonds reached HUF 2817.5 billion by the end of July, raising its share to 9.6 percent in the overall stock of HUF-denominated government bonds. In August 2021, the NBH decided on the gradual tapering off of its purchase program, which will result in a decrease of its share.

Central government gross debt

	December 2020.		September 2021		change
	billion HUF	%	billion HUF	%	percentage points
1. Forint	**29 237.266**	***79.7***	**31 550.873**	***78.8***	***-0.94***
1.1. Loans	**1 161.614**	***3.2***	**1 156.830**	***2.9***	***-0.28***
1.1.1. Foreign loans	1 161.614	*3.2*	1 156.830	***2.9***	***-0.28***
1.1.2. Domestic loans	0.000	*0.0*	0.0	***0,0***	***0,00***
1.2. Government securities	**28 075.652**	***76.5***	**30 394.043**	***75.9***	***-0.66***
1.2.1. Public issues	28 036.474	*76.4*	30 354.865	***75.8***	***-0.65***
1.2.1.1. Bond	*18 206.614*	*49.6*	*20 019.070*	***50.0***	***0.34***
1.2.1.2. Discount T-bills	*658.167*	*1.8*	*559.306*	***1.4***	***-0.40***
1.2.1.3. Retail securities	*9 171.693*	*25.0*	*9 776.489*	***24.4***	***-0.60***
1.2.2. Private placements	39.178	*0.1*	39.178	***0.1***	***-0.01***
2. Foreign exchange	**7 318.230**	***19.9***	**8 343.295**	***20.8***	***0.88***
2.1. Loans	**1 291.084**	***3.5***	**1 342.343**	***3.4***	***-0.17***
2.1.1. Foreign loans	1 291.084	*3.5*	1 342.343	***3.4***	***-0.17***
2.1.2. Domestic loans	*0.000*	*0.0*	0.0	***0.0***	***0.00***
2.2. Government securities	**6 027.146**	***16.4***	**7 000.951**	***17.5***	***1.05***
2.2.1. Issued abroad	5 481.262	*14.9*	6 537.848	***16.3***	***1.38***
2.2.2. Issued in Hungary	545.885	*1.5*	463.103	***1.2***	***-0.33***
Total	**36 555.496**	***99.6***	**39 894.167**	***99.6***	***-0.06***
Other debt	128.840	*0.4*	165.666	***0.4***	***0.06***
TOTAL CENTRAL GOVERNMENT DEBT	**36 684.336**	***100.0***	**40 059.833**	***100.0***	***0.00***

Source: Government Debt Management Agency

Back at the end of 2020, forint-denominated loans and securities financed 79.7 percent of the central government debt – that decreased to 78.8 percent by September. (But this was due to the large-scale issuance of FX bonds on foreign markets in September: at the end of August, the share of HUF-denominated debt was still as high as 82.6 percent. The ÁKK still makes effort to gradually lengthen the average maturity, and to smooth out the maturity structure. Ten-year bonds make up the bulk of the new issuances.

The FX debt of the central government decreased by almost 11 percent from December to August but soared to HUF 8343 billion in September, up 14 percent compared to its December level. The stock of securities in the hands of foreign owners grew by as much as 19.3 percent from last December to September.

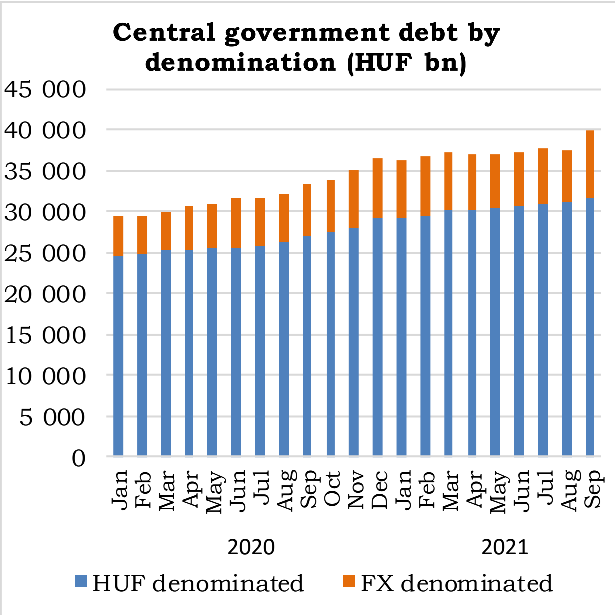
The HUF issuance plan of the ÁKK will be probably met before the end of 2021, but the ÁKK keeps holding bond auctions regularly, to raise its liquidity reserves. The issuance of additional bonds on the institutional HUF bond market – above what was envisaged in the May financing plan – is likely to be successful. The retail market issuance plan, on the other hand, has been revised down.

The enormous increase in the FX issuance plan, unveiled in 13 September permits the issuance of FX bonds at a magnitude up to EUR 4.5 billion. The objective is primarily to cushion the longer delay of the transfer of the advanced payments connected to the recovery and resilience plan by the EU, and also to finance certain government expenditures and to pre-finance a part of the 2022 deficit.

The FX issuance was explained with the favorable yield conditions. Another reason was the objective to raise the average maturity. But still, the ÁKK plans to keep the share of FX debt within the overall debt between 10 percent and 20 percent. The ÁKK also emphasizes that the issuance is about the cover expenditures in 2022, hence it does not affect the accrual-based deficit target of 7.5 percent for this year.

Apart from the officially given reasons, it is worth noting that the demand for securities, under the conditions given, has softened lately (the ÁKK sold less securities than the quantity offered at the auctions), which is not unrelated to the monetary tightening by the NBH, more specifically to the phasing-out of its government bond purchasing program.

In accordance with the amended financing plan, the ÁKK issued 10-year and 30-year FX bonds on September 14, with fixed interest rates of 2.125 and 3.015 percent, respectively, in the amount of USD 2.25 billion and USD 2 billion, respectively. The yields are above the US government bond yields by 1 and 1.5 percentage points, respectively. The next day, another bond issuance of EUR 1 billion, with a 7-year maturity, at a fix rate of 0.125 percent, was implemented. The cross-currency risks are covered hence the real cost of the USD-denominated issuance is not the interest rate of the USD bond but the much lower fixed rate of the euro interest rate swap contract.[2]



The fundraising amounts to a total of HUF 1575 billion (at an EUR/HUF exchange rate of 350), which makes up 3 percent of GDP, assuming a GDP growth of 7 percent. If the reduction of retail issuance and the expansion of the institutional market by HUF 230 billion is taken into account, the amount is smaller. The other side of the equation is the additional inflow of revenues, due to the fact that the budget originally envisaged a growth rate of 4.3 percent, but the actual rate may come close to 7 percent. The latter difference surpasses the amount of the additional borrowing by far, and consequently – assuming unchanged conditions otherwise – the debt-to-GDP ratio will not rise.

[2] Beke, Károly: Miért vett fel hatalmas devizaadósságot Magyarország? https://www.portfolio.hu/gazdasag/20210920/miert-vett-fel-hatalmas-devizaadossagot-magyarorszag-501104

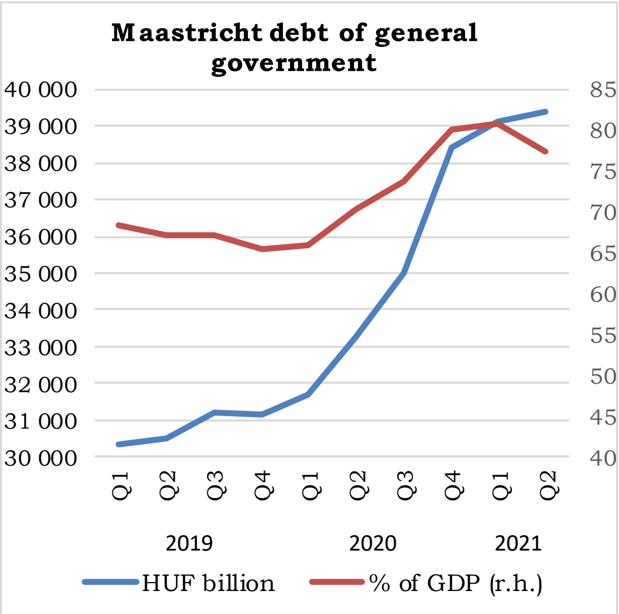
The borrowing of EUR 4.5 billion is noteworthy because the government cited its intention to avoid further indebtedness as a reason for not wanting to draw on the interest-free credit of EUR 9.7 billion offered by the EU as part of the recovery funding.

Hungary's credit rating was unchanged since September 25, 2020 – it belongs to the mid-to-low segment according to both the Standard & Poor and FitchRatings. On the 24th of September 2021, Moody's upgraded Hungary's credit rating, thereby bringing it to the same level as the other rating agencies.

In the short term, neither upgrading nor downgrading is expected. A downgrading may happen if the fiscal situation gets out of hand. Naturally, the assessment of the rating agencies does not affect the magnitude of public debt itself, only the conditions under which this debt can be refinanced.

Due to some improvement in both international and country specific factors, the CDS spread has decreased recently, to around 50 basis points.

In view of the reverberations of the Covid epidemic, the EU institutions suspended the Maastricht debt rules (debt ceiling of 60 percent of GDP, above which the countries must take steps to reduce the debt-to-GDP ratio) until 2023. Thus, the debt levels in 2020 and 2021 do not violate the EU rules. But the domestic debt rule stipulates that the debt ratio must be reduced under 50 percent.



The government's convergence program (for the period of 2021-2025) envisages a debt rate of 79.9 percent for 2021. This entails a symbolic reduction compared to 2020, probably with a view to comply with the Hungarian stability law. The EU Commission predicted a debt rate of 78.6 percent in May, while the July country report of the OECD predicted a higher rate of 81.9 percent.

The 2021 debt-to-GDP rate hinges to a large extent on the fiscal developments, discussed above, that are hard to difficult to predict, due to the considerable positive and negative risks. Whether these risks will materialize depends on unpredictable policy decisions. That said, we expect a debt ratio slightly below 80 percent, with negative risks. If needed, the government can reach this level by purchasing the necessary amount of government securities from the money available on the single treasury account.

The financing of debt through HUF denominated liabilities has the drawback of being more costly than the FX denominated debt financing, especially after the ongoing rate hikes by the NBH. On the other hand, the financing through FX financing creates an exchange rate risk – that is, the risk of weakening of the forint against the euro, which may more than offset the interest rate saving. The higher domestic interest cost is the price that is paid for the reduction of exposure of external impacts. The possibility of a forint appreciation, on the other hand, is a positive risk.

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.

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. The September large-scale FX bond issuance became necessary in part because the households' demand for government bonds fell short of the actual financing needs. Unless the households' preferences shift toward saving, the demand for retail securities will decrease or stagnate.

3.4.2. Inflation

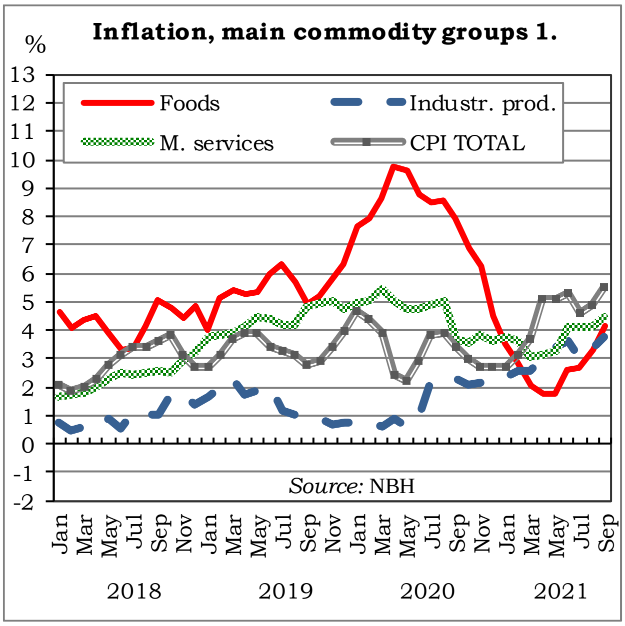
In the first nine months of 2021, the cumulative year-on-year inflation rate was 4.4 percent – 5.5 percent in September alone. In both August and September, prices rose by 0.2 percent compared to the previous month, a slowdown compared to the previous months. But the 5.5 percent year-on-year rate in September was the third highest within the EU member states (behind Estonia and Lithuania). This means that the Hungarian inflationary wave is a relative outlier even if rising inflation has been observed throughout Europe (and the world) as well. The ECB deems the rising inflation a temporary phenomenon, but this opinion is fiercely debated. In any case, we expect the Hungarian inflation rate remain above the target range of the NBH (3 ± 1%) even in the next year.

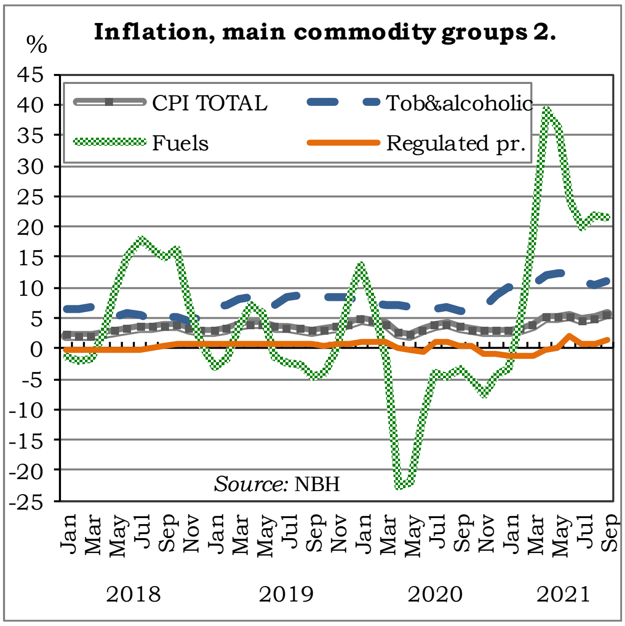
The monthly year-on-year inflation rates displayed a rising trend during the year, from 2.7 percent in January rates to above 5 percent in May and June to 5.5 percent again – after some temporary respite in July and August – in September. The monthly rate will remain above 5 percent during the rest of the year, possibly even surpassing 6 percent in November-December.

Unlike in the last year, in 2021 the inflation is primarily driven not by *food prices* but by skyrocketing *fuel prices*, a result of the surging oil price. In September, food prices were up 4.4 percent, a rate below the average. Still, prices are skyrocketing at some specific food categories: poultry meat and fresh vegetable prices rose at a rate near or above 10 percent, edible oil prices rose by almost 33 percent in September.

On the other hand, *fuel prices*, after a very steep fall in April 2020, at the time of the first Covid outbreak, rose by almost 40 percent in April 2021 compared to the same month of the previous year. Since then, the price hike moderated somewhat but it was still around 20 percent in July-September. Compared to the *previous month*, fuel prices jumped by 4.2 percent in July, but the rate dipped below 1 percent in August and September.

Alcoholic beverages and tobacco products are the second main driver of inflation this year, with a yearly rate of 11.2 percent in September. The price index of this product





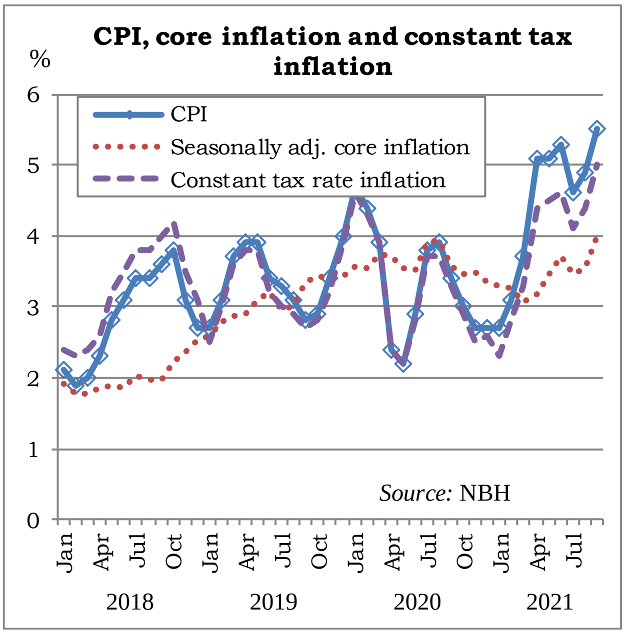
group has been steadily exceeding average inflation in the recent year, a consequence of the repeated excise tax hikes.

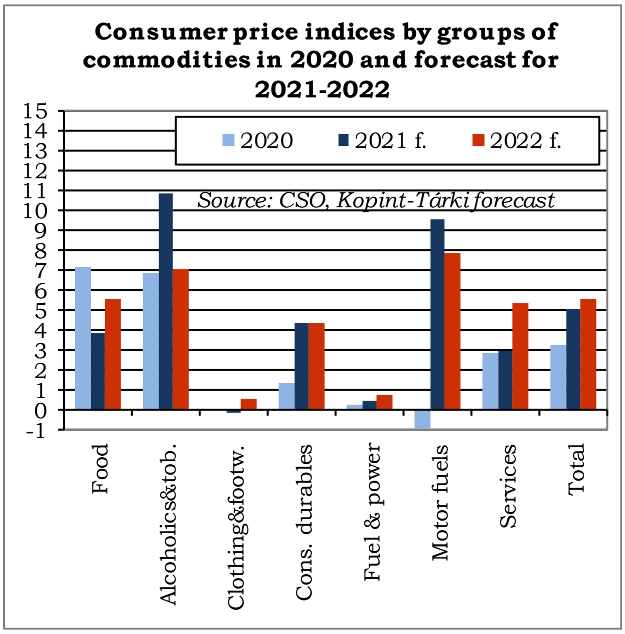
This year, the two-step tax raise (in January and April) made the year-on-year tobbacco price index (along with the previous tax hike in last December) jump to 20 percent in April. Since then, with no further tax hikes, the price index moderated somewhat but it is still way above 10 percent – it might dip below 10 percent by the end of the year.

The year-on-year price index of *market services* significantly moderated after the lockdown – in much of the first half of this year, the index remained below 4 percent but rose again in June and reached 4.5 percent in September – still a rate below average inflation. A further acceleration is expected in the coming months, partly due to the statistical base effect.

Core inflation still falls short of headline inflation, which highlights the prominent role of early season vegetables and raw materials as inflation drivers. In the recent months, the core inflation rate largely moved together with the headline rate, with a difference of 1-1.5 percentage points between them (exactly 1.5 percentage points in September). The lower core inflation would, in principle, point toward a deceleration of inflation but this may be offset by expanding consumer demand. The constant tax rate was 0.5 percentage point lower in September than the headline rate, which means that the tax hikes caused an additional inflation of that magnitude.

In early November, the Kopint-Tárki predicts an **annual inflation of 5 percent**, with upward risks. The monetary council, after starting a rate hike cycle with monthly raises of 30 basis points, moderated the raise to 15 basis points in September, even though the September Inflation Report of the NBH already predicted a high inflation rate of 4.6-4.7 percent for 2021. Formerly we expected the inflation to moderate in 2022 but that is not the case anymore: annual inflation may rise further the next year.





3.4.3. Financial and capital markets

Policy rates and exchange rate

The forint has a weakening trajectory against the euro for years; this trajectory was shaped, with varying intensity, by several external and internal factors. The domestic environment – and with it, the exchange rate trends – began to change in May 2021, when the NBH communication started preparing the markets for a raise of the reference rate. The monetary council, abandoning their former assessment, no longer considered the spring inflationary upsurge temporary (the year-on-year inflation rate reached 5.1 percent, a 8-year record, in April), and diagnosed the presence of significant longer-term inflationary risks.

The June rate hike was already an actual monetary policy turn. The NBH Monetary Council raised again the reference rate by 30 basis points in July and August, and the two margins of the interest rate corridor as well: the overnight loan interest rate rose to 2.45 percent, the overnight deposit interest rate to 0.55 percent. In addition, the NBH indicated that it would gradually phase out its government bond purchase program, taking care to ensure that stability is not to be put in danger. The weakly amount of asset purchase was decreased from HUF 60 billion to HUF 50 billion in August. In September the Monetary Council raised the policy rate only by 15 basis points, to 1.65 percent, and decreased the weakly amount of security purchase further to HUF 40 billion.

The Monetary Council assesses the situation and decides upon the framework for the next period at the end of the quarters. The reduction of the asset purchase begins with the short-term securities. On the other hand, the NBH holds the securities that are already in its books, until their maturity. A related fact is that the Monetary Council increased the allocation for the Bond Funding for Growth scheme by HUF 400 billion, to a total of HUF 1550 billion.

Based on the trends and expectations, the policy rate is expected to reach 2 percent by the end of the year. These past and future steps aim at normalizing the monetary conditions by ending the accommodative policy line and at meeting the inflation target. It is worth mentioning, however, that the real interest rate is still negative, despite the rate hikes.

According to the NBH, the inflation is set to rise further – it will remain above 5 percent in the rest of the year, while core inflation will be around 4 percent. The inflation target range may get within reach in the second half of 2022.

So far, the monetary tightening by the NBH was implemented amid the continuation of expansive monetary stance by the FED and the ECB, although the recent FED communication has already suggested that its stance will change before 2023.

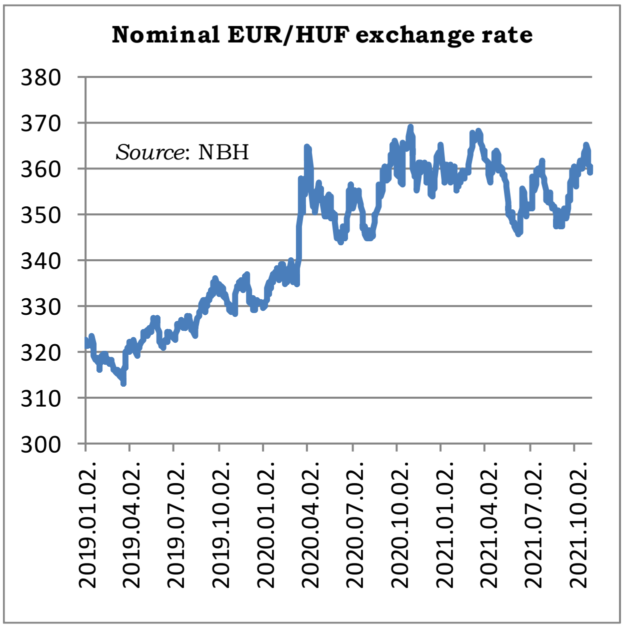
Apart from the external monetary environment and the domestic inflation, the governor of the NBH (and also the Fiscal Council highlighted the danger of overheating the Hungarian economy, to which the expansive fiscal policy is a major contributor. The higher interest rates may offset this overheating.

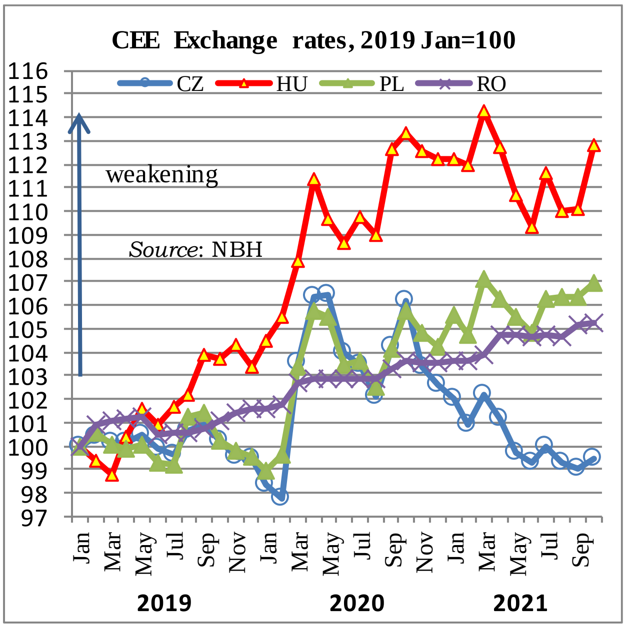
The policy rate is one of the numerous factors that influence the EUR/HUF exchange rate. The NBH does not have a declared exchange rate target but it keeps the exchange rate developments under review and makes steps if the forint weakening becomes a threat to the inflation target. The forint weakening also pushes the debt-to-GDP ratio upward. This means that the decision abouts the rate hike was (and are) made due to considerations regarding the inflation, not the exchange rate. On the other hand, the NBH has a wide range of tools to influence and stabilize the exchange rate. As an intended side effect, the monetary tightening can contribute to the strengthening of the forint against the euro, reducing the vulnerability of the forint, temporarily halting its weakening trend.

Albeit with some delay, the policy rate hike made an impact on the exchange rate: from the 360 EUR/HUF in early May, the forint strengthened to EUR/HUF 347 by August 25 and remained approximately there until mid-September. When the September rate hike fell short of expectations, however, the forint weakened again to 360 again by the end of that month and has been mostly fluctuating between 359 and 365 since then.

In January and October, the monthly average euro/forint exchange rate was virtually the same, with a weakening by only 0.5 percentage point (but with considerable fluctuation in between), while the Czech koruna strengthened somewhat and the Romanian leu and the Polish zloty weakened by more than 1 percent. With the policy rate hikes, the country specific factors behind the former weakening trend are neutralized and the country perception improves.

During the rest of the year, the negative risk is the possible worsening of global investor confidence, the high deficit and debt ratio, the deterioration of the current account balance and more generally the external position of Hungary and a possible loss of confidence regarding the Hungarian political situation and economic policy – for example, the disputes between the Hungarian government and the EU Commission regarding the homophobe law, the rule of law, and the uncertainty regarding the Hungarian recovery and resilience plan and the transfer of funds allocated under the Multiannual Financial Framework. We expect the annual average EUR/HUF exchange rate to be somewhere between 350 and 360 in 2021. A more drastic depreciation (to EUR/HUF 370-380) may occur in case of a sudden deterioration of global economic environment (stock market crash) which may bring about a mass capital flight.





Government yields

The reference rate hike cycle, started by the NBH in June and continued since, indicates the end of the period of low yields. Between January and August 2021, the 3-month yield rose from 0.36 to 0.87 percent, and then above 1 percent in September and October. The longer yields followed suit. Apparently, the government security market responded to the reversal of monetary policy.

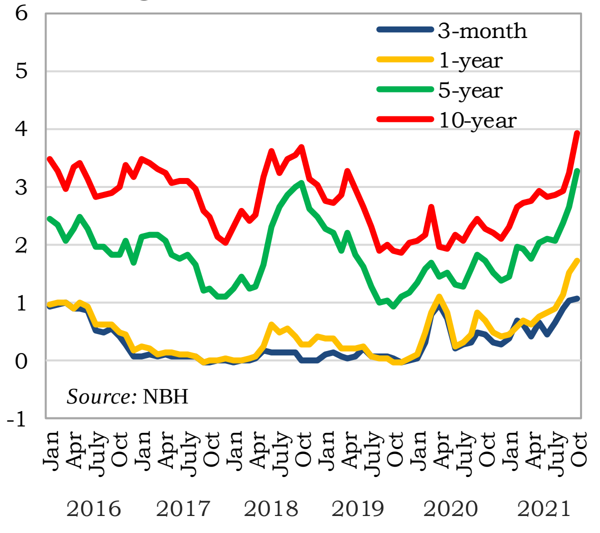
In September-October, due to the large-scale additional bond issuance (made necessary by the rising fiscal deficit and debt) the yield rise continued. In the case of the longer yields, the rise became even became steeper during these months, although they are shaped more by the international environment than the domestic policy choices. With the gradual phasing off of the government security purchase program by the NBH, the safety net role of the central bank may become less prominent on the government security market.

The yield rise leads to a change in the strategy of bond funds as well. Bond fund prices decreased, especially in the case of those funds which invest in bonds with longer maturities. The government security-oriented funds need to adapt their investment strategy to the new environment characterized by rising yields.

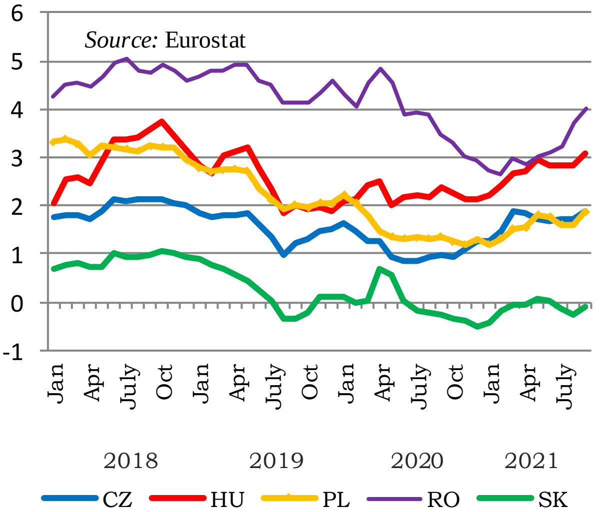
In the first eight months of this year, the impact of global developments was less spectacular but still far from negligible. According to Eurostat data, the negative yield of the AAA-rated central bank bonds came closer to zero in the case of bonds with maturities of 1-12 years and became positive in the case of bonds with maturities of 12-30 years between January and August. The EMU convergence criterion yield rose from -0.18 percent in January to -0.08 percent in August and became positive (0.07 percent) in September. Compared to January, the 10-year US T-bond yield rose as well, although the real yield is still negative. The evolution of the Hungarian yields was in line with these trends.

For the sake of comparison with other countries within the region, between January and September the EMU convergence yield rose from -0.43 to -0.08 percent in Slovakia, from 1.28 to 1.9 percent in Czechia, from 1.19 to 1.87 percent in Poland, from 2.22 to 3.09 in Hungary and from 2.72 to 4 percent in Romania. In line with the past trends,

Benchmark yields on Hungarian government debt securities



Long term government bond yields in Central and Eastern Europe (%)



Czechia, Poland and Slovakia can finance their state debt at lower yield than Hungary, while the financing cost of Romania is higher.

3.4.4. Corporate and household lending and interest rates

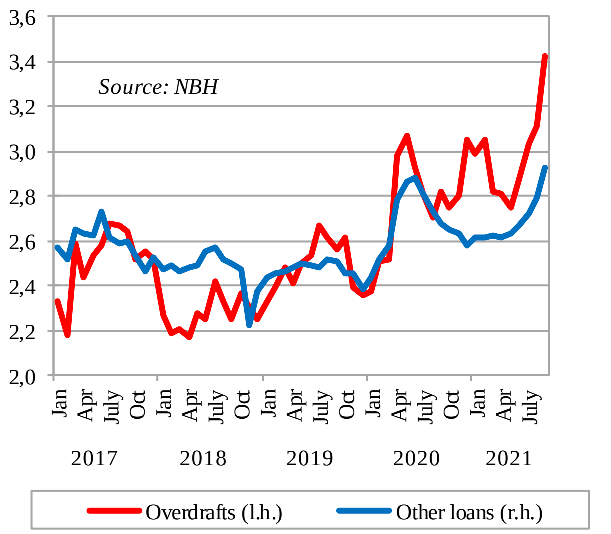
Corporate lending

According to the NBH data, the outstanding loans of non-financial enterprises – taking into account the repayment moratorium – grew only by 3.8 percent, to HUF 347 billion, from March to June. By contrast, the stock of bonds issued jumped by 160-t percent, to HUF 1234 billion at the same time. The latter was due to the widespread replacement of bank loans with bonds, making use of the Bond Funding for Growth Scheme. The total of outstanding loans and bonds was up 16.1 percent. The financing structure shifted from bank loans to bond issuances: the share of bonds within liabilities rose from 7.9 to 17.5 percent during he second quarter. The share of forint loans rose from 42 to 52 percent while the share of long-term loans climbed to 79 percent from 71 percent. The moderate strengthening of the forint in the second quarter reduced the forint-denominated value of FX loans. Construction, real estate, hotel- and food service firms borrowed the most dynamically. Within the stock of bank loans, the share of manufacturing, real estate and the wholesale and retail trade sectors is the largest.

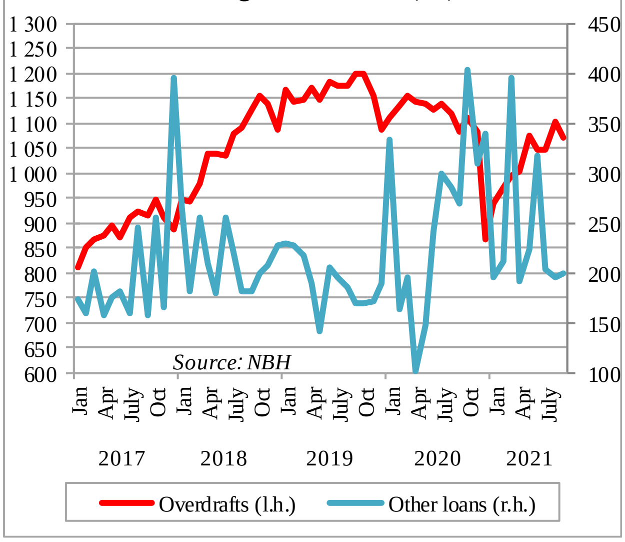
Numerous support schemes helped business borrowing to continue at a good pace, and even expand further. The most important was the FGS Go! program, launched in April 2020, under which 40,416 firms concluded loan or leasing contract, at a total amount of HUF 2921 billion, until July 31. As a result, the earmarked envelop of HUF 3000 billion was almost entirely used up. The stock of unamortized contracts is HUF 2049 billion. Out of the total value of the contracts conducted under the scheme, 37 percent was new investment loan or leasing, 53 percent was working capital loan, and 10 percent served as a replacement of earlier investment loans.

Regarding the sectoral allocation of the scheme, agricultural businesses got HUF 490 billion. The real estate sector, the food and metal industries had significant shares, along with the construction sector (HUF 300 billion) that was also boosted by the family housing support programs. The trade and repair sector got HUF 700 billion – as a result, its outstanding loans grew by a year-on-year 15 percent, to HUF 1600 billion. The stock of loans in the HORECA sector is HUF 307 billion, which reflects, besides new borrowing, the repayment moratorium as well.

New 'other' corporate loans (bn huf) and average interest rate (%)



New corporate overdraft loans (bn huf) and average interest rate (%)



Now the FGS Go! is replaced by the Széchenyi Card Restart Program – it is coordinated by the KAVOSZ Ltd. and has no ceiling regarding the total sum of loans allocated. The overall demand for these loans is expected to amount to HUF 2000 billion. Under this scheme, businesses can apply for three types of loans: working capital loans up to HUF 100 million, with 2-year maturity, at a maximum interest rate of 0.1 percent; liquidity loans up to HUF 250 million, with 3-year maturity, at a maximum interest rate of 0.2 percent; and investment loans up to HUF 1000 million, with a 10-year maturity, at an interest rate limited to 0.5 percent.

Apart from these schemes, the overall lending conditions will harden toward the end of 2021, due to the end of the repayment moratorium at the end of September and to the rate hike cycle started by the NBH. In December 2020, about 60 thousand firms made use of the (interest and principal) payment moratorium – that affected nearly 44 percent of the outstanding corporate loans. At present, 30-35 thousand firms participate in the moratorium. According to an NBH estimate, about 12 percent of the total outstanding loans is vulnerable in connection with the ending of the moratorium. Vulnerability does not automatically implies becoming non-performing, only the elevated risk of becoming non-performing.

As for interest rates, rate fixation is typical in the case of longer-term corporate loans, less so in the case of short-term loans. The interest risk of loans given to large corporations are usually covered with interest rate swaps. As for the SME-sector, here the interest rates of the bulk of the loans are fixed (in part due to the Funding for Growth Scheme of the NBH). The hardening of interest rate conditions affects the most those firms that do not have access to preferential lending schemes. These include the firms with a need for loans of HUF 1-20 billion – before, they had access to the FGS Go! program with a maximum interest rate of 2.5 percent, but this scheme was ended in the summer. Still, a large part of the new corporate loans is still given under a support scheme, with preferential interest rates, the rate hike cycle is likely to have only a limited impact on corporate lending

Household lending

The households' outstanding loans grew by 7.1 percent, to HUF 708 billion, between December 2020 and June 2021. 58 percent of this growth was due to consumption loans and 40 percent to housing loans. About 14 percent of the outstanding loans are "baby loans". It is worth noting that the stock of outstanding loans is the net result of gross borrowing and the repayment of existing loans. Below we give an overview about the trends in gross new borrowing.

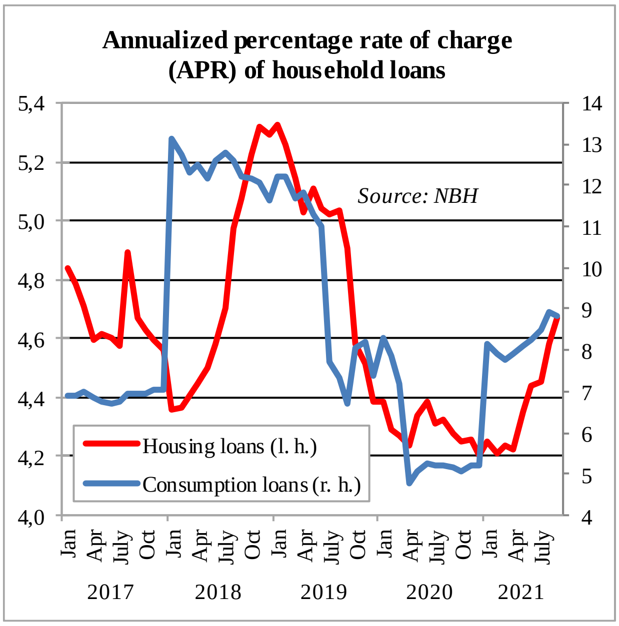
The value of forint-denominated new loans was HUF 974 billion in the case of housing loans and HUF 943 in the case of consumption loans, a year-on-year growth of 40.9 and 6.3 percent, respectively.

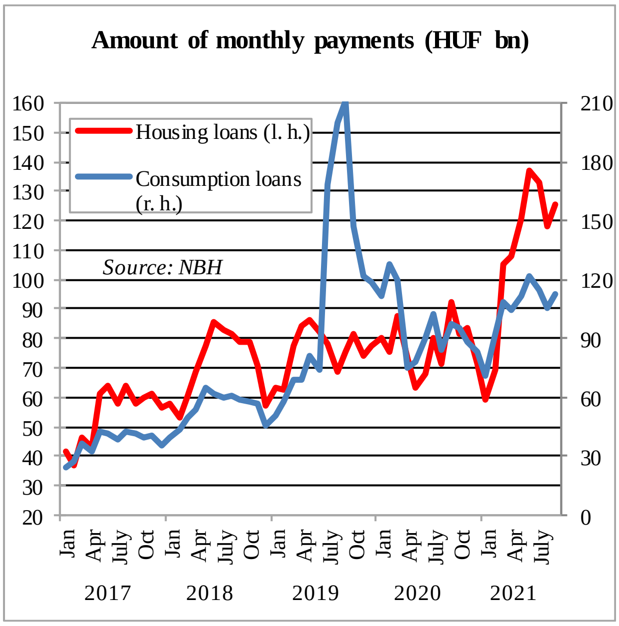
The average annualized interest rate, weighted by the amount of outstandings, was 4.56 percent in the case of housing loans and 6.8 percent in the case of other loans in January-September. In both case, there was a slight year-on-year decrease, but also in both case the trend was rising in August and September.

The new housing loans peaked in June with HUF 136.4 billion, an absolute record and more than double the level one year earlier, but the monthly placement remained steadily above HUF 100 billion since March.

Pent-up demand – from the period of the Covid-related lockdown – was an important driver of dynamic growth. The recent numbers include the loans that were not taken one year earlier, due to the epidemic. The preferential home renovation loan scheme, introduced in February 1, along with the other measures supporting the purchase of homes and taking up housing loans, introduced at the beginning of 2021, also gave a boost to borrowing. The flip side is that formerly borrowing in the last year borrowing was often deferred as many households chose to wait for the introduction of these support measures, thereby lowering the statistical base. This factor affected the monthly growth rates until the expiration of the repayment moratorium in its original form – the end of October.

In October 2021, the NBH launched its green home program, to which it earmarked HUF 200 billion. The scheme offers mortgage loans of up to HUF 70 million for





households, with a maximum 25-year maturity, for new homes that meet various "green" criterions (among others, outstandingly strict energy efficiency criterions).

The rate hike cycle, started by the NBH in June, will affect household lending. Most of all, loans with variable interest rates and new loans will be affected. At the end of 2020, 48 percent of the existing mortgage contracts was variable or fixed at most up to 12 months. A significant chunk of them is former FX loan. These loans will be affected detrimentally. In the case of the new loans, rising interest rates will primarily affect housing loans because – despite the numerous support schemes – five loans out of six do not receive interest rate subsidy. A part of the student loans is already interest-free or has fixed rate, and the same is usually true of the bulk of personal loans.

The most important risk to household lending – primarily housing lending – is the phasing out of the repayment moratorium on October 31. According to the NBH data, 1.2 million persons participated in the moratorium in April 2021. Those who apply will probably receive further extension until after the 2021 elections. According to the NBH estimate, 12 percent of the households' outstanding loans will be put under risk with the phasing out of the moratorium. According to a survey of the GKI Economic Research Co., carried out with a sample of 1000, 15-20 percent of total outstanding household loans may become problematic, based on the share of households that are likely to face a deterioration of their financial standing.

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	1.8	4.2	3.7	2.2	4.3	5.4	4.6	-4.7	6.8	5.0
Domestic Demand	1.7	5.3	2.0	1.8	5.7	7.1	6.8	-2.7	4.7	5.0
Private Consumption	-0.1	2.2	3.6	4.1	4.5	4.2	4.5	-2.0	3.9	4.8
Public Consumption	5.6	8.9	1.3	0.5	3.8	4.2	6.4	5.2	3.2	0.0
Gross Capital Formation	5.1	12.5	-1.6	-3.5	10.1	15.9	12.1	-7.0	6.8	7.3
of which: Fixed Capital Formation	9.8	12.2	4.9	-10.6	19.7	16.3	12.8	-6.9	7.4	7.3
Export	4.1	9.2	7.4	3.8	6.5	5.0	5.4	-5.9	10.9	6.6
Import	4.1	10.9	5.7	3.5	8.1	7.0	8.2	-3.5	8.3	6.6
PRODUCTION INDICES										
Agricultural Production (gross)	12.5	11.4	-2.4	9.3	-4.1	2.7	0.4	-2.2	2.0	0.0
Industrial Production	1.1	7.7	7.4	0.9	4.6	3.5	5.6	-6.0	11.0	6.0
Retail Trade Volume	1.8	5.2	5.8	4.8	5.6	6.7	6.3	-0.3	3.5	4.5
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	4.0	3.6
Gross Nominal Wages	3.4	3.0	4.3	6.2	12.9	11.3	11.4	9.7	8.2	9.6
Net Real Wages	3.1	3.2	4.4	7.4	10.3	8.3	7.7	6.2	3.0	3.9
PRICES, EXCHANGE RATES										
Consumer Price Index	1.7	-0.2	-0.1	0.4	2.4	2.8	3.4	3.3	5.0	4.7
EUR/HUF Exchange Rate (annual average)	297	309	310	311	309	319	325	351	356	356
EUR/USD Exchange Rate (annual average)	1.33	1.33	1.11	1.11	1.13	1.18	1.12	1.14	1.21	1.20
Short-term Interest Rates (3M), eop	2.86	1.43	0.80	0.06	-0.01	0.00	-0.01	0.28	1.0	1.3
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	0.5	1.0
GOVERNMENT BUDGET										
General Government Balance, ESA-95, % of GDP	-2.6	-2.8	-2.0	-1.8	-2.5	-2.1	-2.1	-8.0	-7.5	-5.9
Gross Government Debt, % of GDP [a]	77.2	76.5	75.7	74.8	72.1	69.1	65.5	80.1	79.9	79.0

a Including the balance sheet of Eximbank

* Kopint-Tárki forecast

Source: CSO, NBH

Content