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I. The global economy

The consequences of the coronavirus overturned the conditions of **global economic growth**. Market expectations are primarily affected by the fact that there is no end of the spread of the pandemic on the horizon. During the spring, when the dramatic spread of the epidemic lead to total lockdown in Europe and in other parts of the world, everybody was hoping for a V shaped recovery, that is, they hoped that the plunge in the first half of the year would be followed by the return of growth at some point during the second half. But even before the end of the summer the epidemic returned – while it is not expected to result in a lockdown of similar proportions, since the economies are more prepared now – the economy is likely to contract in the second half of the year as well, or at best grow only at a very meager pace. Since the epidemic appeared virtually everywhere in the world by now, the global economic decline will be more pronounced than it was in 2008-2009. The IMF and the OECD expects a **global economic decline** of 4.5-4.9 percent for 2020, and the recovery may be much slower than what was expected in the spring. As things stand now, it will take years for the global GDP to reach the level of 2019.

Global trade virtually collapsed in the spring of 2020, mostly due to the halt of the flow of supplies from China. In May, the volume of global trade turnover was 18 percent lower than one year earlier. The fall is somewhat less pronounced – 6 percent – in the case of the emerging economies. On the other hand, in the developed countries the export of goods contracted by 12.5 percent in the first half of the year, which means a dramatic fall in net export. While the decrease in the emerging countries was less drastic, its impact on their growth performance was still significant.

In the second quarter, the price of **crude oil** reached historical low levels: during the spring lockdown oil demand collapsed and the volume of oversupply surpassed the volume of storage capacities. This forced the oil producers to cut production further. Beyond the large OPEC producers, Norway, Canada and Russia voluntarily reduced its output. Oil producers in the US severely cut their production as well. In the wake of the end of the lockdown, Chinese oil demand rose by 750 thousand barrels per day in July, demand started to recover in other regions as well. But the market is still vulnerable, and the second wave of the pandemic may easily topple demand once again. The IEA has somewhat reduced its demand forecast for 2021, assuming that the revival will be more muted than they had expected early in the summer. The IEA surmises that oil demand remains subdued until 2022, primarily due to the fall in air transport. We expect an annual crude oil price between 40-45 USD/per barrel in 2020 that – if the conditions are favorable – may rise to 50 USD/barrel or slightly higher. Price volatility is extremely high, the markets strongly react to every new development.

Due to the coronavirus crisis, the trend of **monetary easing**, having started in 2019, continued throughout this year. The *FED* cut the policy rate by 150 basis points to 0 percent, and it is not expected to raise the interest rate before the end of 2024. Besides, it introduced new quantitative expansion measures, and announced a virtually unlimited asset purchase program. The *ECB* eased its conditions as well and expanded its new asset purchase program – introduced in March – to EUR 1350 billion while continuing its formerly existing asset purchase program as well. Also, it keeps the policy rate at 0 percent, too. Both the FED and the ECB hinted that they would tolerate for a while if the inflation rate steadily rose above 2 percent, without any restrictive

countermeasure. The *Bank of England* reduced the reference rate to about 0 percent and in June it raised the sum deployed to quantitative easing from GBP 645 billion to GBP 745 billion. The *Japanese central bank* also introduced new quantitative easing measures, substantially expanded its asset purchase program – by now it is purchasing large quantities of shares as well. The Japanese ten-year government bonds are now sold at zero or even negative yields. The *Russian* central bank reduced the reference rate to 4.25 percent in June – the fourth rate cut this year – and indicated that further rate cuts may follow.

Recession is virtually universal outside the European Union. The COVID crisis put en end, spectacularly, to one of the longest periods of economic growth in the **US**: in the second quarter, the GDP fell by 9.5 percent on a quarterly basis, after a 1.3 percent decline in the first quarter. We expect an annual contraction of 8.5 percent, with a modest growth of 2-4 percent in 2021. In **Japan**, the present recession is unparalleled in the postwar era. The second quarter was the third consecutive quarter that saw a decline of GDP. The overall economic contraction may reach 5.8 percent in 2020, and the Japanese GDP is likely to grow only by about 2 percent in the next year, assuming that the fiscal stimulus measures remain in force. The **Russian economy** was hit not just by the pandemic but also the low oil price. The OECD predicts a 7.3 percent decrease of GDP, along with a 5 percent contraction of private consumption and a 9.5 percent fall in fixed investments. The prospects for 2021 are uncertain, with a possible growth of about 3.5 percent.

In the previous global crisis **China** had a vital role in keeping the world economy afloat. Now, we cannot expect a similar role even if China is the only major economy that is expected to achieve modest growth in 2020. The OECD predicts the Chinese GDP to grow by 1.8 percent this year and 8 percent in 2021. The present-day infrastructure development plans are different now: instead of massive construction projects, the aim is to help the expansion of cutting-edge technologies. During and after the crisis, China's role in the world economy is expected to change: its role as the „workshop of the world" will weaken while it will gain more prominence as an investor, both in terms of FDI export and liquidity support for countries struggling with fiscal difficulties.

The COVID crisis reached most of the **developing countries** relatively late but all the more drastically, and its consequences are still difficult to assess. Clearly the income sources on which these countries mostly rely are heavily reduced. Their revenues from the export of raw materials and fuels, or industrial products produced as suppliers to international value chains, from tourism and the related economic fields, and from remittances by workers working abroad has dried up almost overnight, and they cannot expect a fast revival of these income flows. The prospects were quite bad even before the arrival of the virus. The IMF predicts that the developing world will slide into recession this year. While the overall decline of GDP is may be only 1 percent for developing countries as a whole according to the IMF, Latin-America is expected to decline by 5.2 percent.

For the economy of the European Union, the severe consequences of the COVID recession is hard to absorb. In the second quarter, the GDP of the EU27 fell by 14 percent (14.9 percent in the case of the euro area). The various countries diverged widely: Spain suffered the steepest fall (22.1 percent in the second quarter) while in Ireland the decline remained relatively mild (3 percent). The pandemic forced Spain, France and

Italy to implement particularly harsh lockdown measures, with serious economic reverberations. The growth losses were especially high in manufacturing, trade, transport and tourism. While economic activity rebounded everywhere, to a degree, in the third quarter, the recovery may halt in the fourth, and remain anemic afterward. The differences among countries are large in this regard too. The GDP is to drop by an average 8-9 percent in the **EU27**, possibly followed by a 5 percent growth in 2021, under an optimistic scenario. In the **euro area**, GDP may fall by 9-10 percent. While every component of the GDP fell in the first half of 2020, government consumption remained relatively stable. Investment fell everywhere and construction output collapsed in some countries (France, Italy, Spain). Export and import generally plunged more steeply than GDP, which is a reflection of the high degree dependence of eurozone countries on external markets.

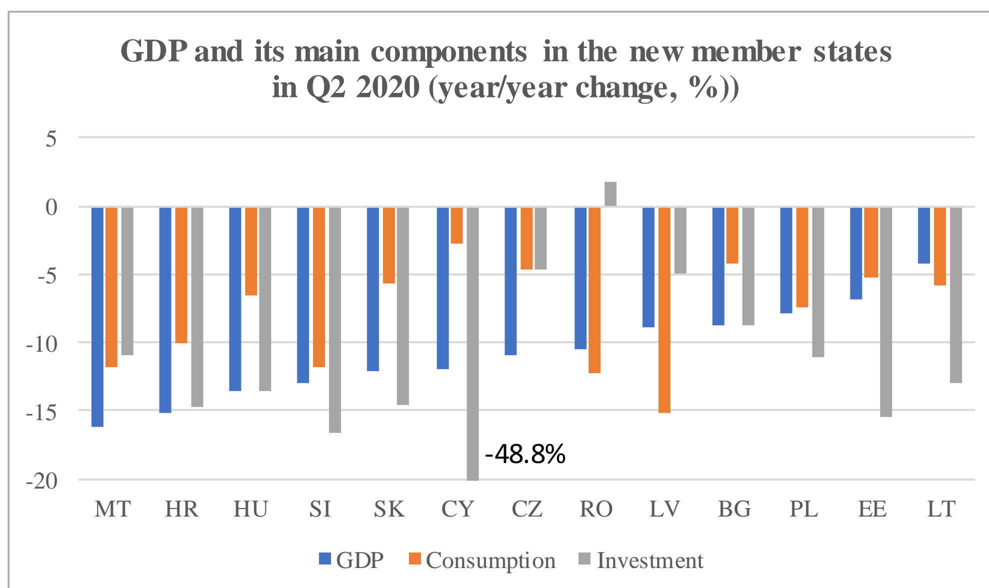
Amid the economic decline **consumer prices** remained relatively stable in the eurozone: the average inflation is unlikely to exceed 0.5 percent in 2020, and it will probably remain under the ECB target („below, but close to, 2 percent") in 2021 as well. With some delay, the economic fall brought about a deterioration in the **labor markets**, pushing unemployment rates upward.

The **German economy** seems to rebound to a significant extent in the third quarter. According to estimates, the low point was in late March, with a stable rising trend afterward. While analysts in Germany expect the GDP to fall by 5.5 percent in 2020, the second wave may result in a 8 percent drop according to the OECD. Predictions regarding the next year have been generally revised downward: now the growth forecasts vary within the 1.7-4.8 percent range. The growth rate may return to about 2 percent in 2022. But the outcome is still uncertain since it is hard to predict the trajectory of the pandemic during the winter months.

The economic reverberations of the pandemic were particularly harsh in the **United Kingdom**, the country that is about to leave the EU. The GDP dropped by 22.8 percent in the second quarter, the highest among the EU member states. One of the causes is that the British government was reluctant to react to the epidemic but in the end, it was forced to implement very harsh measures. Depending on the trajectory of the epidemic in the second half of the year, the GDP may fall at a rate somewhere between 10 and 14 percent in 2020. Even if the next year will see a growth rate of 5-7 percent, the level of GDP will still way below its pre-crisis level. Beyond the coronavirus, economic activity is hindered by the protracted process and the uncertain outcome of Brexit as well.

II. New EU member states

The pandemic-related lockdown caused a worldwide recession, and the Eastern European member states were no exception. The economic fall in the second quarter reduced the volume GDP to levels not seen for years. Malta and Croatia were hit the most, with suffering decrease rates of 16.2 and 15.1 percent, respectively. The third largest fall (13.6 percent) took place in Hungary. On the other end of the spectrum, the Lithuanian and Estonian decline was relatively mild (4.6 and 6.9 percent, respectively), mostly due to the fact that these countries are much less incorporated into the European automotive value chain, and informatics services make up a significant part of their overall export of goods and services. GDP fell by 7.9 percent in Poland in the second quarter – while the large external market somewhat cushioned the decline, the disappearance of Ukrainian guest workers caused large losses. The average rate of GDP decrease among the new member states was 9.9 percent in the second quarter.



Even before the end of the first quarter, every member state started to combine ultra-expansive monetary policy with fiscal stimulus to minimize the shock for the business and household sector. Every country introduced a support scheme for employment under a shortened working time arrangement, but with differences in the duration and the magnitude of the support. As a result, the unemployment did not rise dramatically compared to the pre-crisis period. During the second wave, however, unemployment may rise further if the currently available support – mostly refundable credit – proves insufficient.

The tourism and the passenger transport sectors are in the biggest trouble, but this affects the whole economy through the multiplicator effect. The implosion of air transport hit the largest European aircraft manufacturer, with reverberations for the whole supplier network. The European auto industry was slowing even before the crisis: the shift toward electric vehicles causes the decrease of European and US demand, which is only partially offset by growing orders from Asia. On the one hand, electric vehicles gain prominence even in Asian demand with intense competition from US and Japanese producers, and on the other hand, the local demand is best met by

local producers, which limits the degree Eastern European firms benefit from the Asian upturn.

Price trends have been diverging within the EU: in the eurozone countries deflation prevailed, but outside the euro area the inflation gathered speed. On the one hand, the prices of seasonal food products rose significantly, due to the unfavorable weather, which was compounded by the scarcity of farm guest workers during the epidemic. In countries with prominent tourism sectors, revenue shortfalls caused a fall in prices, along with rising unemployment, while in the eurozone countries prices were pushed downward by the strengthening of euro as well. By contrast, in countries outside the euro area the weakening of their currencies against the euro accelerated inflation.

In 2021 GDP is likely to grow in every new member state, due to the very low basis, but this assumes that the epidemic will not again necessitate closures similar to those in the spring of this year. A warning sign for the future is that while private consumption did not fall drastically, fixed investment did. The personnel cuts in the Western European automotive firms suggest that the investment projects were not just delayed by altogether scrapped. This is ominous for the Eastern European economies as well, but they still have sizeable advantage in terms of wage competitiveness. As a result, economic growth in the new member states may continue to surpass growth in the core countries in the recovery period, even if its absolute pace decelerates.

Besides the epidemic, the largest downward risk comes from the need to reduce the ballooning fiscal and business debt in the future. In this regard, the new member states are in better position than the Western European countries because the crisis found them in a relatively stable macroeconomic position. In the old member states, however, the debt reduction efforts may decrease consumption, which may have a spillover effect on the net export of new member states as well. This, however, is not so much a problem for the next year but rather for the subsequent years. Hence we expect that after an average GDP fall of 5.2 percent in 2020 the new member states will see an economic growth of 4.2 percent in 2021, assuming that there will be no need to introduce much more draconic measures against the epidemic than what is in effect at present.

Table 2/1.

Economic Growth in the EU Member States

(Percentage change of real GDP over the previous year)

	Weight	2014	2015	2016	2017	2018	2019	2020*	2021*
Germany	20.9	2.2	1.7	2.2	2.5	1.5	0.6	-5.5	4.8
France	14.7	1.0	1.1	1.1	2.3	1.7	1.3	-11.4	7.7
Italy	10.9	0.1	0.9	1.1	1.7	0.9	0.3	-11.3	5.5
Netherlands	4.9	1.4	2.0	2.2	2.9	2.6	1.7	-4.2	3.3
Belgium	2.9	1.3	1.7	1.5	1.7	1.4	1.4	-7.0	4.7
Luxembourg	0.4	4.3	3.9	2.4	1.5	2.6	2.3	-5.5	4.0
Ireland	2.1	8.6	25.2	3.7	8.1	8.2	5.5	-1.4	3.8
Greece	1.1	0.7	-0.4	-0.2	1.5	1.9	1.9	-6.8	4.5
Spain	7.6	1.4	3.8	3.0	2.9	2.4	2.0	-12.2	6.3
Portugal	1.3	0.9	1.8	1.9	2.8	2.1	2.2	-7.7	4.6
Austria	2.4	0.7	1.0	2.1	2.5	2.4	1.6	-6.8	4.1
Finland	1.5	-0.6	0.5	2.8	3.0	1.7	1.0	-4.5	2.9
Estonia	0.2	2.9	1.9	3.5	4.9	3.9	4.3	-7.2	3.6
Slovakia	0.6	2.8	4.2	3.1	3.2	4.1	2.3	-8.2	4.5
Slovenia	0.3	3.0	2.3	3.1	4.9	4.5	2.4	-7.1	4.0
Cyprus	0.1	-1.3	2.0	4.8	4.5	3.9	3.2	-7.0	6.5
Malta	0.1	8.2	10.8	5.6	6.8	6.7	4.4	-5.0	5.0
Latvia	0.2	1.9	3.0	2.1	4.6	4.8	2.2	-7.0	5.1
Lithuania	0.3	3.5	2.0	2.4	4.1	3.5	3.9	-4.0	4.0
Euro Area	**72.4**	**1.4**	**2.1**	**1.9**	**2.5**	**1.9**	**1.2**	**-9.2**	**6.1**
United Kingdom	15.3	2.9	2.3	1.8	1.8	1.4	1.4	-14.0	5.0
Denmark	1.9	1.6	2.3	2.4	2.3	1.5	2.2	-5.8	3.4
Sweden	2.9	2.7	4.4	2.4	2.4	2.3	1.2	-6.7	1.7
Hungary	**0.9**	**4.2**	**3.8**	**2.1**	**4.3**	**5.4**	**4.6**	**-5.8**	**3.5**
Czech Republic	1.3	2.7	5.3	2.5	4.4	2.9	2.4	-6.9	4.1
Poland	3.2	3.3	3.8	3.1	4.8	5.1	4.1	-4.3	4.4
Romania	1.4	3.4	3.9	4.8	7	4.1	4.1	-5.5	4.0
Bulgaria	0.4	1.3	3.5	3.9	3.8	3.1	3.4	-5.4	4.0
Croatia	0.3	-0.1	2.4	3.5	2.9	2.6	2.9	-11.0	4.3
EU-15	**90.8**	**1.3**	**2.4**	**1.9**	**2.3**	**1.8**	***1.3***	**-9.9**	**5.7**
New EU-13	**9.2**	**2.7**	**3.8**	**3.2**	**4.8**	**4.3**	***3.6***	**-5.8**	**4.2**
EU-28	**100**	**1.8**	**2.3**	**2.0**	**2.6**	**2.0**	***1.5***	**-9.5**	**5.6**
BREXIT	**84.7**			**2.0**	**2.7**	**2.1**	***1.5***	**-8.7**	**5.7**
Memorandum items									
USA		1.8	2.5	2.9	1.6	2.2	2.3	-8.5	4.0
Japan		2.0	0.3	1.1	1.0	1.9	0.7	-5.8	1.5
China		7.7	7.3	7.0	6.7	6.8	6.1	1.8	8.0
Russia		1.3	0.7	-2.8	-0.2	2.2	1.3	-7.3	3.5
South-Eastern Europe									
Serbia		-1.8	1.7	3.3	2.1	4.3	3.2	-4.0	6.1
Turkey		5.2	6.1	3.2	7.4	2.5	-2.3	-5.4	4.4

* Kopint-Tárki forecast

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

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

Source: Eurostat, national statistical offices, OECD

Table 2/2.

Inflation in the EU Member States

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

	Weight	2014	2015	2016	2017	2018	2019	2020*	2021*
Germany	19.8	0.8	0.1	0.4	1.7	1.9	1.4	0.3	2.9
France	14.2	0.6	0.1	0.3	1.2	2.1	1.3	0.9	2.0
Italy	12.1	0.2	0.1	-0.1	1.3	1.2	0.6	0.8	1.4
Netherlands	4.0	0.3	0.2	0.1	1.3	1.6	2.7	1.5	2.5
Belgium	2.7	0.5	0.6	1.8	2.2	2.3	1.2	0.8	1.6
Luxembourg	0.2	0.7	0.1	0.0	2.1	2.0	1.6	1.0	2.0
Ireland	1.2	0.3	0.0	-0.2	0.3	0.7	0.9	0.9	1.5
Greece	1.4	-1.4	-1.1	0.0	1.1	0.8	0.5	0.6	1.4
Spain	8.0	-0.2	-0.6	-0.3	2.0	1.7	0.8	0.3	1.4
Portugal	1.5	-0.2	0.5	0.6	1.6	1.5	0.3	0.3	1.4
Austria	2.2	1.5	0.8	1.0	2.2	2.1	1.5	0.6	0.9
Finland	1.4	1.2	-0.2	0.4	0.8	1.2	1.1	0.7	1.8
Estonia	0.2	0.4	0.1	0.8	3.7	3.4	2.3	-0.1	2.0
Slovakia	0.6	-0.1	-0.3	-0.5	1.3	2.5	2.8	2.2	1.5
Slovenia	0.3	0.4	-0.8	-0.2	1.6	1.9	1.7	0.5	1.7
Cyprus	0.2	-0.2	-1.6	-1.2	1.0	0.8	0.5	-0.5	0.9
Malta	0.1	0.7	1.2	0.9	1.3	1.7	1.5	0.9	1.5
Latvia	0.2	0.7	0.2	0.1	2.9	2.6	2.7	0.7	1.4
Lithuania	0.3	0.3	-0.7	0.7	3.8	2.5	2.2	1.0	2.0
Euro Area	**70.4**	**0.4**	**0.0**	**0.2**	**1.5**	**1.8**	**1.3**	**0.7**	**2.1**
United Kingdom	18.0	1.5	0.0	0.7	2.7	2.5	1.8	1.2	2.2
Denmark	1.6	0.4	0.2	0.0	1.1	0.7	0.7	0.4	1.0
Sweden	2.3	0.2	0.7	1.1	1.9	2.0	1.7	1.2	1.7
Hungary	**0.8**	**0.0**	**0.1**	**0.4**	**2.4**	**2.9**	**3.4**	**3.4**	**3.3**
Czech Republic	1.2	0.5	0.2	0.7	2.3	2.0	2.6	3.0	2.4
Poland	3.4	0.1	-0.7	-0.2	1.6	1.2	2.1	3.5	2.5
Romania	1.6	1.4	-0.4	-1.1	1.0	4.1	3.9	2.7	3.0
Bulgaria	0.4	-1.6	-1.1	-1.3	1.0	2.6	2.5	2.0	2.0
Croatia	0.3	0.3	-0.3	-0.6	1.3	1.6	0.8	-0.2	1.4
EU-15	**90.6**	**0.6**	**0.1**	**0.4**	**1.7**	**1.9**	***1.4***	**0.8**	**2.1**
New EU-13	**9.4**	**0.3**	**-0.4**	**-0.2**	**1.7**	**2.2**	***2.6***	**2.7**	**2.4**
EU-28	**100.0**	**0.5**	**0.0**	**0.3**	**1.7**	**1.9**	***1.5***	**1.0**	**2.1**
BREXIT	**82.0**			**0.2**	**1.6**	**1.8**	**1.4**	**0.9**	**2.1**
Memorandum items [a]									
USA		2.1	1.5	1.6	0.1	1.3	1.8	1.2	1.5
Japan		0.0	0.4	2.7	0.8	0.5	0.5	-0.3	-0.1
China		2.6	2.6	2.0	1.4	2.0	2.2	3.8	1.9
Russia [b]		6.8	7.8	15.5	7.0	2.9	4.5		
South-Eastern Europe									
Serbia		1.5	2.3	1.1	3.1	2.0	2.5	0.8	1.9
Turkey		7.8	8.9	7.7	11.0	16.7	13.3	11.4	11.7

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

Table 2/3.

Harmonized Unemployment rates in the EU Member States

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

	Weight	2014	2015	2016	2017	2018	2019	2020*	2021*
Germany	17.5	5	4.6	4.1	3.8	3.4	3.2	4.8	4.9
France	12.2	10.3	10.4	10.1	9.4	9.1	8.5	11.0	10.5
Italy	10.5	12.7	11.9	11.7	11.2	10.6	10.4	10.9	11.9
Netherlands	3.7	7.4	6.9	6.0	4.9	3.8	3.4	4.8	4.5
Belgium	2.1	8.5	8.5	7.8	7.1	5.9	5.6	7.0	7.8
Luxembourg	0.1	6.0	6.5	6.3	5.6	5.3	5.3	6.5	5.6
Ireland	1.0	11.9	10	8.4	6.7	5.8	5.1	5.8	6.0
Greece	1.9	26.5	24.9	23.6	21.5	19.3	17.8	18.1	16.0
Spain	9.4	24.5	22.1	19.6	17.2	15.3	14.0	15.8	16.8
Portugal	2.1	14.1	12.6	11.2	9.0	7.0	6.4	7.0	6.9
Austria	1.8	5.6	5.7	6.0	5.5	4.9	4.7	5.5	5.2
Finland	1.1	8.7	9.4	8.8	8.6	7.4	6.8	7.5	7.2
Estonia	0.3	7.4	6.2	6.8	5.8	5.7	5.5	9.0	6.5
Slovakia	1.1	13.2	11.5	9.7	8.1	6.9	5.8	9.0	7.0
Slovenia	0.4	9.7	9	8.0	6.6	5.6	4.2	7.0	5.0
Cyprus	0.2	16.1	15	13	11.1	8.2	6.5	9.0	8.0
Malta	0.1	5.8	5.4	4.7	4.0	3.9	3.5	6.0	5.0
Latvia	0.4	10.8	9.9	9.6	8.7	7.3	6.5	8.5	7.8
Lithuania	0.6	10.7	9.1	7.9	7.1	6.5	6.1	10.0	8.0
Euro Area	**66.4**	**11.6**	**10.9**	**10**	**9.1**	**8.2**	**7.6**	**9.2**	**9.3**
United Kingdom	13.5	6.1	5.3	4.8	4.4	4.0	3.8	9.1	7.8
Denmark	1.2	6.6	6.2	6.2	5.7	5.0	4.9	6.0	5.4
Sweden	2.2	7.9	7.4	6.9	6.7	6.3	6.8	8.5	8.0
Hungary	**1.9**	**7.7**	**6.8**	**5.1**	**4.2**	**3.7**	**3.4**	**4.3**	**4.0**
Czech Republic	2.2	6.1	5.1	4.0	2.9	2.4	2.3	5.0	4.0
Poland	7.0	9.0	7.5	6.2	4.9	3.3	3.8	7.5	5.0
Romania	3.6	6.8	6.8	5.9	4.9	4.3	4.2	7.0	5.5
Bulgaria	1.3	11.4	9.2	7.6	6.2	6.0	4.0	7.0	6.0
Croatia	0.7	17.2	16.1	13.4	11.1	9.1	6.0	10.0	7.0
EU-15	**80.2**	**10.5**	**9.9**	**9.2**	**8.4**	**7.5**	**7.1**	**9.2**	**9.1**
New EU-13	**19.8**	**10.4**	**7.9**	**6.6**	**5.5**	**4.5**	**4.1**	**7.2**	**5.4**
EU-28	**100.0**	**10.2**	**9.4**	**8.6**	**7.6**	**6.8**	**6.4**	**8.8**	**8.3**
BREXIT	**86.5**			**9.2**	**8.2**	**7.3**	**6.7**	**8.7**	**8.4**
Memorandum items [a]									
USA		7.4	6.2	5.3	4.9	4.3	3.7	10.0	8.5
Japan		4.0	3.6	3.4	3.1	2.8	2.4	3.2	3.2
China [b]		4.6	4.7	4.1	4.0	4.0	3.8	4.2	3.8
Russia [c]		5.5	5.1	5.6	5.7	5.4	5.2		
South-Eastern Europe									
Serbia [d]		22.1	19.2	15.3	13.5	12.7	11.0	12.0	10.0
Turkey		9.0	9.9	10.9	10.9	11.0	14.0	17.0	17.0

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

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

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

Source: Eurostat, national statistical offices, OECD

Macroeconomic indicators for Hungary and Kopint-Tárki forecast

(year-on-year change, percentage)

	Data					Forecast		
			2020			2020		2021
	2018	**2019**	**Q1**	**Q2**	**Jul-Aug**	**2020 July**	**2020 Oct.**	**2020 Oct.**
GDP aggregates, real growth								
GDP total	5.4	4.6	*2.2*	*-13.6*		-5.0	**-5.8**	**3.5**
Domestic Demand	7.1	6.0	*3.9*	*-6.5*		-2.2	**-2.9**	**2.8**
Private Consumption	4.5	4.2	*3.6*	*-8.4*		-2.3	**-3.1**	**3.0**
Public Consumption	1.8	4.7	*-0.4*	*3.5*		1.0	**1.7**	**0.0**
Gross Fixed Capital Formation	16.4	12.2	*-4.1*	*-10.9*		-5.3	**-7.0**	**4.5**
Gross Capital Formation	16.2	10.4	*6.7*	*-6.1*		-2.8	**-4.1**	**3.5**
Export	5.0	5.8	*-0.3*	*-24.2*		-10.1	**-8.8**	**5.6**
Import	7.0	7.5	*1.4*	*-16.4*		-6.8	**-5.4**	**4.7**
Industrial production	3.5	5.6	*0.3*	*-25.4*	*-5.1*	-10.0	**-7.6**	**5.0**
Consumer Price Index	2.8	3.4	*4.3*	*2.5*	*3.7* [e]	3.2	**3.4**	**3.3**
Employment, earnings								
Number of Employed, growth [a]	1.1	1.0	*-0.7*	*-2.3*	*-0.9* [e]	-3.0	**-1.2**	**1.0**
Employment rate [a]	60.4	60.8	*60.3*	*59.5*	*60.4* [e]	59.0	**60.2**	**60.6**
Unemployment Rate [a]	3.7	3.4	*3.7*	*4.6*	*4.3* [e]	5.5	**4.3**	**4.0**
Unit Labor Costs, in EUR [b]	6.2	7.2	*-2.1*	*5.3*		2.9	**2.9**	**3.4**
Gross Nominal Wages	11.3	11.4	*9.1*	*10.9*	*10.8*	6.5	**9.2**	**7.0**
Net Real Wages	8.3	7.7	*4.6*	*8.2*	*6.7*	3.2	**5.6**	**3.6**
Savings Rate, % of GDP [c]	6.0	4.9	*5.3*	*5.7*		5.8	**6.0**	**5.0**
Current and Capital Accounts Balance, % of GDP	2.5	1.5	*1.6* [d]	*-0.5* [d]		0.4	**0.3**	**0.3**
General government								
Fiscal Balance, ESA-2010, % of GDP	-2.1	-2.0	*-1.5*	*-9.1*		-5.2	**-7.0** [g]	**-5.0**
Gross Government Debt, % of GDP	69.1	65.4	*65.7*	*70.3*		74.6	**76.2**	**74.0**
Short-term Government Yields (3M), eop	0.00	-0.01	*0.77*	*0.18*	*0.48* [f]	0.8	**0.5**	**0.5**
Long-term Government Yields (10Y), eop	3.01	2.01	*2.65*	*2.15*	*2.43* [f]	3.0	**2.5**	**2.5**
External assumptions								
Internat. Trade in Goods and Services [d]	4.0	4.0				-11.9	**-12.0**	**8.0**
Brent Oil Price ($/bbl, p. avg.)	71.3	64.4	*50.3*	*29.3*	*43.0* [e]	40.0	**42.0**	**50.0**
GDP Real Growth, Eurozone	1.9	1.2	*-3.8*	*-14.9*		-10.2	**-9.2**	**6.1**
GDP Real Growth, New EU Members	4.3	3.6	*0.7*	*-9.9*		-4.9	**-5.8**	**4.2**
EUR-HUF, period average	319	325	*339*	*352*	*354* [e]	347	**353**	**355**
EUR-USD, period average	1.18	1.12	*1.10*	*1.10*	*1.17* [e]	1.10	**1.12**	**1.12**

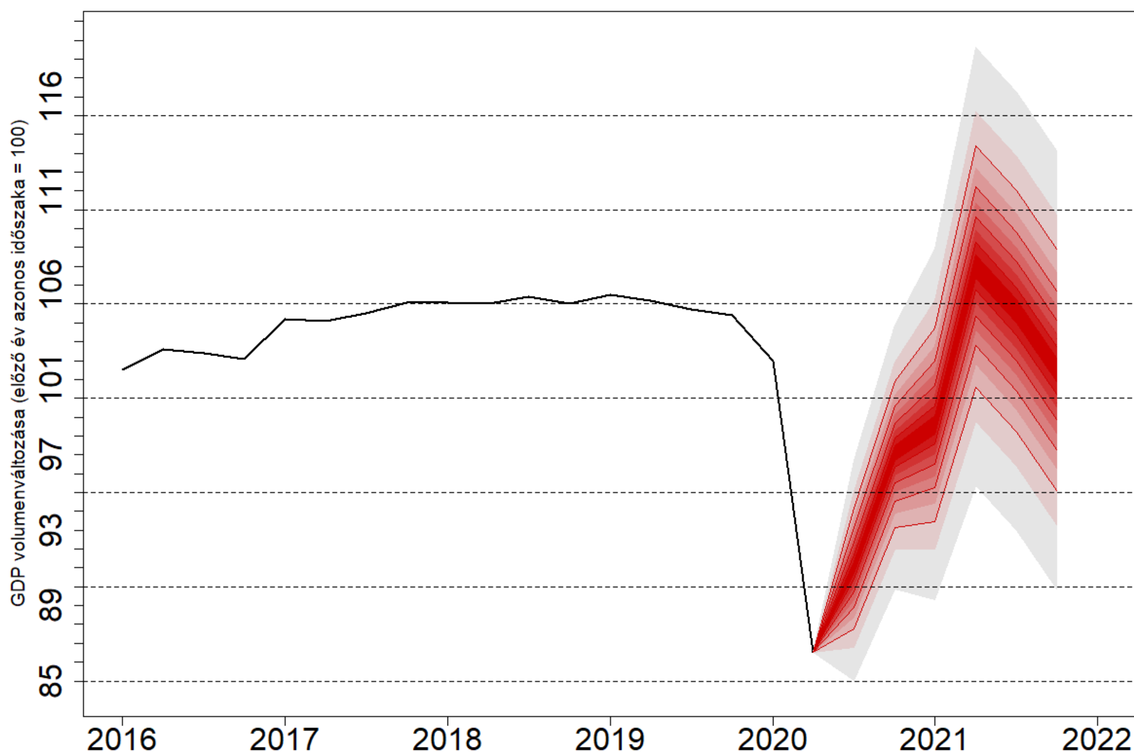
a ILO methodology, period averages, aged 15-74, public workers are counted as employed.
b Manufacturing, based on gross value added and the monthly average compensation of employees in euro, cumulated from the beginning of the year
c Net lending of households according to the financial accounts statistics, percentage of GDP, four-quarter cumulative data
d Seasonally adjusted data by the NBH
e Third quarter
f September
g The fiscal measures introduced until late October suggest only a deficit of 6 percent, but we expect the introduction of further, presently not known fiscal steps to prop up the economy.

III. The Hungarian economy

The second-quarter fall of Hungarian GDP – 13.6 percent – is very close to the forecast we gave in our spring Economic Trend report. Then, we expected the GDP to decrease by 12.2 percent in the second quarter, only 1.4 percentage points lower than the eventual outcome, as part of our prediction of a 5.5 percent fall in 2020 as a whole. The difference is mostly due to an unexpected drastic fall of government investments. Major actors of economic policy (like the NBH) pointed to public investments as an important tool to alleviate the recession, yet, apparently nothing happened in the second quarter to make use of this tool.

As for the prospects for the second half of the year, in April we expected a fall of 6-11 percent in the third quarter and a much milder contraction of 2-5 percent in the fourth. Since then, the initial recovery after the spring shock was somewhat more buoyant than originally expected (mostly due to an upturn in consumption, including domestic tourism). On the other hand, the return of the epidemic spells a halt of improvement in economic activity – or even another deterioration. Hence now **we expect a relatively mild decrease (5-6 percent) in the third quarter but an almost identical decrease (roughly 5 percent) in the fourth quarter**.

Estimate of the Kopint-Tárki on the year-on-year change of Hungarian GDP in 2020-2022



Not just the second wave of the pandemic but also the deterioration of the international economic climate hinders the continuation of improvement at the end of this year.

Pessimism has been more widespread regarding both global trade and the economic performance of Hungary's main trade and economic partners.

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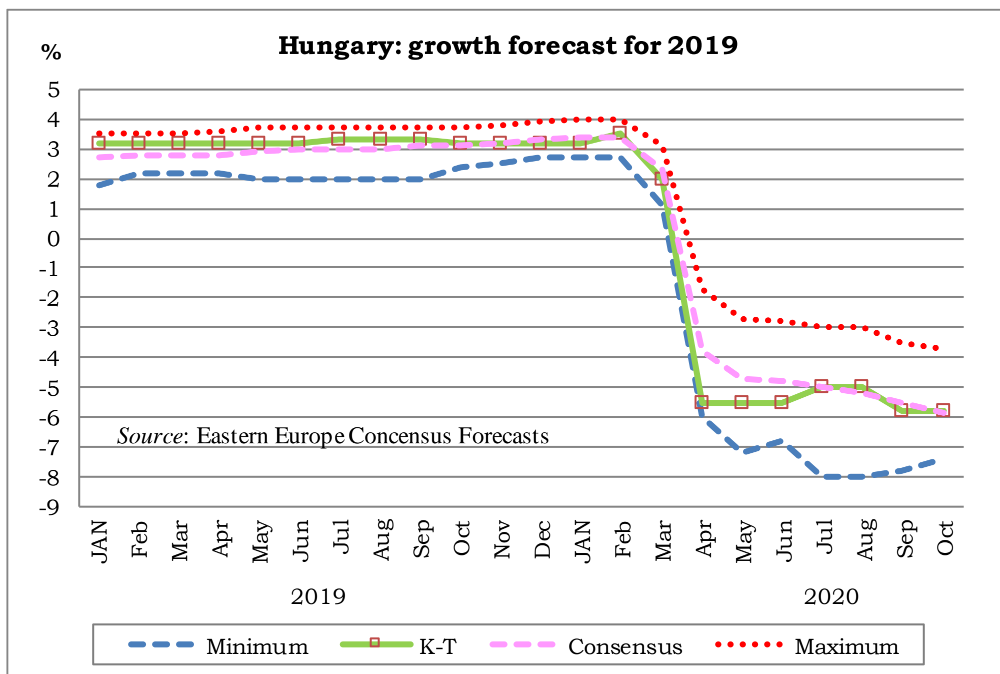
The Hungarian government in its April *Convergence Program* envisaged a GDP fall of 3 percent for 2020 and a 4.8 percent growth for 2021. By then, this prediction was much more optimistic than the expectations of independent analysts (5-7 percent drop) or the EU Commission (7 percent drop). The NBH, in turn, even expected *economic growth* during much of the year, and did not fundamentally revised its forecast until September when, at last, it predicted a GDP fall of 5.1-6.8 percent.

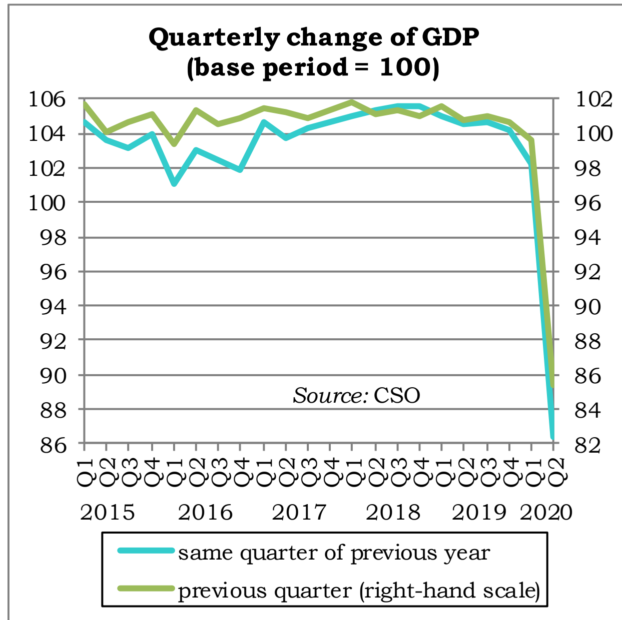
As can be seen from the chart below, as early as in April the Kopint-Tárki predicted that the GDP would decrease by more than 5 percent while the consensus forecast dropped below -5 percent only in August. From April the divergence between the individual forecasts suddenly increased, and widened further during the summer, mostly because the pessimistic forecasters became even more pessimistic. In the meanwhile, the Kopint-Tárki temporarily revised its forecast slightly upwards, mostly because private consumption seemed to rebound more quickly than originally expected. But this tentative optimism became moot with the massive return of the epidemic: now we **expect**



an economic fall of 5.8 percent for 2020, which is almost identical with the consensus. This prediction assumes that the government will not fundamentally change the way it handles the epidemic: the scope of the restrictions remain limited, and there will be no second lockdown.

The GDP and its components

In the second quarter of 2020, the unadjusted GDP dropped 13.6 percent, a rate significantly higher than in the other countries in the region. Compared to *the previous quarter,* the GDP fell by 14.6 percent, which exceeds the fall experienced in most of the other EU member states.

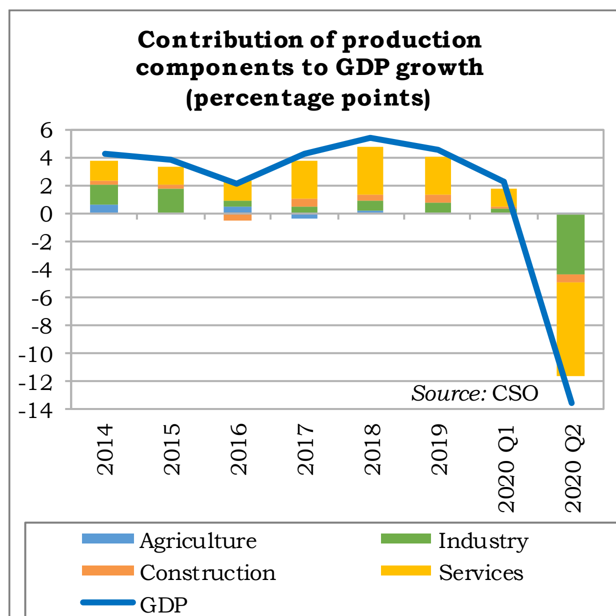


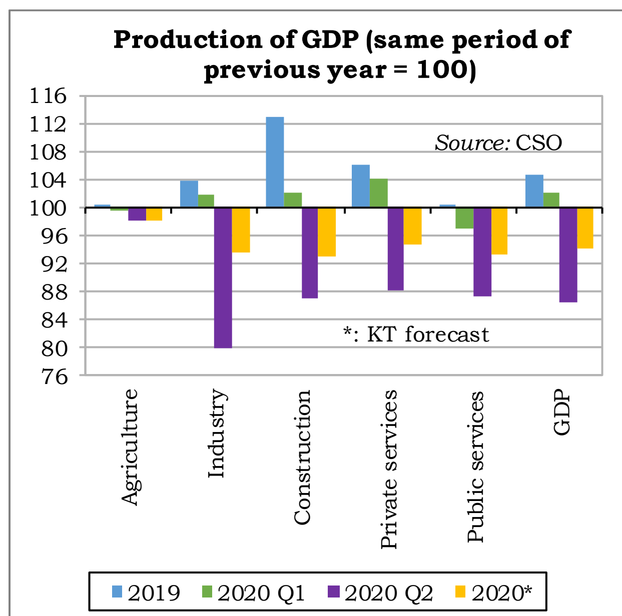
Since in the first quarter the Hungarian growth performance was still relatively favorable, the average GDP decline in the *first half of the year* was much less drastic, 6.1 percent.

On the ***production side***, the volume of value added declined in every main economic industry. Agriculture was the least affected – its output declined mostly due to the bad weather rather than the pandemic. On the other hand, industrial value added dropped by about 20 percent and the value added of both construction and services fell by more than 10 percent.

Industry suffered the most during April-May, due to the lockdown measures, the virtually total halt of operation in the automotive industry and the disruption of the value chains. Industrial export sales were fell by about 38 percent during these two months. The subsequent months, however, saw a fast (but partial) recovery – as a result, industrial production was only 2.1 percent lower in August than in the same month of the previous year. This upturn may come to a halt, however, during the autumn, as the global economic climate worsens again.

The *construction* value added fell by about 13 percent in the second quarter despite the fact that here the coronavirus shock only arrived in May. Here the subsequent





improvement is less spectacular than in industry. Some of the hindering factors – for example, the phasing out of large-scale construction projects co-financed by the EU – are unrelated to the pandemic, which makes a quick recovery difficult.

The unprecedented drop in the value added of *services* – by 12 percent – was a result of widespread decline in many areas within the services sector. Among the most important sections, only transportation and storage value added contracted by more than 20 percent – due to the temporary halt in the external trade flows and the travel restrictions – while the smaller art-entertainment-recreation sector plummeted by 27 percent. But public services and the trade, accommodation and food service industry also suffered a decline of 12-13 percent. Within the latter, retail trade was relatively mildly affected while food service and especially tourism accommodation imploded.

On the ***expenditure side***, the COVID crisis affected heavily almost all components in the second quarter. Private consumption – that previously was a vital factor of stable growth – fell steeply, by 8.4 percent, whiles fixed capital formation dropped by 10.9 percent. But the deterioration of *net export* was even more dramatic, with the export plummeting of the export of goods and services by 20 and 38 percent, respectively.

In addition to a smaller component (final consumption of government), the change in inventories was the main exception – without the positive contribution of the latter, GDP would have dropped by more than 16 percent in the second quarter (instead of 13.6 percent). Of course, increasing inventories themselves are an indication of economic crisis – more specifically, the accumulation of unsold output.

On the whole, the volume of ***final domestic use*** fell only by 6.5 percent in the second quarter. That means that the bulk of the overall economic fall was due to the unprecedented negative contribution – 7.3 percentage points – of the ***net export of goods and services***. Within the latter, the net export of services was, unsurprisingly, the dominant factor, due to the collapse of international tourism and the temporary collapse of international freight transport flows. But the net export of goods also had a negative contribution to economic growth: although import was down 15 percent, at the same time export dropped by 20 percent.

The question is, what will happen in the second half of the year.

In the spring, we assumed that the epidemic would abate by mid-summer – the possibility of a second wave carried too much unknown to take it into account in our forecast at that time. On the other hand, the third-quarter recovery – at least in certain areas – was steeper for a while than we originally expected.

Industry began to revive in the third quarter, and this will bring about an improvement in the net export position as well. The sharp decrease of export changed into near-stagnation from June, and the same is true for retail trade turnover in July-August. By the end of summer, the turnover by *domestic customers* normalized in the restaurant sector as well. (On the other hand, the absence of foreign tourists will continue to affect the net export of services.) The fact that wage growth remained relatively strong and eventually the labor market situation did not worsen as radically as previously expected helped the recovery of consumption.

Based on all this, it could have been hoped that the annual GDP fall would not exceed 5 percent. But the return of the epidemic on steroids annulled this optimistic expectation.

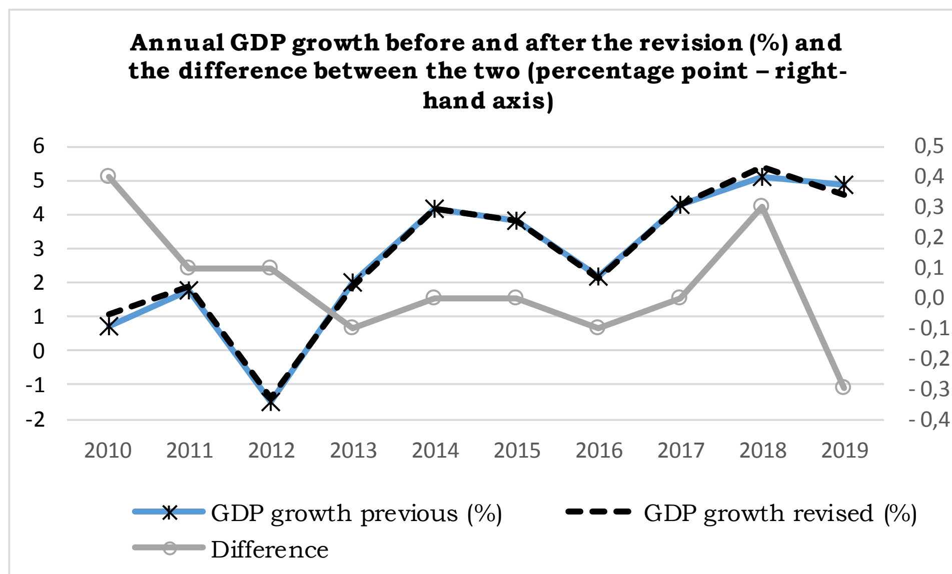
For the time being, the government tries to keep the reopened economy opened and minimize restrictive measures. But even so, the new wave of the epidemic changed the situation and affects the ongoing recovery of household consumption. On top of that, the financial reserve of a part of the enterprises was used up by autumn, and the second wave may push them over the edge, precipitating a new wave of layoffs. (An example of this is the September decision about a mass layoff at the Budapest airport.)

This is why we expect that the improving trend of ***consumption*** will mostly halt in the fourth quarter. Due to the financial shock, the firms' willingness to **invest** dropped sharply. Some improvement in this regard may have taken place in the third quarter, but the elevated level of uncertainty will keep exerting a dissuading effect. Compared to the disastrous second quarter, a marked improvement has taken place with regard to ***external trade***, but this may stop too in the fourth quarter, due to the souring international economic sentiment.

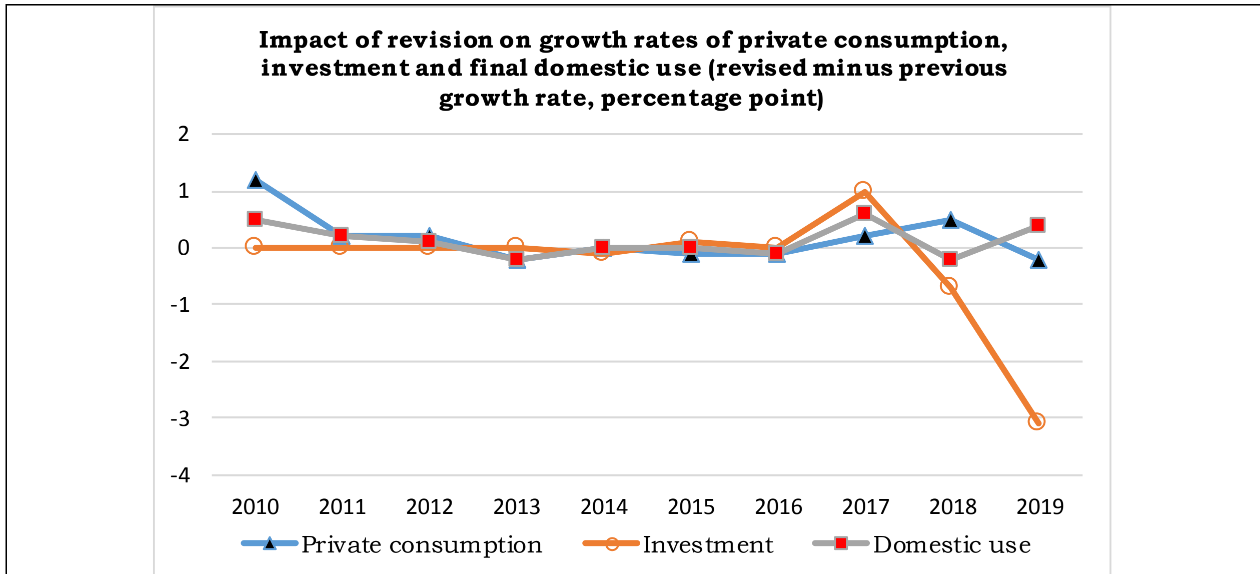
As a result, the **annual** decrease in private consumption may surpass 3 percent. On the other hand, the softening of the fall of investments will be probably decelerated but not entirely stopped by the second wave of the epidemic. Thus, the yearly average drop in ***final domestic use*** is expected to be mild (2-3 percent). In the meanwhile, external trade is expected to continue to contribute negatively to economic growth, but at a much smaller scale than in the second quarter. On the whole, the **GDP is expected to decrease by 5.8 percent in 2020**, with a moderate rebound in 2021. By now, the majority of analysts think – along with the Kopint-Tárki – that the economy will not entirely regain in 2021 what it lost in 2020. It will take more than one year to return to the GDP-level of 2019, not to mention the returning to the pre-crisis growth trend.

The revision of the GDP data of the 2010-2019 period

In early October, the CSO published the revised data on the past decade. When the data about a longer period is revised, it is worth giving an overview of „how the past is different from now“: to what degree we need to reassess our previous notions about the trends of the last decade. But actually, the revision was far from drastic and only minimally changed the level of overall GDP. The average yearly HUF-denominated GDP rose by 0.7 percent, and the cumulative real GDP growth from 2009 to 2019 became higher by a symbolic 0.5 percentage point (from 30.9 to 31.4 percent). The revisions did not alter the big picture regarding the past decade. The growth rates in specific years, however, changed somewhat: according to the new numbers, GDP growth was slightly higher in 2010 and 2018 and somewhat lower in 2019.



The graph below shows how the revision changed the numbers on final domestic use. The slightly higher growth at the start of the decade is connected to higher consumption, while the downward revision in 2019 is connected to lower fixed investment growth. Basically, these are the only changes that are worth mentioning.

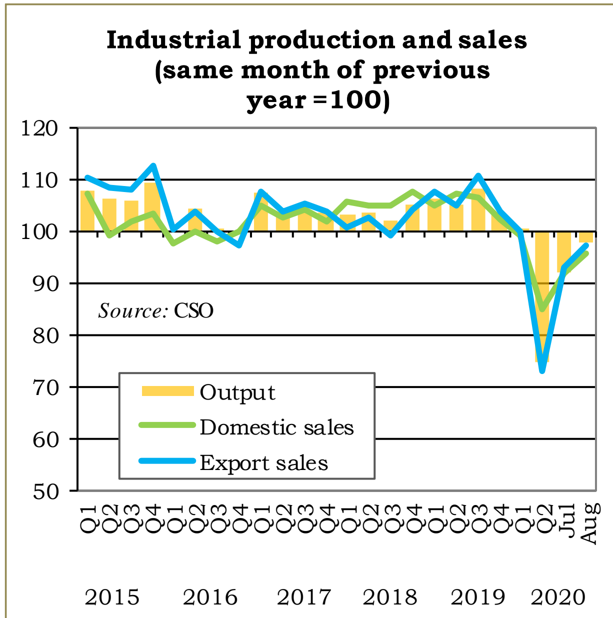


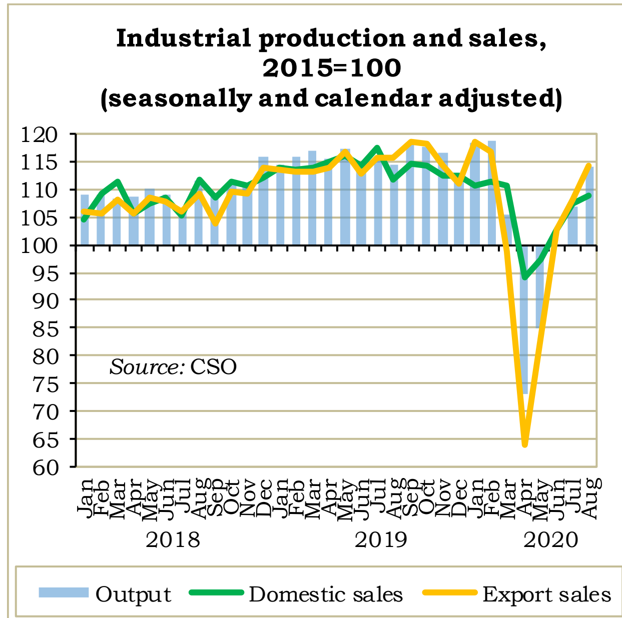
While the pre-revision data suggested an almost steady investment growth of 15-19 percent, the revised data shows a steeper deceleration during the same period, from 20 to 12 percent.

The CSO revised the quarterly data as well. Regarding the second-quarter data for 2020, the overall growth number remained unchanged, but the change of final domestic use was revised downward, from -6.1 percent to -6.5 percent. Accordingly, the negative growth contribution of net export is now somewhat smaller than before the revision.

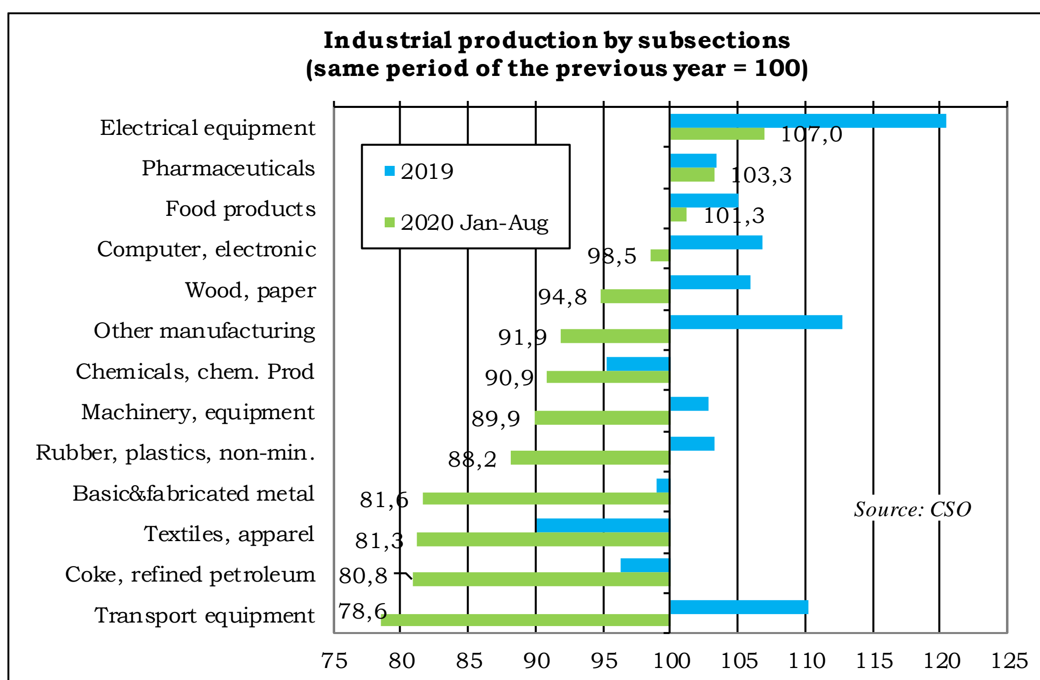
3.1. The production of GDP

3.1.1. Industry





The initial drastic measures to halt the spread of the epidemic resulted in a sudden drop in industrial production in April. This, however, was followed by a remarkable rebound that lasted till the end of summer: in August, the volume of industrial output was only 2.1 percent lower than in August 2019. In the first eight months, the output fell by 11 percent on an annual basis. The drop in *export sales* was much more drastic (in April-May, export sales fell by almost 44 percent), but by August the decrease of export sales also softened, to 2.9 percent, which is actually better than the growth performance of domestic sales in the same month.



Within industry, the automotive sector suffered the heaviest loss: here the year-on-year decrease of output was 80 percent in April. But April-May saw the output decreasing by more than 20 percent in the majority of industrial branches, for example in the chemical, rubber and plastic, electronic industries and in mechanical engineering. On the other hand, the output loss was significant but below-average in the food and electrical industries. From June, all affected industrial branches rebounded to various degree. But with the exception of food, electronic and electrical industries, production kept decreasing in June-August even though output growth returned in the automotive sector in August.

While in April the export sales of manufacturing collapsed in Hungary more drastically than in Germany, the following rebound was also more pronounced in Hungary. As a result, by August the level of manufacturing export sales was much closer to its pre-crisis level in Hungary than in Germany.

This, of course, will not be much of a help if the European and German industrial recovery comes to a halt. This is a distinct possibility, considering the arrival of the second wave of European pandemic. The question is whether a deterioration brings about a wave of bankruptcies during the autumn and winter months.

For now, we do not expect a reversal of the recent improvement, only a flattening of the curve of improvement. While in June an annual output fall of 10 percent seemed to be likely, by now it is clear that the overall decrease will be less drastic.

On the whole, we expect **a 7-8 percent drop in industrial production in 2020**.

Manufacturing export sales in Germany and Hungary (2015 average = 100, seasonally adjusted)

Source: Eurostat

3.1.2. Construction

In the first eight months, construction output fell by 10.4 percent. This is primarily the result of the coronavirus crisis: as opposed to the minimal decrease in January-April, production was down 17.8 percent in May-August. But the growth cycle was already over even before the pandemic.

In any case, the output fall means a loss of nearly one-third of the cumulative growth performance in 2016-2019. The May-August decrease was somewhat more pronounced in the construction of buildings (-18%) than in civil construction (-15.8%), mostly because the initial drop in May was more drastic in the former.

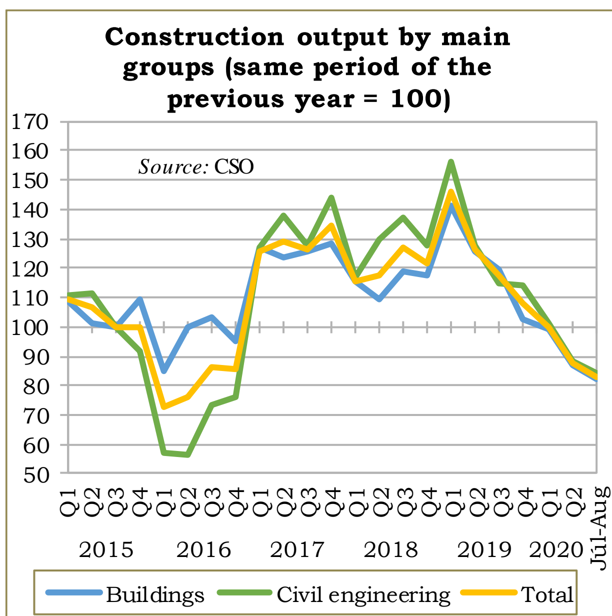
The total value of the *newly started* construction projects began to drop steeply from the second half of March. In the second quarter the value decreased by 37 percent, with no big difference between the two main group.

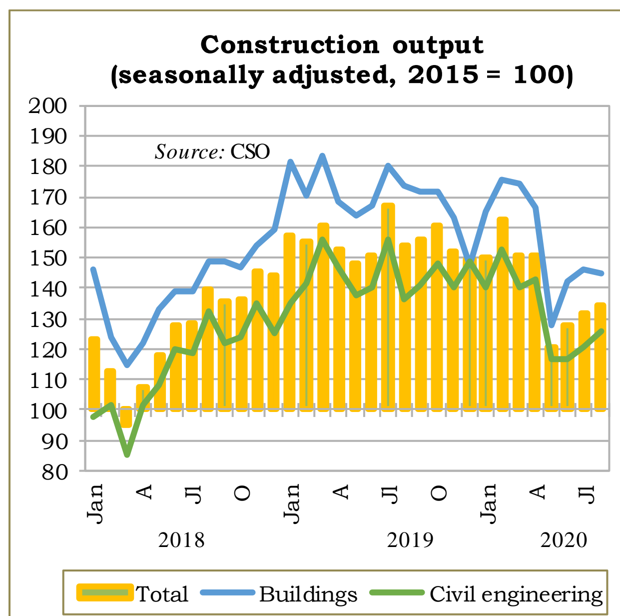
But the level of orders indicates differing perspectives: the level of orders in civil engineering has been on a decrease since years, while in building construction the level of orders is still higher than it was one year ago. The civil engineering outlook is affected by the phasing-out of several EU-funded infrastructure projects.

In the construction of building, on the other hand, a significant part of the fall may be a result of projects that are only delayed but not canceled. A question is whether the fall in the construction of office building will be lasting since the more prominent role home office work may become a long-term phenomenon. The new government measures to boost residential construction will not affect building activity in this year – to what degree the impact becomes visible in 2021 is uncertain.

While construction projects may, in principle, get a boost from central government projects in the last third of the year, the local government are forced to suspend their projects, since much of their resources is syphoned into the anti-epidemic fund.

On the whole, **the fall of construction output will be steeper in 2020 – 8-9 percent or even more – than what we expected before**.



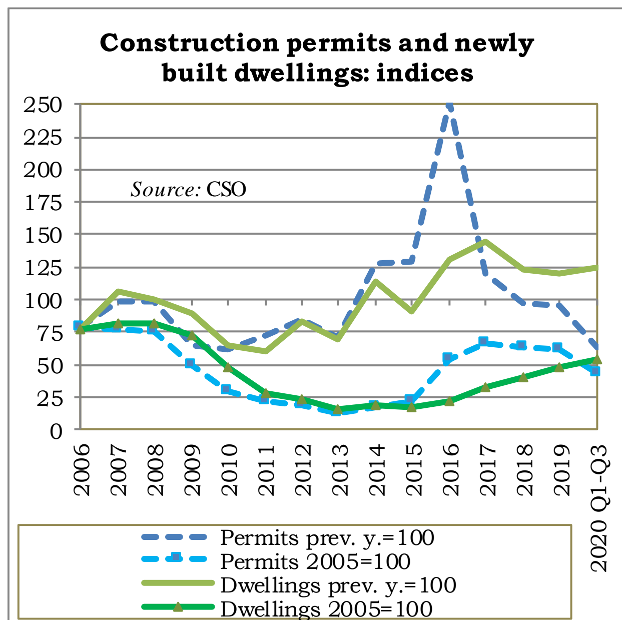


3.1.3. Housing construction

The wave of housing construction completions – as opposed to our previous expectation – continued throughout the first three quarters of the year, even though the third quarter saw a marked deceleration. The number of dwellings built was 9.1 percent higher in the third quarter, and 25 percent higher in the first three quarters, than in the same periods of the previous year. But both the number of the *newly started* housing projects and the value of the *ongoing* housing construction projects decreases sharply, according to the ibuild.info. Thus, the CSO-data about the dwellings completed creates a misleading impression about the overall housing construction activity.

Since the bulk of the dwellings are put on the market before their completion, the fall in the volume of newly started projects will reduce the supply of new dwellings. Due to the epidemic-related uncertainty, developers often revoke the building projects or try to sell the plots on which they have already received the building permits.

We expect that the surge of completions will not last and the annual number of dwellings built will decrease somewhat in 2020. While the falling number of newly started projects suggest a continued decline, the reintroduction of the preferential VAT rate (5%) for housing construction will turn the table in the future. The short-term effect on 2021 is uncertain, however.

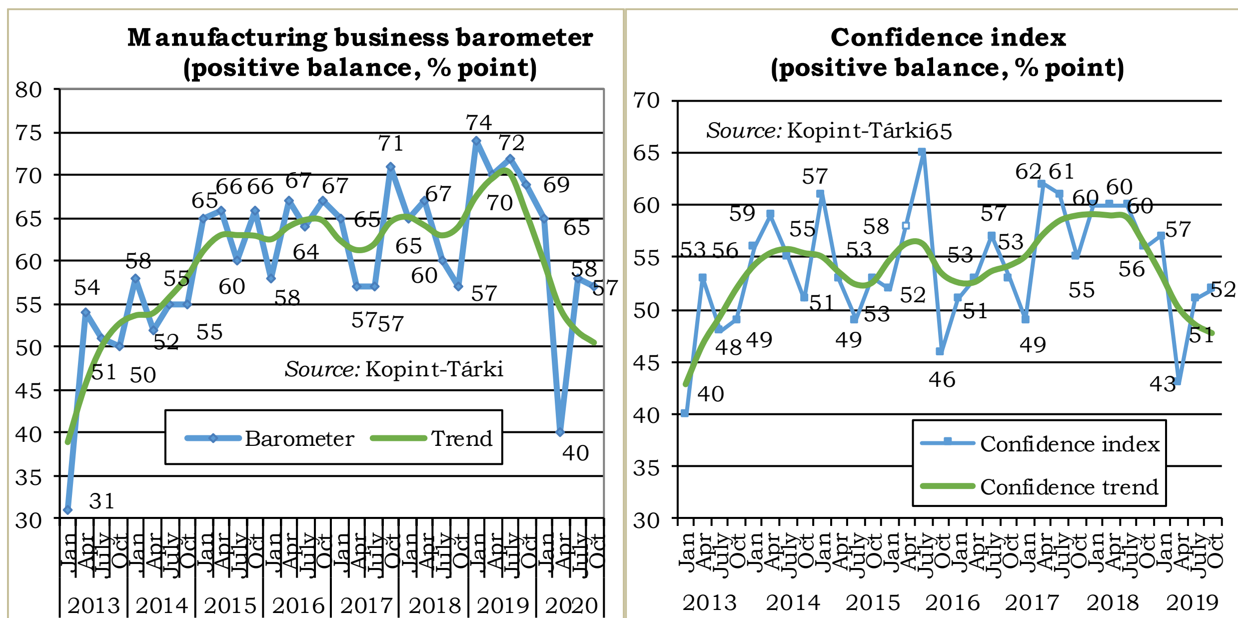


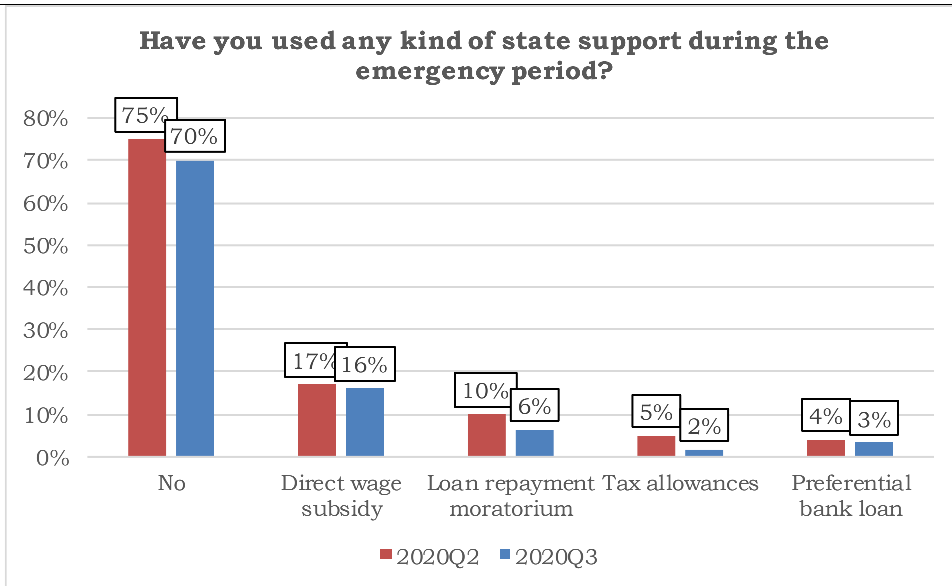
Manufacturing confidence survey

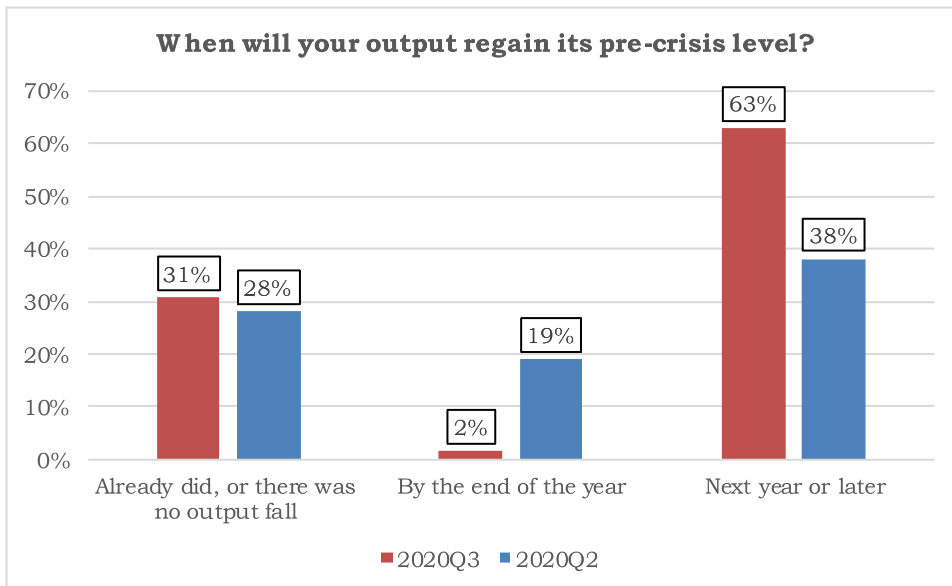
Although industrial production somewhat rebounded after the April collapse, the perceived outlook only slightly improved compared to our previous, summer survey. The business barometer (that combines subjective perceptions) is at 52 points, 1 point lower than a quarter ago, while the confidence index – which combines objective indicators – stands at 57 points, 1 point higher than in the previous quarter. This means that the firms expect stagnation in the short term. The short-term production outlook is quite good (59 points) but the stock of orders is low (45 points), which implies that firms produce rather to build up their stock than to sell. The stock of output is at 50 points, better than in the summer but still much higher than the level in 2019 (around 40 points).

The firms that have not benefited from any state assistance scheme still constitute the majority of the respondents. Also, the firms remained reluctant to respond to the crisis by introducing profound structural changes, although some of them laid off some of the workforce. It is worrying, however, that a growing segment of the respondents thinks it unlikely that their output could return to pre-crisis levels soon. While three months ago only 38 percent of the companies thought that recovery will not arrive before 2021 but now 63 percent thinks that the next year – or even the year after – is when production will return to pre-crisis levels.

Selected charts




Have you used any kind of state support during the emergency period?
80%
70%
60%
50%
40%
30%
20%
10%
0%
75%
70%
17%
16%
10%
6%
5%
2%
4%
3%
No
Direct wage subsidy
Loan repayment moratorium
Tax allowances
Preferential bank loan
2020Q2
2020Q3


When will your output regain its pre-crisis level?
70%
60%
50%
40%
30%
20%
10%
0%
31%
28%
2%
19%
63%
38%
Already did, or there was no output fall
By the end of the year
Next year or later
2020Q3
2020Q2

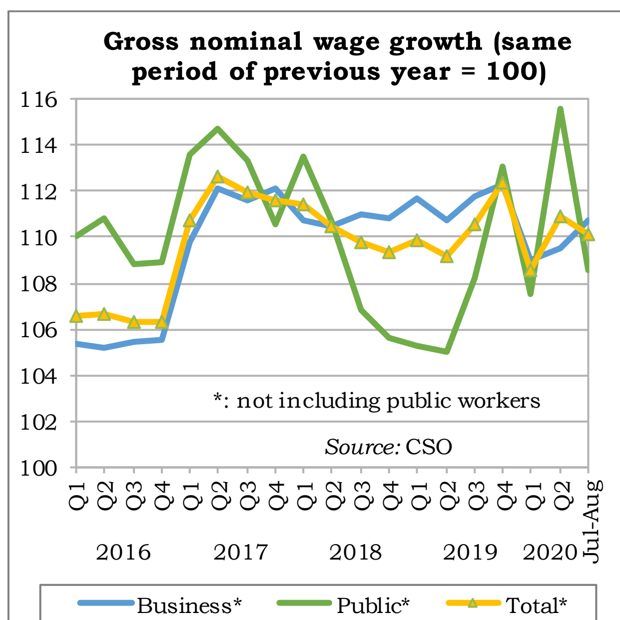
3.2. The final use of GDP

3.2.1. Household income, consumption and savings

Back in the spring we expected that the drastically changed economic conditions will be reflected in a substantial slowdown of wage growth. This expectation, however, did not materialize. In the first eight months, the average wage growth (without public workers) was 9.7 percent, only a minor slowdown compared to the 10.6 percent growth in 2019. Furthermore, during the crisis-ridden period of April-August wages rose at a higher pace than in the first quarter (still largely unaffected by the crisis), and this would be true – to a degree – even if the one-off large-scale disbursement of wage supplements in the healthcare sector in July did not happen.

If public workers are included, the average wage growth was slightly higher, 9.9 percent, in January-August. **Real wages** were up 6.2 percent, quite good during a major crisis.

Three qualifying factors should be taken into account, however. First, the wage statistics entails only the wages of full-time workers, which means that everyone who was put into part-time status during the crisis, and therefore suffered a reduction of paycheck dropped out of the statistics. The same is true of those who were sent to non-payed leave for a period longer than one month.



Second, the employment of low-wage earners was hit by the crisis the most, which – due to the composition effect – had an upward distorting effect on the registered wage level.

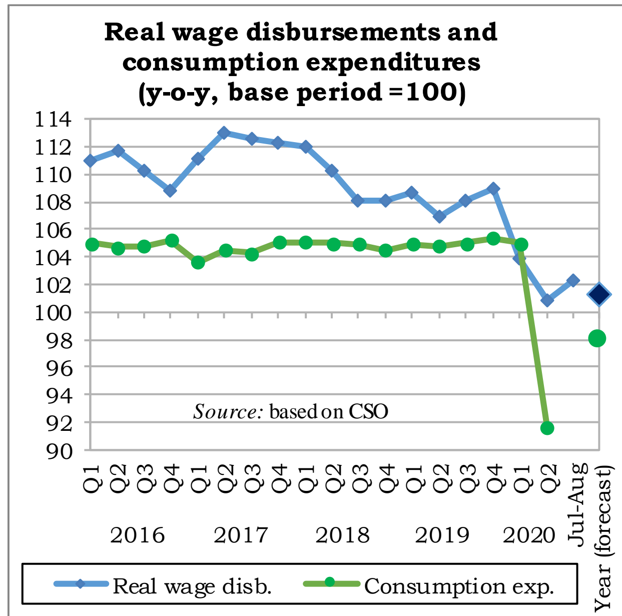
Third, amid the ongoing dynamic growth of full-time wages the *number of employees* fell drastically according to the payroll statistics. This means that the primary response of the labor markets to the crisis manifested itself not in wages but in the number of persons in formal employment. As a result, the growth of **net real wage disbursements** took a hit – it was 1.2 percent in April-August, as opposed to the 7.3 percent growth in net real wages during the same period.

To sum up, the crisis does have an effect, only not primarily in the wages of full-time employees under formal employment contracts.

We still expect some deceleration of wage growth during the rest of the year, but even so, nominal wages are likely to grow by slightly **more than 9 percent in 2020**, and there is an upward risk to this prediction. As a result, **real wage disbursements continue to grow in 2020**, although only at a slow pace.

On the other hand, the COVID crisis resulted in a real rupture of ***household consumption*** trends: in the second quarter, private consumption expenditures fell by 8.3 percent. This is a much steeper fall than what would be expected amid a slight growth of real wage disbursements and this is true even if we keep in mind that overall

real household incomes may have decreased somewhat, due to the steep fall in mixed incomes (the income of individual entrepreneurs).

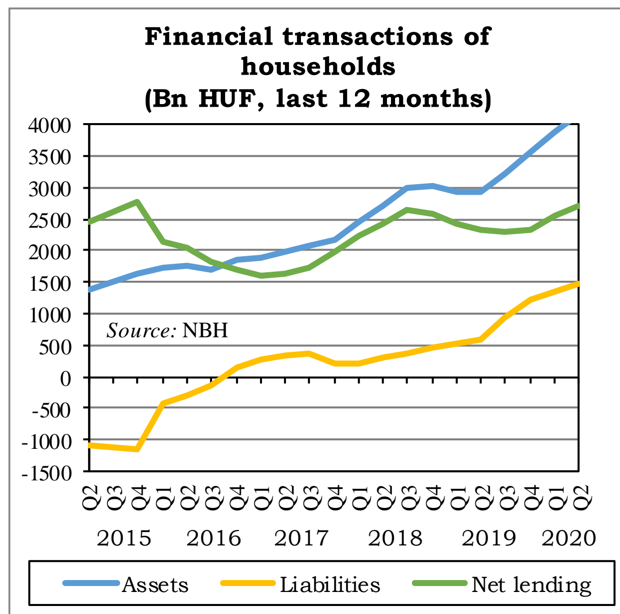


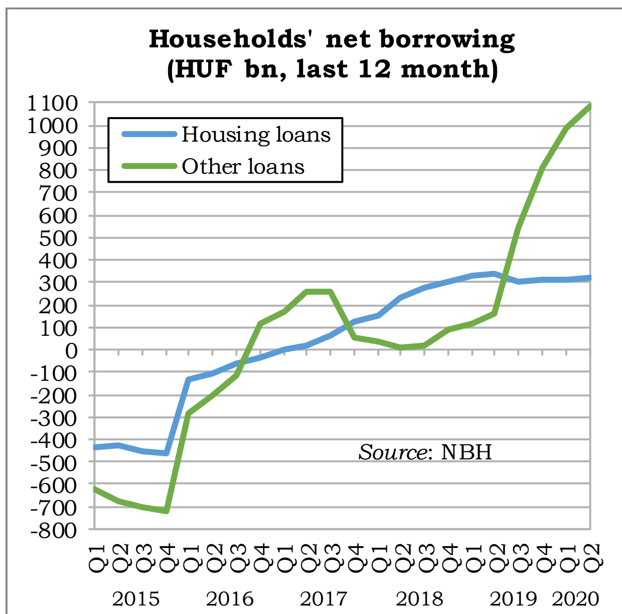
This means that the fall in consumption is at least partly a result of worsening household sentiment and growing uncertainties, and even more a consequence of the initial drastic lockdown measures. The latter was not relevant in the third quarter, however.

While consumption rebounded to a significant degree in the third quarter, according to retail trade food service data, the fourth quarter will probably see a halt of the upward trend, due to the return of the epidemic. How badly the effect of the second wave will be is uncertain: the government apparently extremely reluctant to introduce really drastic restrictive measures despite the steep upward trend in new infections, which may result in a milder or – eventually – in an even sharper deterioration. In any case, the households will become more cautious again.

Due to the strong partial recovery in the third quarter, now we expect household consumption decrease **by only slightly more than 3 percent in 2020**. This prediction is more optimistic than our expectation during the spring about a near-4 percent consumption fall

The households' ***net financing capacity*** continued to grow in the second quarter, which is not surprising in the light of diverging trends in incomes and consumption. Both *gross savings* and *net borrowing* grew. The latter, however, is not due to a rise in new borrowing but a result of a slowdown of debt repayment – that is, the repayment moratorium. The four-quarter cumulative *savings rate* (as a percentage of GDP) rose to 5.7 percent in the second quarter from 4.9 percent. The annual rate may surpass 6 percent in 2020.





3.2.2. Investment

After a slight decline in the first quarter, investments fell sharply – by 9.9 percent – in the second quarter, mostly due to the COVID crisis.

The close link between the epidemic and the worsening of trends of investment is shown by the fact that *business investments* were harshly hit in the second quarter. While business investments grew by 4 percent in the first quarter, they dropped nearly 12 percent in the second. The government investments decreased at a steep pace too, but that was only the continuation of earlier, pre-pandemic trends (the phasing off of EU-funded investment projects). In any case, the possibility of a strong boost to government investments to offset the effect of the crisis did not materialize during the second quarter.

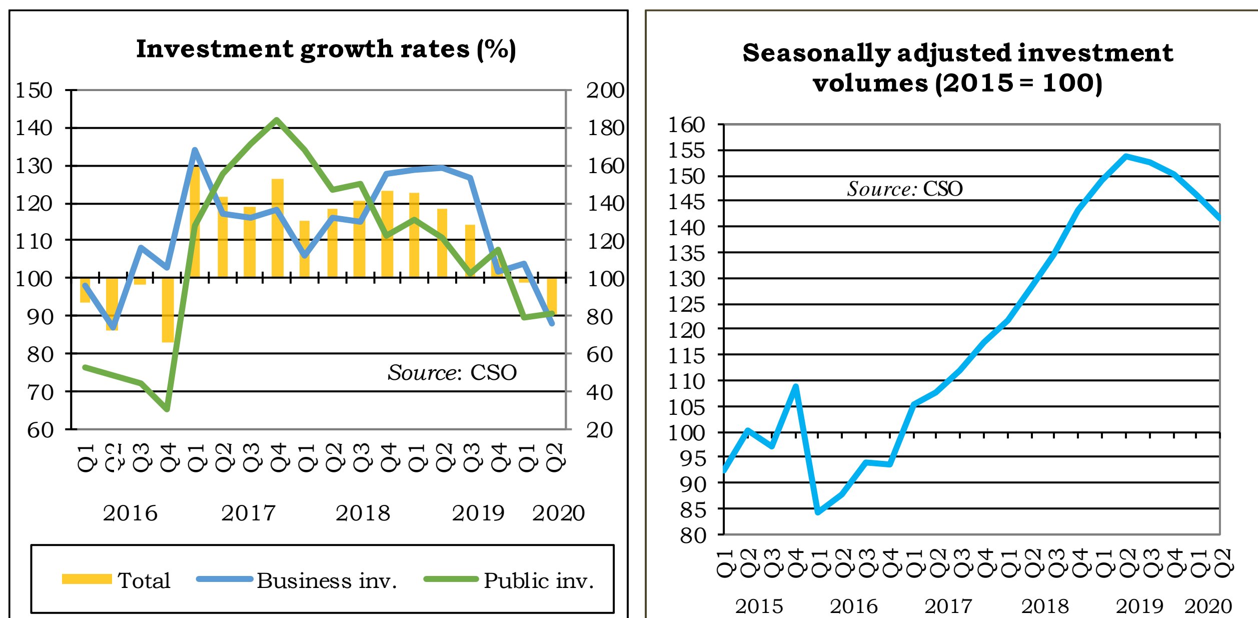
Business investments, on the other hand, fell because of the sudden worsening of economic prospects and the financial standing of many companies. The changed environment prompted firms to suspend, delay or even revoke their investment projects. According to a survey by the K&H Bank, both the willingness to invest and the planned volume of investment projects primarily dropped among service sector companies.

The impact of the epidemic is reflected in the sudden worsening in *manufacturing investments* (from a 8 percent growth in the first quarter to a 10 percent fall in the second), in the steep acceleration of fall of construction investments (to 36 percent), and the two-digit decrease of investment volume in the area of wholesale and retail trade. Within manufacturing, automotive investments were the most heavily affected.

Furthermore, according to the NBH the investments of households also contracted in the second quarter.

It is uncertain whether the central government will be able to rev up government investments in the second half of the year, but local government investments will certainly keep suffering, due to the transfer of resources from them toward the central government under the aegis of the fight against the epidemic.

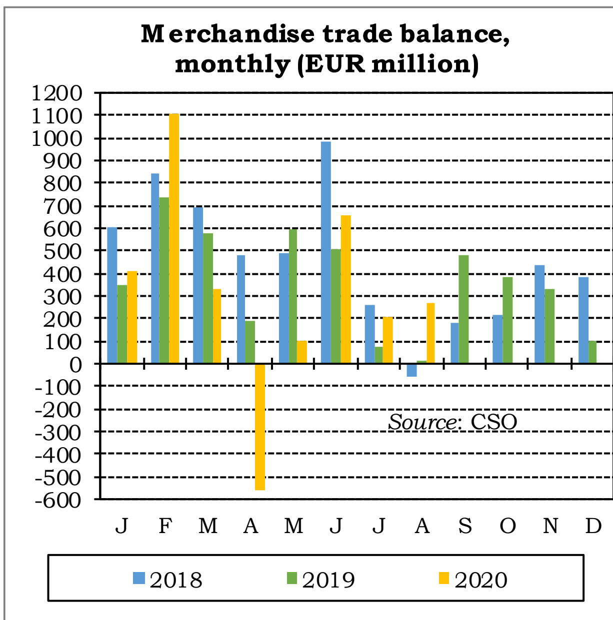
On the whole, we expect investments to **decrease by about 6 percent in 2020**.

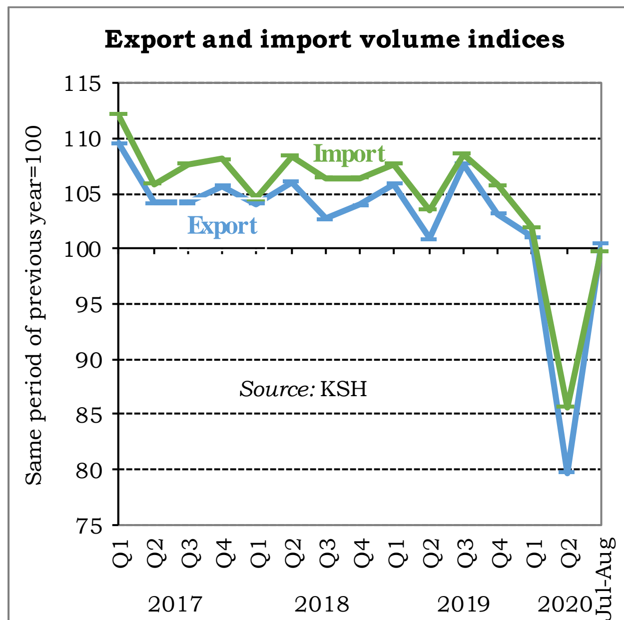


3.2.3. External trade

The external trade turnover began to decrease in March and collapsed in April-May. Although in June the volume of turnover suddenly recovered (it was approximately the same as one year earlier), the second quarter as a whole saw a fall of both export and import by more 20 percent and nearly 15 percent, respectively.

Besides food product, export decreased in every other product group in the second quarter, most of all in the case of machinery and transport vehicles. The latter is a temporary consequence of the auto industry shutdown in the spring. Import volume decreased at a lesser degree, due to somewhat the less drastic fall of machinery and

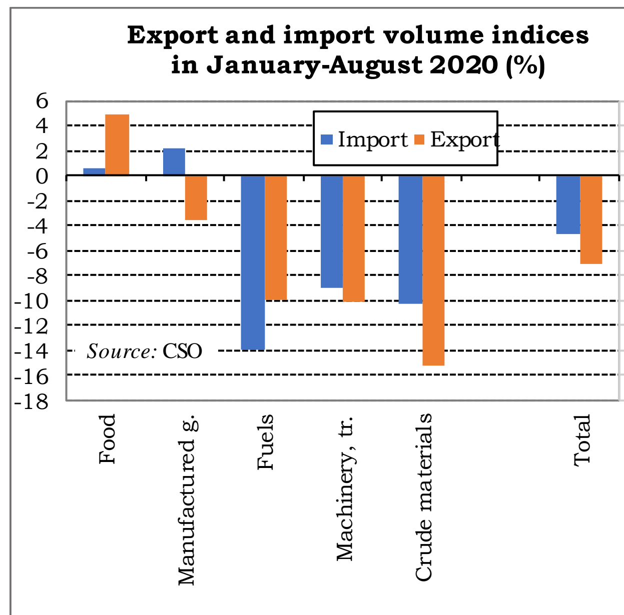




trasport vehicle import (compared to that of export) and the much less drastic fall of manufactured products. The latter was caused by the large-scale import of pharmaceutical products and the even more massive import of professional, scientific and controlling instrument and apparatus (respirators).

June-August saw a minimal growth of export volume and a minimal decrease of import volume. Amid the moderate growth of the export of food products and manufactured products, the export of machinery and transport vehicles basically stagnated.

Despite the moderately favorable trend in the summer months, the spring collapse resulted in a 17 percent fall of cumulative trade surplus (on an annual basis) in January-August. But due to the better trade balances in the summer, the cumulative drop is somewhat less steep than it was in 2019.

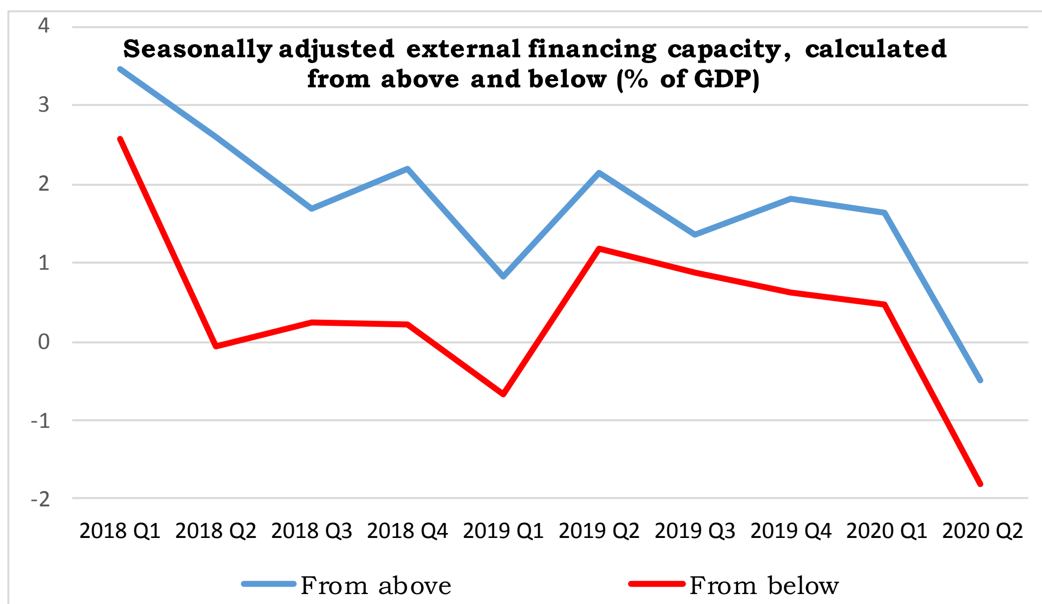


The question is whether the recently closed negative gap between export and import growth rates reopens due to the possible hit by the second wave on export, or due to by some additional large-scale import transactions. At present, we assume that export and import growth rates remain close during the rest of the year, and monthly trade surpluses stagnate or even slightly grow on a year-on-year basis. Still, there is a good chance that the annual surplus dips below EUR 4 billion after the EUR 4.3 billion registered in 2019.

3.2.4. Balance of payments

In the first half of 2020, the current account balance turned to a deficit of EUR 0.5 billion from the EUR 0.6 billion surplus in the first half of the previous year. The combined current and capital account (the so-called external financing capacity calculated from above), which also entails the EU transfers, was also negative, EUR 0.7 billion, as opposed to the 1.4 billion one year earlier. The difference – EUR 0.4 billion – between the negative changes (EUR 1.1 and 0.7 billion, respectively – in the two balances indicates that the inflow of EU transfers softened the negative consequences of the worsening of the current account in the first half of 2020. This cushioning effect was roughly evenly distributed between the first and second quarters, but apart from this similarity, the two quarters differed profoundly in other aspects. Thus, the direct comparison of the first half with the same period of the previous year is quite misleading this time.

Just as in many other areas of the economy, the first quarter saw the continuation of the former trends while the second quarter brought about a radical rupture. While usually single quarters do not have particular significance, this time is different. This is amply demonstrated by the seasonally adjusted data, calculated by the NBH, which makes it possible to compare the subsequent quarters. The chart below shows the evolution of the quarterly external financing capacity, calculated from above and below. The former equals the combined balance of current and capital accounts while the latter is the financial account balance (the external financing).

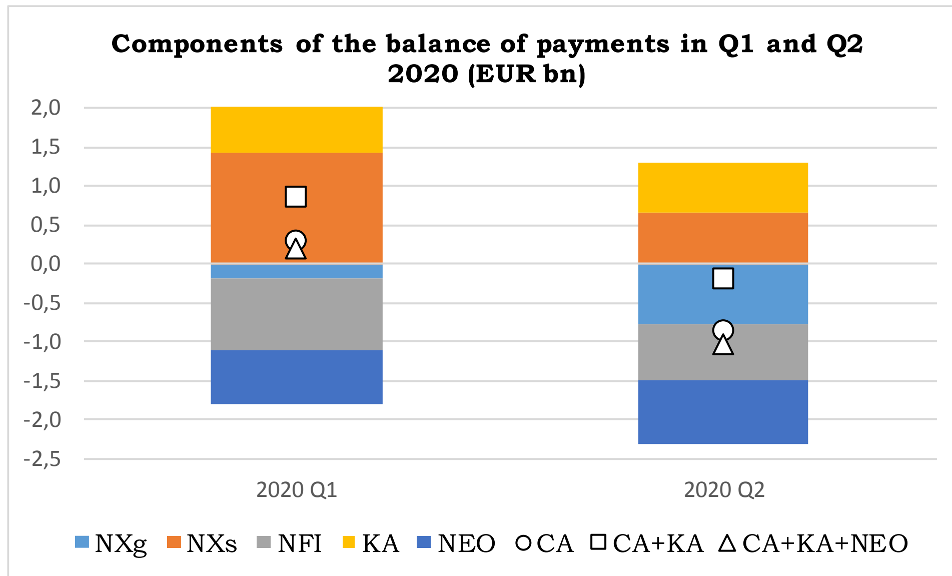


Source: NBH

The chart highlights not only the severe change in the second quarter but the qualitative negative turn in the net financial position of the Hungarian economy: the former financing capacity turned into a financing need amounting to almost 2 percent of GDP (see the red line).

The next chart shows the components of the balance of payments in the first and second quarters. While in the first quarter every major component (current account, net financing capacity from both above and below) posted a surplus, all three of them changed into deficit in the second quarter. The negative turn is predominantly due to

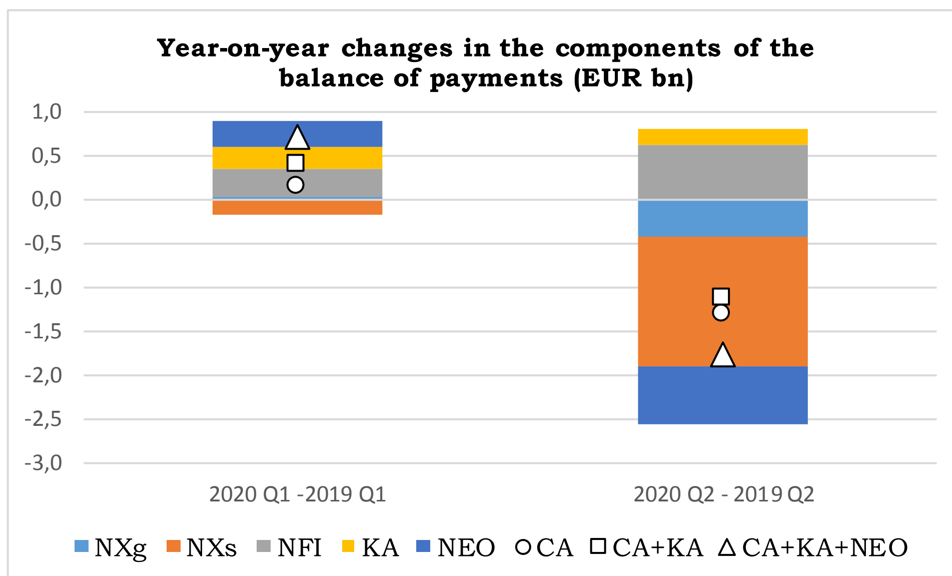
the plunge in the surplus of the balance of services – especially tourism and transport – on the one hand and to the jump in the deficit of the balance of the turnover of goods on the other. At the same time, the net income deficit moderated somewhat, primarily a result of decreasing profits at the foreign companies. The capital account surplus contributed by about EUR 0.6 billion to the financing of the Hungarian economy in both quarters.



Source: NBH

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

The next chart shows the year-on-year changes in the same components, thus highlighting more clearly the rupture and its main factors in the second quarter.



Source and codes: see the previous chart

In the first quarter, almost every component improved on an annual basis – the minimal negative change in net services was the only exception. By contrast, the second quarter saw a year-on-year deterioration of both the balance of goods and the balance of services, by EUR 1.5 billion and almost 0.5 billion, respectively. The improvement of the balance of incomes can be seen too, but it could offset only one-third of the worsening of overall net export.

In the second half of the year, export is expected to pick up some pace, resulting in a decrease of the negative balance of goods, but the balance of services, especially tourism services, is not likely to substantially improve in the short run. The current account deficit may reach 1.5-2 percent of GDP in 2020, while the combined balance of current and capital accounts may turn into the negative this year.

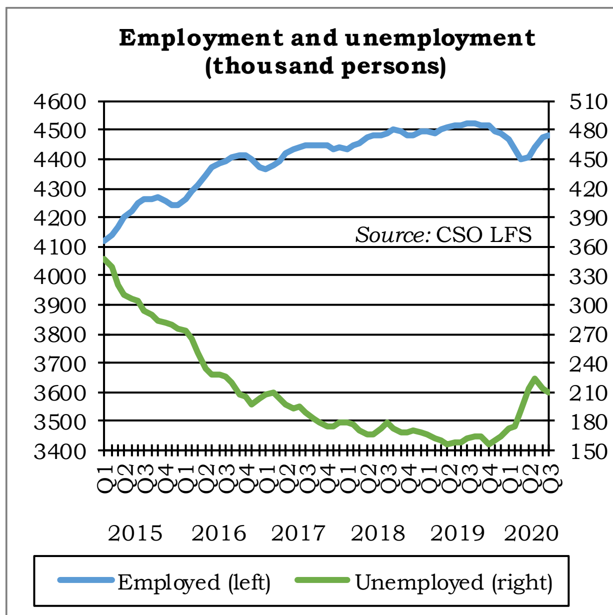
3.2.5. Employment, unemployment

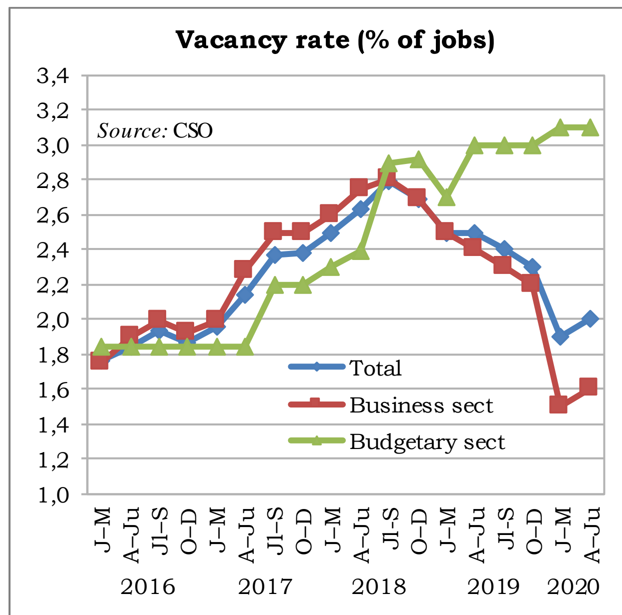
According to the labor force statistics (LFS) data, the number of employed dropped by 2.3 percent in the second quarter, a marked acceleration from the mild decrease of 0.7percent in the first quarter. According to the monthly data, the low point was in April when the number of employed was less by 140 thousand than in December 2019. This is significant but *much less drastic than what we expected at the beginning of the pandemic*. In the third quarter, after a partial recovery, the number of employed was just 0.8 percent lower than in the same period of the last year, a rate almost identical to that of the first quarter.

The *unemployment rate* rose until June – to 5.1 percent), but the quarterly unemployment rate never rose above 4.8 percent (in May-July) and it moderated to 4.4 in the third quarter. It should be noted, however, that the improving trend reversed in September (from 3.9 percent in August back to 4.7 percent). Apparently, the labor market problems are far from over and they may deteriorate again throughout the second wave.

Furthermore, the *payroll statistics* suggests that the labor market shock was larger than what is reflected in the LFS data: in May, the year-on-year decrease in the number of employees was 7.6 percent, which moderated to 3.4 percent by August (and possibly worsened again in September). Although, the unemployment situation seems more serious if the data about the *registered jobseekers*, provided by the National Employment Service, is considered. The latter dataset suggests that the rise in the number of jobless was 40 percent higher between December and June than what is shown by the LFS numbers.

These discrepancies are mostly due to differences in the definitions. According to the LFS definition, one needs to work one hour a week (either in a formal or in an informal setting) to be considered employed while to be an employee according to the payroll statistics one needs to have a formal job that entails a monthly worktime of at least 60 hours. On the other hand, the LFS definition of unemployment is quite restrictive while the category of registered jobseekers includes the casual workers and – in practice – a significant part of the informally employed.





On the whole, the LFS data seems to capture those who fall out from the labor market completely while the payroll statistics and the employment service statistics may give a better picture about how many were profoundly *affected* by the crisis – how many were put into part-time status or became informally employed instead of their previous formal contract.

In parallel to the bounce in unemployment, the number of vacancies continued to decrease, but only in the business sector: in the budgetary sector, both the number and the rate of vacancies rose in the second quarter.

The fact that the unemployment rate rose again in September shows that the period of post-shock improvement may be over. The return of the pandemic may hit the labor market again. A part of the firms ran out of financial reserves by autumn, and this time they cannot rely on the shortened time working subsidy scheme as many of them could during the summer.

But for now, we assume that the impact of the second wave will not be very drastic. As a result, the annual fall in the number of employed will probably remain below 1.5 percent and the annual unemployment rate will not reach 4.5 percent.

3.3. Fiscal, monetary and financial developments

3.3.1. Fiscal developments

The 2020 budget

The global crisis and the anti-epidemic restrictions caused a two-digit recession in Hungary in the second quarter. During the summer the situation improved, but by mid-September it became clear that a second wave of the epidemic was unavoidable. The uncertainties regarding the trajectory of this second wave makes it almost as difficult to assess fiscal prospects than it was three months ago. On the other hand, we know more about the fiscal impact of the first wave: the more pessimistic predictions materialized. The deficit surged drastically, along with the fiscal debt which was on a decrease over the past years. Thus, it is certain now that the country's fiscal position will deteriorate in 2020 to a degree not seen in a long time. In the short term, this is appropriate but in the long run it may necessitate a severe fiscal consolidation.

By the end of September, the cumulative deficit of the central subsystem reached a level more than six time the annual target. In 2019, the January-September deficit was about 25 percent of the yearly target, but this may not mean that much: some items (like investments) have an entirely irregular trajectory within the year. According to the Ministry of Finance, many large-scale expenditures that pushed up the deficit were unrelated to the epidemic and were budgeted, for example the purchase of tanks and helicopters, or spending related to the tourism development envelope. Yet, a significant part of the deterioration of the fiscal balance is related to anti-epidemic efforts and to the adverse economic effects of the restrictive measures.

Tax revenues decreased at double-digit rates in May and June but, on the whole, mostly recovered afterwards. But there are differences between the various kinds of tax.

Consumption tax revenues were hit heavily by the outbreak. In May, gross VAT revenues fell by 16 percent, excise tax revenues by 17 percent and financial transaction tax revenues by 24 percent. But in the case of the former two, revenues spectacularly rebounded afterwards. Excise tax revenues even grew (on an annual basis) in the third quarter, partly because the recovery in revenues from the excise tax on fuels.

In the case of taxes payed by households, both the contraction and the subsequent recovery was milder. The low point was in June, when personal income tax revenues decreased by 7 percent while social security payments were down 9 percent. From July, monthly PIT revenues again rose above the level seen in the same month of the previous year, while revenues from social security contributions come close to those in the base period.

The picture is more mixed regarding corporate taxes. The fluctuation of corporate income tax revenues and the changing rules regarding this type of tax makes it difficult to assess the trend. In any case, corporate income tax revenues rose between March and August. On the other hand, revenues contracted from the tax on small corporation and especially from the itemized tax on minor taxpayers. The latter is not simply a consequence of the recession but in large part a result of government measures that suspended the obligation to pay this tax in certain economic sectors.

Until the end of August, according to our estimate, the cumulative loss of revenue due to the COVID crisis and the related expansionary tax measures amounted to HUF 800-950 billion. On the expenditure side, the government spent about HUF 550 billion on purchasing healthcare-related equipment and another HUF 250-300 billion on wage subsidies, investment support and income supplements. On the whole, the overall fiscal effect of the pandemic might have amounted to HUF 1500-1800 billion until August. This estimate is in line with the NBH statistics that shows that Hungary's financing need increased from HUF 53 billion in 2019 to HUF 1246 billion in the first half of 2020.

In the light of the drastic second wave, tax revenues may well decrease on an annual basis in the last quarter. But no further large-scale fiscal stimulus measures are known at present that would cause further direct costs for the budget.

We expect that – due to the crisis – the revenue loss will amount to 3.2 percent of GDP in 2020. About third of this comes from the decline of consumption taxes, another third comes from missing wage tax revenues, and the rest is a result of falling corporate tax receipts and the growth in the number of jobless eligible for unemployment benefits. The fiscal measures announced so far raise the deficit by additional 2.4 percentage points but a part of these (0.6 percent of GDP) can be financed from the liquidity support coming from the EU. As a result, our calculation suggests an annual deficit of 6 percent of GDP – instead of the original fiscal target, 1 percent. But we also expect that additional measures will be introduced during the rest of the year that will push the deficit up to 7 percent of GDP.

Fiscal debt

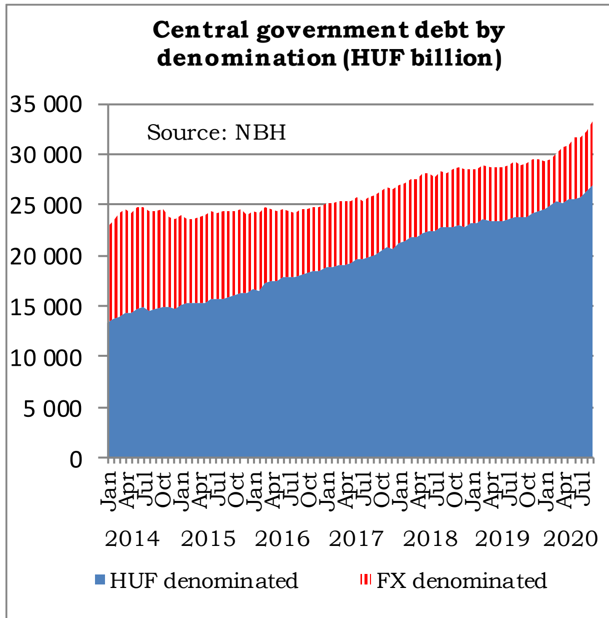
At the end of the second quarter, the fiscal debt stood at 70.3 percent of GDP, including the debt of the Eximbank. At the end of the second quarter, the debt amounted to 65.7 percent of GDP. The growth is a result of transactions, while debt revaluations minimally reduced the amount of the outstanding debt. The net fiscal debt stood at 54.2 percent.

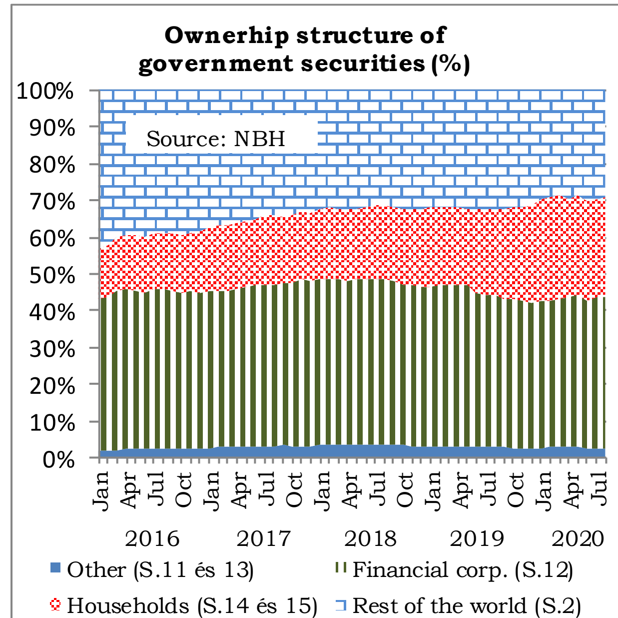
As for the ownership structure, the former trend of growing share of households reversed recently: after 28.2 percent in February, the households' share in government securities decreased to 26.7 percent by August. At the same time, the share of financial corporations grew to a similar degree.

Also, the share of FX debt rose from 15.4 percent in February to the territory of 18-19 percent June-September. This is partly due to the issuance of euro denominated green bonds amounting to EUR 1.5 billion in June and yen denominated bonds amounting to EUR 500 million in the Japanese market in September.

Since the government sharply raised its fiscal target, the Debt Management Agency was also forced to raise the planned value of issuance of forint securities by 18 percent (to HUF 10.3 billion) and the issuance of FX securities by 25 percent (to HUF 1.6 billion). In the case of the former, more than 40 percent is planned to be sold to households, resulting in a rising share of households. Besides the household sector, securities will be sold through the increased sale of HUF-denominated bonds at the regular weekly auctions. According to the modified plans, the overall magnitude of the yearly net issuance will by five times the magnitude in 2019.

The growing deficit puts also puts an end to the eight-year period of decreasing debt-to-GDP ratio. The recession, the elevated fiscal debt and the substantial weakening of the forint will lead, according to our prediction, to a rise in the debt ratio to 75.2 percent. This means a 9.8 percentage point rise from 2019 and the return to levels last seen in 2016.





3.3.2. Inflation

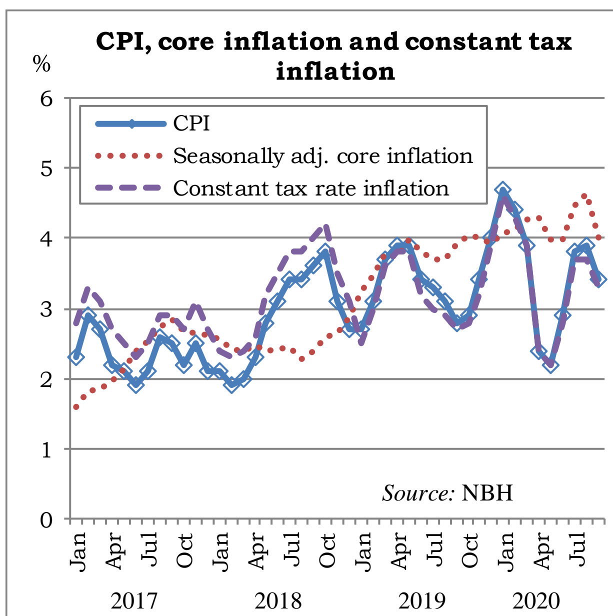
In the first nine months of 2020, consumer prices climbed 3.5 percent, according to the CSO. Monthly inflation rates fluctuated widely, with rates exceeding 4 percent in the first months of the year which was followed by an average 2.5 percent rate in the second quarter. In the third quarter, inflation picked up pace again (3.7 percent on average). In September, Hungary had the second highest year-on-year inflation rate – 3.4 percent – within the EU ("surpassed" only by Poland), but in August, Hungary was the first, in the negative sense, with 3.9 percent.

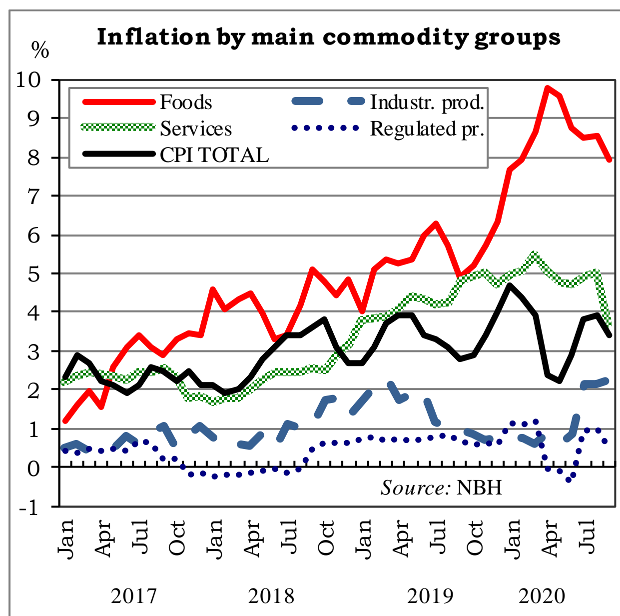
The seasonally adjusted core inflation rate was steadily above 4 percent between January and August, peaking at 4.6 percent in August and moderating to 4 percent in September. Since this indicator measures the actual endogenous inflationary pressure in the economy while filters out the transitory and external factors, high core inflation warns about the danger of further significant price hike.

Without doubt, food products are mainly responsible for the high inflation. In January-September, food prices were up 7.7 percent while the prices or alcoholic beverages and tobacco products rose by 6.9 percent. The price indices or the other groups of commodities remained below the average.

On the other hand, the rebound of price indices in the third quarter was not primarily due to these two product groups. Food price inflation peaked in April and has been gradually subsiding since then, and alcohol and tobacco prices did not accelerate either in the third quarter, despite the usual excise tax hike in July.

Instead, certain industrial products and services were the main factors behind the third-quarter acceleration. The prices of industrial products responded to the weakening of the forint and the post-quarantine rebound of demand. The price of new cars was 12.4 percent higher in the third quarter than one year earlier. Besides, the prices of travel, cultural and accommodation services rose at an above-average pace. Domestic tourism prices rose due to a recovery of demand, while foreign travel prices jumped because of the forint weakening.





As for food products, the prices or seasonal products hiked due to both the bad weather (spring frost) and the restrictions of movement that caused a labor shortage during the harvest period for crops that need manual harvesting. As disturbances around harvest and transport of crops occurred abroad too, import food prices soared as well. For example, from April the price of orange has been continually higher by more than 40 percent than one year earlier. At the same time, apple prices doubled.

We expect food prices to continue to rise at a fast pace. Even if consumer demand falters during the second wave, demand for food is expected to be the least affected.

On the whole, however, the worsening domestic demand outlook suggests a slowdown of price increase. Even if truly radical steps are not on the horizon, the spread of the virus and the further safety measures will lead to market disturbances that will have an impact on labor markets and household incomes. For example, the unemployment benefit of those who became unemployed during the April-May shock phased out during September-October and the same applies to those who benefited from the shortened worktime support scheme. Besides, households tend to respond to crisis and worsening income outlook with elevated savings activity.

On the other hand, as the duration of the pandemic increases, the supply side may be affected again. The return of supply chain disturbances would offset much of the impact of softening demand, keeping inflation high.

Still, taking into account the deceleration of inflation in September, we expect that the monthly price indexes during the rest of the year will be closer to 3 percent than to 4 percent. As a result, we revise our August forecast – 3.2 percent – only marginally upward, **to 3.4 percent**, despite the bounce in the third quarter.

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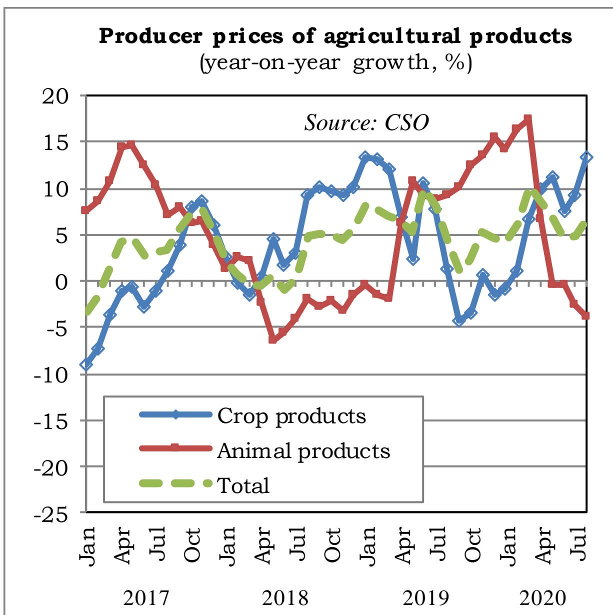
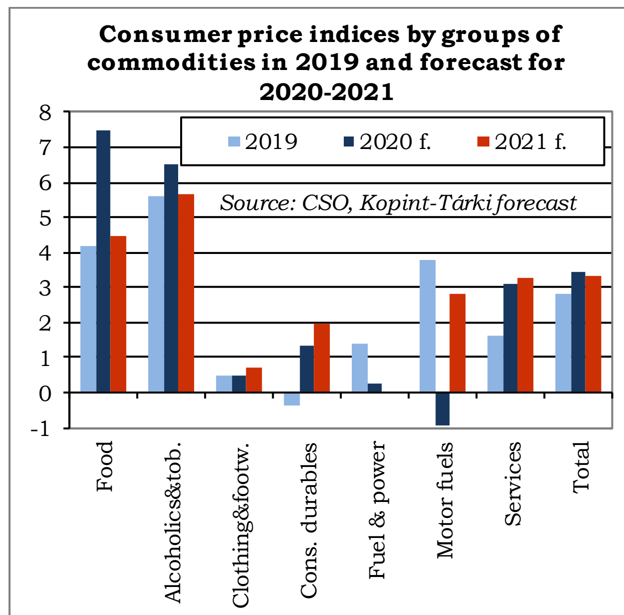
There is an important caveat, however. Our 3.2 percent prediction for 2020 is based on the internationally accepted methodology, that is, the calculation is based on the basket of goods in 2018. Usually, the use of the consumer basket of a year from the recent past does not cause any problems, because the change in the composition of the basket is usually slow.





This year, however, will see a sudden and drastic change in the composition of goods and services purchased by the population, due to decreasing households' income and also because the temporarily reduced mobility of the households caused a shift in the structure of everyday needs. A bigger part of the income is spent on food, on the expense of many other categories of goods and services. If we take into account this sudden change in the composition of consumption, the overall inflation rate may well exceed 4 percent in 2020.

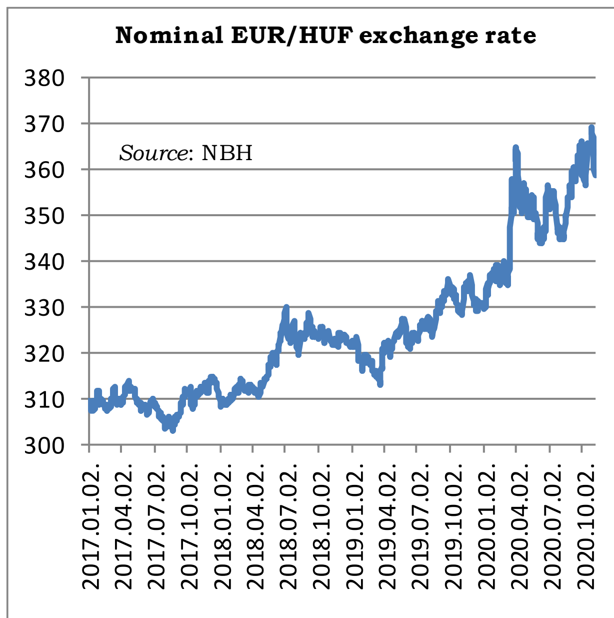
3.3.3. Financial and capital markets

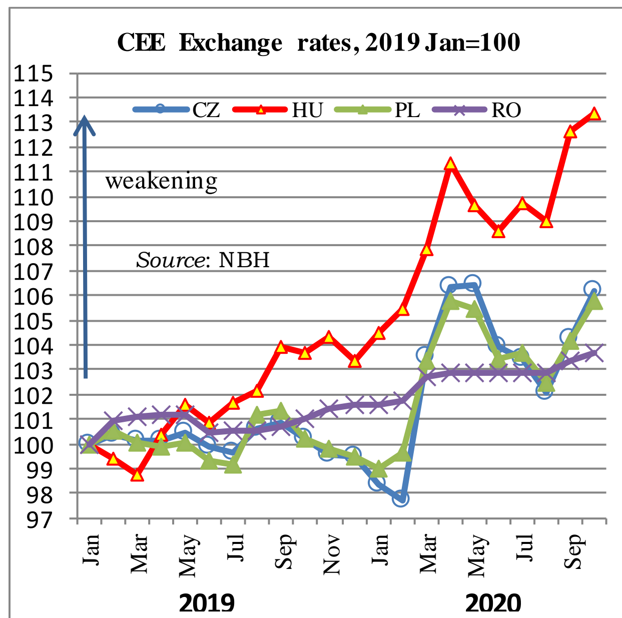
Exchange rate

While the drastic weakening during the spring was not much worse than in other countries of the region, the forint was the only currency that had been gradually weakening even during the year before. Against this background came the stabilization during the summer around 350 HUF/EUR and the return of the weakening spell in the autumn: by mid-September, the exchange rate was above 365 forints per euro. The weakening was preceded by two rate cuts during the summer by a cumulative 15 basis points, to 0.6 percent. But the real interest rate was reduced by the reacceleration of inflation as well.

The NBH responded to the weakening with the introduction of swap tenders to provide foreign currency liquidity, to ensure that the short-term market yields stabilize near the short-term interest rates. Besides, the central bank restored the penalty in case of reserve deficit that it had suspended in late March to alleviate the coronavirus shock. Furthermore, it decided that from the 1st of October 2020, the interest rate after the banking reserves *above* the required reserves is always either the O/N deposit rate or zero percent, depending on which is the lower at the moment.

Also, the NBH raised the one-week deposit rate by 15 basis points in September 24, which is practically a silent rate hike.



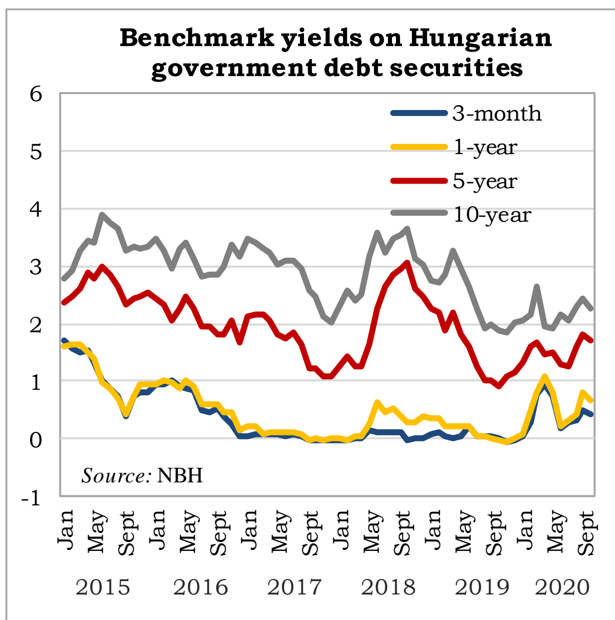


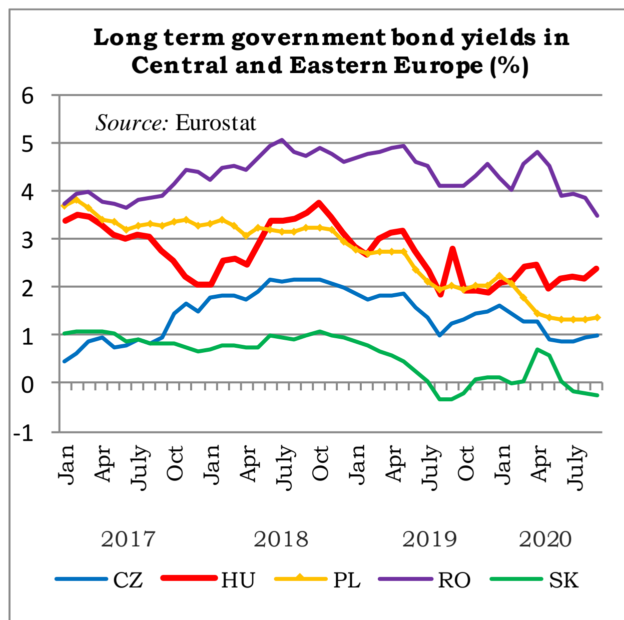
Government yields

Government yields underwent significant movement during the past months. After the outbreak of the crisis, the *short-term* yields (formerly around 0 percent) rose to 1 percent but it eased back to around 0.2 percent by June. A less pronounced rise occurred in August-September. *Long-term* yields surged at the beginning of the COVID crisis – the ten-year yield rose to 2.7 percent by the end of March. After a fast but short-lived correction a gradual rise began in the summer – in the end of October, the ten-year yield stood at 2.3 percent.

Partly these developments prompted the NBH to announce the intensifying of its asset purchase program. In May the central bank decided upon purchasing HUF 1000 billion worth of bonds, but the impetus petered out fast, and the cumulative value of purchases was only HUF 204 billion at the start of September. In August, however, the central bank announced its intent to strengthen its role in purchasing government bonds, to offset growing external risks and the increase in the financing needs of the state. The announcement implies that the envelope for the asset purchase program will be used up by early 2021.

In the majority of Hungary's regional competitors long yields tended to slightly decrease in the recent months – unlike in Hungary – but this did not disrupt the ranking of the countries. The Slovakian yield is again below 0 percent, with the Czech and Polish yields close to 1 percent, the Hungarian yield above 2 percent. Due to the recent decrease, the Romanian long yield eased below 4 percent after years of higher yield levels. Due to the Polish decreasing trend and the Hungarian slight upward trend, Hungarian and Polish yields now differ substantially, after years of strong correlation.





3.3.4. Corporate and household lending

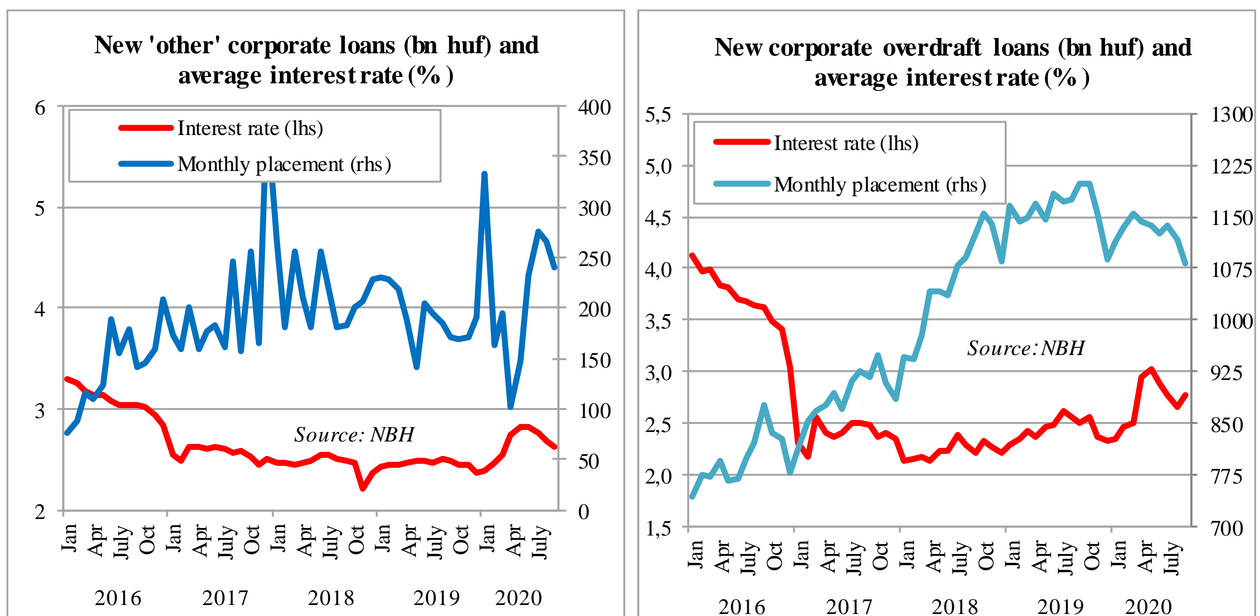
Corporate lending

The epidemic-related restrictive measures and the growing uncertainties heavily affected the lending developments this year. According to an NBH, the balance of new borrowing and repayments somewhat reduced the stock of corporate loans from the first quarter to the second. The decrease of FX loans was accompanied by a slight increase in forint loans. As a result, the year-on-year growth in net borrowing strongly decelerated in the second quarter.

The decreased financing need was reflected in new borrowing as well. The value of new "other" loans dropped in April and May, and even with a subsequent rebound the overall magnitude of new loans in the second quarter was 17 percent lower than in the second quarter of 2019. There was no such fluctuation in the case of overdraft loans, with monthly placements that are lower by only a couple of percent, on average, than in the same months of the previous year.

Interest rates have moderated somewhat after the initial jump in the spring. The interest rates of the other loans eased to an average 2.6 percent from the 2.8 percent in May, while the interest rate of overdraft loans dipped below 2.8 percent from the 3 percent in May.

Lending activity is in great part maintained by the FGS GO program by the NBH: between April and the end of October, HUF 934 billion was distributed out of the total envelope (HUF 1500 billion). This program facilitates more than half of the new SME loans.



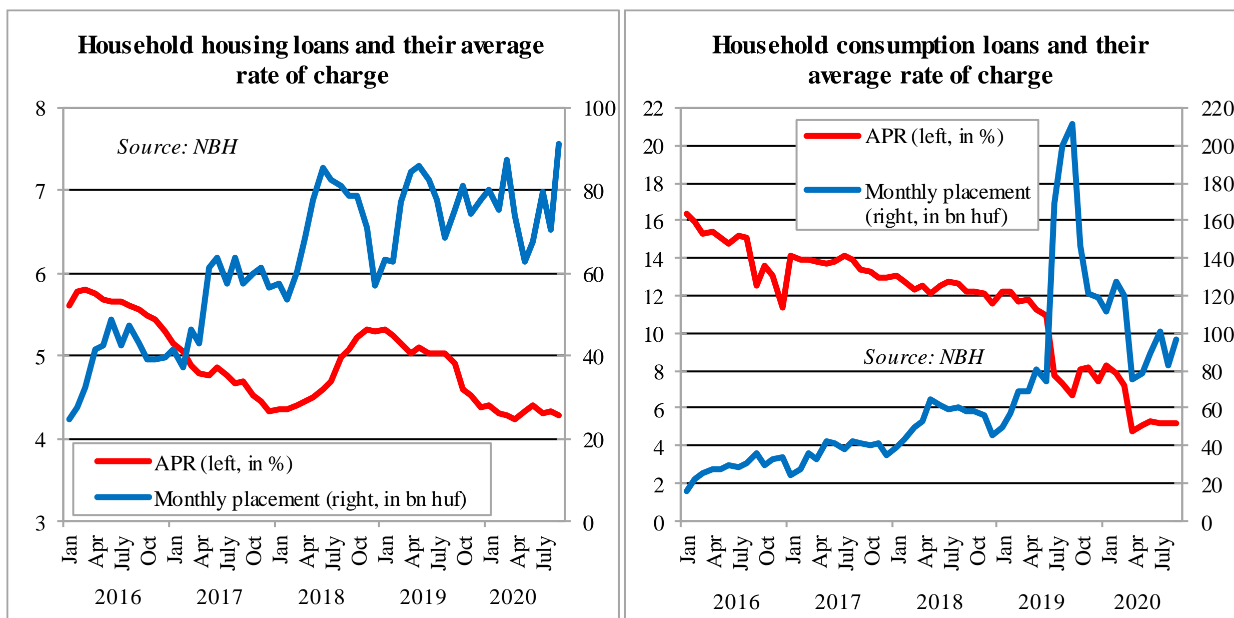
Retail lending

While the global crisis adversely affected household borrowing, this impact was moderated by the continuing effect of the introduction of the “baby expecting loan” in last July. These two contradictory factors resulted in a 3 percent rise in the stock of outstanding household loans in the second quarter. The year-on-year growth was almost 18 percent, predominantly due to transactions. But this is in part due to the slower pace of decrease of existing debt – that is, slower repayment, courtesy of the debt repayment moratorium. In the second quarter, 60 percent of the growth was a result of the baby expecting loans (on a quarter-on-quarter basis) with a smaller share of housing loans).

In the case of new lending, however, the impact of the COVID crisis is more spectacular. In the second quarter, the sum of new housing and consumption loans decreased by 6 percent, due to a 19 percent fall in housing loans. In the third quarter, on the other hand, housing loans grew on an annual basis (due to an uptick in September) while consumer loans plunged – but only due to the statistical base effect, the enormous jump in the third quarter of 2019, a result of the newly introduced baby expecting loan.

According to the NBH survey conducted in every six months, the average sum of housing loans increased along with the growing housing prices, at two-digit rates (year-on-year), in the second quarter. The average maturity of the new housing loans was typically 18-19 months.

The interest rates of housing loans have slightly increased in the second quarter but subsided afterwards. The same happened – to a smaller degree – in the case of consumption loans. The previous steep fall in the consumption loan APR is due to the introduction of the baby expecting loan (a scheme with very favorable conditions) in July 2019.



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

	2012	2013	2014	2015	2016	2017	2018	2019	2020*	2021*
GDP AGGREGATES, ANNUAL REAL GROWTH										
GDP total	-1.4	1.9	4.2	3.8	2.1	4.3	5.4	4.6	-5.8	3.5
Domestic Demand	-2.9	1.8	5.3	2.4	1.6	5.8	7.1	6.0	-2.9	2.8
Private Consumption	-2.3	-0.1	2.1	3.6	4.1	4.4	4.5	4.2	-3.1	3.0
Public Consumption	0.0	6.0	9.8	1.1	0.3	3.5	1.8	4.7	1.7	0.0
Gross Capital Formation	-6.0	6.1	12.9	-0.1	-4.1	10.8	16.2	10.4	-4.1	4.5
of which: Fixed Capital Formation	-3.0	9.8	12.2	4.9	-10.6	19.7	16.4	12.2	-7.0	3.5
Export	-1.7	4.1	9.2	7.4	3.8	6.5	5.0	5.8	-8.8	5.6
Import	-3.5	4.3	11.0	6.0	3.4	8.5	7.0	7.5	-5.4	4.7
PRODUCTION INDICES										
Agricultural Production (gross)	-10.0	12.5	11.4	-2.4	9.3	-4.1	2.7	-0.3	-2.0	0.0
Industrial Production	-1.8	1.1	7.7	7.4	0.9	4.6	3.5	5.6	-7.6	5.0
Retail Trade Volume	-2.2	1.8	5.2	5.8	4.8	5.6	6.7	6.2	0.7	3.0
EMPLOYMENT, EARNINGS										
Number of Employed	1.8	1.7	5.3	2.7	3.4	1.6	1.1	1.0	-1.2	1.0
Unemployment Rate	11.0	10.2	7.7	6.8	5.1	4.2	3.7	3.4	4.3	4.0
Gross Nominal Wages	4.6	3.4	3.0	4.3	6.2	12.9	11.3	11.4	9.2	7.0
Net Real Wages[a]	-3.4	3.1	3.2	4.4	7.4	10.3	8.3	7.7	5.6	3.6
PRICES, EXCHANGE RATES										
Consumer Price Index	5.7	1.7	-0.2	-0.1	0.4	2.4	2.8	3.4	3.4	3.3
EUR/HUF Exchange Rate (annual average)	289	297	309	310	311	309	319	325	353	355
EUR/USD Exchange Rate (annual average)	1.28	1.33	1.33	1.11	1.11	1.13	1.18	1.12	1.12	1.12
Short-term Interest Rates (3M), eop	5.33	2.86	1.43	0.80	0.06	-0.01	0.00	-0.01	0.5	0.5
Long-term Interest Rates (10Y), eop	6.11	5.61	3.60	3.33	3.16	2.02	3.01	2.01	2.5	2.5
BALANCE OF PAYMENTS										
Current and Capital Accounts, % of GDP	4.1	7.3	4.9	6.9	4.5	2.8	2.5	1.5	0.3	0.3
GOVERNMENT BUDGET										
General Government Balance, ESA-95, % of GDP	-2.3	-2.6	-2.8	-2.0	-1.8	-2.4	-2.1	-2.0	-7.0	-5.0
Gross Government Debt, % of GDP[b]	78.4	77.4	76.7	75.8	74.9	72.9	69.1	65.4	76.2	74.0

a The numbers do not take into account the effect of the the family tax benefits
b Including the balance sheet of Eximbank
* Kopint-Tárki forecast

Source: CSO, NBH

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