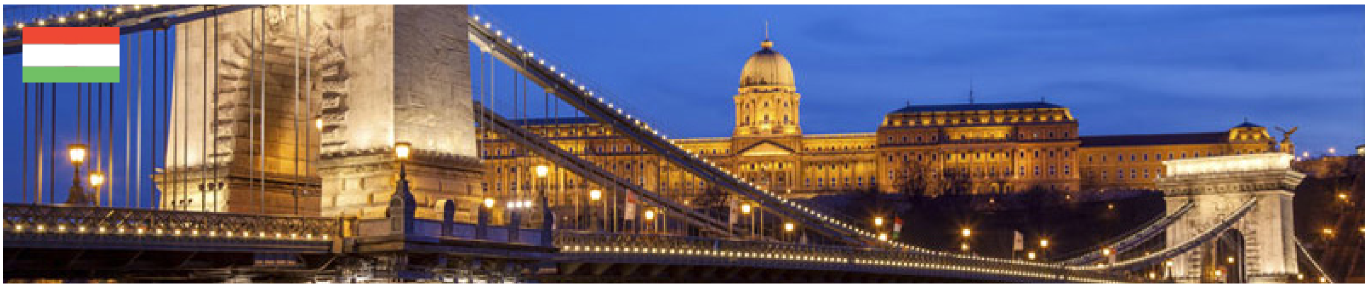

Hungary

Highlights

- **Growing household consumption is pulling the Hungarian economy out of recession, but investments remain subdued.** At the same time, fiscal consolidation is ongoing, although the European Commission (EC) has formally proposed initiating an excessive deficit procedure against Hungary in light of the large government budget deficit in 2023.
- **Hungary has secured alternative gas supplies amid geopolitical tensions.** New contracts with Türkiye and Azerbaijan will help ensure energy security despite potential disruptions in Russian gas transit through Ukraine.
- **The EC's 2024 Rule of Law Report identified deficiencies in the rule of law and the anti-corruption framework.** The European Union (EU)'s conditionality regulation procedure, which was triggered in 2022, has been maintained, leading to the ongoing suspension of EU funds.

Key priorities for 2025

- **The authorities should implement structural reforms to address rule-of-law and anti-corruption issues.** Failure to do so has resulted in blocked EU funds, which in turn may undermine efforts to promote sustainable growth.
- **Further fiscal consolidation is needed to reduce the budget deficit faster and comply with the excessive deficit procedure.** Success in this area would align fiscal and monetary policies, thereby reducing inflation and improving public finance sustainability.
- **The authorities should accelerate renewable energy deployment.** Key short-term measures should include streamlining permit procedures and creating a supportive and predictable regulatory environment. This would reduce reliance on fossil fuels and help in the push towards energy security and sustainability, with a targeted 30 per cent share of renewables by 2030.

Main macroeconomic indicators (per cent)

	2020	2021	2022	2023	2024 proj.
GDP growth	-4.3	7.1	4.3	-0.9	1.8
Inflation (average)	3.4	5.2	15.3	17.0	4.0
Government balance/GDP	-7.6	-7.2	-6.2	-6.7	-4.5
Current account balance/GDP	-0.9	-4.1	-7.2	0.7	1.5
Net FDI/GDP [neg. sign = inflows]	-1.5	-2.2	-2.8	-0.5	-1.0
External debt/GDP	83.9	89.0	93.9	86.1	na
Gross reserves/GDP	26.0	23.8	23.3	32.9	na
Credit to private sector/GDP	34.6	34.5	32.5	30.1	na

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Macroeconomic developments and policy response

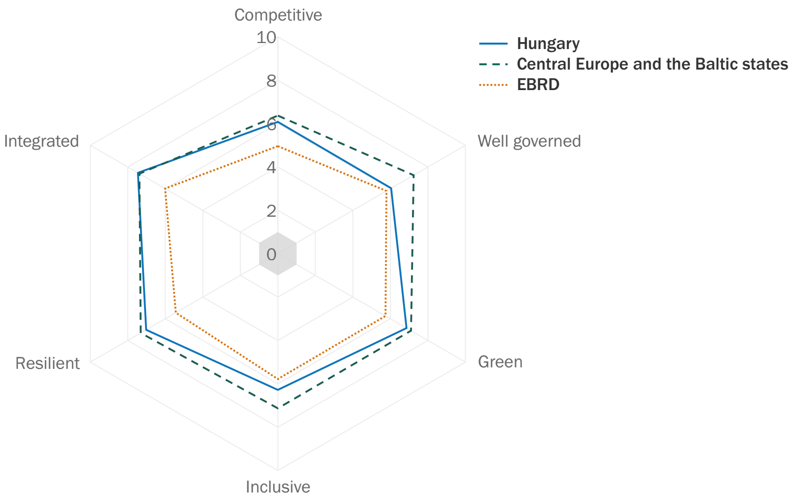
Growing household consumption is pulling the Hungarian economy out of recession. In 2023, the economy contracted by 0.9 per cent, dragged down by a slump in domestic demand, including a significant decline in investments. In the first half of 2024, however, the economy rebounded by 1.5 per cent year on year, primarily due to improving private consumption, which was boosted by rising real wages, at almost 10 per cent in mid-2024. Inflation has fallen steadily in the past year, reaching 4.1 per cent in July 2024. The strong labour market is fuelling the recovery in household spending, with unemployment at 4.3 per cent in June 2024 and the second-highest employment rate in central Europe and the Baltic states region, exceeding 81 per cent of the total population. Investments continued to decline, however, due to high economic uncertainty, elevated labour costs and a weak demand outlook.

Hungary has emerged as a major destination for Chinese investments in Europe. In 2023, Hungary overtook long-standing leaders Germany, France and the United Kingdom to become the primary European recipient of Chinese foreign direct investment (FDI), accounting for 44 per cent of all Chinese investments in the EU plus the United Kingdom, according to a 2024 report by the Rhodium Group and the Mercator Institute for China Studies. Hungary played a pivotal role in attracting investment in the electric vehicle (EV) sector, which drew more than two-thirds of Chinese FDI in Europe. According to the Financial Times' FDI database, the value of Chinese investments in Hungary from 2023 to mid-2024 reached almost €5 billion (nearly 2.5 per cent of Hungary's 2023 GDP), ultimately creating an estimated 9,000 jobs.

The European Commission (EC) has formally proposed opening an excessive deficit procedure against Hungary. In its Spring Semester report from mid-June 2024, the EC flagged Hungary's budget deficit, which reached 6.7 per cent of GDP in 2023, with government debt at 73.4 per cent of GDP by the end of the year. In response, the government introduced new taxes in August 2024, totalling HUF 400 billion (€1 billion), to help manage the budget. It also decided to defer some public-sector investments, amid elevated interest costs, to 2025 or even later. The government anticipates that these measures will reduce the fiscal deficit to 4.5 per cent of GDP in 2024.

Household consumption will continue to be the primary engine of short-term growth, while investments and exports are expected to rebound. We forecast real GDP growth at 1.8 per cent in 2024 and 3.3 per cent in 2025.The rise in disposable incomes should further boost consumption, with inflation staying within the central bank's target range of 2-4 per cent. As bank lending is anticipated to increase and export market conditions improve, corporate investments are likely to gain momentum. However, the low use of EU funds remains a downside risk, particularly affecting public investment. A notable strength of the Hungarian economy lies in its strong manufacturing base, deeply integrated into the supply chains of German automakers. With significant Chinese investments in EVs and its involvement in the German auto industry, Hungary has effectively hedged its position against the potential impact of EU tariffs on Chinese EVs in the medium term.

Assessment of transition qualities (1-10)



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Structural reform developments

Hungary has secured alternative gas supplies. New energy sources include a new contract with Türkiye for 275 million cubic metres of gas that started in April 2024. In addition, Hungary's state-owned energy company, MVM, acquired a 5 per cent stake in Azerbaijan's Shah Deniz gas field in June 2024, securing an annual entitlement of 1.5 billion cubic metres of gas. These measures aim to ensure energy security amid geopolitical tensions and EU embargoes on Russian energy imports.

Progress on the rule of law remains uneven. In July 2024, the European Commission's Rule of Law Report highlighted that Hungary had made no progress on any of the recommendations from the previous year. Despite the 2023 judicial reform, currently under way, the report noted the lack of transparency in low-instance courts, insufficient reforms in lobbying and tackling high-level corruption, and the failure to enhance the independence of the media regulator. Also, the EC noted that political influence on the prosecution and freedom of expression of judges remains a significant concern. In February 2024, the government adopted an anti-corruption strategy for 2024-25, focusing on public procurement procedures to address these issues. However, the absence of new measures to remedy the outstanding rule-of-law and anti-corruption issues has resulted in continued suspension of EU funds under several programmes.

The state has acquired a majority stake in Budapest Airport. In June 2024, the government finalised the purchase of an 80 per cent stake in Budapest Airport for €3.1 billion, with French operator Vinci acquiring the remaining 20 per cent. The acquisition, financed through asset sales, loans and a capital hike, aims to enhance the airport's role as a key transport hub. Major investments, including a new terminal, are planned.

China and Hungary are deepening economic ties through major infrastructure and energy projects. In May 2024, China and Hungary signed 18 agreements, primarily under the Belt and Road Initiative. These agreements include the construction of two new railway lines, one bypassing Budapest for freight transport and another connecting Budapest to its airport. In addition, a large border crossing with Serbia will be built to alleviate congestion. Cooperation on nuclear energy will address rising electricity demand, potentially leading to a new nuclear power plant. The agreements also cover the export licensing of cherry and cattle propagating material.

The country's railways are being upgraded with new investment. The government aims to finalise by the end of 2024 the terms of a €1 billion loan from the European Investment Bank for railway investment, with project implementation starting in 2025. The loan, supplemented by €1 billion from the state budget, will fund 500 km of new railways, a railway bridge reconstruction, tram line renovations and digitalisation of railway communication. This is part of a broader transport development plan, including public transport fleet renewal and restructuring the state-owned railway company, MAV. Construction of the Budapest-Belgrade railway line, a key project under the China Belt and Road Initiative, resumed after a six-month hiatus.

Windfall taxes are being phased out. The government announced in July 2024 that it would phase out windfall taxes on pharmaceutical and telecom companies in 2025. This move follows the announced abolition of the windfall tax on airlines, also set for next year. The government extended the banks' windfall tax relief to the insurance sector, offering 50 per cent relief for purchasing government securities. The windfall tax on pharmaceutical companies, introduced in late 2022, was expected to generate HUF 32 billion (€81.2 million) in 2024, with potential relief for research and development investments. Telecoms windfall tax revenues were estimated at HUF 40 billion (€101.5 million).

The government has launched a new employment programme. In May 2024, the government introduced a HUF 150 billion (€380.7 million) initiative to boost employment and labour force participation. The programme, partly financed by EU funds, aims to support 77,000 job seekers, focusing on disadvantaged groups. It includes wage, training, housing and commuting subsidies. Wage subsidies cover 50 per cent of the gross monthly wage, up to HUF 250,000 (€635.50), for six months for disadvantaged employees. This aligns with the government's strategy to mobilise the country's 300,000-strong labour reserve and boost the employment ratio to 85 per cent by 2030.

Hungary has been fined for migration policy violation. In June 2024, the European Court of Justice (ECJ) imposed a fine on Hungary for failing to comply with EU asylum policy, a €200 million lump sum and a penalty of €1 million for each day of delay. This unprecedented breach of EU law, as described by the ECJ, stems from Hungary's refusal to uphold the right to seek asylum, which poses a major threat to the unity of EU law, per the court's ruling. The Hungarian government has signalled its intention to review the ruling and explore potential responses. ●