INTERNATIONAL MONETARY FUND

IMF Country Report No. 21/135

HUNGARY

2021 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT

June 2021

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2021 Article IV consultation with Hungary, the following documents have been released and are included in this package:

- A **Press Release**.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on lapse of time basis, following discussions that ended on April 30, 2021, with the officials of Hungary on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 3, 2021.
- An **Informational Annex** prepared by the IMF staff.

The documents listed below have been or will be separately released.

Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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PRESS RELEASE

PR21/192

IMF Executive Board Concludes 2021 Article IV Consultation with Hungary

FOR IMMEDIATE RELEASE

Washington, DC – June 29, 2021: On June 18, 2021, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Hungary and endorsed the staff appraisal without a meeting.[1]

The economy has been hit hard by the pandemic. GDP declined by 5 percent in 2020. Average inflation was 3.3 percent but, with continued strong wage growth, core inflation was 4.1 percent (old definition), just above the central bank (MNB)'s tolerance band. Partly owing to support measures, the unemployment rate rose only modestly to 4.1 percent, remaining the lowest in the region. Tourism flows dropped sharply, and exports declined, but this was counterbalanced by lower imports and profit remittances by large multinationals. As a result, the current account remained broadly balanced in 2020. The fiscal deficit increased to an unprecedented 8.1 percent of GDP as a result of tax deferrals and increased spending. The banking sector buffers remained, on average, comfortable. While Hungary has been among the countries with the highest COVID-related death rates, vaccination has been faster than the EU average.

Following first quarter outcome, a strong recovery is expected to take hold in 2021. Growth is projected around 6 percent, driven by net exports, as external demand improves, and recovering consumption supported by fiscal outlays, still fast-growing private wages, and accumulated households' savings. Headline inflation is projected to temporarily increase in the short run before returning toward 3½ percent while unemployment is expected to gradually return close to pre-crisis levels. Yet, uncertainty remains significant.

Executive Board Assessment[2]

In concluding the Article IV consultation with Hungary, Executive Directors endorsed the staff's appraisal as follows:

The authorities' policy response to the crisis was appropriately strong. The fiscal policy response was large and timely. Consequently, the deficit increased to 8.1 percent of GDP and public debt rose above 80 percent of GDP. The MNB swiftly reacted to market pressures by providing ample liquidity through a variety of policy tools. Like other EU banking regulators, the MNB allowed temporary easing and deferment of some capital requirements and took other micro and macro prudential measures.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team normally visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. In this case, discussions were held from headquarters through videoconferencing.

[2] The Executive Board takes decisions under its lapse-of-time procedure when the Board agrees that a proposal can be considered without convening formal discussions.

Fiscal policy needs to flexibly balance supporting the economy and preserving medium-term sustainability. The continued, significant economic support embedded in the revised 2021 and 2022 budgets appeared justified when they were prepared, considering significant uncertainty, the severity of the pandemic's third wave, and the need to avoid abrupt adjustments that could jeopardize the recovery. However, with growth prospects having improved, buffers can be rebuilt more rapidly by saving the windfall from higher revenues and, possibly, under-spending if less support is needed to entrench the recovery. Conversely, a setback in the recovery may warrant additional support for households and firms. Given high gross financing needs, debt management policy should continue to aim at lengthening public debt maturity. Considering the magnitude of fiscal spending, transparency in the use of public fund is crucial.

Minimizing scarring from the crisis and enabling economic transformation should be priorities going forward. Targeted support to viable firms, especially SMEs, can help support those objectives, together with strengthened social safety nets and investment in infrastructure and human capital. Fiscal space can be created by continuing to enhance revenue and lowering current spending, such as further reducing the public wage bill as a share of GDP through a rationalization of public employment. While efforts should made to further improve tax collection and reduce exemptions and preferential regimes, the recent reintroduction of a temporary low preferential VAT rate on new home purchases should be reconsidered. Also, increasing labor market participation of the youth under 25 would better be achieved through other means than the planned blanket income tax exemption.

The monetary policy response to the crisis was appropriate. Monetary policy going forward should continue to be data-driven to ensure that inflation stays within the target range, as risks are now mostly on the upside. Some overshooting of the inflation band due to temporary shocks is acceptable. Looking ahead, at this stage, no more than a modest tightening of monetary conditions will be necessary as long as inflation expectations remain well-anchored, but upward risks to inflation will need to be monitored closely. Conversely, monetary policy might need to be further eased should the recovery falter. Thus far, the adaption of monetary instruments has effectively provided needed liquidity and addressed market dysfunction. As conditions normalize, the MNB should continue to review the effectiveness and necessity of its unconventional tools and consider tapering its still-growing APP.

Prudential policies should continue to focus on mitigating immediate vulnerabilities. As the recovery takes hold, withdrawal of support measures will need to be gradual. Aggregate buffers of the banking system are comfortable but continued supervisory vigilance is warranted. Recent measures aimed at strengthening the anti-money laundering framework are welcome.

The structural reform agenda should facilitate the transformation toward a more resilient economy post-pandemic. Over the medium term, some pre-existing trends in the global economy were accelerated by the pandemic and will likely require economic transformation and labor reskilling. The recently proposed revisions to the bankruptcy framework aim to support more orderly and efficient corporate restructuring. Labor reallocation across sectors needs to be supported by a strengthened social safety net, including unemployment benefits, and higher investment in human capital, including healthcare and life-long (re)training, as spending in these categories is below the EU average.

Greening the economy, to which the authorities are strongly committed, is necessary for sustainable growth and should be supported by higher carbon pricing. Hungary aims to reach climate neutrality by 2050, relying on renewable and nuclear energy production, recycling, and energy conservation. Higher carbon pricing would foster energy efficiency and innovation and bring revenue that could help finance green investment and compensate the most vulnerable users for higher energy costs. Given the evolving EU framework, it may be preferable at this stage to incentivize green investment through transparent fiscal subsidies, applying equally to self- and credit-financed investment, rather than prudential measures.

The EU Recovery and Resilience Funds can help leverage the authorities' efforts. The timely implementation of reforms, within strengthened competition, governance and transparency frameworks, is key to putting the economy post crisis on a more sustainable and resilient path.

Hungary: Selected Economic Indicators

Adult literacy rate (%, 2016) 99.4

Main exports: transport and electrical equipment
Key export markets: Germany (28%), Romania, Austria, Slovakia, Italy, and France

	2018	2019	2020	2021
Output				
Real GDP growth (%)	5.4	4.6	-4.9	6.2
Employment				
Unemployment rate (average, %)	3.7	3.5	4.1	4.1
Prices				
Inflation (average, %)	2.8	3.4	3.3	4.1
General government finances (% of GDP)				
Revenue	43.8	43.6	43.5	42.6
Expenditure	45.9	45.7	51.6	49.8
Fiscal balance	-2.1	-2.1	-8.1	-7.1
Primary structural balance (percent of potential GDP)	-0.7	-1.1	-5.0	-5.1
Public debt	69.1	65.5	80.4	78.3
Gross financing need	21.1	23.5	25.3	20.5
Money and credit				
Broad money (% change)	11.8	8.1	20.9	…
Credit to the private sector (flow based, % change)	10.6	15.3	11.8	…
Government bond yield (5-year, average, %)	2.2	1.6	1.5	…
5-year sovereign CDS (average in bps)	86.6	80.4	67.2	…
External sector				
Current account (% of GDP)	0.3	-0.5	0.1	0.5
Reserves (percent of short-term debt at remaining maturity)	162.1	163.6	156.4	152.6
External debt (% of GDP)	78.9	71.6	78.6	69.9
Exchange rate				
Exchange rate, HUF per euro, period average	319.3	325.2	351.2	...
REER (% change, "-" = appreciation)	1.8	0.7	4.8	...

Sources: Hungarian authorities, OECD, and staff projections.

HUNGARY

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION

June 3, 2021

KEY ISSUES

Context. Hungary's economy entered the COVID-19 pandemic on a strong footing and the authorities responded swiftly and strongly to the crisis it triggered. While the lockdowns weighed heavily on activity, the fast vaccination pace is allowing an early relaxation of containment measures, and the economy has started to rebound.

Policy recommendations

Continued, well-targeted policy support remains needed to entrench the recovery. Given uncertainties, policies will need to be flexible to ensure that adequate support is provided while preserving fiscal sustainability and keeping inflation expectations well anchored.

Fiscal policy. The fiscal stance was appropriately relaxed in response to the crisis. The significant support embedded in the revised 2021 and 2022 budgets appeared justified when they were prepared, but the authorities should be ready to save if the strength of the recovery allows for less support than planned. Beyond immediate emergency response, fiscal policy will need to focus on minimizing scarring from the crisis and supporting the transition to a greener and more resilient economy. Fiscal space can be rebuilt by enhancing revenue and reducing current spending, as conditions allow.

Monetary policy. The central bank provided timely and ample liquidity to markets through a variety of tools. Monetary policy should stay tuned to inflationary pressures, which are likely to increase as the recovery ensues. Unconventional instruments need to be continuously assessed to ensure their effectiveness and appropriate calibration.

Structural reforms. Reinvigorating reforms is needed to accelerate convergence. The crisis underscored the need to support an efficient reallocation of resources for economic transformation and labor reskilling. Greening the economy is necessary for the sustainability of growth and should be supported by higher carbon pricing.

Approved By
Jörg Decressin (EUR) and Martin Sommer (SPR)

Virtual meetings took place during April 19–30, 2021. The staff team comprised Messrs. Dauphin (head), Dybczak and Lybek, and Ms. Vtyurina (all EUR). Mr. Palotai and Mr. Meizer (both OED) also attended meetings. Mses. Zhang and Samuel (both EUR) assisted in the preparation of the report. Staff met with the Economic Policy Advisor to the Prime Minister, Mr. Nagy, State Secretaries Banai and Gion, Deputy Central Bank Governors Kandrács, Patai and Virag, Deputy State Secretaries Balogh, Botos, Marczinko, and Salgo, several other officials, representatives from banks, trade chambers, employer association, and academia.

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COVID-19 SHOCK AND POLICY RESPONSE

1. **Hungary's economy performed strongly prior to the COVID crisis.** During 2015–19, policies delivered a very strong economic performance: growth was above 4 percent on average (among the highest in Europe); unemployment reached historic lows close to 3 percent; inflation broadly stayed within its tolerance band; the external position was stronger than warranted by fundamentals; and the financial sector remained sound. While fiscal policies appeared somewhat procyclical, the public debt ratio decreased significantly.

2. **While the first and second waves of the pandemic were relatively mild, the third wave was severe.** Strict containment measures were introduced in March 2020 as the first wave struck Europe, helping reduce the initial toll of the pandemic. Restrictions were relaxed in the summer, then tightened again in response to second and third waves. In March 2021, all non-essential business and schools were closed again. By end-April 2021, Hungary had the highest reported number of Covid-related deaths-per-population ratio (Figure 1). Meanwhile, the authorities accelerated the pace of vaccination. Besides EU-procured ones, they authorized four other vaccines, becoming the only country in the world with seven vaccines available. By end-May, close to half of the adult population had received at least one dose, and the number of infections was declining.

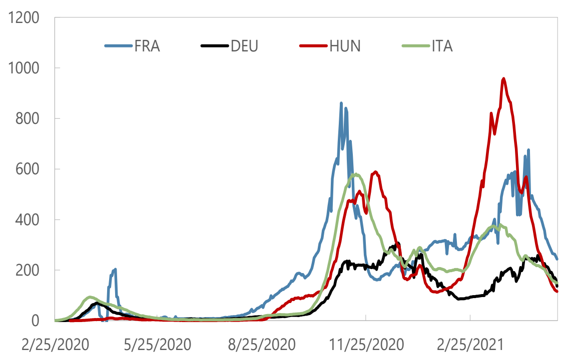
3. **The pandemic has hit the economy hard in 2020 but growth rebounded more strongly than expected in early 2021**. In the first half of 2020, real activity was severely affected by mobility restrictions, temporary factory closures, impaired global supply chains, the drying up of tourism, reduced consumption, and a contraction in investment. Despite a summer rebound, GDP declined by close to 5 percent for the year (Figure 2). Average inflation was 3.3 percent in 2020 but, with continued strong wage growth, core inflation was 4.1 percent, just above the central bank's (MNB) tolerance band. Partly owing to government wage support, the unemployment rate rose only modestly to 4.1 percent, remaining the lowest in the region. The economy, however, seemed to adjust to the new restrictions imposed in March 2021. Published after the mission, real GDP data significantly exceeded expectations, with a 2 percent growth (q/q, s.a.) as industry and construction rebounded strongly. Headline inflation accelerated, pushed by higher excises taxes and fuel prices, and reached 5.1 percent in April 2021. However, core inflation, at 3.1 percent, was close the MNB target.[1]

4. **The authorities' fiscal response was large.** In addition to automatic stabilizers, the authorities sought to contain the epidemic and support the economy by granting tax holidays, increasing and reprioritizing spending, and mobilizing additional resources (including through increased taxes on large retail trade companies and, temporarily, on banks). Temporary and permanent tax relief was provided to employees, employers, and self-employed in specific sectors. Measures supporting jobs and SMEs, including a wage subsidy scheme, were partially financed by

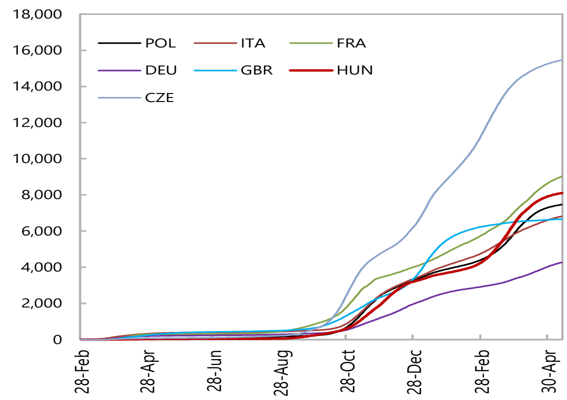
[1] The core inflation basket was revised in April 2021 to exclude alcoholic beverages and tobacco products. The ratio for 2020 is under the old definition.

Figure 1. COVID-19: Cases, Mobility Restrictions, and Vaccination

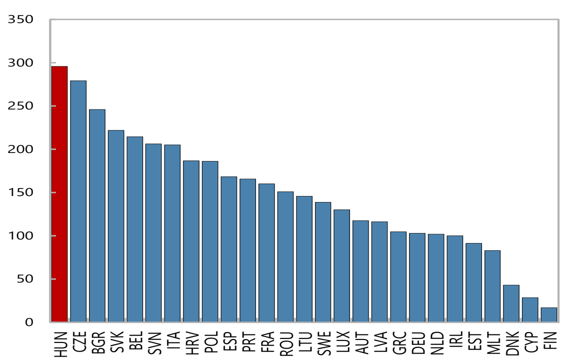
Daily New Confirmed Cases per Million People
(7-day moving average)



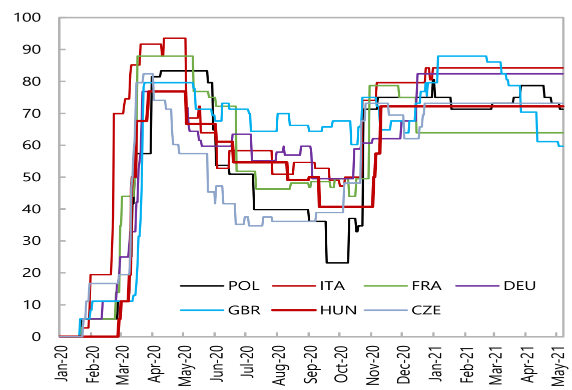
Cumulative Reported Cases (7-day moving average, per 100k residents, as of May 13, 2021)



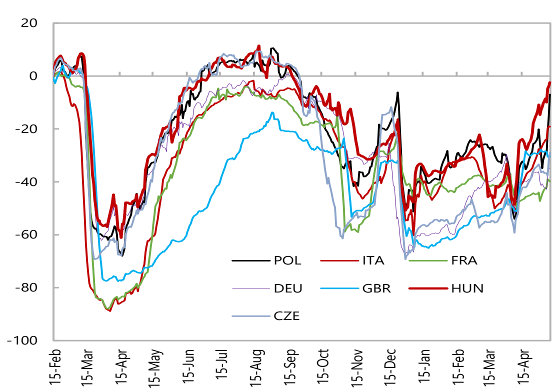
EU Countries: COVID-19 Deaths
(Per 100,000 residents, as of May 13, 2021)



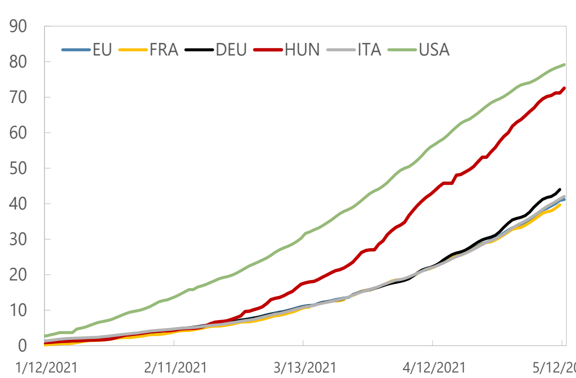
Government Response Stringency Index (Index: 100=most restrictive)



Retail and Recreation Mobility
(Percent change from baseline, as of May 13, 2021)



Vaccine Doses Administered
(Per 100 people)



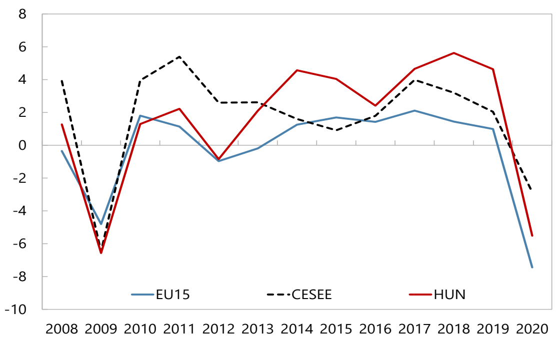
Sources: Bloomberg; JHU; Our World in Data; Blavatnik School of Government at University of Oxford; and Google

Figure 2. Selected Economic Indicators

COVID shock had a profound effect on real incomes,

Real PPP per GDP per Capital Growth

(In percent)

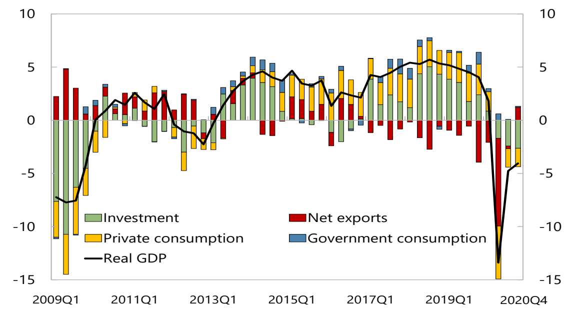


Sources: IMF World Economic Outlook (WEO); and IMF staff calculations.

...driven by activity declines across sectors.

Contributions to Growth

(Percent)

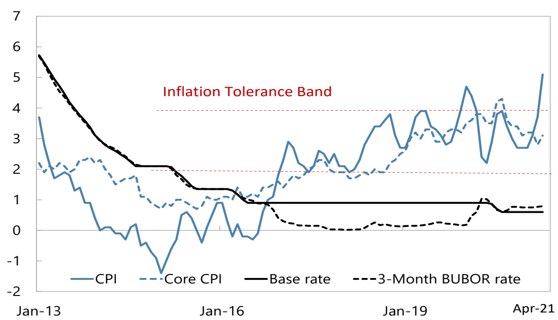


Sources: Haver.

Inflation has stayed in the tolerance band, despite some one-off spikes...

Inflation and Policy Rate

(Percent change, year on year)

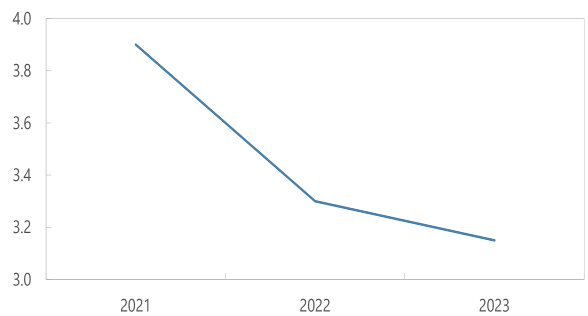


Sources: Hungarian National Bank (MNB); Hungarian Central Statistical Office (HCSO); and IMF staff calculations.

... and inflation expectations have remained anchored.

Market Inflation Expectations 1/

(In percent)

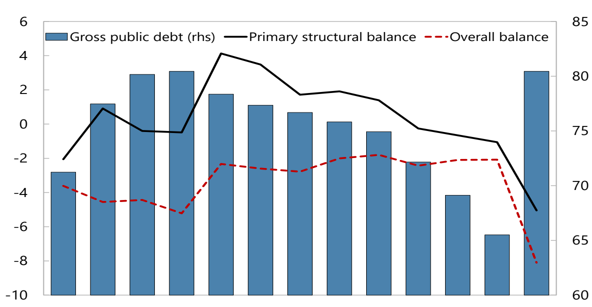


1/ as of May 19, 2021.
Sources: Refinitiv, and Reuters Poll.

Fiscal expansion was unprecedented, driven by support measures.

Fiscal Stance of the General Government

(In percent of GDP)

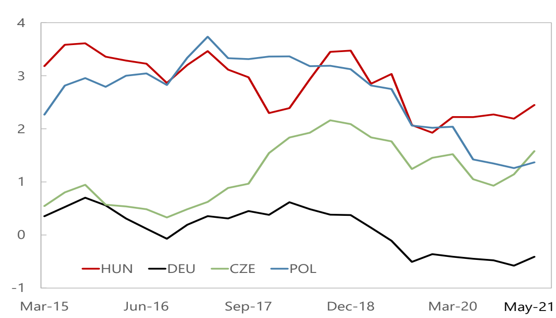


Sources: Hungarian authorities; and IMF staff estimates.

The deficit was easily financed due to conducive market conditions.

10-Year Government Bond Yields

(In percent)



Sources: Magyar Nemzeti Bank; and Haver Analytics.

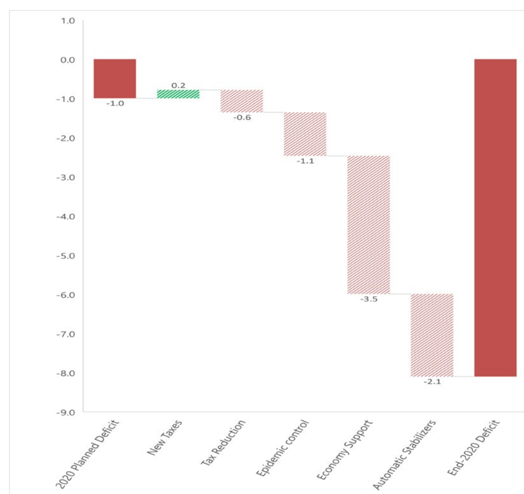
the EU funds. Support was also provided by reallocating resources from existing budgetary appropriations, reserves, and local governments to two newly created funds:

- The *Anti-epidemic Fund* aimed to contain the epidemic by channeling additional health-related spending. In 2020, the authorities used the fund to purchase additional medical equipment and supplies and grant bonuses and wage increases to healthcare staff.

- The *Economic Protection Fund* was established to cushion the economic fallout of the pandemic by providing support to businesses and households. The Fund channeled resources to the hardest hit sectors (tourism, services, and agriculture) mostly in the form of direct subsidies and targeted support to SMEs. The fund also incorporated the existing National Employment Fund into the Economic Protection Fund.

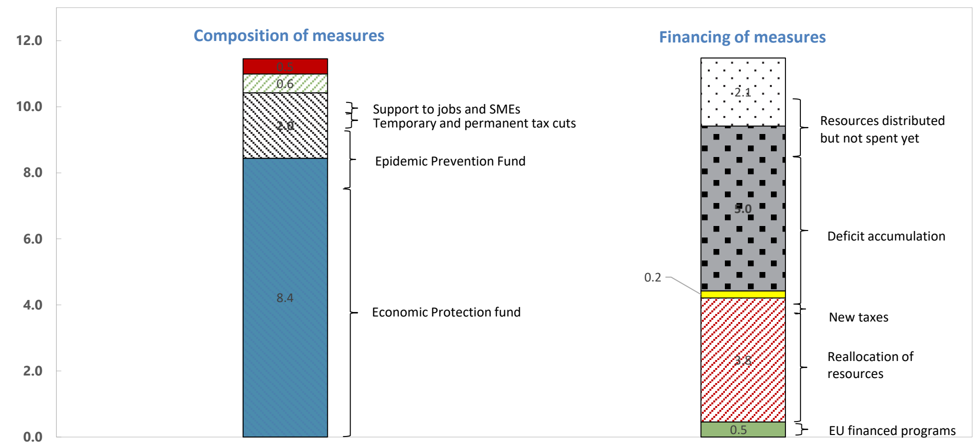
5. As a result, the fiscal deficit increased to an unprecedented level. The government estimates that the overall size of the fiscal response to the crisis was 12 percent of GDP. Above net additional spending, this estimate includes support that came from reshuffled budget allocations (almost 4 percent of GDP). In addition, in December 2020, about 2 percent of GDP were transferred from the central budget to institutions in the broader public sector that did not use them in 2020. The funds remained with these institutions and are expected to be used in 2021. Overall, staff estimates the net fiscal impact of new measures at about 5 percent of GDP. As a result, the ESA fiscal deficit (accrual) increased to 8.1 percent of GDP, compared to a target of -1 percent of GDP in the initial 2020 budget.

From Initial Target to Actual 2020 Fiscal Deficit: Contribution of Support Measures
(In percent)



6. Public debt increased significantly, and gross financing needs (GFNs) remained elevated. In 2020, the increase in deficit and additional borrowing to pre-finance 2021 spending led to a rise in public debt by 15 percent of GDP to 80 percent of GDP (Annex I). With favorable global financing conditions, the government issued €6.5 billion in external bonds, of which around €1.7 billion in green bonds in 2020. FX borrowing increased to about 20 percent of total debt. GFNs remained high, including due to the previous debt strategy that led to a reduction of maturities. Although the 2019 Article IV assessed fiscal space as at risk, the large fiscal response to the pandemic did not trigger an adverse market reaction. With ample global and domestic liquidity continuing to allow for cheap financing conditions, staff is not revising the assessment despite the increase in debt.

Fiscal Measures in Response to COVID-19
(Percent of GDP, accounting on cash basis)



7. The MNB swiftly reacted to market pressures. It provided ample liquidity through a variety of policy measures, including FX liquidity swaps, enhanced lending facility, and the expansion of its asset purchase program (APP), which includes government, corporate and mortgage bonds, and adjustment of the policy rate (Annex II). It also increased the limits under its funding facilities for large companies and SMEs. The MNB reacted to initial pressures on the forint by steering an increase in money market interest rates (Figure 3). To facilitate FX liquidity support and build a safety net should the crisis worsen, it established repo agreements with the ECB (€4 billion), the BIS (€2 billion), and the Federal Reserve (US$1–2 billion), while a swap agreement with the People's Bank of China (about €2.5 billion) was already in place. As conditions stabilized, the various support measures were adjusted.

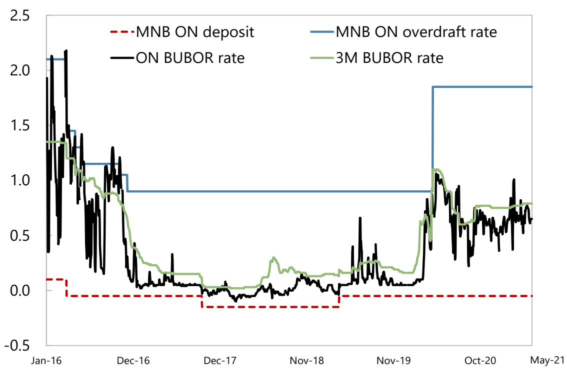
8. Strong banking system buffers and timely measures allowed to temporarily relieve borrowers' balance sheets. Banks' capital position was strong and assessed by the MNB to be resilient to even severe shocks. Like other EU banking regulators, and in line with European Banking Authority's (EBA) guidance, the MNB allowed a temporary easing and deferment of some capital requirements. This, together with the provision of liquidity through monetary operations, gave banks substantial space to adjust to the blanket payment moratorium (with an opt-out option) in effect since March 2020, which has benefited almost 1.6 million retail and 50 thousand corporate debtors. The MNB also adjusted microprudential (e.g., classification of restructured loans, per EBA guidance) and macroprudential ratios (including a temporary tightening of external funding prudential requirements early in the crisis, which was subsequently reversed as market turbulences eased). Credit to non-financial corporations and households continued to grow rapidly, in part due to the moratorium.

Figure 3. Financial Sector and Housing Indicators

MNB maintained accommodating liquidity conditions, which was conducive to credit growth, while NPLs were held back in part owing to the support measures provided to borrowers.

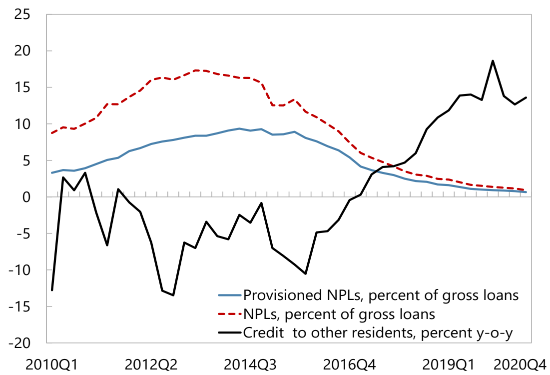
Money Market Interest Rates

(Percent)



Sources: Hungarian National Bank/Haver Analytics; and IMF staff calculations.

Credit Growth and Non-Performing Loans

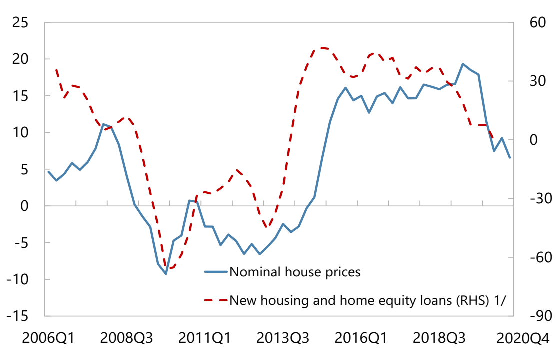


Sources: MNB; IMF Financial Soundness Indicators Database; and IMF staff calculations.

House price growth slowed during the pandemic but remained high, and...

House Prices and New Loans

(Annual percentage change)

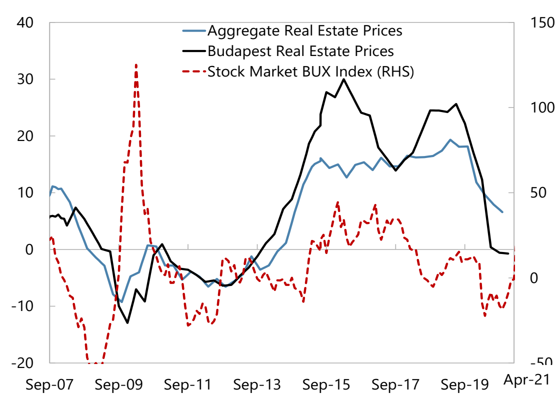


Sources: HCSO, MNB; and IMF staff calculations.
1/ Date break at 2009 Q3.

... the stock market performance was temporarily affected by reduced activity and pressures on balance sheets.

Selected Asset Price Indicators

(Year on year percent change)



Sources: Haver.

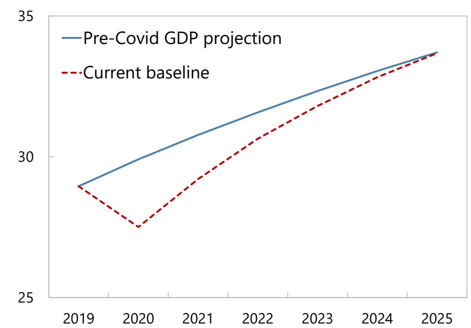
9. **The 2020 external position is assessed as stronger than warranted by medium-term fundamentals and desirable policies** (Annex III). Tourism flows dropped sharply, and exports declined, but this was counterbalanced by lower non-medical imports and profit repatriation by multinationals. As a result, the current account remained broadly balanced in 2020. The forint reached historical lows, but this did not lead to a significant increase in vulnerabilities. Most Hungarian banks hold net foreign assets, while household debt is now mostly in local currency, and most large corporations are naturally hedged. International reserves increased, partly due to Eurobond placements, and reserve adequacy improved.

OUTLOOK AND RISKS

10. **The recovery is expected to take hold in 2021.** Given the strong first quarter data, staff expects growth to be about 6 percent in 2021. This assumes vaccination keeps its current pace and that significant disruptions in semiconductor supply, which led to car factory closures earlier in 2021, do not reoccur. Growth will be driven by net exports, as external demand improves and capacities increase, and recovering consumption supported by fiscal outlays, still fast-growing private wages, and accumulated households' savings. The recovery of domestic private investment may be somewhat protracted as businesses repair their balance sheets, although new significant foreign investment projects (e.g., in electric vehicles) are expected to proceed as planned.

11. **However, uncertainty remains significant.** The recovery depends on global conditions and the race between the virus and vaccination, domestically and globally (Annex IV). Higher global risk aversion would increase financing costs, although opportunities on the domestic market may lower this risk. If the pandemic gets under control more rapidly than expected, a return of confidence could boost investment and growth more rapidly than in the baseline scenario.

Real GDP
(In billions of forints)



Source: IMF staff estimates.

12. **EU funds could greatly help the recovery**. Damages inflicted to productive capacity, including from health, labor, and firm-related scarring effects, may impact the economy for long. Over the medium term, accelerated shifts to e-commerce, teleworking, the likely reshaping of global value chains, and, possibly, less business travel will require transformation and retraining. Hungary is expected to receive about €7.2 billion (5 percent of 2021 GDP) in grants from Next Generation EU funds over 2021–27, which would be crucial in supporting the economic transformation and green recovery. It is also eligible for €10 billion (6.5 percent of 2021 GDP) in loans but thus far is not planning on utilizing them. The timing of delivery of EU fund is another source of uncertainty that may affect the recovery path.

Authorities' Views

13. **The authorities broadly shared staff's views on the outlook and the balance of risks.** They consider that economic performance in 2020 outstripped their expectations and that this could herald a more rapid recovery, which is also supported by structural and demand-related factors. Prior to the release of Q1 data, they expected GDP growth to be at least 4 percent and possibly up to 6 percent, supported by a rise in household incomes and a pick-up in public and private investment. Their alternative negative scenario presumes a protracted pandemic resulting in lower domestic inflation and growth. Their upside scenario involves a faster implementation of competitiveness reforms that boost growth potential.

POLICY DISCUSSIONS

14. Discussions focused on policies to address the COVID-related crisis and support a strong, inclusive, and durable recovery, including by greening the economy. The initial policy response was adequate and helped contain the initial damage from the pandemic. Going forward, policies will need to remain supportive but can better target the most affected sectors and should focus on mitigating scarring. Continued flexibility in policy will be required given the largely uncertain recovery path. In a positive scenario, where confidence boosts the recovery beyond baseline projections, fiscal support could be withdrawn earlier to help rebuild buffers more rapidly and monetary policy may have to remove accommodation faster to keep inflation on target over the medium run. Conversely, in a risk scenario assuming a more protracted recovery, targeted support would be needed for longer. If such a scenario was accompanied by increased global risk aversion and renewed forex market turbulences, fiscal policy would need to play a greater role, as monetary policy would have to watch for the impact on inflation expectations.

A. Fiscal Policy: Supporting the Economy while Keeping Vulnerabilities in Check

15. Fiscal policy needs to balance providing adequate support for the recovery in the short run and gradually rebuilding room for maneuver in the medium run.

- *2021–22 objectives.* The continued, significant economic support embedded in the revised 2021 budget, which targets a 7½ percent of GDP deficit, appeared justified when it was prepared considering the severity of the third wave of the pandemic and significant downward risks. The authorities' relatively high 2022 fiscal deficit target of 5.9 percent of GDP, which aims to avoid an abrupt removal of the stimulus, also seemed appropriate in staff's view.

- *Risks and need for flexibility.* Staff stressed the need for a flexible approach to setting fiscal targets, within a strong commitment to returning toward a balanced fiscal position over the medium term. It emphasized that, given high uncertainty, fiscal targets and budget composition this year and beyond will need to be regularly reassessed and flexibly adjusted. Given the strong Q1 outcome, growth in 2021 now appears likely to exceed the budget projection of 4.3 percent. If, indeed, the recovery turns out faster than expected, buffers should be rebuilt more rapidly by saving the tax windfall from higher growth and, possibly, under-executing the budget if less support appears needed. In such a scenario, a less accommodative fiscal stance would also help keep inflationary pressures in check. Conversely, a further setback to the recovery may warrant additional support for households and firms.

- *Debt management.* Given high gross financing needs, it is also important to continue lengthening public debt maturity, as started in 2020. Staff also agreed with the authorities that the share of FX-denominated debt in total public debt should be kept relatively low to prevent the buildup of new vulnerabilities.

16. Beyond the immediate emergency response, fiscal policy will need to focus on minimizing scarring from the crisis and supporting economic transformation. In the short run, the authorities intend to provide additional crisis support through greater spending on healthcare, family support, home-building program, tax relief, and more allocations to local governments. While blanket support such as tax rate holidays and the loan moratorium was appropriate initially, a more targeted approach would be needed going forward. Fiscal measures that could accelerate the recovery and reallocation of resources in the short run include temporary incentives to hiring or investing (e.g., temporary investment tax credits), or favorable financing conditions (e.g., grants to cover selected operational costs) offered only to viable SMEs and micro firms. Staff also emphasized that minimizing scarring would be supported by a strengthened social safety net, higher investment in human capital, and green investment, as discussed in Section C. Notably, further extension of the broader wage support schemes should be considered if the recovery falters.

17. Fiscal space could be gradually created by implementing some of staff's longstanding recommendations to enhance revenue and lower current spending. Regarding spending, consideration could be given to gradually further reducing the public wage bill as a share of GDP, by rationalizing employment in the public sector. With respect to revenues, measures include continuing to improve tax collection, reducing exemptions and preferential regimes, and broadening the tax base. In this regard, the reintroduction of a temporary low preferential VAT rate on new home purchases may not have been needed given the strength of the housing market and other incentives to increase supply. Also, raising labor market participation of the youth under 25 could be better addressed through active labor market policies, training, and hiring subsidies, rather than though the planned blanket personal income tax (PIT) exemption for income below the national average.

18. Considering the magnitude of the fiscal response, transparent use of public funds and assets is crucial. The recent transfer of public universities' and other State assets to existing or newly created public-interest foundations, together with a constitutional amendment that redefined the concept of public money, have raised questions about possible risks to the transparency of use public funds.[2] Staff stressed the importance of fiscal transparency, which is key to ensuring the effectiveness of spending and maintaining public trust. Staff advised that all COVID-related procurement contracts, including beneficial ownership, should be made publicly available. Staff also suggested that participation in the Fund's Public Investment Management Assessment could help identify ways to strengthen the efficiency of public investment.

Authorities' Views

19. Fiscal measures have been instrumental in supporting the economy and reducing the social and economic fallout from the crisis. With the health crisis still ongoing, the revised 2021 deficit target provides the needed support to the economy and is in line with EU's average deficits. Returning to deficits below 3 percent of GDP and bringing debt down continue to be key medium-

[2] Staff did not have comprehensive information when preparing this report to assess the possible macro-implications of these measures.

term objectives. The PIT exemption for youth aims to incentivize an increase in their labor force participation, as some young are reluctant to enter the job market. Housing incentives are needed to address demographic challenges and encourage investment.

20. A framework is in place to ensure the transparency of public spending. The redefinition of public money was necessary to avoid inconsistent court rulings regarding what transactions fall under the fiscal transparency policy; in that context, the authorities clarified that any institution that carries public policy has an obligation of transparency when using funds for that purpose. As part of the general budget auditing activity, the assessment COVID-related spending will be carried out by the State Audit Office.[3] Furthermore, the law requires the publication of certain data of public procurement contracts exceeding 5 million HUF. Public contract data for the National Healthcare Service Center and the Ministry of Foreign Affairs and Trade are already available for 2020 and under preparation for 2021.

B. Monetary and Financial Policies: Accommodating, with Vigilance on Risks

21. The monetary policy response to the crisis was appropriate to support price and financial stability, as well as growth. Core and headline inflation had been rising since 2016, pushed by a positive output gap and tight labor market, with wage growth outpacing productivity gains, and a gradual depreciation of the exchange rate. Still, the MNB successfully kept it broadly within its 2–4 percent tolerance band. Headline inflation abated in 2020 following the pandemic, while core inflation hovered around the upper limit of the band.

22. A data-driven approach should continue to guide policy decisions to ensure that inflation stays within the target range, as risks are now mostly on the upside.

- *Baseline*. Inflation expectations have so far remained anchored. Staff's baseline projection is for headline inflation to temporarily increase in the short run (as seen in April) before returning toward 4 percent by year end. The temporary increase reflects rising energy prices, some recent increases in excises, exchange rate depreciation, and continued strong wage growth, and some overshooting is acceptable. Looking ahead, at this stage, no more than a modest tightening of monetary conditions will be necessary as long as the negative output gap pushes inflationary pressures down and expectations stay well anchored.

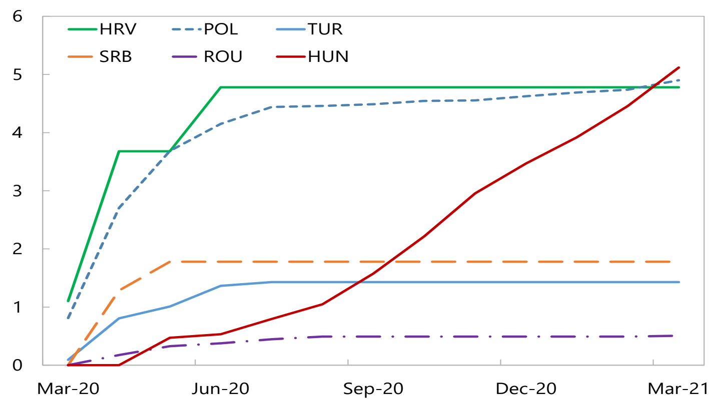
- *Risks*. As headline inflation is already above the target band and the recovery in activity and employment was strong in Q1, wage dynamics will need to be watched closely. Monetary conditions may need to be tightened more rapidly to ensure that inflation expectations remain well anchored. Already, some private analysts are concerned that inflationary pressures may tilt to the upside. Conversely, should the recovery falter, monetary conditions might need to be

[3] A bill on final accounts should be submitted to parliament by September 30 following the budget year, together with the report of the State Audit Office.

further eased. Also, the MNB might have to increase interest rates and use other tools should new market turbulence threaten price or financial stability.

23. The operational framework for monetary policy needs careful monitoring. Thus far, monetary operations have effectively provided needed liquidity and addressed market dysfunction. As global and domestic conditions normalize, the MNB should continue to review the effectiveness and necessity of its unconventional tools and should consider tapering its still-growing APP, also considering rising inflation risks. Staff noted that APP in corporate securities should ideally only take place in the secondary market.

Cumulative Central Bank Asset Purchases, 2020
(In percent of GDP)



Sources: IFS; national central banks; and IMF staff calculations.

24. Prudential policies should continue focusing on immediate vulnerabilities. As the recovery takes hold, withdrawal of support measures will need to be gradual. The MNB's stress tests indicate that the banking sector should withstand the expected increase in nonperforming loans (NPLs) as the support measures wind down. Aggregate buffers of the banking system are currently comfortable but are somewhat unevenly distributed among banks. Thus, continued supervisory vigilance remains warranted. The anti-money laundering framework should continue to be strengthened in line with international standards, including to address Moneyval recommendations.[4] Staff welcomed recent amendments to framework, which mandate, inter alia, the creation of the databases on beneficial owners and banking accounts.

Authorities' Views

25. The MNB sees inflation risks to the upside. Given the latest inflation and growth outcomes, in the context of ample fiscal support, the MNB communicated in May that it is ready to tighten monetary conditions in a proactive manner to the extent necessary to ensure price stability and mitigate inflation risks. A variety of instruments will continue to be employed in the conduct of monetary policy. The purchase of government securities will be driven by an ongoing assessment of both global and domestic conditions, and with a view to preserving the stability and dynamism of domestic markets.

[4] Recommendations mostly relate to non-profit organizations, politically exposed persons, correspondent banking, controls of financial groups and their foreign branches, transparency and beneficial ownership of legal persons, and cash couriers.

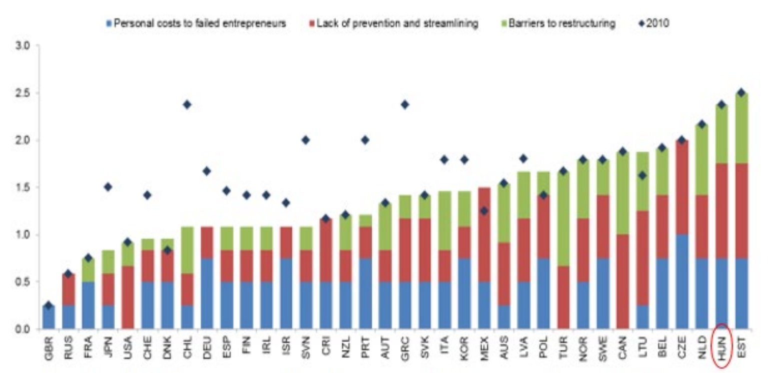
C. Preventing Scarring, Laying the Ground for a Stronger Economy Post Recovery

26. **The authorities appropriately aim to strengthen Hungary's medium-term growth prospects.** Over the past decades, their strategy focused on attracting investment from large multinationals, especially in the automotive and electronics industry. Recent priorities have appropriately included improving the business environment, fostering labor participation, increasing efficiency of government services, digitalizing the economy, and enhancing the procurement system.[5] While the pandemic resulted in delays in implementing the reform agenda, some progress towards the Program for Competitive Hungary has been made, including in regard to staff's past recommendations (Annex V).

27. **The crisis underscored the need to strengthen the safety net and invest in human capital.** In recent years, social policies largely focused on reversing the population decline through family-support schemes. The share of spending on healthcare remains low compared to EU average, which affects the elderly the hardest; thus, the increased investment in health sector planned under the Recovery and Resilience Plan (RRP) is welcome. Moreover, the EU estimates that increasing inequalities in the pension system are set to worsen (Figure 4). The crisis also pointed out the shortcomings in unemployment benefits, which are among the shortest in the EU. Furthermore, wage support was quickly discontinued for employees outside the most affected sectors. Staff advocated to review the benefits structure, including the length of unemployment benefits, especially given the potential fallout from economic transformation and scarring. Moreover, (re)training programs and life-long learning need to be enhanced, as Hungary displays one of the lowest rates of training and education for people 25-64 years old.

28. **Efficient insolvency and debt recovery frameworks are necessary to support the reallocation of resources.** The number of bankruptcies has remained low given the provided support and loan moratorium but are likely increase as support is withdrawn and the economy adjusts to a new normal. Revisions to the bankruptcy framework, which the OECD assessed as one of the

OECD Indicator of Insolvency Regimes



Note: The stacked bars correspond to three subcomponents of the insolvency indicator in 2016. The diamond corresponds to the value of the aggregate insolvency indicator based on these three subcomponents in 2010. Only countries for which data are available for the three sub-components in 2016 are included.
Source Calculations based on the OECD questionnaire on insolvency regimes.

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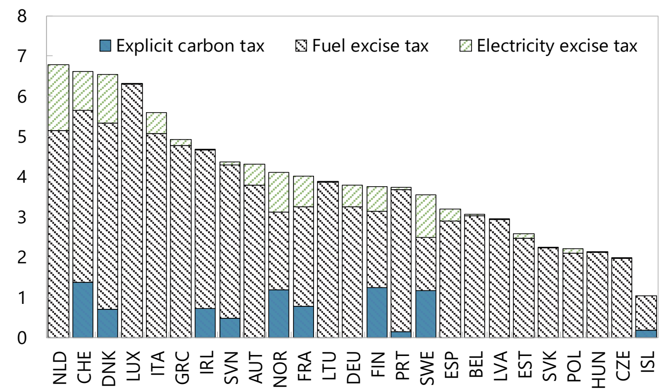
[5] The EU estimates that Hungary had irregularities in nearly 4 percent of its spending of EU funds in 2015–19, compared to an EU average of 0.4 percent.

costliest among its members, were introduced in 2020.[6] They should make it easier for companies to embark on efficient restructuring rather than outright bankruptcy. Staff also welcomed the authorities' preparations to transpose the 2019 EU Directive on Preventive Restructuring Frameworks to become effective in 2022. The Directive aims to reduce disruptive insolvencies and facilitate resource reallocation.

29. Efforts to green the economy are welcome and should be supported by higher carbon pricing.[7] Hungary intends to reach climate neutrality by 2050. Its approach relies on renewable and nuclear energy production, recycling, and energy conservation. Staff welcomed Hungary's ambitious goals and efforts to achieve them, including through EU-financed investment, tighter regulation, and the development of a green bonds market.[8]

Average Effective Energy Tax Rate, 2019
(Percent)



Source: OECD.

- *Staff advocated for increases in carbon pricing, which the authorities are not considering.* Such increases would stimulate improvements in energy efficiency, promote innovation, and bring revenue that could help finance green investment and compensate the most vulnerable users for higher energy costs. Staff noted that the authorities' understandable concerns about energy affordability could be addressed through specific measures, for instance by increasing electricity tariffs with the level of energy consumption or through broader redistributive fiscal policies.

- *Staff suggested that, at this stage, incentives for green investment may be better embedded in fiscal policy than in the MNB's prudential framework.* The MNB's initiative to lower Pillar 2 capital charge for green bank lending is well-intended and accounts for the fact that green investment may increase collateral value and borrowers' solvency (through energy cost saving). At the same time, no surcharges are currently in place to account for climate and transition risks. Until a harmonized EU framework is adopted to evaluate green financial products, staff advised that it might be preferable to incentivize green investment through transparent fiscal subsidies that would apply equally to self- or credit-financed investment.

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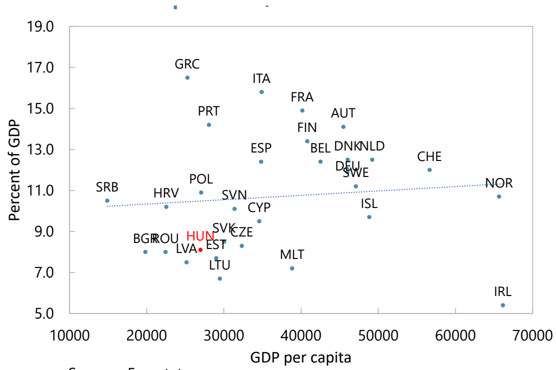
[6] Act LXXIII. In addition, two government decrees were temporarily introduced to facilitate restructuring during the state of emergency.

[7] See accompanying Selected Issue Paper.

[8] Hungary issued its first domestic, 30-year, green bond on Earth Day, April 22, 2021.

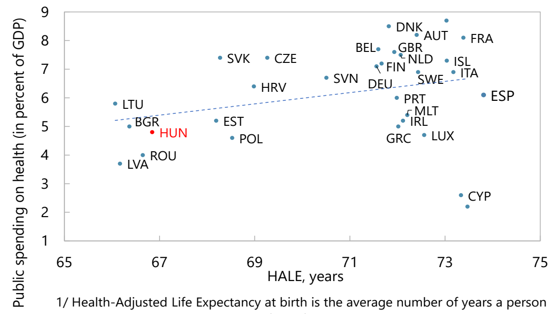
Figure 4. Selected Social Indicators

Pension Expenditure, 2017



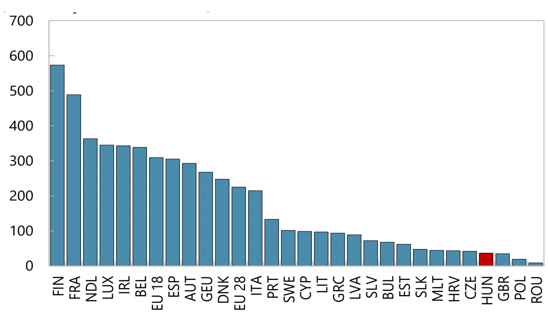
Sources: Eurostat.

Health-Adjusted Life Expectancy and Public Health Spending, 2016 1/



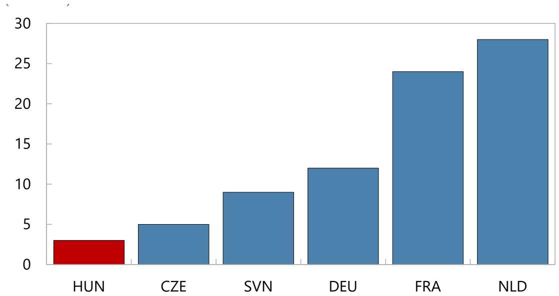
1/ Health-Adjusted Life Expectancy at birth is the average number of years a person can expect to live in good health or free of disease and injury.
Sources: Eurostat; and WHO.

Unemployment Benefits, 2018
(In PPS per inhabitant)



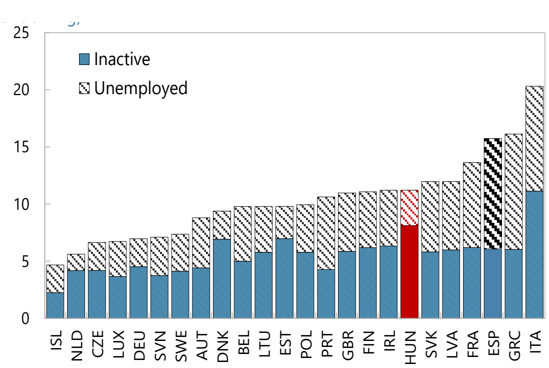
Source: Eurostat.

Maximum Duration of Unemployment Benefits, 2018[1/] (Months)



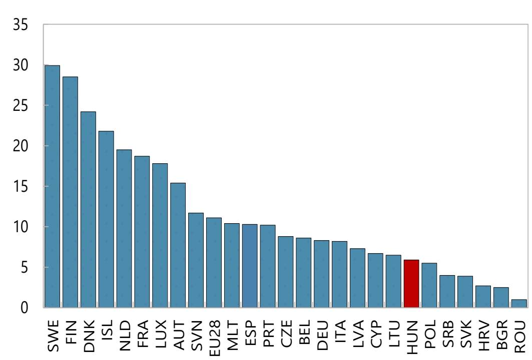
1/ Maximum benefit duration for a 40-year old displaced worker with 22 years of contributions (continuous employment since age 18).
Source: OECD.

MEET Rates, 2017 (Percent of total 15-24 population neither in employment, nor in education or training)



Source: OECD.

Participation Rate in Education and Training, 2018[1/] (percent, 25-64 years)



1/ Projection.
Sources: Eurostat.

30. The EU Recovery and Resilience Funds can play a key role in supporting the recovery and economic transformation. The timely implementation of the above reform package, with a focus on leveling the playing field for SMEs and improving governance and transparency, will be crucial for a strong recovery and to set the economy on a more sustainable path. A judicious, transparent use of EU funds, supported by a strong RRP, could greatly help progress on all these fronts.

Authorities' Views

31. Improving the economy's productivity and efficiency is key to accelerating convergence. The ongoing modernization of the vocational training system, involving the private sector, should help improve skills matching and reduce shortages of skilled workers. Improvements in government efficiency have resulted in a large increase in cases resolved electronically which, for the first time, exceeded 50 percent in 2020. More efficient construction permitting and utility connection processes are being implemented while deregulation of certain professions is also on the agenda. While, there is no plan to review unemployment benefit, investment in health will be a prominent part of the RRP. EU Funds are also expected to play a key role in improving the demographic situation, skills, water management, green and sustainable energy and transport, circular economy, digitalization, and public infrastructure.

32. Significant investment will be made on advancing the ambitious climate objectives. To keep energy prices affordable, Hungary is not currently considering introducing additional carbon pricing beyond the existing EU framework. Regarding green housing, the authorities see a need to find a balance in providing both fiscal and credit-linked incentives. The MNB considers that it should play a key role in greening the economy, and its statutes are being revised to that effect.

STAFF APPRAISAL

33. The authorities' policy response to the crisis was appropriately strong. The fiscal policy response was large and timely. Consequently, the deficit increased to 8.1 percent of GDP and public debt rose above 80 percent of GDP. The MNB swiftly reacted to market pressures by providing ample liquidity through a variety of policy tools. Like other EU banking regulators, the MNB allowed temporary easing and deferment of some capital requirements and took other micro and macro prudential measures.

34. Fiscal policy needs to flexibly balance supporting the economy and preserving medium-term sustainability. The continued, significant economic support embedded in the revised 2021 and 2022 budgets appeared justified when they were prepared, considering significant uncertainty, the severity of the pandemic's third wave, and the need to avoid abrupt adjustments that could jeopardize the recovery. However, with growth prospects having improved, buffers can be rebuilt more rapidly by saving the windfall from higher revenues and, possibly, under-spending if less support is needed to entrench the recovery. Conversely, a setback in the recovery may warrant additional support for households and firms. Given high gross financing needs, debt management policy should continue to aim at lengthening public debt maturity. Considering the magnitude of fiscal spending, transparency in the use of public fund is crucial.

35. **Minimizing scarring from the crisis and enabling economic transformation should be priorities going forward.** Targeted support to viable firms, especially SMEs, can help support those objectives, together with strengthened social safety nets and investment in infrastructure and human capital. Fiscal space can be created by continuing to enhance revenue and lowering current spending, such as further reducing the public wage bill as a share of GDP through a rationalization of public employment. While efforts should made to further improve tax collection and reduce exemptions and preferential regimes, the recent reintroduction of a temporary low preferential VAT rate on new home purchases should be reconsidered. Also, increasing labor market participation of the youth under 25 would better be achieved through other means than the planned blanket income tax exemption.

36. **The monetary policy response to the crisis was appropriate.** Monetary policy going forward should continue to be data-driven to ensure that inflation stays within the target range, as risks are now mostly on the upside. Some overshooting of the inflation band due to temporary shocks is acceptable. Looking ahead, at this stage, no more than a modest tightening of monetary conditions will be necessary as long as inflation expectations remain well-anchored, but upward risks to inflation will need to be monitored closely. Conversely, monetary policy might need to be further eased should the recovery falter. Thus far, the adaption of monetary instruments has effectively provided needed liquidity and addressed market dysfunction. As conditions normalize, the MNB should continue to review the effectiveness and necessity of its unconventional tools and consider tapering its still-growing APP.

37. **Prudential policies should continue to focus on mitigating immediate vulnerabilities.** As the recovery takes hold, withdrawal of support measures will need to be gradual. Aggregate buffers of the banking system are comfortable but continued supervisory vigilance is warranted. Recent measures aimed at strengthening the anti-money laundering framework are welcome.

38. **The structural reform agenda should facilitate the transformation toward a more resilient economy post-pandemic.** Over the medium term, some pre-existing trends in the global economy were accelerated by the pandemic and will likely require economic transformation and labor reskilling. The recently proposed revisions to the bankruptcy framework aim to support more orderly and efficient corporate restructuring. Labor reallocation across sectors needs to be supported by a strengthened social safety net, including unemployment benefits, and higher investment in human capital, including healthcare and life-long (re)training, as spending in these categories is below the EU average.

39. **Greening the economy, to which the authorities are strongly committed, is necessary for sustainable growth and should be supported by higher carbon pricing.** Hungary aims to reach climate neutrality by 2050, relying on renewable and nuclear energy production, recycling, and energy conservation. Higher carbon pricing would foster energy efficiency and innovation and bring revenue that could help finance green investment and compensate the most vulnerable users for

higher energy costs. Given the evolving EU framework, it may be preferable at this stage to incentivize green investment through transparent fiscal subsidies, applying equally to self- and credit-financed investment, rather than prudential measures.

40. The EU Recovery and Resilience Funds can help leverage the authorities' efforts. The timely implementation of reforms, within strengthened competition, governance and transparency frameworks, is key to putting the economy post crisis on a more sustainable and resilient path.

41. It is recommended that the next Article IV consultation be held on the standard 12-month cycle.

Table 1. Hungary: Selected Economic Indicators, 2016–22

	2016	2017	2018	2019	2020	2021	2022
					Est.		*Proj.*
	(Percentage change, unless otherwise indicated)						
Real economy							
Real GDP (percentage change)	2.1	4.3	5.4	4.6	-4.9	6.2	4.9
Total domestic demand (contribution to growth)	1.5	5.3	6.6	5.7	-2.9	4.7	4.5
Private consumption	2.4	2.7	2.7	2.5	-1.6	3.9	2.2
Government consumption	0.0	0.3	0.2	0.5	0.3	-0.1	0.3
Gross fixed investment	-2.4	3.8	3.6	3.0	-2.0	2.2	2.1
Foreign balance (contribution to growth)	0.6	-1.0	-1.2	-1.1	-2.1	1.5	0.4
CPI inflation (average)	0.4	2.4	2.8	3.4	3.3	4.1	3.6
CPI inflation (end year)	1.8	2.1	2.7	4.0	2.7	4.3	3.6
Unemployment rate (average, ages 15-64)	5.0	4.0	3.6	3.3	4.1	4.1	3.8
Gross fixed capital formation (percent of GDP)	19.5	22.2	24.8	27.2	27.3	27.6	27.9
Gross national saving (percent of GDP, from BOP)	24.0	24.2	25.1	26.8	27.4	28.1	28.7
General government 1/							
Overall balance	-1.8	-2.4	-2.1	-2.1	-8.1	-7.1	-5.8
Primary balance	1.2	0.2	0.2	0.1	-5.8	-5.1	-3.8
Primary structural balance (percent of potential GDP)	1.4	-0.3	-0.7	-1.1	-5.0	-5.1	-3.9
Public debt	74.9	72.2	69.1	65.5	80.4	78.3	77.1
Money and credit (end-of-period)							
Broad money	7.1	7.8	11.8	8.1	20.9	12.7	10.2
Lending to the private sector, flow-based	2.0	6.5	10.6	15.3	11.8	10.5	10.3
Interest rates							
T-bill (90-day, average)	0.7	0.0	0.0	0.0	0.4	…	…
Government bond yield (5-year, average)	2.1	1.7	2.2	1.6	1.5	…	…
Balance of payments							
Current account	4.5	2.0	0.3	-0.5	0.1	0.5	0.8
Reserves (billions of Euros)	24.4	23.4	27.4	28.4	33.7	35.9	36.7
Gross external debt 2/	95.5	83.4	78.9	71.6	78.5	69.9	64.1
Gross official reserves (percent of short-term debt at remaining maturity)	129.7	136.6	162.1	163.6	156.4	152.6	175.7
Exchange rate							
Exchange regime							
Exchange rate, HUF per euro, period average	311.5	309.9	319.3	325.2	351.2	…	…
Nominal effective rate (2000=100, average)	116.7	115.5	118.6	121.5	130.5	…	…
Real effective rate, CPI basis (2000=100, average)	79.7	78.4	79.8	80.3	84.2	…	…
Memorandum Items:							
Nominal GDP (billions of Forints)	36,167	39,233	43,347	47,514	47,743	52,630	57,418
Per capita GDP (EUR)	11,813	12,920	13,885	14,949	13,914	15,267	16,578

Sources: Hungarian authorities; IMF, International Financial Statistics; Bloomberg; and Fund staff estimates and projections.

1/ Consists of the central government budget, social security funds, extrabudgetary funds, and local governments.

2/ Excluding Special Purpose Entities. Including inter-company loans and nonresident holdings of forint-denominated assets.

Table 2. Hungary: Medium-Term Scenario, 2016–26

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
					Est.			*Proj.*			
	Percentage change, unless otherwise indicated										
Real GDP growth	2.1	4.3	5.4	4.6	-4.9	6.2	4.9	3.8	3.2	2.6	2.6
Inflation (CPI; year average basis)	0.4	2.4	2.8	3.4	3.3	4.1	3.6	3.2	3.0	3.0	3.0
Inflation (CPI; end-year basis)	1.8	2.1	2.7	4.0	2.7	4.3	3.6	3.3	3.0	3.0	3.0
Domestic demand	1.6	5.8	7.1	6.0	-2.4	5.2	4.6	2.6	2.1	1.5	1.3
Consumption	3.6	4.3	4.1	4.2	-1.5	5.6	3.7	3.5	3.5	2.6	2.7
Gross fixed capital formation	-10.6	19.7	16.4	12.2	-6.8	8.0	7.5	7.9	5.5	3.5	2.0
Exports of GNFS	3.8	6.5	5.0	5.8	-6.8	9.8	6.8	5.1	5.4	5.5	5.6
Imports of GNFS	3.4	8.5	7.0	7.5	-3.8	8.2	6.5	3.8	4.3	4.6	4.5
Lending to the private sector, flow-based (current prices, eop)	2.0	6.5	10.6	15.3	11.8	10.5	10.3	9.5	9.0	8.5	7.5
	In percent of GDP										
External current account balance	4.5	2.0	0.3	-0.5	0.1	0.5	0.8	1.5	1.1	0.7	0.7
Gross national saving	24.0	24.2	25.1	26.8	27.4	28.1	28.7	30.3	29.9	29.4	28.7
Gross domestic investment	19.5	22.2	24.8	27.2	27.3	27.6	27.9	28.8	28.8	28.6	28.0
Gross external debt 1/	95.5	83.4	78.9	71.6	78.5	69.9	64.1	59.6	55.6	53.0	49.2
Gross official reserves (percent of short-term debt at remaining matur	129.7	136.6	162.1	163.6	156.4	152.6	175.7	215.0	178.6	187.4	196.8
	In percent of GDP										
General government											
Revenue, total	45.0	44.1	43.8	43.6	43.5	42.6	42.5	43.0	43.4	43.7	43.9
Expenditure, total	46.8	46.5	45.9	45.7	51.6	49.8	48.3	46.8	46.3	45.8	45.1
General government overall balance	-1.8	-2.4	-2.1	-2.1	-8.1	-7.1	-5.8	-3.8	-2.9	-2.0	-1.2
Structural general government balance (percent of potential GDP)	-1.5	-2.8	-3.0	-3.4	-7.3	-7.3	-6.1	-4.1	-3.1	-2.3	-1.4
Structural primary balance (percent of potential GDP) 2/	1.4	-0.3	-0.7	-1.1	-5.0	-5.1	-3.9	-2.1	-0.9	0.0	1.5
General government cyclically adjusted primary balance 2/	1.8	0.1	-0.7	-1.1	-5.0	-5.1	-3.9	-2.1	-0.9	0.0	1.5
General government debt	74.9	72.2	69.1	65.5	80.4	78.3	77.1	75.5	73.6	71.6	69.0
Memorandum items:	Percentage change, unless otherwise indicated										
Output gap (percent of potential GDP)	-1.3	0.2	1.9	2.5	-1.9	-0.6	-0.4	-0.3	-0.3	-0.1	0.0
Potential GDP growth	2.3	2.8	3.6	3.9	-0.6	4.8	4.7	3.7	3.2	2.4	2.5

Sources: Hungarian authorities; and Fund staff estimates and projections.

1/ Excluding Special Purpose Entities. Including inter-company loans, and nonresident holdings of forint-denominated assets.

2/ The difference between the cyclically-adjusted and structural balances mostly reflect one-off health spending and time-bound tax holidays to address the covid crisis. Estimates for 2021 are very preliminary and subject to potentially significant revision.

Table 3. Hungary: Consolidated General Government, 2016–26

(In percent of GDP, unless otherwise indicated)

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
					Est.			*Proj.*			
Revenue	45.0	44.1	43.8	43.6	43.5	42.6	42.5	43.0	43.4	43.7	43.9
Tax revenue	25.3	25.1	24.7	24.6	25.0	24.4	24.4	24.8	25.1	25.4	25.7
Taxes on goods and services	18.0	17.9	18.1	17.9	18.2	17.7	17.7	18.0	18.2	18.6	18.9
VAT	9.1	9.2	9.5	9.5	9.9	9.5	9.5	9.7	9.9	10.1	10.3
Excises and other	8.9	8.6	8.5	8.4	8.4	8.2	8.2	8.3	8.4	8.5	8.6
Taxes on income, profits and capital gains	7.2	7.1	6.6	6.6	6.8	6.6	6.7	6.8	6.8	6.8	6.8
Personal income tax	5.1	5.3	5.4	5.4	5.6	5.5	5.6	5.6	5.6	5.6	5.6
Corporate taxes	2.1	1.8	1.2	1.2	1.2	1.1	1.2	1.2	1.2	1.2	1.2
Other	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Social contributions	13.8	12.8	12.1	11.8	11.3	10.8	10.7	10.7	10.7	10.7	10.7
Current non-tax revenue	4.2	4.1	4.1	4.1	3.9	3.9	3.9	3.9	3.9	3.9	3.9
Current grants	1.3	1.1	1.5	1.4	1.4	1.2	1.2	1.2	1.3	1.3	1.3
Capital revenues and grants	0.6	0.9	1.3	1.8	1.9	2.4	2.3	2.4	2.5	2.5	2.3
Expenditure	46.8	46.5	45.9	45.7	51.6	49.8	48.3	46.8	46.3	45.8	45.1
Compensation of employees 1/	10.8	10.7	10.4	10.2	10.6	10.0	9.6	9.4	9.3	9.2	9.1
Goods and services	7.5	7.9	7.9	8.2	8.3	7.7	7.7	7.7	7.8	7.8	7.7
Interest	3.1	2.7	2.3	2.2	2.4	2.2	2.1	1.9	2.0	2.1	2.6
Subsidies	2.0	1.9	1.5	1.4	1.7	1.7	1.7	1.7	1.7	1.7	1.7
Current transfers to households	14.3	13.6	12.8	12.2	12.8	12.3	11.7	11.2	10.9	10.6	10.4
Social security	11.6	11.1	10.5	10.1	10.5	9.6	9.1	8.7	8.4	8.2	7.9
Other	2.8	2.5	2.3	2.1	2.2	2.7	2.6	2.5	2.5	2.5	2.5
Other current transfers	3.5	3.0	3.3	3.2	3.8	3.8	3.6	3.5	3.4	3.3	3.2
Capital expenditures	3.0	4.4	6.0	6.4	7.4	7.0	7.1	7.0	7.1	7.0	6.9
Capital transfers	3.5	3.0	3.3	1.9	4.6	5.1	4.8	4.5	4.2	4.0	3.5
General government balance	-1.8	-2.4	-2.1	-2.1	-8.1	-7.1	-5.8	-3.8	-2.9	-2.0	-1.2
Primary balance	1.2	0.2	0.2	0.1	-5.8	-5.1	-3.8	-2.0	-1.0	0.0	1.3
Memorandum items:											
Structural balance (% of potential GDP)	-1.6	-2.8	-2.9	-3.2	-7.2	-6.9	-5.6	-3.7	-2.8	-2.0	-1.2
Structural primary balance (% of potential GDP)	1.4	-0.3	-0.7	-1.1	-5.0	-5.1	-3.9	-2.1	-0.9	0.0	1.5
Gross public debt (Maastricht definition)	74.9	72.2	69.1	65.5	80.4	78.3	77.1	75.5	73.6	71.6	69.0
GDP (billions of Forints)	36,167	39,233	43,347	47,514	47,743	52,630	57,418	61,805	66,015	69,898	73,939

Sources: Hungarian authorities; and Fund staff estimates.

1/ Includes social security contributions.

Table 4. Hungary: Central Bank Survey, 2016–22
(In billions of forints, unless otherwise indicated)

	2016	2017	2018	2019	2020	2021	2022
						Proj.	
Net foreign assets	7,376	7,112	8,690	9,168	9,813	11,047	11,424
Foreign Assets	8,213	7,841	9,442	10,040	12,988	12,656	13,033
Foreign Liabilities	837	730	752	872	3,175	1,609	1,609
Net domestic assets	-1,943	-812	-1,434	-991	-533	-625	-30
Net claims on government	-1,101	-655	-1,357	-907	-1,631	-908	-677
Assets	39	39	39	39	1,114	2,276	2,088
Liabilities (Govt Deposits at MNB)	1,140	694	1,397	946	2,745	3,184	2,765
HUF	786	385	1,164	603	1,733	...	...
FX	354	309	233	343	1,012	...	...
Net claims on banks 1/	-156	384	1,038	1,006	1,900	1,353	1,769
Assets	1,546	1,240	1,383	1,749	5,144	5,817	5,834
Liabilities	1,702	856	345	742	3,244	4,464	4,065
Deposits & CDs excl. current & overnight deposits	1,702	856	345	742	3,244	4,464	4,065
Securities Issued by MNB 2/	0	0	0	0	0	0	0
Net claims on the economy 3/	11	11	13	197	547	613	460
Other items, net	-696	-552	-1,128	-1,287	-1,350	-1,683	-1,583
Base money (M0)	5,433	6,300	7,256	8,177	9,280	10,422	11,393
Currency in Circulation	4,655	5,177	6,078	6,641	7,332	8,235	9,002
Banks' Reserves	778	1,123	1,178	1,536	1,948	2,187	2,391
Current Account Balances	180	212	259	258	339	381	416
Overnight Deposits	598	912	919	1,278	1,608	1,807	1,975
Memorandum items:							
International Reserves (billions of Euros)	24.4	23.4	27.4	28.4	33.7	35.9	36.7
Base Money (yoy percent change)	13.6	16.0	15.2	12.7	13.5	12.3	9.3
NFA (contribution to change)	-40.1	-4.9	25.1	6.6	7.9	13.3	3.6
NDA (contribution to change)	53.7	20.8	-9.9	6.1	5.6	-1.0	5.7
Government Deposits at Central Bank (percent of GDP)	3.2	1.8	3.2	2.0	5.7	6.0	4.8
HUF	2.2	1.0	2.7	1.3	3.6	...	...
FX	1.0	0.8	0.5	0.7	2.1	...	...
Reserve Requirement Ratio (percent of select liabilities)	1.0	1.0	1.0	1.0	1.0	1.0	1.0

Sources: Hungarian National Bank (MNB); and Fund staff estimates and projections.

1/ Excluding swaps. Evaluation effects of swaps with other credit institutions are captured in other items net.

2/ Data are from MNB's monetary statistics Table 2.a.1 on bank assets.

3/ Does not include holdings of shares and equity stakes issued by other residents, which are captured in other items net. The Pallas Athene Foundations are independent and not part of the MNB's balance sheet.

Table 5. Hungary: Monetary Survey, 2016–22
(In billions of forints, unless otherwise indicated)

	2016	2017	2018	2019	2020	2021	2022
						Proj.	
Net foreign assets	8,443	8,051	10,381	10,646	12,339	13,586	13,994
Central Bank	7,376	7,112	8,690	9,168	9,813	11,047	11,424
Commercial Banks	1,067	940	1,692	1,478	2,526	2,539	2,570
Net domestic assets	12,821	14,876	15,255	17,078	21,169	24,170	27,611
Domestic credit	19,469	21,376	22,250	24,699	28,981	33,137	36,600
Net claims on government	6,334	7,895	7,308	7,525	8,894	10,933	12,325
From Central Bank	-1,101	-655	-1,357	-907	-1,631	-908	-677
From Commercial Banks	7,435	8,549	8,665	8,432	10,525	11,841	13,002
Gross Credit to the economy	13,134	13,482	14,942	17,174	20,087	22,204	24,275
From Commercial Banks	13,124	13,471	14,929	16,977	19,539	21,591	23,815
Other items, net	-6,648	-6,500	-6,995	-7,621	-7,812	-8,967	-8,989
Broad money (M3)	21,264	22,928	25,637	27,724	33,508	37,756	41,605
M2	20,389	22,405	25,212	27,610	33,441	37,681	41,522
M1	16,306	19,360	21,971	24,531	30,209	34,039	37,509
Currency in circulation	4,368	4,878	5,708	6,188	6,969	7,852	8,653
Overnight Deposits	11,939	14,482	16,263	18,343	23,240	26,187	28,856
Deposits with Maturities up to 2 years	4,083	3,045	3,241	3,079	3,232	3,642	4,013
Repos	31	0	9	9	0	0	0
Money Market Fund Shares/Units	781	488	371	68	42	47	52
Debt Securities	63	35	44	38	25	28	31
Memorandum items:							
	(Percentage change by contribution, y-o-y)						
Broad Money	7.1	7.8	11.8	8.1	20.9	12.7	10.2
NFA	3.4	-1.8	10.2	1.0	6.1	3.7	1.1
NDA	3.6	9.7	1.7	7.1	14.8	9.0	9.1
	(Percentage change, y-o-y)						
Credit to Private Sector 1/ 2/	2.0	6.5	10.6	15.3	11.8	10.5	10.3
HUF	3.4	4.4	11.7	17.4		...	...
FX	-2.3	14.1	7.6	16.2		...	...
Bank Deposits	9.9	8.4	11.2	9.6	22.3	12.7	10.1
Bank Holdings of Government Paper (percent	20.9	21.6	19.4	17.1	21.3	21.8	22.0

Sources: Hungarian National Bank (MNB); and Fund staff estimates and projections.
1/ Only credit to households and firms.
2/ Based on transaction data, i.e., adjusted for exchange rate changes.

Table 6. Hungary: Balance of Payments, 2016–26

(In billions of euros, unless otherwise specified)

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
					Est.			*Proj.*			
Current Account	**5.2**	**2.5**	**0.4**	**-0.7**	**0.1**	**0.7**	**1.3**	**2.6**	**2.0**	**1.4**	**1.4**
Goods and service (GS), net	10.1	8.7	6.0	4.1	3.1	3.9	6.0	8.2	7.6	7.2	7.4
Exports	100.5	109.1	114.0	120.2	108.3	119.0	127.0	134.2	141.1	148.9	157.3
Imports	-90.4	-100.4	-108.0	-116.0	-105.2	-115.0	-121.1	-126.0	-133.4	-141.7	-150.0
Primary Income, net	-3.1	-5.0	-5.0	-3.9	-2.3	-2.5	-3.4	-3.9	-3.8	-3.9	-4.0
Secondary Income/Current transfers, net	-1.7	-1.1	-0.5	-0.9	-0.7	-0.7	-1.3	-1.7	-1.9	-1.9	-1.9
Capital Account	0.0	1.1	3.1	2.7	2.7	4.2	4.9	4.9	5.2	5.3	5.3
Financial Account 1/	9.6	1.8	-2.5	-0.2	-5.7	2.8	5.3	7.0	6.7	5.9	5.7
Direct investment, net	-2.6	-2.0	-2.9	-0.9	0.0	-1.1	-1.6	-1.6	-1.2	-2.0	-1.3
Net acquisition of assets	-8.4	5.0	3.7	1.4	0.7	1.1	2.4	2.6	3.1	3.1	5.1
Net incurrence of liabilities	-5.9	7.0	6.6	2.3	0.7	2.3	4.1	4.2	4.3	5.1	6.4
Portfolio investment, net 2/	4.9	2.7	-1.1	1.6	-2.8	2.7	5.8	7.5	6.8	6.6	5.3
Other investment	5.8	1.2	1.5	-0.8	-2.9	1.2	1.1	1.1	1.1	1.2	1.7
Net errors and omissions	-1.6	-1.7	-2.4	-1.9	-2.6	0.0	0.0	0.0	0.0	0.0	0.0
Overall Balance	**-6.1**	**0.0**	**3.6**	**0.3**	**5.9**	**2.2**	**0.9**	**0.4**	**0.5**	**0.9**	**1.0**
Financing	**4.6**	**0.0**	**-3.6**	**-0.3**	**-5.9**	**-2.2**	**-0.9**	**-0.4**	**-0.5**	**-0.9**	**-1.0**
Gross Reserves ("-": increase)	6.1	0.0	-3.6	-0.3	-5.9	-2.2	-0.9	-0.4	-0.5	-0.9	-1.0
Other Official Financing (EU) (net)	-1.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum Items:											
Current account (percent of GDP)	4.5	2.0	0.3	-0.5	0.1	0.5	0.8	1.5	1.1	0.7	0.7
Exports volume (percentage change)	3.8	6.5	5.0	5.8	-6.8	9.8	6.8	5.1	5.4	5.5	5.6
Imports volume (percentage change)	3.4	8.5	7.0	7.5	-3.8	8.2	6.5	3.8	4.3	4.6	4.5
Gross external debt (percent of GDP) 3/	95.5	83.4	78.9	71.6	78.5	69.9	64.1	59.6	55.6	53.0	49.2
Net International Investment Position	-59.2	-54.5	-51.0	-49.3	-45.8	-38.4	-37.2	-37.4	-36.8	-35.2	-32.2
Gross official reserves	24.4	23.4	27.4	28.4	33.7	35.9	36.7	37.2	37.7	38.6	39.5
In percent of s-t debt at remaining maturity 4/	129.7	136.6	162.1	163.6	156.4	152.6	175.7	215.0	178.6	187.4	196.8
In months of next year's imports of G&S	2.9	2.6	2.8	3.2	3.5	3.6	3.5	3.3	3.4	3.3	3.2
In percent of IMF metric	97.6	92.4	107.0	105.9	121.1	122.1	125.1	128.7	123.0	123.7	124.8

Sources: Hungarian authorities; and Fund staff estimates.
1/ A negative sign for financial accounts items indicates a net inflow from non-resident investors.
2/ Includes financial derivatives.
3/ Excludes Special Purpose Entities.
4/ Excludes Special Purpose Entities and direct investment (inter-company) debt liabilities.

Table 7. Hungary: Financial Soundness Indicators for the Banking Sector, 2016–20

	2016	2017	2018	2019	2020
Capital					
Regulatory capital to risk-weighted assets	18.0	18.1	18.5	18.0	18.3
Regulatory Tier 1 capital to risk-weighted assets	15.9	16.2	16.7	15.9	16.2
Asset Quality					
NPLs (90 days overdue) net of provisions to capital	9.4	5.0	3.2	2.2	1.4
NPLs (90 days overdue) to gross loans	7.4	4.2	2.5	1.5	0.9
New NPL definition 1/	10.7	7.5	5.4	4.1	3.6
Distribution of Loans (Percent of Total)					
Firms	35.9	37.9	39.3	36.7	35.7
Households and Non-Profits	37.9	37.0	35.2	35.2	34.8
Non-Residents	9.7	7.7	8.2	9.0	8.7
Other	16.5	17.4	17.3	19.1	20.8
FX loans	22.0	23.4	23.4	23.4	21.7
Profitability					
ROA	1.6	1.9	1.9	2.0	1.0
ROE	16.7	19.7	19.4	19.5	9.8
Net interest income to gross income	46.9	46.0	47.7	46.8	52.1
Noninterest expenses to gross income	71.9	72.8	70.1	68.1	64.7
Liquidity					
Liquid assets to total assets	36.0	30.5	27.0	24.9	23.1
Liquid assets to short term liabilities	59.7	46.9	41.6	39.7	36.8
Sensitivity to Market risk					
Net open FX position to Regulatory capital	16.4	-1.3	-1.0	-0.8	-1.5

Sources: Magyar Nemzeti Bank (MNB); and IMF's *Financial Soundness Indicators*

1/ New definition to better reflect the EBA methodology and the introduction of IFRS 9.

Annex I. Debt Sustainability Analysis

With a sharp contraction of GDP and a large fiscal response, the pandemic led a steep increase in public debt-to-GDP ratio, which grew by 15 percentage points in 2020. Yet, debt remains sustainable owing to the planned reduction in deficit, recovering growth, and favorable financing conditions; it is projected to return on a downward path under the baseline and all but an unlikely stress scenario. A strong fiscal framework, anchored in the EU Stability and Growth pact and Hungary's own fundamental law, provides additional reassurance of sustainability.

1. Public debt increased significantly in 2020 because of the pandemic. The unprecedented size of the primary deficit (-5.8 percent of GDP) as well as the contraction in economic activity (-4.9 percent) resulted in public debt increasing by 15 percentage points of GDP in 2020. It reached 80.4 percent of GDP, equaling the historic highs in 2010 and 2011 (80 percent of GDP). The share of external financing in total debt increased by about 5 percentage points but remained just below the authorities' threshold of 20 percent. The share of short-term financing remained broadly unchanged compared to 2019. The average term to maturity of public debt increased, mainly on account of foreign bonds issued with maturities ranging between 6 to 30 years.

2. Going forward, the baseline scenario assumes a gradual reduction in the headline primary fiscal deficit starting 2021. It is underpinned by the following assumptions:

- *Real GDP growth* is projected to rebound to 6.2 and 4.9 percent in 2021 and 2022, respectively, and afterwards to gradually converge to pre-pandemic levels of about 3 percent. The medium-term growth projection reflects the expected disbursement of grants from the 2021–2027 long-term EU budget and Next Generation initiative, as well as pre-pandemic potential trend growth.

- *GDP deflator* is projected to reach 4 percent in 2022 and then gradually converge towards the central bank's inflation target of 3 percent over the medium term.

- *The primary fiscal position* is projected to gradually improve from the unprecedented deficit of 5.8 percent in 2020 to 1.3 percent of GDP by 2026. The primary balance is projected to gradually improve as revenue increases and crisis-related expenditure unwind with the projected economic recovery, the EU grants support the budget, and financing conditions remain favorable.

3. Baseline projections are underpinned by realistic assumptions but surrounded by high uncertainty. Previous forecasts of growth, primary balance and inflation tended to be slightly conservative. Compared to other countries, projection errors seem reasonable, as reflected in the interquartile range. However, the short-term evolution of the pandemic (and thus of containment measures), as well as the medium-term impact of the crisis on the economy (scarring) and debt sustainability, remain highly uncertain.

4. Debt projections are also informed by the authorities' short and medium-term debt management strategy. To reduce refinancing risk, the authorities seek to increase the average term to maturity of domestic debt above 4.5 years. This is to be partially achieved by broadening the domestic investor base, relying more on retail financing. The authorities also plan to limit the share of the foreign currency denominated debt within a 10–20 percent interval and keep the share of fixed rate financing instruments—both domestic and foreign-currency denominated—between 70 and 90 percent. To mitigate risks from cross-currency exchange rate movements, foreign currency obligations—after swaps—should be 100 percent in euros.

5. Public debt is projected to return on a downward trend under the baseline in all but one stress scenarios. The public debt-to-GDP ratio is forecast to decline from 80.4 percent in 2020 to 69 percent by 2026. Under the baseline scenario, in cumulative term, the primary balance will contribute positively by about 11 percentage points to the debt path between 2021 and 2026. In contrast, the cumulative contribution of the interest rate-growth differential is projected to contribute by -19 percentage points over the same period, reflecting growth being substantially above the effective interest rate on public debt. Gross financing needs are forecast to drop from 25 percent of GDP in 2021 to 13 percent over the projection horizon.[1] Despite the favorable projection of the interest rate-growth differential and declining primary deficits, the gross financing needs continue to remain elevated and are largely affected by the average maturity of public debt (about 4.5 years) and the size of maturities falling due on existing debt. Therefore, the more pronounced positive impact of lower deficits and declining stock of public debt on the development of gross financing needs would be visible only after 2026.

6. The projections of public debt and gross financing needs are particularly sensitive to growth, combined macro-fiscal, and contingent liabilities shocks.

- *Growth shock.* Slower growth remains a substantive risk to debt sustainability. A decline in growth by one standard deviation would increase debt to reach 80 percent of GDP, i.e., about 11 percent of GDP above the baseline in 2026, but still on a downward path. Under the same assumption, gross financing needs would reach about 15 percent of GDP, i.e., about 2 percent of GDP above the baseline by the end of the projection period.

- *Macro-fiscal shock.* If shocks to growth, interest rate, and primary balance occurred simultaneously, the debt-to-GDP ratio would reach 90 percent at the end of the projection horizon, but would stabilize, and financing needs would reach at 19 percent of GDP.

- *Contingent liabilities shock.* A standardized shock of 10 percent of financial sector assets is used to represent a hypothetical realization of contingent liabilities. In such a scenario, the debt-to-GDP ratio would reach 85 percent at the end of the projection horizon and financing needs would reach at 19 percent of GDP.

[1] The government debt management agency (AKK) estimates the size of gross financing needs at 27.3 percent of GDP at the end of 2020. Excluding the value of buybacks and switches, AKK estimates the gross financing needs at 24.9 percent of GDP.

- *Only under an unrealistic scenario would debt not return to a downward path.* Assuming that the unprecedented fiscal support of 2020 (primary deficit of 5.8 percent of GDP) would continue for the rest of the projection horizon would place public debt on an unsustainable path. Under such a scenario, in five years, public debt would reach 88 percent of GDP and gross financing needs would be at 21 percent of GDP. As revenue is projected to rebound and supportive measures unwind automatically with the projected recovery, primary balances will gradually improve back to precrisis levels, thus this scenario is very unlikely to materialize.

7. **The fan charts show moderate uncertainty around the baseline**. The width of the symmetric fan chart, estimated at around 20 percent of GDP, illustrates the degree of uncertainty for equal-probability upside and downside shocks. Assuming less favorable economic conditions than under the baseline scenario—upside shocks to growth and primary balance are constrained to zero—the central projection of the public debt dynamics would return debt level just below 70 percent of GDP.

8. **Hungary's debt profile has improved but still indicates some risks.** The external financing needs are at the upper risk-assessment benchmark. Public debt in foreign currency and public debt held by non-residents have declined considerably in recent years and are both within or below the risk-assessment benchmark. In line with current favorable financing conditions and large investor base, spreads are within the risk assessment benchmarks. The share of short-term debt is projected to decline.

9. **Risks to debt sustainability are, however, mitigated by a number of factors.**

- *Fiscal framework*. Hungary's fiscal policy is bound by the European Stability and Growth Pact (SGP). In addition to commitments under the SGP, the authorities adopted strict fiscal and debt rules in 2008 and amended them in 2013. As a result, under the current fiscal framework, the general government deficit must not exceed 3 percent of GDP (with SGP escape clauses), and parliament may only adopt budget laws that result in the reduction of the government debt-to-GDP ratio, until this ratio falls to below 50 percent of GDP. The rule on debt reduction can be suspended when real GDP contracts. With GDP growth projected to remain positive in the next five years as the economy recovers from the COVID crisis, debt is bound by law to be put back on a downward path.

- *Investor base*. Although the government reentered external bond markets for the first time since 2018, issuing €6 billion, debt continues to be held predominantly by domestic financial institutions and households. This factor—coupled with ample liquidity in the system—has incentivized banks to purchase sovereign debt.

- Buffers. A part (€2 billion) of the external bond emission (€6 billion) was used to pre-finance the 2021 budget. This cash cushion implies a lower public debt-to-GDP ratio on a net basis and is expected to help cover financing needs in 2021.

Figure 1. Hungary: Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario

(In percent of GDP unless otherwise indicated)

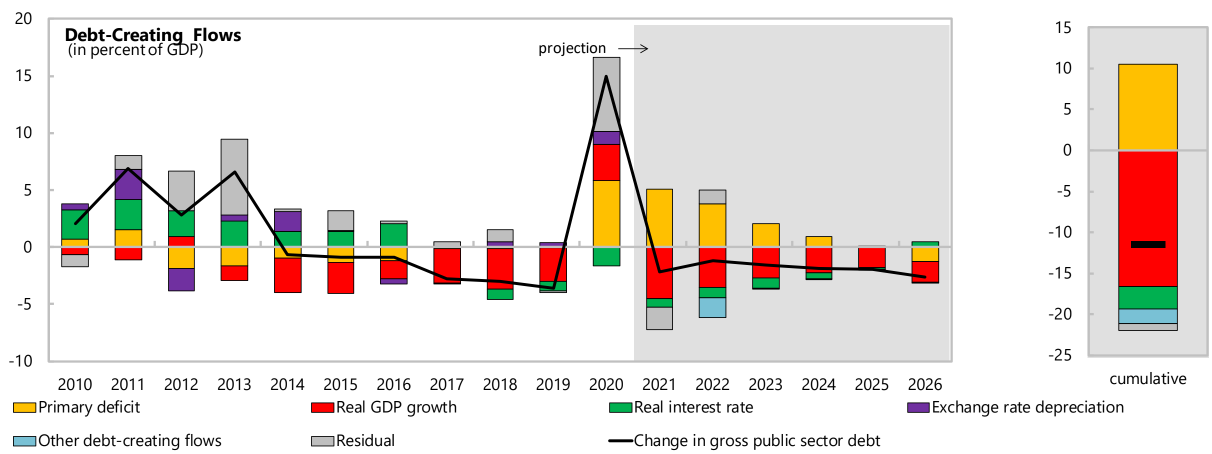
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2010-2018 [2/]	2019	2020	2021	2022	2023	2024	2025	2026
Nominal gross public debt	71.8	65.5	80.4	78.3	77.1	75.5	73.6	71.6	69.0
Public gross financing needs	19.6	23.6	24.9	20.5	18.3	15.5	15.8	14.3	13.3
Real GDP growth (in percent)	2.6	4.6	-4.9	6.2	4.9	3.8	3.2	2.6	2.6
Inflation (GDP deflator, in percent)	3.0	4.8	5.7	3.8	4.0	3.7	3.5	3.2	3.1
Nominal GDP growth (in percent)	5.7	9.6	0.5	10.2	9.1	7.6	6.8	5.9	5.8
Effective interest rate (in percent) [4/]	5.5	3.5	3.6	3.0	2.9	2.6	2.9	3.1	3.9

As of May 18, 2021		
Sovereign Spreads		
EMBIG (bp) 3/		95
5Y CDS (bp)		57.8
Ratings	Foreign	Local
Moody's	Baa3	Baa3
S&Ps	BBB	BBB
Fitch	BBB	BBB

Contribution to Changes in Public Debt

	Actual			Projections							
	2010-2018	2019	2020	2021	2022	2023	2024	2025	2026	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	1.1	-3.6	14.9	-2.2	-1.2	-1.6	-1.9	-2.0	-2.6	-11.5	
Identified debt-creating flows	-0.4	-3.5	8.5	-0.2	-2.4	-1.6	-1.8	-1.9	-2.6	-10.6	
Primary deficit	-0.6	-0.1	5.8	5.1	3.8	2.0	1.0	0.0	-1.3	10.5	-1.3
Primary (noninterest) revenue and grants	45.5	43.6	43.4	42.5	42.4	42.9	43.3	43.6	43.8	258.7	
Primary (noninterest) expenditure	44.9	43.5	49.3	47.6	46.2	45.0	44.3	43.6	42.5	269.2	
Automatic debt dynamics [5/]	0.1	-3.4	2.6	-5.3	-4.4	-3.6	-2.8	-1.9	-1.3	-19.4	
Interest rate/growth differential [6/]	-0.3	-3.7	1.5	-5.3	-4.4	-3.6	-2.8	-1.9	-1.3	-19.4	
Of which: real interest rate	1.5	-0.9	-1.7	-0.8	-0.9	-0.9	-0.5	-0.1	0.5	-2.8	
Of which: real GDP growth	-1.8	-2.9	3.2	-4.5	-3.5	-2.7	-2.3	-1.8	-1.8	-16.6	
Exchange rate depreciation [7/]	0.4	0.4	1.1	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	-1.7	0.0	0.0	0.0	0.0	-1.7	
Prefinancing (negative)	0.0	0.0	0.0	0.0	-1.7	0.0	0.0	0.0	0.0	-1.7	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	1.6	-0.2	6.5	-2.0	1.2	0.0	0.0	0.0	0.0	-0.9	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ EMBIG.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi(1+g)$ and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

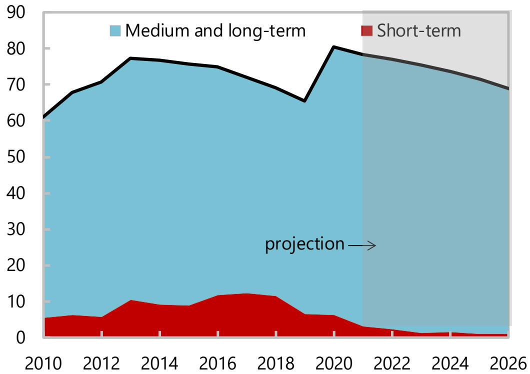
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

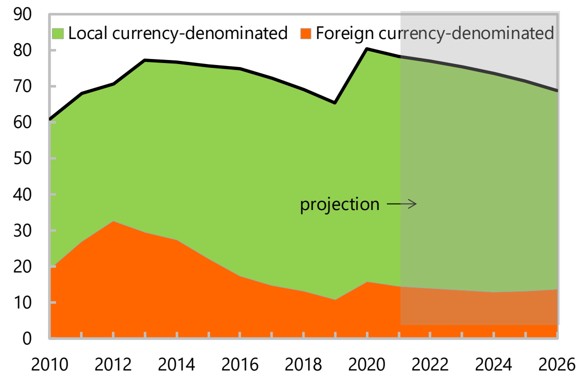
Figure 2. Hungary: Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



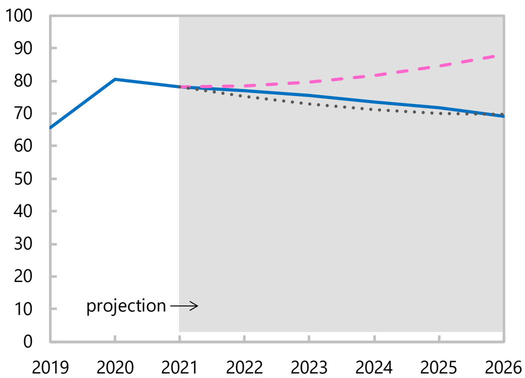
By Currency
(in percent of GDP)



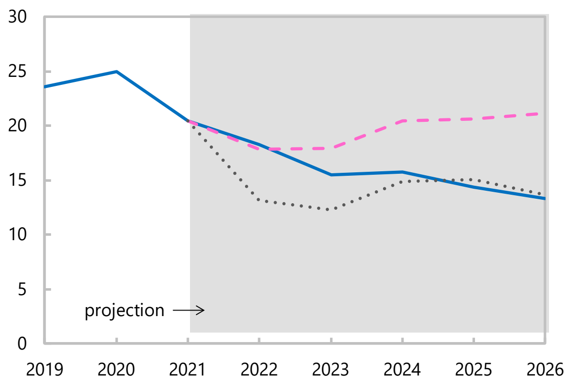
Alternative Scenarios

Baseline Historical Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



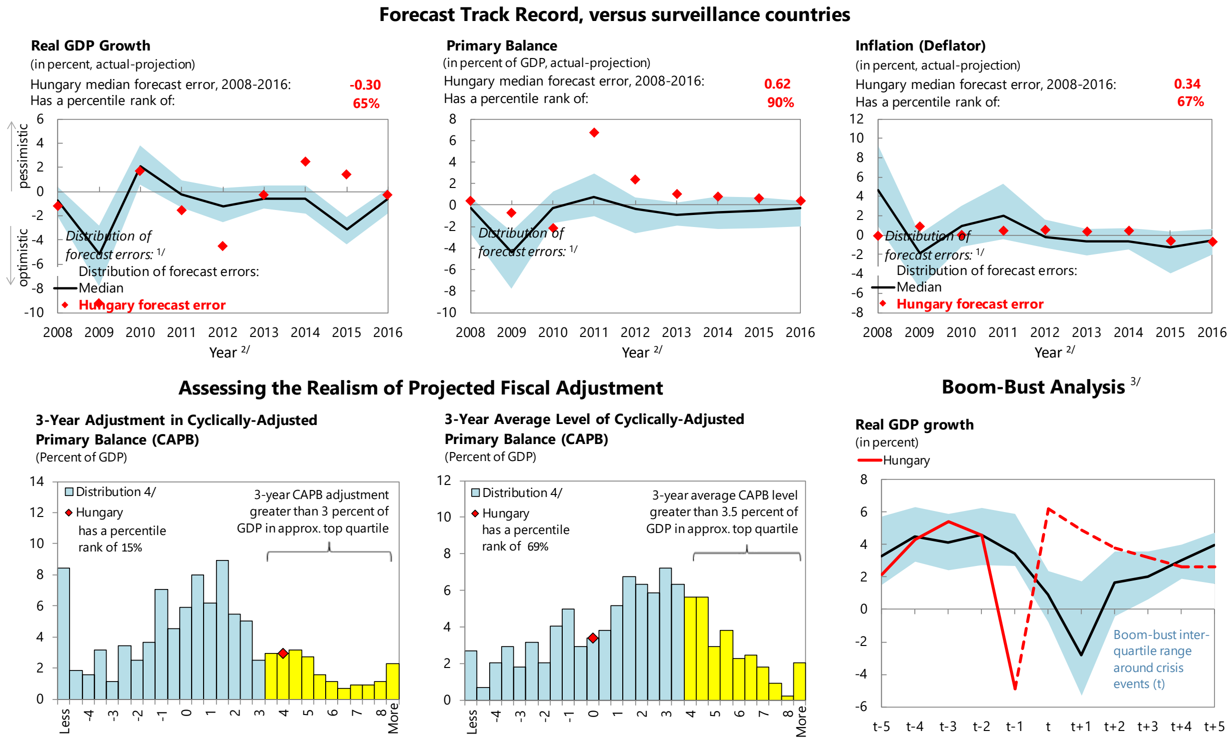
Underlying Assumptions
(in percent)

Baseline Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	6.2	4.9	3.8	3.2	2.6	2.6
Inflation	3.8	4.0	3.7	3.5	3.2	3.1
Primary Balance	-5.1	-3.8	-2.0	-1.0	0.0	1.3
Effective interest rate	3.0	2.9	2.6	2.9	3.1	3.9
Constant Primary Balance Scenario						
Real GDP growth	6.2	4.9	3.8	3.2	2.6	2.6
Inflation	3.8	4.0	3.7	3.5	3.2	3.1
Primary Balance	-5.1	-5.1	-5.1	-5.1	-5.1	-5.1
Effective interest rate	3.0	2.9	2.6	2.8	3.0	3.8

Historical Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	6.2	2.2	2.2	2.2	2.2	2.2
Inflation	3.8	4.0	3.7	3.5	3.2	3.1
Primary Balance	-5.1	0.0	0.0	0.0	0.0	0.0
Effective interest rate	3.0	2.9	2.8	3.3	3.8	4.9

Source: IMF staff.

Figure 3. Hungary: Public DSA – Realism of Baseline Assumptions



Source : IMF Staff.

1/ Plotted distribution includes surveillance countries, percentile rank refers to all countries.

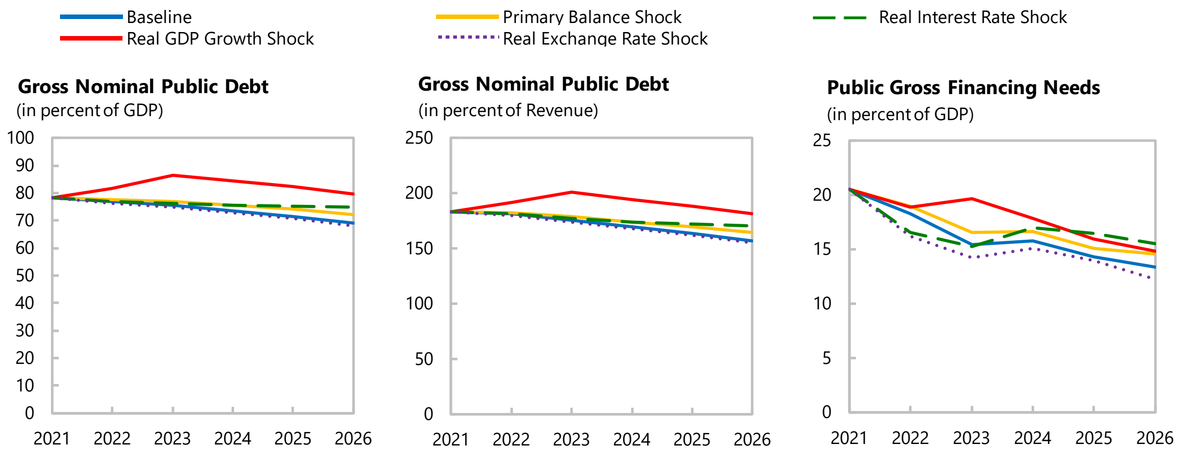
2/ Projections made in the spring WEO vintage of the preceding year.

3/ Hungary has had a positive output gap for 3 consecutive years, 2018-2020 and a cumulative increase in private sector credit of 80 percent of GDP, 2017-2020. For Hungary, t corresponds to 2021; for the distribution, t cc

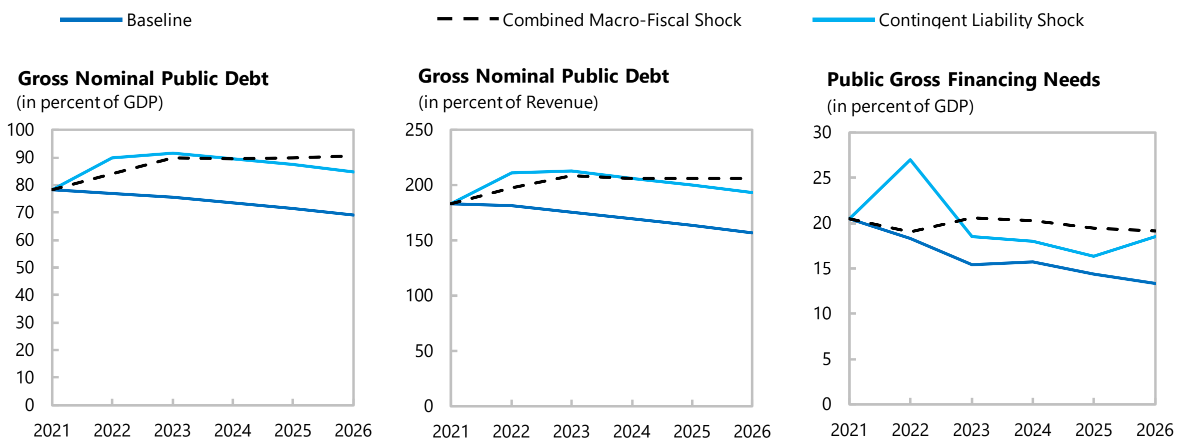
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Figure 4. Hungary: Public DSA – Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

	2021	2022	2023	2024	2025	2026
Primary Balance Shock						
Real GDP growth	6.2	4.9	3.8	3.2	2.6	2.6
Inflation	3.8	4.0	3.7	3.5	3.2	3.1
Primary balance	-5.1	-4.4	-2.9	-1.5	-0.5	0.6
Effective interest rate	3.0	2.9	2.6	3.0	3.2	3.9
Real Interest Rate Shock						
Real GDP growth	6.2	4.9	3.8	3.2	2.6	2.6
Inflation	3.8	4.0	3.7	3.5	3.2	3.1
Primary balance	-5.1	-3.8	-2.0	-1.0	0.0	1.3
Effective interest rate	3.0	2.9	3.5	4.6	5.7	7.1
Combined Shock						
Real GDP growth	6.2	1.7	0.6	3.2	2.6	2.6
Inflation	3.8	3.2	2.9	3.5	3.2	3.1
Primary balance	-5.1	-5.6	-5.6	-1.5	-0.5	0.6
Effective interest rate	3.0	3.0	3.6	4.7	5.8	7.1

	2021	2022	2023	2024	2025	2026
Real GDP Growth Shock						
Real GDP growth	6.2	1.7	0.6	3.2	2.6	2.6
Inflation	3.8	3.2	2.9	3.5	3.2	3.1
Primary balance	-5.1	-5.6	-5.6	-1.0	0.0	1.3
Effective interest rate	3.0	2.9	2.6	3.1	3.2	4.0
Real Exchange Rate Shock						
Real GDP growth	6.2	4.9	3.8	3.2	2.6	2.6
Inflation	3.8	8.4	3.7	3.5	3.2	3.1
Primary balance	-5.1	-3.8	-2.0	-1.0	0.0	1.3
Effective interest rate	3.0	3.0	2.5	2.7	2.9	3.7
Contingent Liability Shock						
Real GDP growth	6.2	1.7	0.6	3.2	2.6	2.6
Inflation	3.8	3.2	2.9	3.5	3.2	3.1
Primary balance	-5.1	-13.6	-2.0	-1.0	0.0	1.3
Effective interest rate	3.0	3.1	3.2	3.4	3.6	4.1

Source: IMF staff.

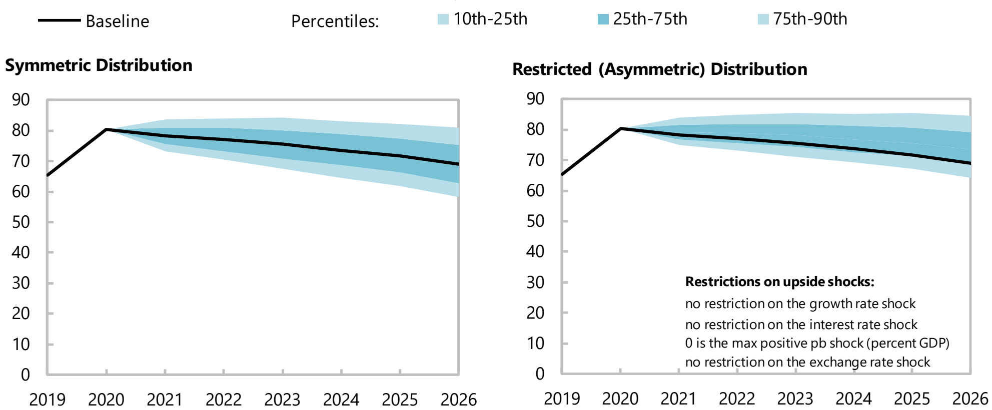
Figure 5. Hungary: Public DSA Risk Assessment

Heat Map

Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile 3/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

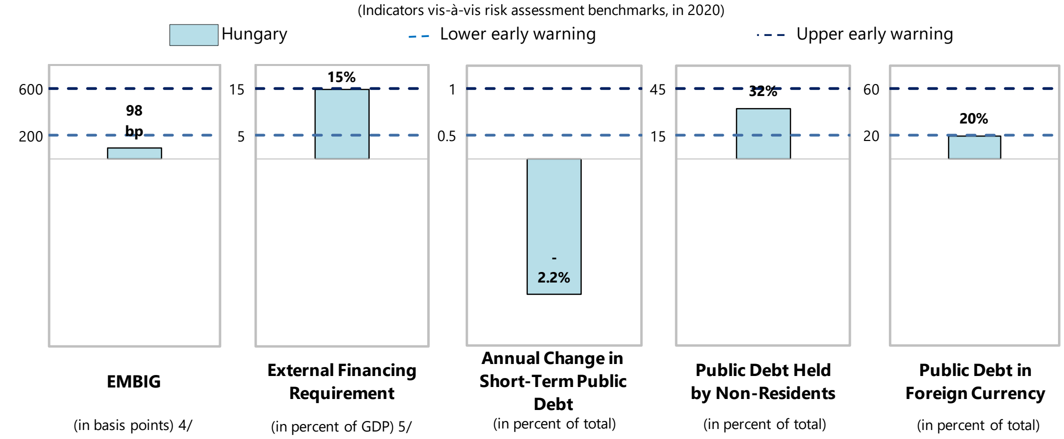
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2020)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ EMBIG, an average over the last 3 months, 3/18/2021 - 5/18/2021.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

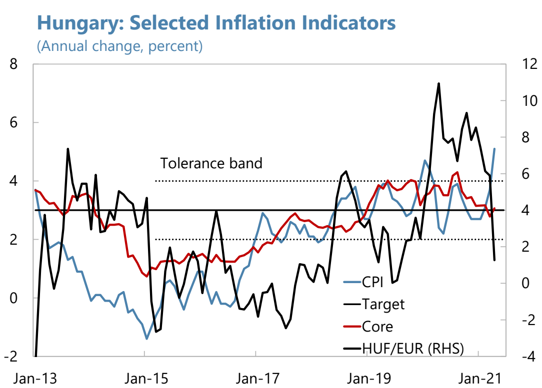
Annex II. Monetary Policy Measures

When the pandemic began, the MNB promptly revamped its monetary operations, helping mitigate pressures and stabilize markets.

1. **While the official policy rate initially stayed unchanged, the overhaul of conventional tools resulted in higher money market rates while ensuring ample liquidity.** Before the pandemic, the MNB mainly used FX liquidity swaps to manage the overall liquidity to keep the short money-market rates close to the interest corridor floor (Figure 1). The base rate—the official policy rate—equaled the overnight overdraft rate. As the pandemic hit, the MNB provided additional liquidity by increasing its FX liquidity swaps. However, the exchange rate came under pressure. The MNB introduced regular tenders of collateralized long-term loans with 3-month to 5-year maturities, at the policy rate. It also broadened eligible collateral (by almost 5.5 percent of GDP) to include performing corporate bank loans, with a haircut of 30 percent, irrespective of maturity and currency. To absorb excess liquidity, it introduced regular auctions of 1-week deposits at the policy rate. Moreover, it increased its overnight overdraft rate, so the interest corridor became symmetrical around the base rate. It was thus possible to increase the money market rates and contain exchange rate volatility, without initially changing the policy rate, while ensuring adequate liquidity in the banking system.

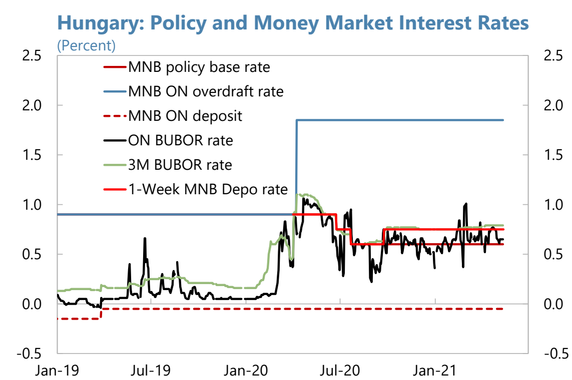
Figure 1. Hungary: Inflation and Selected Monetary Policy Interest Rates

Headline Inflation has subsided, but core inflation has remained persistent, following COVID-19.



Source: Hungarian Central Statistical Office and Magyar Nemzeti Bank (MNB).

The change of instruments resulted in higher money market rates. The policy rate was later lowered.



Sources: Magyar Nemzeti Bank (MNB); Haver Analytics, and IMF staff calculations.

2. **Existing unconventional monetary tools were adjusted, as the pandemic unfolded.** Early on, the MNB used a range of unconventional instruments to primarily address market dysfunction and support fledgling capital markets. The MNB clearly communicated the purpose, scope, and size of these enhanced programs.

- The *Funding for Growth Scheme*—initiated in 2013—aims to support bank lending to micro-, small- and medium-sized enterprises (SMEs). The MNB provides inexpensive liquidity to banks to on-lend under specified conditions, while these banks can make preferential deposits with the MNB at a premium. With the pandemic, the envelope was increased, the maximum maturity of the loans doubled to 20 years, and the maximum loan amount available per borrower increased significantly (to about €55 million). By late 2020, over half of new bank loans to SMEs were funded via this scheme.

- The MNB's *Mortgage Bond Purchase Program*, created in 2018 to support the market for covered mortgage bonds, was reactivated after the pandemic. In November 2020, the MNB paused the program until it would be ready to purchase green-mortgage bonds. From May to November 2020, purchases amounted to about 0.6 percent of GDP.

- The *Bond Funding for Growth Scheme,* aiming to support corporate bond market development, was launched in mid-2019. With the pandemic, its conditions (issuer credit rating, maturity, and amount per business group) were eased. Its size was increased to about 1.6 percent of GDP. Its liquidity impact is directly sterilized through a preferential deposit facility at the MNB. From May 2020 to April 2021, MNB's purchases under this program amounted to about 0.9 percent of GDP, of which almost 0.7 percent of GDP in the primary market.

- In April 2020, the MNB announced a new *Asset Purchase Program (APP) of government securities* (Figure 2). It aims to mitigate market dysfunction and lower long-term interest rates. Purchases were conducted only in the secondary market, per the statute of the European System of Central Banks, and in longer maturities. To ensure the bonds' liquidity, purchases were initially limited to 33 percent per issued security, but this limit was increased and eventually abolished in March 2021. In late summer 2020, the scope was extended to government-guaranteed bonds and the envelope was later doubled. From early May 2020 to early May 2021, purchases amounted to about 3.9 percent of GDP, mostly though weekly tenders (2.5 percent of GDP) and the rest as bilateral trades. In April 2021, the envelope was increased to about 5.8 percent of GDP.

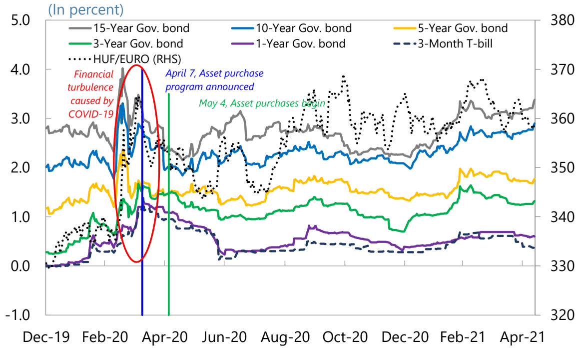
3. **Event studies suggest that both the announcement and initial purchases lowered long-term yields.** Whether the APPs have a lasting impact on yields remains to be seen. It is challenging to control for the various initiatives that the MNB, the government, and foreign central banks took during the pandemic to distill the APP impact. The spread between the Hungarian and the Czech 10-year benchmark bonds declined after the announcement of the APP, but it recently increased again and remains higher than before the pandemic (the Czech Central Bank did not introduce an APP). In January 2021, the MNB announced that it would rely more on its APP and scale down its collateralized long-term extended loan facility to provide liquidity.

Figure 2. Hungary: Asset Purchase Program of the Hungarian Central Bank

The APP and other measures appear to have contained the financial turbulence triggered by COVID-19.

Hungary: Interest Rates and Exchange Rate, 2020-21

(In percent)

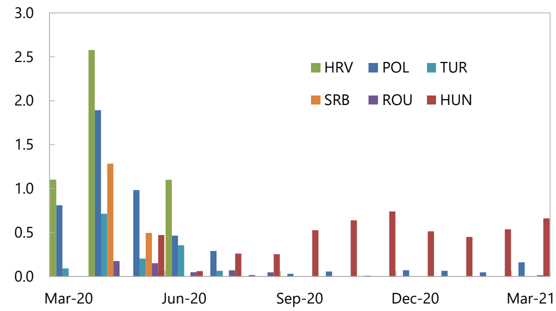


Sources: Central Bank of Hungary (MNB) and Haver Analytics.

After the initial modest bond purchases, the programs were paused, but intensified in late 2020.

European EM Central Bank Asset Purchases

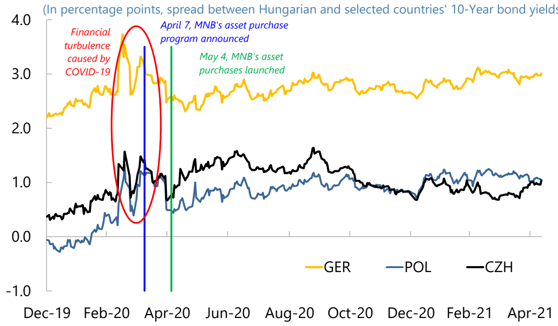
(Purchases per month as a percentage of 2020 GDP)



Spreads of 10-year benchmark bonds vis-à-vis selected countries also initially declined and then recouped.

Spreads of 10-Year Government Bonds, 2020-21

(In percentage points, spread between Hungarian and selected countries' 10-Year bond yields)



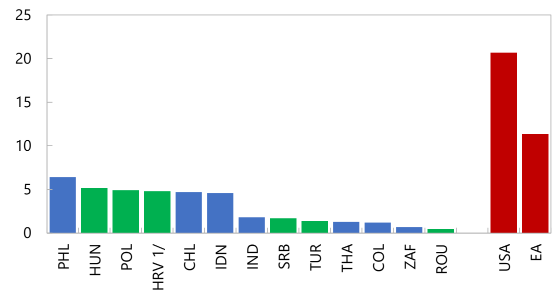
Note: The Central Bank of the Czech Republic did not have an APP.

Sources: Central Bank of Hungary (MNB) and Haver Analytics.

The purchased government bonds of the MNB are now broadly at par with Croatia and Poland.

Asset Purchases by Central Banks During Pandemic

(Percent of 2020 GDP; end-February 2020 to end-March 2021)



1/ The market value of securities purchased by the Croatian National Bank is 5.5 percent of GDP.

Sources: Haver; IFS; national central banks; and IMF staff calculations.

Annex III. External Sector Assessment

Hungary's current account remained close to balance in 2020. Hungary's external position in 2020 is assessed to be stronger than warranted by medium-term fundamentals and desirable policies.

1. **Hungary did not experience major market turbulence, but the crisis took a toll on both exports and imports reflecting reduced demand.** Tourism flows dropped sharply, and overall export volumes declined by about 7 precent due to supply chain disruptions and lower global activity. This was counterbalanced by lower imports (about 4 percent decline). Primary income fell by more than 1 percent of GDP, driven by the reduction in profit remittances by large multinationals. As a result, the current account (CA) remained close to balance in 2020

2. **Hungary's net international investment position (NIIP) improved in 2020.** The NIIP increased to about -45.8 percent of GDP in 2020 from -49.3 percent in 2019, largely driven by increase in Hungarian companies' assets abroad and an increase in international reserves. It is expected that bond flows will moderate as government borrowing concentrates on domestic markets in 2021 and beyond.

3. **The level of international reserves is adequate**. International reserves increased by €5 billion to almost €34 billion by year end on account of large government forex bond issues, and EU funds inflows (Figure 1). They remain above the Fund's reserve adequacy metric.[1] Reserve coverage of short-term debt further improved and continued to provide a comfortable cushion.

4. **The real effective exchange rate (REER) depreciated by 4.8 percent over 2019–20, despite high inflation**. The forint depreciated in nominal terms against both the dollar and the euro.

5. **Hungary's 2020 external position is assessed to be stronger than warranted by medium-term fundamentals and desirable policies.** The EBA models yield mixed results, pointing to a range of estimates for the valuation of the REER of about -10 percent (CA approach) to +9 percent (REER-level approach),

- The *CA approach* estimates a current account gap of 3.9 percent of GDP when accounting for COVID-related adjustments to shocks on oil (-0.6 percent of GDP), tourism (1.1 percent of GDP), shift to tradable (-0.7 percent of GDP), medical goods imports (1.9 percent of GDP), and retained earnings (-0.3 percent of GDP). Applying an estimated elasticity of 0.38, this implies an exchange rate *undervaluation* of about 10 percent. The model current account gap is 2.5 percent of GDP

[1] Reserves are expected to increase by about €2.2 billion with the approval of the expected SDR allocation in 2021.

2020 (which corresponds to a 6.6 percent *undervaluation*), out of which 2.1 percentage points are attributed to identified policies.[2]

- The *External Sustainability* (ES) approach suggests an exchange rate *undervalued* by about 6 percent. This is based on stabilizing Hungary's net borrower position (NFA/GDP) at its recent level, which would be consistent with a medium-term current account deficit of 2.3 percent of GDP.

- The two EBA *REER approaches* suggest that the real exchange rate was *overvalued* in the range of 1-9 percent with a large residual (about 15 percent) that is not explained by the policy variables.

- Note that these estimates are marred by significant *uncertainty* linked to inherent limitations of the models and frequent and large revisions of balance of payment data in Hungary.[3]

- On balance, the external position is assessed as stronger than warranted by fundamentals and desirable policies. Looking ahead, structural reforms that encourage more investment (with attendant imports of investment goods) would help move the external position closer to level consistent with medium-term fundamentals and desired policy settings. However, the expected dominance of industrial exports because of abundant recent FDI is still expected to offset the increase in imports and profit repatriation, keeping the current account in small surpluses over the medium term.

External Balance Assessment Results

	CA	REER-level	REER-index	ES
		(percent of GDP)		
CA balance	0.1	...	...	...
Cyclically-adjusted CA	0.4	...	...	...
Model CA norm (percent of GDP)	-2.1	...	...	...
CA-stabilizing NFA at 2019 level	...	...	...	-2.3
Model CA gap	2.5	...	...	2.4
Temporary COVID-related adjustment	1.7	...	...	...
Temporary COVID-related adjustment (staff)	-0.3			
CA gap, staff-adjusted	3.9	...	...	...
Semi-elasticity of CA/GDP to REER	0.38	...	...	0.38
Exchange-rate gap (percent)	-10.3	8.5	1.4	-6.3

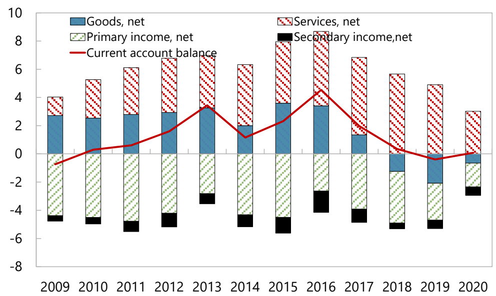
Source: April 2021 External Balance Assessment.

[2] A large part of the explained current account gap is attributed by the model to weak private sector credit and loose fiscal policies (relative to other countries) as the result of the crisis. This implies the presence of the credit policy gap. For Hungary, this could be explained by the fact that, after a credit bust following the global financial crisis but less as a result of the COVID crisis, the credit-to-GDP ratio is not expected to return to its pre-crisis level over a protracted period.

[3] In addition, significant errors and omissions in the balance of payments blur the overall picture. They amounted to 1.3 percent of GDP in 2019 and -1.9 percent of GDP in the 2020 preliminary data.

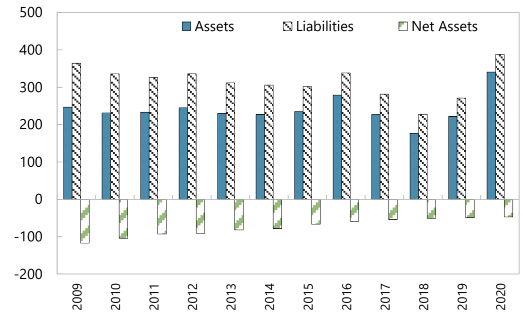
Figure 1. External Indicators

Current Account Balance
(Percent of GDP)



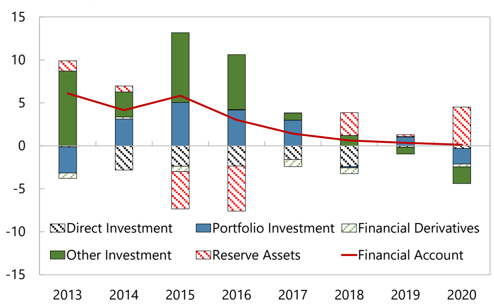
Sources: Haver Analytics and IMF staff calculations.

International Investment Position
(Percent of GDP)



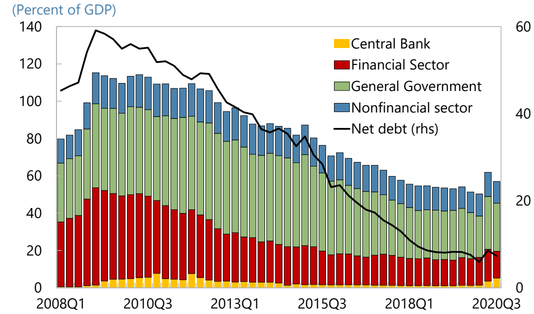
Sources: Haver Analytics and IMF Staff Calculations.

Financial Account Components, Net
(Percent of GDP)



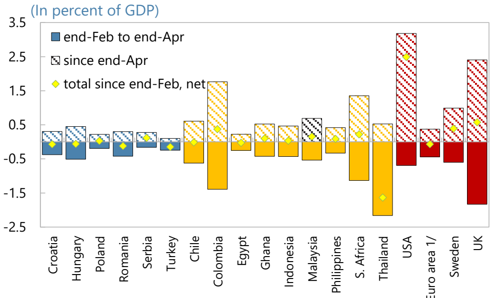
Sources: Haver Analytics and IMF staff calculations.

External Debt by Sector /1
(Percent of GDP)



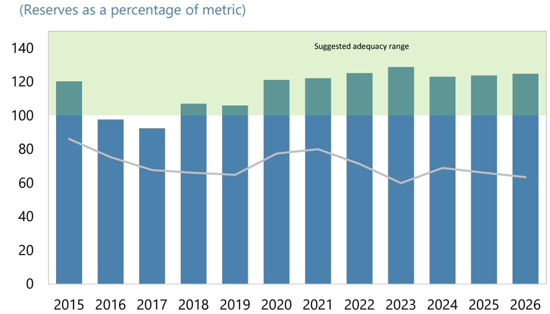
1/ Sectoral debt excludes intercompany/direct investment instruments.
Sources: Hungarian National Bank/Haver Analytics; and IMF staff calculations.

ETF and Mutual Funds Bond and Equity Flows, 2020
(In percent of GDP)



1/ ETF, Mutual Funds Bond and Equity Flows. Excluding Cyprus, Estonia, Latvia, Luxembourg, Malta, Slovakia and Slovenia.
Sources: EPFR; and IMF WEO.

International Reserve Cover
(Reserves as a percentage of metric)



Sources: Hungarian National Bank; and IMF staff calculations.
Note 1: Projections for 2021-26.
Note 2: Based on IMF, 2015, "Assessing Reserve Adequacy-Specific Proposals", IMF Policy Paper.

Annex IV. Risk Assessment Matrix[1]

Risks	Likelihood of Risk	Impact of Risk	Policy Response
Unexpected shifts in the COVID-19 pandemic. ▪ **Downside.** The disease proves harder to eradicate (e.g., due to new virus strains, short effectiveness of vaccines, or widespread unwillingness to take them), requiring costly containment efforts and prompting persistent behavioral changes rendering many activities unviable. For countries with policy space, prolonged support—while needed to cushion the economy—exacerbates stretched asset valuations, fueling financial vulnerabilities. For those with limited space, especially EMs, policy support is insufficient.	M	**Medium:** Demand in contact intensive services remains low and travel restrictions stay in place longer for longer. Financial markets reassess real economy risks leading to a repricing of risk assets. Vulnerabilities worsen, affecting banks.	Keep providing adequate support to the health system. Fully use available fiscal space to support households and businesses overcome liquidity needs while encouraging necessary reallocation of resources.
▪ **Upside.** Pandemic is contained faster than expected due to the rapid production and distribution of vaccines, boosting confidence and economic activity.	M	**High:** Strong confidence impact in the near term; activity recovers faster than expected over the medium term and limits scarring.	
Sharp rise in global risk premia exposes financial vulnerabilities. A reassessment of market fundamentals (e.g., in response to adverse COVID-19 developments) triggers a widespread risk-off event. Risk asset prices fall sharply and volatility spikes, leading to significant losses in major non-bank financial institutions. Higher risk premia generate financing difficulties for leveraged firms (including those operating in unviable activities) and households, and a wave of bankruptcies erode banks' capital buffers.	M	**Medium:** Pressure on bank capital adequacy triggering credit tightening. Highly indebted corporates come under pressure. Adverse spillover to other (viable) sectors through lower incomes and intermediate input demand.	Stand ready to implement further policy support. Maintain flow of credit by making sure financial policies are adequately targeted and effectively deployed.
Accelerating de-globalization. Geopolitical competition and fraying consensus about the benefits of globalization lead to further fragmentation. Reshoring and less trade reduce potential growth.	M	**High:** Higher barriers to trade–particularly those on Hungary's automotive sector–would dampen exports and investment and weaken growth.	Provide monetary and fiscal support, facilitate sectoral reallocation of labor and capital through retraining.
Faster implementation of competitiveness reforms. The improvement in competitiveness will boost the domestic economy though higher productivity and investment, increasing the economy's potential.	M	**High:** With higher potential growth, GDP growth above the baseline projection would have a lower inflationary impact. Exports would be more competitive, but investment and consumption imports may increase.	Accelerate fiscal consolidation.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent).

Annex V. Authorities' Response to Past IMF Policy Recommendations

Advice implementation to some degree were thwarted by the crisis but some progress was made.

IMF 2019 Article IV Recommendations	Authorities' Response
Fiscal Policy	
Implement a mix of growth-friendly revenue and expenditure measures.	The implementation of the recommendations was delayed by the crisis.
Rationalizing public sector employment.	No progress since abolishing "ghost" positions a few years ago.
Structural Reforms	
Reduce the large number of taxes and phase out the sector-specific taxes.	The number of taxes were reduced to 54. Accelerated depreciation of investments and introducing group taxation, was implemented.
Ensuring transparent and competitive procurement processes.	The implications of a recent constitutional change that redefined the concept of "public money", aimed at clarifying that public money is "income, spending, and receivable of the State", remain to be fully understood.
Improve the oversight of risks emanating from the SOEs.	No progress.
Offer more opportunities for adult education and vocational training opportunities.	There was an overhaul of the system in 2020, establish several layers of vocational training and engaging private sector in the process.
Increase the number of daycares.	The number of daycares continued to increase towards the objective of 70 thousand and public funds are being allocated for this purpose.
Reduce Public Works Scheme (PSW) participation	The employment in PWS decreased from 101k in 2019 to 89k in 2020.
Micro-Financial Issues	
Market-based consolidation of the banking system.	The second largest banking group in Hungary was created with the merger between two private banks (MTB and MKB) and state-owned Budapest Bank.

IMF 2019 Article IV Recommendations	Authorities' Response
Further improvements to insolvency legislation	Revisions to the Bankruptcy framework were introduced through the two temporary government decrees and Act LXXIII of 2020.
Continue their AML/CFT efforts	The AML law has been amended to address several Moneyval recommendations.

INTERNATIONAL MONETARY FUND

HUNGARY

June 3, 2021

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

European Department
In Consultation with Other Departments

CONTENTS

FUND RELATIONS

(As of April 30, 2021)

Membership Status: Joined on May 6, 1982; Article VIII.

General Resources Account:

	SDR Million	Percent Quota
Quota	1940.00	100.00
Fund holdings of currency (Holdings Rate)	1640.76	84.58
Reserve tranche position	299.24	15.42

SDR Department:

	SDR Million	Percent Allocation
Net cumulative allocation	991.05	100.00
Holdings	2.42	0.24

Outstanding Purchases and Loans: None

Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By	Nov 6, 2008	Oct 5, 2010	10,537.50	7,637.00
Stand-By	Mar 15, 1996	Feb 14, 1998	264.18	0.00
Stand-By	Sep 15, 1993	Dec 14, 1994	340.00	56.70

Projected Payments to Fund:

(SDR million; based on existing use of resources and present holdings of SDRs)

		Forthcoming			
	2021	**2022**	**2022**	**2024**	**2025**
Principal					
Charges/Interest	0.39	0.51	0.51	0.51	0.51
Total	0.39	0.51	0.51	0.51	0.51

Current Status of Safeguards Assessment:

The safeguards assessment of the Magyar Nemzeti Bank (MNB) was finalized on January 28, 2009. The assessment found that the central bank had a relatively strong safeguards framework in place. The MNB's control environment was well established, and the audit and financial reporting practices adhered to international standards. The assessment recommended measures to improve the process of program data reporting to the Fund and to strengthen audit oversight, especially over the central bank's basic tasks. In recent years the central bank law was subject to numerous changes. Going forward, it is critical to avoid undue changes to the MNB's legal framework and to ensure that the law continues to support MNB's operational and legal independence.

Exchange Rate Arrangements:

Hungary's de jure exchange rate arrangement is free floating, and the de facto exchange rate arrangement is classified as floating, effective November 1, 2008. Hungary has accepted the obligations of Article VIII and maintains an exchange rate system free of restrictions on the making of payments and transfers on current international transactions except for those maintained solely for the preservation of national or international security and that have been notified to the Fund pursuant to Executive Board Decision No. 144-(52/51).

Article IV Consultation:

Hungary is on a 12-month consultation cycle. The last Article IV Board discussion took place on November 27, 2019. The associated the staff report is available at https://www.imf.org/en/Publications/CR/Issues/2019/12/04/Hungary-2019-Article-IV-Consultation-Press-Release-Staff-Report-and-Statement-by-the-48848

Technical Assistance:

The table below summarizes the technical assistance missions provided by the Fund to Hungary.

Hungary: Technical Assistance from the Fund, FY2010–2019

Department	Purpose	Date
MCM	Banking Supervision	June 2009
LEG	Bank Resolution Framework	September 2009
FAD	Expenditure Policy	October 2009
MCM	Monetary Policy	February 2010
FAD	Expenditure Policy	June 2010
MCM	Financial Stability	July 2010
FAD	Tax Policy	September 2010
MCM	Financial Stability	November 2010
MCM	Monetary and Foreign Exchange Policy	June 2011
FAD	Fiscal Federalism	October 2011
MCM	Monetary and Foreign Exchange Policy	November 2011
LEG	VAT Fraud and Anti-Money Laundering Activities	January 2013
LEG	Bank Resolution and Crisis Management	November 2013
MCM	Operational Aspects of Establishing an Asset	January 2015 and
FAD	Management Company	June 2015
	Workshop on Revenue Forecasting and Micro-simulation Analysis	January 2016
FAD	PIT and CIT Micro-Simulation	January 2018
FAD	VAT Gap Analysis	February 2018

STATISTICAL ISSUES

Assessment of Data Adequacy for Surveillance

- **General**: Data provision is adequate for surveillance.

- **Government Finance Statistics**: The statistical authorities compile and disseminate comprehensive general government annual and quarterly accrual based data according to the ESA 2010 methodology. The data include non-financial accounts, financial accounts, and financial balance sheet. These data are bridged into the GFSM 2014 framework and provided to the Fund through Eurostat for the IFS and GFS yearbooks. However, there is some room to further improve data provided to the Fund for surveillance. Data on central government revenue and expenditure arrears as well as that on local government revenues and expenditures, and financial statements of state-owned enterprises have been readily provided to the mission team by the authorities upon request, but provision of this data on an automatic basis would facilitate the monitoring of obligations on an accrual basis and allow for closer regular monitoring of the general government.

- **Monetary and Financial Statistics**: Monthly monetary data consisting of the central bank and other depository corporations which accords to the IMF's Monetary and Financial Statistics Manual are reported by STA in the International Financial Statistics. The source data are obtained through a gateway arrangement with the European Central Bank and are based on the ECB framework for collecting, compiling, and reporting monetary data. Hungary also reports several data and indicators of the Financial Access Survey (FAS), including the two indicators (commercial bank branches per 100,000 adults and ATMs per 100,000 adults) adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals (SDGs).

- **Financial Sector Surveillance:** Hungary reports all 12 core Financial Soundness Indicators (FSIs) on a quarterly basis. The latest FSIs and metadata are available on the IMF's FSI webpage.

- **External sector statistics:** Frequent and large revisions of balance of payment data generate uncertainty when assessing Hungary's external sector position.

Data Standards and Quality

- Subscriber to the Fund's Special Data Dissemination Standard (SDDS) since May 1996 and met all SDDS requirements on January 24, 2000.

- Hungary published its original ROSC Data Module in 2001 and updates are available on the IMF website. The latest update is Hungary: Report on the Observance of Standards and Codes—Data Module, 2004 Update (July 2004).

Hungary: Table of Common Indicators Required for Surveillance as of May 31, 2021

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of publication[7]	Memo Items: Data Quality – Methodological soundness[8]	Memo Items: Data Quality Accuracy and reliability[9]
Exchange Rates	04/30/2021	05/03/2021	D and M	D and M	D and M		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	March 2021	04/30/2021 (Preliminary)	M	M	M		
Reserve/Base Money	March 2021	04/30/2021	M	M	M	O,O,LO,LO	O,O,O,O,LO
Broad Money	March 2021	04/30/2021	M	M	M		
Central Bank Balance Sheet	March 2021	04/30/2021	M	M	M		
Consolidated Balance Sheet of the Banking System	March 2021	04/30/2021	M	M	M		
Interest Rates[2]	March 2021	04/30/2021	M	M	M		
Consumer Price Index	April 2021	05/03/2021	M	M	M	O,O,O,O	O,O,O,O,NO
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	2019	10/30/2020	A	A	A	O,LNO,LO,O	LO,O,O,O,NO
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	March 2021	04/30/2021	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	December 2020	04/30/2021	Q	Q	Q		
External Current Account Balance	Q4 2020	03/30/2021	Q	Q	Q	O,LO,LO,LO	O,O,O,O,NO
Exports and Imports of Goods and Services	Q4 2020	03/30/2021	Q	Q	Q		
GDP/GNP	Q4 2020	03/30/2021	Q	Q	Q	O,O,O,LO	O,LO,O,O,NO
Gross External Debt	Q4 2020	03/30/2021	Q	Q	Q		
International investment Position [6]	Q4 2020	03/30/2021	Q	Q	Q		

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds. Daily data are readily available.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[7] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); Not Available (NA).
[8] Reflects the assessment provided in the data ROSC and Substantive Update published in May 2001 and July 2004, respectively, and based on the findings of the respective missions that took place during January 2001 and January 2004 for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning (respectively) concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).
[9] Same as footnote 8, except referring to international standards concerning (respectively) source data, statistical techniques, assessment and validation of source data, assessment and validation of intermediate data and statistical outputs, and revision studies.