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COMMISSION STAFF WORKING DOCUMENT

In-depth review for Hungary

Prepared under Regulation 1176/2011 on the prevention and correction of macroeconomic imbalances

European Commission

Hungary

In-Depth Review 2025

This in-depth review presents the main findings of the Commission's staff assessment of macroeconomic vulnerabilities for Hungary for the purposes of Regulation (EU) No 1176/2011 on the prevention and correction of macroeconomic imbalances. It provides technical input to the Commission for the Communication "European Semester – 2025 Spring Package" that will set out the Commission's assessment as to the existence of imbalances or excessive imbalances in Hungary. That Communication will be published in

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1. INTRODUCTION

This in-depth review (IDR) analyses the evolution of Hungary's vulnerabilities related to cost competitiveness, external accounts, housing, and the financial sector. This year's IDR, which follows the 2025 Alert Mechanism Report (AMR) published in December 2024, assesses the persistence or unwinding of the vulnerabilities identified last year, potential emerging risks, and relevant policy progress and policy options that could be considered for the future.[1]

Vulnerabilities are analysed at a time when economic growth in 2024 remained sluggish stemming from uncertainties surrounding domestic policies and external demand. Following a contraction of 0.9% in 2023, GDP growth recovered to 0.5% in 2024, driven primarily by consumption. However, investment and exports remained subdued due to uncertainty, deteriorating business sentiment and weak demand from Hungary's trading partners. GDP growth is projected to accelerate to 1.8% in 2025 and 3.1% in 2026, with consumption expected to remain the key driver, supported by strong real income growth.[2] The economic outlook remains sensitive to energy prices, uncertainties in the automotive industry, and global investor sentiment. Debt servicing costs and gross financing needs are set to remain high.

Inflation has eased but remains elevated due to increasing demand, strong wage growth and currency depreciation. Headline inflation declined significantly from 17.0% in 2023 to 3.7% in 2024, as the impact of earlier energy and food price increases and supply chain bottlenecks dissipated. However, inflation rebounded in 2024 with HICP inflation reaching 5.7% in February 2025. Moreover, core inflation remained high at 5.9% in 2024 even if it more than halved from the previous year.[3] Nominal wage growth remained strong, reflecting an adjustment in real wages in the aftermath of high inflation in previous years.

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(1) European Commission (2024), Alert Mechanism Report 2025, Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee, COM(2024) 702 final; and European Commission (2024), Alert Mechanism Report 2025, Staff Working Document, SWD(2024) 700 final.

(2) All forecast data used in the IDR come from the Commission Autumn 2024 Forecast (European Economy, Institutional Paper 296), unless stated otherwise, in order to ensure the coherence of the various figures and calculations. The cut-off date for the data for the preparation of this IDR was 24 March 2025. Actual outturn data that have become available after the Autumn Forecast, and before the cut-off date for the IDR, are mentioned.

(3) Input-output analysis indicates that over the period 2020-2024, foreign demand contributed 0.1 pps. to Hungary's cumulated GDP growth of 6.4%; conversely, due to its limited size, the Hungarian domestic demand had little impact on the EU growth. Over that same period, imported value-added inflation accounted for 5.2 pps. of the 52.3% cumulated inflation. See European Commission Institutional Paper 2025 (forthcoming) – "Economic spillovers and financial linkages in the EU".

2. ASSESSMENT OF MACROECONOMIC IMBALANCES

In recent years, sharp cost pressures have weighed on Hungary's competitiveness, and government financing needs and debt servicing costs have remained significant. The budget deficit declined in 2024, but it is set to remain elevated in 2025-26 and the reduction in the government debt ratio has stalled. Inflationary pressures remain persistent while the recovery is slow and subject to downside risks. External financing risks have been mitigated by favourable developments in the terms of trade and a decline in investment, which have increased the current account surplus. In the financial sector, the risks that arose during the economic downturn in 2023 have receded, and the sector is characterised by ample capital and liquidity buffers and a solid credit portfolio. House prices picked up in 2024, on the back of increased lending after it had markedly but briefly moderated, but housing undersupply remains an issue. The policy mix remains broadly unchanged. Monetary policy has been tight, but its transmission to the real economy has been weakened by government interventions. Fiscal targets and commitments are not fully backed by detailed measures over the medium-term.

2.1. Government sector

Assessment of gravity, evolution and prospects of vulnerabilities

The budget deficit decreased in 2024 but is set to remain elevated in 2025-26. According to the central bank's preliminary financial account data, the budget deficit is estimated at 4.8% of GDP in 2024.[4] The deficit narrowed significantly from 6.7% of GDP in 2023, but was slightly higher than the government's target of 4.5% of GDP.[5] The Commission's Autumn 2024 Forecast projected the headline deficit to remain elevated at 4.6% of GDP in 2025 and 4.1% in 2026. Recent policy announcements risk pushing the deficit higher than previously forecast.

The government debt ratio is set to decrease slowly while debt-servicing costs remain high. The general government debt-to-GDP ratio increased to 73.6% of GDP in 2024 due to the large deficit, a revaluation of the currency-debt due to the weakening of the forint and

[4] The preliminary financial accounts use estimates instead of outturn data for transfers from the EU and on the accrual accounting of tax revenues. Therefore, the actual ESA deficit might differ slightly from these figures. See: MNB (2025), Preliminary financial accounts of general government and households 2024 Q4, Magyar Nemzeti Bank (statisztika.mnb.hu/sw/static/file/pszla-2024q4e-en.pdf)

[5] The 2024 budget adopted in Spring 2023 set the deficit target at 2.9% of GDP and was revised to 4.5% of GDP in the Convergence Programme 2024-2028 submitted to the European Commission in April 2024.

the acquisition of the Budapest airport. Elevated budget deficits and lower nominal GDP growth are expected to limit debt reduction in the medium term. Spreads between Hungarian government bond yields and German government bond yields stand above 400 bps and are the second highest in the EU. Debt-servicing costs are projected to remain the highest in the EU, with the implicit interest rate on government debt reaching close to 6% in 2025-26. Gross financing needs amounted to some 16% of GDP on average over 2023-2024 and are expected to remain at around 14% of GDP over 2025-2026 (see Box 2.2). The debt sustainability analysis indicates that risks to fiscal sustainability are overall high in the medium term (see Box 2.1).

Assessment of MIP relevant policies

Hungary's fiscal consolidation in 2024 was primarily driven by lower spending on energy subsidies and cuts in public investment. Since 2022, large deficits are explained by costly measures to mitigate the impact of high energy prices and other discretionary spending measures (see the 2023 and 2024 In-Depth Reviews for Hungary)[6], a rising interest burden owing to very high financing costs, and shortfalls in tax revenue due to weak GDP growth. A moderation in energy prices, cuts in public investments and revenue from taxes levied in the energy, financial and retail sectors helped decrease the deficit in 2024. Still, other categories of expenditure, including generous housing subsidies and largely untargeted preferential lending schemes to households and SMEs, continue to exert pressure on public finances. With the adoption of the 2025 budget in November 2024, the government unveiled a 21-point Economic Policy Action Plan, featuring further stimulus measures, which are set to be offset by tax increases, notably the higher financial transaction levies, a modified windfall tax on banks, and hikes in excise duties. However, the recently announced personal income tax (PIT) exemption for mothers with two children is estimated to decrease tax-to-GDP ratio by around 1% of GDP by 2029 (see Table A). In 2025 and beyond, permanent fiscal measures, both on the revenue and expenditure side, would be needed to ensure that fiscal targets are achieved (see Box 2.2).

In its medium-term fiscal-structural plan, Hungary commits to a net expenditure growth[7] path but the government does not specify policy measures to achieve it. In its plan, Hungary commits to a net expenditure growth that does not exceed 4.3% in 2025, 4.0% in 2026, 3.9% in 2027 and 3.7% in 2028.[8] According to the plan, general government debt would gradually decrease from 74% of GDP in 2024 to 68.2% of GDP in 2028 (the end of the fiscal adjustment period). The plan does not include a fully-fledged and quantified fiscal strategy.

There are risks to the achievement of fiscal targets in the short and medium term. The 2025 budget law, adopted by the Parliament on 20 December 2024, sets the deficit target at

(6) See: European Commission (2023, 2024): In-Depth Review 2023 Hungary, In-Depth Review 2024 Hungary

(7) Net expenditure as defined in Article 2 of Regulation (EU) 2024/1263, namely government expenditure net of (i) interest expenditure, (ii) discretionary revenue measures, (iii) expenditure on Union programmes fully matched by revenue from Union funds, (iv) national expenditure on co-financing of programmes funded by the Union, (v) cyclical elements of unemployment benefit expenditure and (vi) one-offs and other temporary measures.

(8) These are also the growth rates that the Council recommended when it endorsed Hungary's plan. The cumulative growth rates are calculated by reference to the base year of 2023. Council Recommendation of 18 February 2025 endorsing the national medium-term fiscal-structural plan of Hungary OJ C, C/2025/1707, 18.3.2025.

3.7% of GDP. However, as also pointed out by the Hungarian Fiscal Council, there are risks to the government's projections, stemming from optimistic GDP and investment forecasts, spending pressures due to high inflation, and the uncertain external outlook.[9] Recent deficit-increasing announcements coupled with limited progress in absorbing EU funds, increase uncertainty and are likely to negatively impact confidence going forward.

The national fiscal framework offers only limited medium-term orientation and accountability. As discussed in the 2023 and 2024 In-Depth Reviews, Hungary's fiscal framework suffers from weaknesses, which limit budget transparency and exacerbate an expansionary bias. The continued early budget adoption and frequent revisions of the fiscal targets limit policy predictability and proper accountability.[10] According to the Commission's fiscal governance database, Hungary's score on the index on the quality of medium-term budgetary framework ranks among the lowest in the EU.[11] The introduction of a 'state of danger', in force since 2020, has lifted the requirement to publish a 3-year budget plan, as required by the Act on Public Finances, and has increased the discretion in implementing the annual budgets.[12] The mandate and own operational capacities of the Hungarian Fiscal Council remain limited.

2.2. COST COMPETITIVENESS

Assessment of gravity, evolution and prospects of vulnerabilities

Despite a deceleration in 2024, inflation remains elevated, driven by high wage growth and strong consumer demand. Consumer prices soared by 35% between 2021 and 2023, fuelling high wage growth. HICP average annual inflation fell to 3.7% in 2024, due to strong base effects related to energy and food prices and to the easing of supply chain disruptions. However, inflation has rebounded, with HICP inflation reaching 5.7% in February 2025. This increase was driven by renewed energy and food price increases, as well as elevated service price inflation and indirect tax hikes. Underlying inflation pressures have remained elevated, with HICP inflation excluding energy, food, alcohol and tobacco averaging 5.9% in 2024 and the core inflation differential between the euro area and Hungary remaining one of the highest in the EU, at 3.1 percentage points (pps.) (Graph 2.1.f).

(9) Resolution No. 6/2024.11.07. Opinion of the Fiscal Council on the draft bill on the 2025 central budget of Hungary. Accessible at: https://www.parlament.hu/documents/d/koltsegvetesi-tanacs/resolution-no-6-on-the-draft-budget-of-2025

(10) Between 2016 and 2023, the draft annual budgets were submitted by the government to the Parliament in spring and adopted in early summer, making Hungary the only OECD country to publish the budgetary projections some 6 months ahead of the fiscal year concerned. The 2025 budget was adopted in December 2024, but the earlier practise is expected to continue.

(11) Accessible at: Fiscal governance database - European Commission

(12) The state of danger under the Article 53 of the Fundamental Law was introduced during COVID-19 pandemic and has been repeatedly extended. It is currently in force until 18 May 2025. Under the state of danger, the government may issue decrees by which it can suspend the application of certain laws, deviate from legal provisions, and take other extraordinary measures, which can be adopted by the parliament as laws ex post.

Rising labour costs have eroded cost competitiveness in recent years. Unit labour costs (ULC) surged by 12% in 2024, following a 15% increase in 2023. Wage growth was also fuelled by a 15% minimum wage hike in December 2023 and public sector wage increases, while productivity remained feeble amid weak growth. Export prices in manufacturing increased by 3% in 2024, one of the highest rises in the EU, suggesting that Hungarian firms were able to partially pass rising costs onto selling prices within their value chains. Wage increases were also partly absorbed by firms' reduced profit margins, as evidenced by the fall of gross operating surplus as a share of value added to 50% in 2024 from 52% in 2023.

Currency depreciation has not fully offset the increase in labour costs. The Hungarian forint depreciated by 1.6% in nominal terms against a basket of currencies in 2024, on the back of increased geopolitical uncertainty, and a decline in the central bank reference rate from 10.75% in the beginning of 2024 to 6.5% by year end. While the HICP-based real effective exchange rate (REER) also depreciated, the impact of nominal currency depreciation on the real exchange rate is expected to be mitigated in the medium term as currency depreciation also contributes to increases in domestic prices.[13] In contrast, the ULC-based REER appreciated by 2.4% in 2024, suggesting that the increase in labour costs deteriorated cost competitiveness (Graph 2.1.e).

Assessment of MIP relevant policies

Tight monetary and fiscal policies helped to contain inflation in 2024, but price pressures are persistent, driven by high wage growth. In 2024, postponements of investments and cuts in subsidies helped to lower the budget deficit. The central bank cut its base rate by 425 bps in 2024 in the context of lower inflation. Looking ahead, monetary conditions may remain tight. A tight policy mix can help further anchor expectations and contain inflation in the medium run and could be instrumental to improve the cost competitiveness of the economy. The government also announced a profit margin cap on basic food products from 17 March 2025 to the end May 2025, which should contribute to moderate food prices.[14] Nominal and real wages growth in Hungary are expected to be among the highest in the EU in 2025, and further minimum wage increases agreed among social partners and the government are planned up to 2027 (see Annex 2). While Hungary has one of the lowest minimum wages in the EU, these increases, should go hand in hand with improvements in productivity and structural reforms in order to increase competitiveness and not risking fuelling inflationary pressures.[15]

2.3. EXTERNAL SECTOR

Assessment of gravity, evolution and prospects of vulnerabilities

[13] An analysis shows that the pass through of exchange rate changes to prices doubled see: Balatoni A. – Soós G. (2023), Változó világ, változó hatások – Az árfolyam makrogazdasági hatásai. Magyar Nemzeti Bank (in Hungarian, link here).

[14] See Box 3-3 in MNB (2025): Inflation Report March 2025.

[15] See also Box 1-5 in MNB (2024): Inflation Report December 2024.

The current account surplus increased in 2024 due to declining imports, linked to a slowdown in investment and improvements in the terms of trade. The current account balance surplus increased to 2.3% of GDP in Q3 2024 driven by favourable terms of trade developments and declining imports which markedly improved the trade balance.[16] Net energy imports declined by some 1.3% of GDP in 2024, thanks to lower prices and a reduction in import volumes driven by increasing solar power generation. The incomes and current transfers deficits declined due to lower interest income outflows. The current account balance is set to remain positive and net external liabilities are projected to decline further in 2025-26 on the back of higher exports (Graph 2.1.a-b). Exports related to the electric vehicles (EV) industry are set to pick up (see Annex 1). However, increasing imports stemming from domestic demand are set to decrease the trade balance. Risks to external sustainability could become more prominent if export growth remains sluggish or if energy prices costs rise significantly.

With a larger current and capital account surplus, net liabilities have declined below the prudential benchmark in 2024. From a savings investment perspective, the increasing current account surplus reflects higher household saving and lower private and public investment. In terms of financing, the current account surplus has led to foreign loan repayment and increasing reserves. Net lending vis-à-vis the rest of the world and high nominal GDP growth increased the net international investment position (NIIP) to GDP ratio from -37% at the end of 2023 to -33% in Q3 2024. As net FDI liabilities remained stable at 32% of GDP, the net international investment position excluding non-defaultable instruments turned positive in 2024, standing at 4% of GDP in Q3-2024 (Graph 2.1.c-d).

Assessment of MIP relevant policies

The external balance is still impacted by domestic policies. Fiscal policy measures across different sectors (e.g., subsidised lending schemes, wages policies) have had a significant impact on demand (see Section 2.1: Government Finance and Section 2.2: Cost Competitiveness). At the same time, the sizeable fall in public investment is impacting potential GDP growth and is unlikely to persist. Government energy subsidies to households have remained generous, stimulating energy consumption and imports while policies to lower energy intensity and imports remain subdued.[17]

2.4. HOUSING MARKETS

Assessment of gravity, evolution and prospects of vulnerabilities

House prices have risen on the back of strong demand and restricted supply. Nominal house price growth reached 13.4% year-on-year in Q3 2024 driven by lower mortgage

[16] The current account surplus is above the estimated cyclically-adjusted balance, indicating that subdued demand is a key factor behind the higher surplus, rather than structural factors.

[17] See European Commission (2024): In-Depth Review 2024 Hungary

interest rates, higher wages and government subsidy schemes. The strong housing demand was not met with a corresponding increase in supply. In 2024, new dwelling construction declined by 29% compared to 2023. The number of building permits issued fell by 5% in the same period, suggesting that supply may remain subdued in the short run. Lending conditions and government policies to support demand remain supportive. Supply is set to adjust to booming demand with a lag, notably aided by the extension of the reduced VAT for new dwellings.[18]

Assessment of MIP relevant policies

Generous housing policies are exerting pressure on both prices and public finances while efforts to ease supply constraints remain limited. In 2024, the government redesigned the Home Purchase Subsidy that offered subsidies to families with children by a subsidised mortgage scheme (HPS Plus) tailored only to married couples planning to have children.[19] However, the schemes for home purchases appear to remain generous, potentially fuelling house price overvaluation.[20] The supply of housing is constrained, with new dwelling constructions amounting to only 13,300 units in 2024. This equates to a renewal rate of just 0.3% against a housing stock of 4.6 million units, significantly lower than the 1% renewal rate observed among regional peers.[21] The continuous extension of the preferential VAT, that was first introduced in 2016 seems to be insufficient to tackle the persistent undersupply of new dwellings.

[18] See MNB (2024): Housing Market Report, November 2024

[19] The Home Purchase Subsidy remained available only in communities with less than 5000 inhabitants.

[20] See: European Commission (2024): In-Depth Review 2024 Hungary

[21] See MNB (2024): Housing Market Report, May 2024

2.5. FINANCIAL SECTOR

Assessment of gravity, evolution and prospects of vulnerabilities

The banking sector is characterised by robust capital and liquidity buffers. In Q3 2024, the Common Equity Tier 1 (CET1) ratio reached 18.8%, representing a notable increase from 16.8% in the corresponding period of the previous year. The sector's profitability has remained robust, with a return on equity of 21.3% in Q3 2024, and the quality of bank portfolios has been sustained at a satisfactory level. The non-performing loan (NPL) ratio has continued to decrease, from 2.4% in Q3 2023 to 2.3% in Q3 2024. However, the share of government bond holdings in banks' total assets increased from 14% in December 2023 to 16% by the end of 2024, driven by a tax incentive that allows banks to reduce their windfall tax liability by increasing their government bond holdings in 2024 and 2025. Furthermore, government contingent liabilities to the financial sector were one of the highest in the EU in 2023. These developments increase risks associated with the bank-sovereign nexus (see Annex 3).

Household lending picked up in 2024, and corporate debt declined due to subdued credit demand. The introduction of voluntary interest rate ceilings by banks on mortgages and firms' working capital loans — in return for abolishing the interest rate freezing for SMEs[22]— and the implementation of the HPS Plus scheme (see: Part 2.4: Housing Markets) contributed to a significant increase in household lending in 2024. Despite this expansion, the household debt-to-GDP ratio remained relatively low at 17% in Q3 2024, the second-lowest level among EU countries. In contrast, corporate debt decreased to 55% of GDP in Q3 2024, down from 57% in Q3 2023, largely driven by sluggish investment activity and the gradual phase-out of certain subsidised lending programs. Looking ahead, lending surveys in Q4 2024 suggest a potential pickup in lending to firms in 2025.[23]

Assessment of MIP relevant policies

The interest rate ceilings on new mortgage loans fuel housing demand and create distortions in the credit market. The interest rate ceiling on new mortgages has contributed to a surge in household lending in 2024. Moreover, the Hungarian Banking Association launched a new mortgage scheme in late 2024, which features an interest rate ceiling of 5% (well below the 5-year interbank reference rate in February 2025) to be applied between April and October 2025, targeting debtors under the age of 35 who meet specific eligibility criteria. The freezing of floating mortgage rates to 2021 levels continues to be in place, compromising the transmission mechanism of monetary policy.[24] The MNB indicates that maintaining such pricing policies in the long term may drive riskier debtors out of the

[22] See the government communication on the call here, and the Hungarian Banking Association's reply here

[23] See: MNB (2025): Trend in lending, February 2025

[24] See: European Commission (2024): In-Depth Review 2024 Hungary

mortgage market and that banks may increase the price of other financial services to offset lower profit on household lending.[25]

Subsidised lending remains significant, negatively affecting capital allocation and public finances and limiting the effectiveness of monetary policy. The share of subsidised corporate loans in total disbursements declined from 34% in 2023 to below 19% in 2024, as certain untargeted lending schemes that allowed for the refinancing of existing loans were phased out. Nevertheless, the share of subsidised loans remains elevated compared to the pre-COVID level of 7%. These schemes can lead to suboptimal capital allocation by financing projects with low returns and limited productivity gains, this also limiting the transmission mechanism of monetary policy.

Tax incentives to domestic banks in return for purchasing government debt strengthened the bank-sovereign nexus in 2024. Domestic banks' government bond holdings increased in 2024 driven by a tax incentive that allows banks to reduce their windfall tax. Such incentives enhance banks' demand for government bonds in the short run, but this effect may be followed by a decline in demand once banks' bond portfolios reached the desired level, leading to increased bond market volatility. Furthermore, incentives to channel bank lending to the bond market may crowd out loans and lead to suboptimal capital allocation (see Annex 3).

Table A: **Policy considerations in context of this year's In-depth Review for Hungary**

Vulnerability	Policies	Implementation status
Government sector	*Doubling the child tax allowance* The increase in family tax and contribution allowance by 50 per cent from 1 July 2025, and doubling from the beginning of 2026.	Implementation in 2025 and 2026
	PIT exemption for mothers PIT exemption for mothers with two children, phased in over 2026-2029: (i) for mothers under the age of 40 from 2026, (ii) for mothers under the age of 50 from 2027, (iii) from 2028 to those under the age of 60, (iv) and from 2029 to those over the age of 60.	Announced in 2025 for implementation over 2026-2029
	Modification of the financial transaction levy and introduction of a levy on FX transactions The increase in the rates and the upper limit of the financial transaction levy from 1 August and the introduction of the additional financial transaction levy on foreign exchange conversion operations from 1 October.	Enacted in 2024
	Pension reform	The OECD report on reform options published in July 2024, but no legislative initiative taken

[25] See: MNB (2024): Financial Stability Report, November 2024

Price competitiveness	*Minimum wage increase* Minimum wage increased by 9% in 2025, with further planned increases of 13% and 14% in 2026 and 2027, respectively, following an agreement with labour unions and employer organisations.	Agreed in 2024. Implemented in 2025, 2026 and 2027
	Retail profit margin cap on food The difference between the retail purchase price and the sales price of certain basic food products may not exceed 10 percent.	Applicable as of 17 March 2025 until end of May 2025
External sector	*Electricity price reduction for producers* The regulated electricity prices offered for small producers and set by the government under the KÁT-METÁR scheme	Implemented in 2025, applicable until 2029
	House renovation subsidy A 50% subsidy is provided for dwelling renovation related to energy efficiency improvements, with a dedicated program for houses in settlements with less than 5000 inhabitants.	Implemented in 2024 and 2025 The housing subsidy is available as of 1 July 2024 until 31 December 2025 while the rural housing subsidy is available as of 1 January 2025 until 30 June 2026.
Financial sector	*Subsidised lending schemes* Subsidised lending schemes for (i) SMEs investment, and (ii) young workers aged 17-26. expenditure.	Implemented in 2025
	Prenatal baby loan - restriction Lower age limit for women eligible for the prenatal baby loan from 41 to 30 years	Announced in 2024
	Windfall tax relief for banks and insurance companies Banks can reduce their windfall tax liability by 10% of the increase in their government bond holdings up to 50%, while insurance companies can reduce theirs by up to 30% of their government bond purchases.	Implemented in 2024, applicable in 2024 and 2025
	Loan-to-value limit increase The loan-to-value limit for first-time homebuyers has been increased to 90% as of 2024, and will also apply to green mortgages starting from 2025	Implemented in 2024 and 2025
	Countercyclical capital buffer (CCyB) MNB activated CCyB at 0.5 % as of July 2024 and at 1.0 % as of July 2025.	Implementation in 2024 and 2025 until, applicable until 1 January 2026
Housing markets	*Subsidised mortgages scheme (Home Subsidy Plus)* Subsidised mortgages to couples who commit to having children, featuring a reduced interest rate and partial debt forgiveness for the birth of a second and third child.	Implemented in 2024, ongoing
	Tax exemption to use supplementary pensions savings for housing Households are allowed to use their tax exempted supplementary pension savings for	Implemented in 2024, applicable in 2025

	housing purposes in 2025.	
	Reduced VAT on new dwelling The 5% VAT rate applicable to new dwelling purchases was extended until 2026.	Implemented in 2024, applicable until end 2026
	Housing Investment Program Capital injection (0.2% of GDP) through the state owned development bank to investment funds to facilitate the construction of rental housing and new dwellings.	Announced in 2024 for implementation in 2025

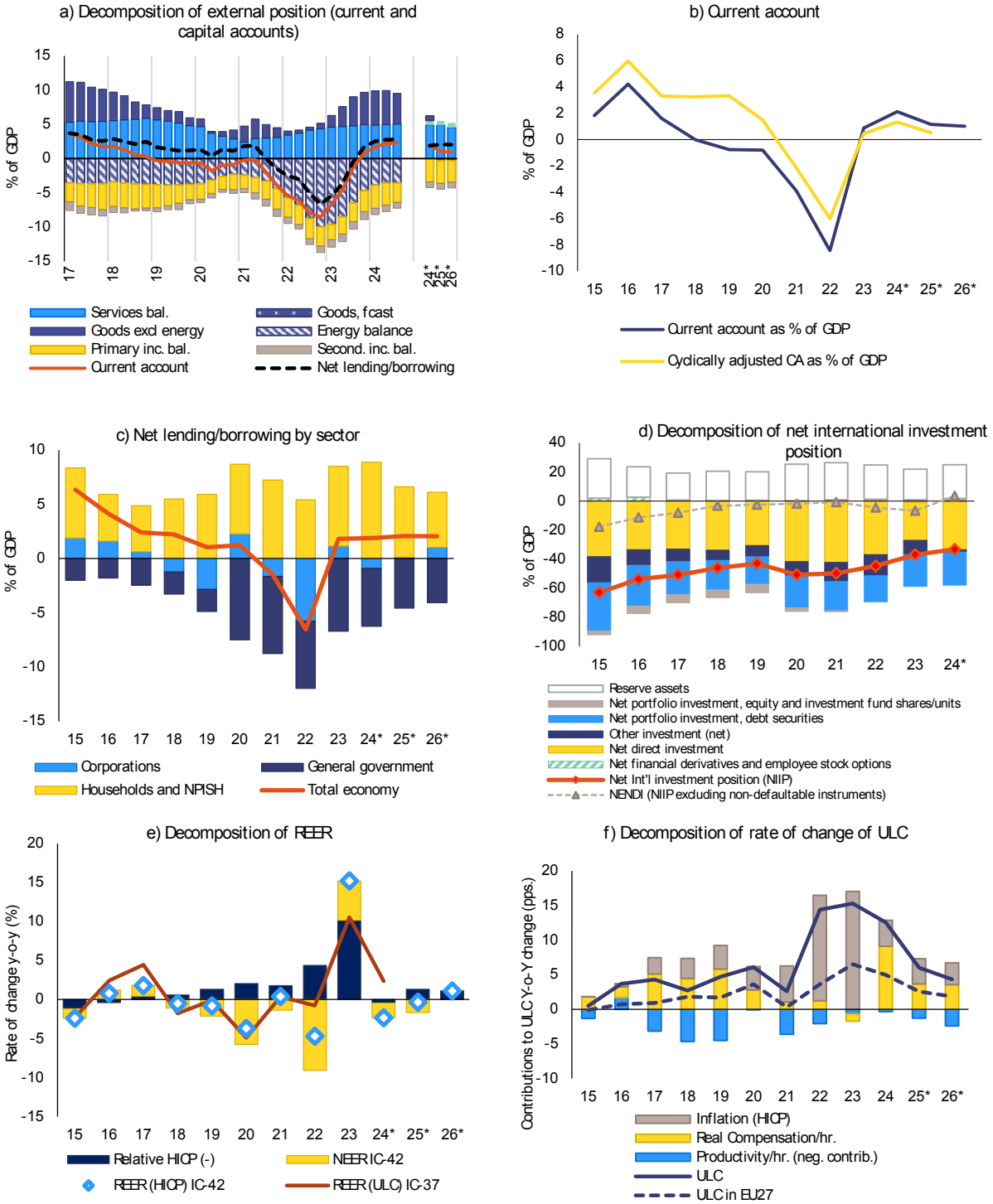
Note: This table lists the main measures that may increase or reduce the risks of macroeconomic imbalances. The measures are described more at length and reviewed in the text of this IDR.

Conclusions

Hungary continues to face vulnerabilities, primarily related to competitiveness and government financing needs. Public debt increased in 2024, and debt-servicing costs and gross financing needs remain at high levels. Meanwhile, rapid wage growth in recent years has compromised cost competitiveness. Planned minimum wage hikes in 2026 and 2027 are expected to exert pressure on wages, prices and competitiveness. Overall, inflationary pressures remain persistent while the economic recovery is slow and subject to downside risks. Vulnerabilities related to the external balance reduced in 2024, but policies aimed at boosting domestic demand and remaining substantial energy imports pose risks to external sustainability. House price growth accelerated in 2024 driven by strong demand and accommodative financial conditions. The financial sector is marked by capital and liquidity buffers and a solid credit portfolio. However, the bank-sovereign link has deepened due to tax incentives for domestic banks in return for purchasing government debt.

Policy progress has been limited, and risks of external and domestic shocks remain. Monetary policy has been tight, but its transmission to the real economy has been weakened by government interventions. At the same time, fiscal policy targets are not yet backed by policy measures over the medium-term. The government deficit decreased due to lower expenditure on public investment and a decrease in spending on energy subsidies, but this was partly offset by weaker revenue performance. The practice of poorly-targeted subsidies and loans to household and corporations persists and administrative controls of lending rates limit the effectiveness of monetary policy. Housing subsidies and preferential lending schemes continue to distort the housing market and exacerbate price pressures. In its medium-term fiscal-structural plan, Hungary committed to a net expenditure growth path, but specific policy measures remain to follow. The national fiscal framework continues to lack a medium-term orientation. To ensure that fiscal targets are achieved, Hungary will need to introduce permanent fiscal measures, and rely less on temporary windfall and profit taxes or cuts in public investments.

Graph 2.1:**Selected graphs, Hungary**



Source: Eurostat, Comext and European Commission forecasts and calculations.

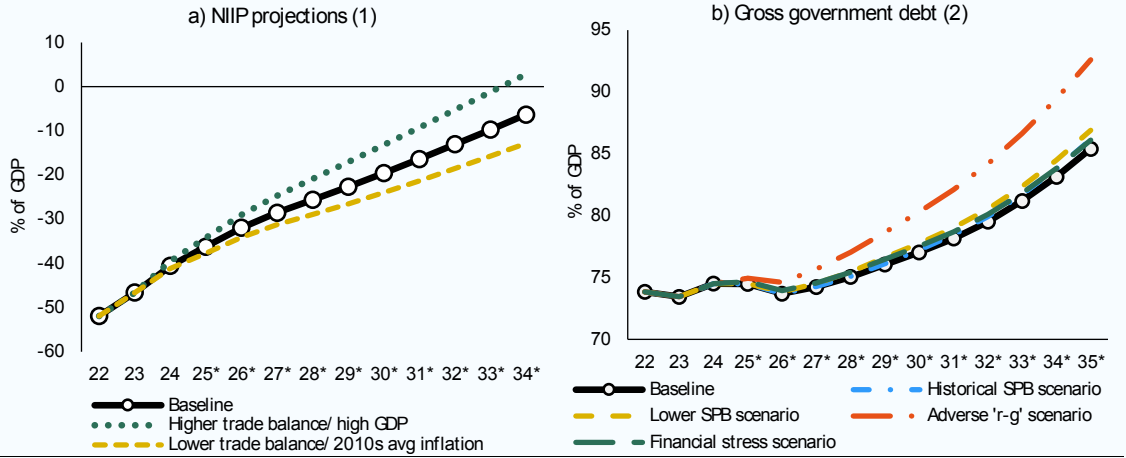
Box 2.1: **Medium-term external and government debt projections**

This Box summarises external and internal debt-to-GDP projections for Hungary over the next decade, based on scenario analysis conducted by the Commission. It covers scenarios to take into account different underlying assumptions for external debt stocks, as well as the outcomes of the latest government debt sustainability analysis conducted by the Commission.

Hungary's net international investment position (NIIP) is projected to improve in the medium term under a broad range of scenarios. In the baseline projections the NIIP strengthens, coming closer to around -6% of GDP at the end of the forecast period, exceeding the prudential benchmarks of around -55% of GDP. According to the baseline scenario, with a trade balance surplus as key contributor, the NIIP will increase. In an adverse scenario of a lower trade balance and if the annual inflation is assumed to be slightly below the baseline (assuming an annual average inflation rate of 3.2%), the NIIP ratio would continue to improve, reaching around -13% of GDP. Risks to the country's external position are partly mitigated by the favourable NIIP structure, as non-defaultable instruments account for the bulk of net liabilities and are composed mostly of foreign direct investments. The NENDI (NIIP net of non-defaultable instruments) was around -7% of GDP in 2023.

Medium-term risks to fiscal sustainability for Hungary are overall high, whereas they are overall low in the short term and overall medium in the long term. The debt sustainability analysis carried out by the Commission indicates that, under the baseline scenario, the government debt-to-GDP ratio is projected to be at around 76% in 2029 and to increase to around 83% in 2034 (Graph 1.b) [1]. This Commission's assessment of fiscal sustainability risks does not take into account Member States' commitments as outlined in the medium-term fiscal-structural plans. In line with standard practice, it only incorporates fiscal measures that have been legislated or agreed for 2025 and assumes unchanged policy afterwards.

Graph 1: **External and government debt projections, based on scenario analysis for Hungary**



(1) The baseline NIIP projections are based on the Commission's medium-term forecasts for GDP and interest rates. Additionally, assumptions are made about the drawdown of NGEU and MFF funds, and the median value of the last 3 years is used for non-investment income. The 'higher trade balance/ high GDP' scenario assumes higher trade balance in 2025 and beyond, with the difference to the baseline calculated as half the interquartile range of the annual 10-year-average trade balance to GDP ratios over 2013-2023 and additionally reflects a permanent 1 pp increase in GDP growth relative to the baseline scenario. The 'lower trade balance/ 2010s avg inflation' scenario assumes the same as the first scenario but with an opposite sign in the trade balance and also reflects an inflation rate that is set to the country-specific average inflation rate observed over the 2010s.
(2) The baseline projection for government debt is stress-tested against four alternative deterministic scenarios to assess the impact of changes in key assumptions: 'historical structural primary balance (SPB)' scenario, in which the SPB returns to its historical 15-year average of -0.2% of GDP; 'lower SPB' scenario: the SPB in 2025 deteriorates by 50% more than in the forecast; 'adverse interest-growth rate differential' scenario: the interest-growth rate differential is 1 pp. higher compared with the baseline; 'financial stress' scenario: interest rates temporarily increase by 1 pp. compared with the baseline.
Source: Eurostat, DSM 2024, and European Commission forecasts and calculations.

[1] European Commission (2025), Debt Sustainability Monitor 2024, European Economy Institutional Paper 306.

Box 2.2: **Tax revenue in Hungary**

Erosion of Hungary's tax revenue

Hungary's tax-to-GDP ratio has been declining in recent years, falling from 39.0% of GDP in 2016 to 35.1% in 2023. This decline is largely due to labour tax cuts and a reduction in the corporate tax rate, which were implemented since 2017 to stimulate employment growth and investments. Changes in the composition of GDP have exacerbated the decline, as the share of the consumption tax base and the labour tax base in GDP decreased significantly (see 2024 In-depth review for Hungary).

Main characteristics of Hungary's tax mix

Hungary's tax system is characterised by the strong reliance on consumption taxes (13.5% of GDP in 2023, in comparison to EU average of 10.5%), as a result of the increase of the VAT rate to 27% in 2012 and introduction of a series of sectoral consumption-related taxes. Labour taxes account for a relatively low share of GDP in comparison to the EU average (14.8% in 2023, as compared to 20.0%) and their share decreased over time due to multiannual cuts in social contributions enacted since 2017. Revenue from capital taxation, at 6.8% in 2023, remains below the EU average of 8.5% of GDP, largely as a result of low CIT rate. Revenue from environmental taxation is close to the EU aggregate (2.2% of GDP in 2023 as compared with 2% in the EU). The property taxes, in particular recurrent property taxes, remain relatively low compared with the EU aggregate, at 0.8%.

Table 1: **Types of tax in Hungary and EU as % of the GDP (2016, 2021-2023)**

		Hungary				EU-27			
		2016	2021	2022	2023	2016	2021	2022	2023
Total taxes (including compulsory actual social contributions) (% of GDP)		**39.0**	**33.6**	**35.0**	**35.1**	**39.8**	**40.2**	**39.7**	**39.0**
By tax base	Labour taxes (as % of GDP)	18.1	14.4	14.6	14.8	20.4	20.5	20.1	20.0
	of which, Social Security Contributions (SSC, % of GDP)	13.7	10.4	9.8	9.9	13.1	13.0	12.7	12.7
	Consumption taxes (as % of GDP)	13.8	13.8	14.1	13.5	11.3	11.2	10.9	10.5
	of which, Vale Added taxes (VAT, % of GDP)	9.1	9.8	10.1	9.4	7.0	7.3	7.4	7.1
	Capital taxes (as % of GDP)	7.1	5.4	6.3	6.8	8.1	8.5	8.7	8.5
Some tax types	Personal income taxes (PIT, % of GDP)	4.7	4.1	5.3	5.4	9.3	9.6	9.4	9.3
	Corporate income taxes (CIT, % of GDP)	2.1	1.2	1.3	1.7	2.5	2.9	3.2	3.2
	Total property taxes (as % of GDP)	1.1	0.9	1.0	0.8	2.3	2.2	2.1	1.9
	of which, Recurrent taxes on immovable property (as % of GDP)	0.5	0.4	0.3	0.3	1.3	1.1	1.0	0.9
	Environmental taxes (as % of GDP)	2.5	2.0	1.9	2.2	2.7	2.4	2.1	2.0

Source: European Commission, DG Taxation and Customs Union, based on Eurostat data

Specific weaknesses in the Hungarian tax system

Hungary's tax system suffers from several weaknesses:

- **Revenue from CIT remains low.** The CIT rate, at 9%, is the lowest in the EU (EU average is at around 21%). In addition to CIT, Hungarian resident companies are subject to Local business Tax, which is deductible for CIT purposes. The forward-looking average effective tax rate (ETR) was 11.1% in 2022 (third lowest among EU member states; EU average around 19%). The low statutory tax rates, combined with a limited tax base due to various tax incentives and exemptions reduces the tax revenue generated from CIT. Additionally, the low statutory rates and the lack of withholding tax on dividends, interest, and royalties increases the risk of aggressive tax planning.

- **Tax expenditures are estimated at some 2.1% of GDP in 2022.** The Hungarian tax system is characterised by numerous tax deductions and exemptions that bring limited economic and social benefits relative to their budgetary cost. These include among others: (i) the personal income tax exemptions for workers under age 25 (0.2% of GDP), (ii) the deductibility of donations to sport clubs from corporate tax obligations, up to 80% of the total tax obligation (amounting to 0.2% of GDP in 2022), (ii) the exemption of

(Continued on the next page)

Box (continued)

employed pensioners from social contributions (0.36% of GDP in 2022), and (iii) the personal income tax exemptions for women with at least 4 children (0.05% of GDP in 2022) and mothers under age 30.

- **Environmental taxation could better internalise negative environmental costs.** In 2022, revenue from environment-related taxes was slightly below the EU average, at 1.9% of GDP. Still, Hungary's tax revenues raised on energy and transport are below the EU average. While the environmental taxes on resources and pollution are above the EU average. There is room to increase environmental taxes to further internalise the cost of air pollution and to limit water pollution, for example on solid fuels like biomass in the residential sector, or on waste such as beverage containers.

- **The redistributive function of the labour tax system remains low.** This is due to flat rate personal income tax system, with the taxation rate at 15%, and high reliance on flat-rate social contributions. Due to the lack of progressivity, low-income earners are taxed relatively high - the tax wedge remains at the same level (41.2%) for different level income earners. The highest in the EU VAT rate puts an additional burden on the low-income earners. More progressive labour tax system could increase the redistributive capacity of the tax system, while strengthening work incentives for low earners.

- **The tax system does not address the high wealth concentration in Hungary.** The concentration of personal wealth in Hungary is the second highest in the EU (with the top 1% share of taxpayers holding some 33.5% of total net personal wealth in 2022, as compared to the EU average of c. 25% in the same year) and has increased significantly since 2013 (from 25%)[(1)]. Currently, there is no net-wealth, nor exit tax for individuals in Hungary. The inheritance and gifts are taxed at an 18% rate, if the beneficiary is not a close relative, while residential property and rights with monetary value are subject to only a 9% rate. Large exemptions substantially decrease the effective tax rates, including on (i) inheritance of land suitable for constructing a residential property or inheritance of rights with monetary value on such land if the beneficiary builds a residential property on it within 4 years, (ii) inheritance of debt securities issued by a member state of the EEA; (iii) and estate inherited by descendants, ascendants or spouse of the deceased.

In the current context of heightened consolidation needs, the decline in tax revenue is constraining fiscal policy choices in Hungary. The gradual decrease in the deficit in 2024 and in 2025 is expected to be mainly driven by decreases in interest payments and energy subsidies, cuts to public investments and temporary revenue from the windfall profit and sectoral taxes. To ensure that fiscal targets are achieved, Hungary will need to introduce permanent fiscal measures that do not undermine the growth potential of the economy. Unless Hungary shores up tax revenue in a sustainable way, further fiscal adjustment is likely to disproportionately affect the expenditure side of the budget leading to cuts to growth-friendly expenditure, such as public investments and spending on essential public services.

(1) World Inequality Lab

Table 2.1: **Key economic and financial indicators, Hungary**

	average 2017-2019	average 2020-2022	2023	2024+	forecast 2025	2026
Output and Prices						
Real GDP (1 year % change)	4.9	2.2	-0.9	0.5	1.8	3.1
Real GDP per capita (1 year % change)	5.2	2.5	-0.8	0.8	2.1	3.4
GDP deflator (1 year % change)	4.5	8.9	14.6	7.5	4.1	3.3
Harmonised index of consumer prices (1 year % change)	2.9	7.8	17.0	3.7	3.6	3.2
Core inflation (HICP excluding energy, food, alcohol and tobacco) (1 year % change)	2.0	5.6	14.0	5.9	4.0	3.4
External position						
Current account balance, balance of payments (% GDP, 3y average)	**1.8**	**-2.2**	**-3.9**	**-1.9**	**1.3**	**1.3**
Current account balance, balance of payments (% of GDP)	0.5	-4.5	0.8	2.0	1.1	0.9
of which: trade balance (% GDP)	4.3	-0.9	5.0			
of which: income balance (% GDP)	-3.8	-3.5	-4.2			
Current account norm (% of GDP) (1)	-0.5	-0.3	-0.3	-0.1	-0.1	0.2
Current account req. to reach fund. NIIP (% of GDP) (2)	-3.5	-2.9	-2.0	-1.8		
Net international investment position (% of GDP)	**-46.5**	**-48.3**	**-36.8**	**-34.3**	**-31.8**	**-29.5**
NIENDI - NIIP excluding non-defaultable instruments (% of GDP)	-4.6	-2.3	-6.7			
Net lending-borrowing (% of GDP)	2.1	-2.4	1.7			
Competitiveness						
Nominal unit labour cost index per hour worked (3y % change)	**10.6**	**17.6**	**35.4**	**47.3**	**36.5**	**23.5**
Nominal unit labour cost index per hour worked (1 year % change)	3.9	7.7	15.3	11.7	6.0	4.3
Real effective exchange rate - 42 trad. part., HICP defl. (3y % ch.)	**0.9**	**-5.7**	**10.3**	**7.3**	**9.0**	**-1.7**
Real effective exchange rate - 42 trading partners, HICP deflator (1 year % change)	0.1	-2.7	15.3	-2.3	-0.5	1.4
Export performance against advanced economies (3y % change)	**2.8**	**-0.1**	**1.2**	**-3.1**	**-2.3**	**-3.9**
Export performance against advanced economies (1 year % change)	0.9	-1.0	7.5	-5.9	-0.5	2.7
Core inflation differential vis-à-vis the euro area (pps.)	0.9	3.6	9.1	3.1	1.5	1.3
Corporations						
Non-financial corporate (NFCs) debt, consolidated (% of GDP) (3)	**50.3**	**60.2**	**55.5**	**54.4**		
NFCs debt fundamental benchmark (% of GDP) (4)	36.2	42.8	46.1	46.1		
NFC (excl. FDI) credit flow, cons. (% debt stock t-1, excl. FDI)	9.0	17.0	6.8	8.4		
Households and housing market						
Household debt, consolidated (% of GDP) (3)	**18.3**	**20.1**	**16.9**	**17.0**		
Household debt fundamental benchmark (% of GDP) (4)	22.2	29.0	32.5	33.0		
Household debt, consolidated (% of Households' GDI)	27.2	29.2	24.1	23.3		
Household credit flow, consolidated (% debt stock t-1)	**7.5**	**12.0**	**3.4**	**9.0**		
Household gross saving rate (&)	14.8	17.4	19.0			
House price index, nominal (1 year % change)	**14.5**	**14.3**	**7.1**	**12.8**		
House prices over/undervaluation gap (5)	-0.9	11.6	13.0	15.4		
Standardized price-to-income ratio	100.4	108.6	102.6			
Building permits (m2 per 1000 inh)	406.5	353.7	259.6			
Government						
General government gross debt (% of GDP)	**68.6**	**76.2**	**73.4**	**74.5**	**74.5**	**73.8**
General government balance (% of GDP)	-2.2	-6.9	-6.7	-5.3	-4.6	-4.1
Banking sector						
Return on equity of banks (%)	14.5	10.8	21.2			
Tier-1 capital ratio banking sector (% risk-weighted assets)	15.6	17.1	17.8			
Gross non-performing loans, domestic and foreign entities (% gross loans)	6.0	3.3	2.4	2.3		
Cost of borrowing for households for house purchase (%)	4.5	5.1	9.8	7.1		
Cost of borrowing for NFCs (%)	1.7	4.8	12.7	9.0		
Labour market						
Unemployment rate (% labour force Y15-74)	**3.6**	**3.9**	**4.1**	**4.5**	**4.3**	**4.1**
Labour force participation rate - % pop. aged 15-64 (3y change in pp)	**3.6**	**2.2**	**3.0**	**2.3**	**1.6**	**1.1**

+ If actual data were unavailable at the cut-off date, forecast or nowcast data are presented instead; * Denotes values above prudential thresholds;
(1) Current accounts in line with fundamentals (current account norms): derived from reduced form regressions capturing the main determinant of the saving-investment balance, including fundamental determinants, policy factors and global financial conditions. See Coutinho, Turrini and Zeugner (2018), "Methodologies for the Assessment of Current Account Benchmarks", European Economy, Discussion Paper 86, DG ECFIN, European Commission.
(2) Current account required to reach the prudential level of the NIIP over 10 years: calculations make use of Commission's T+10 projections. See Coutinho, Turrini and Zeugner (2018), "Methodologies for the Assessment of Current Account Benchmarks", European Economy, Discussion Paper 86, DG ECFIN, European Commission.
(3) Prudential threshold for non-financial corporate and household debt-to-GDP ratio: corresponds to the level above which banking crises become more likely. It is derived from regressions minimising the probability of missed crises and that of false alerts. See Bricongne et al. (2020), "Is Private Debt Excessive?", Open Economies Review, 31:471-512.
(4) Fundamentals-based benchmarks for non-financial corporate and household debt-to-GDP ratios: assesses private debt from regressions capturing the main determinants of credit growth and taking into account a given initial stock of debt. See Bricongne et al. (2020), "Is Private Debt Excessive?", Open Economies Review, 31:471-512.
(5) House prices over/undervaluation gap: is the simple average of the price-to-income, price-to-rent and model valuation gaps. The model valuation gap is estimated in a cointegration framework using a system of five fundamental variables: total population, real housing stock, real disposable income per capita, real long-term interest rate and price deflator of final consumption expenditure. Based on Philiponnet, N., Turrini, A. (2017), "Assessing House Price Developments in the EU", European Economy - Discussion Papers 2015 - 048, DG ECFIN, European Commission.

Source: Eurostat and ECB; European Commission for forecast figures (Autumn Forecast 2024).

Investment began to slowdown in recent years, following a period of robust expansion. Over the past two decades, Hungary's investment (gross fixed capital formation, GFCF) has grown by an average annual rate of 1.1% in real terms (same as the EU), with GFCF contributing 0.28 pps. to GDP growth between 2005 and 2014. This trend was marked by a period of rapid expansion between 2016 and 2019, during which GFCF jumped by 57%. However, this momentum was short-lived, as GFCF began to decline in 2022 and has fallen by 18% over the past two years. This contrasts to increases in other regional peers - Slovakia (+12%), Poland (+14%) and Czechia (+1%). Nevertheless, GFCF remains a crucial component of Hungary's economy, accounting for 23% of GDP on average between 2005 and 2024, with a peak of 27% in 2019, one of the highest levels in the EU.

The automotive sector has been a key driver of investment in manufacturing, but the recent shift to electric vehicles has altered the investment landscape. A sizable part of Hungary's investment has been directed towards the automotive sector[26], which accounted, on average, for 25% of total GFCF in manufacturing between 2005 and 2023 (Graph A1.1). However, after reaching a peak in 2012, investment in the sector started to decline moderately. In contrast, investment in the electrical equipment sector[27], which includes the production of batteries, has increased dramatically since 2017 (+693% in volume). The Hungarian government[28] has adopted a strategy to attract FDI for EV production to position the Hungarian economy as an important hub in the global value chain for electric vehicles (EVs).[29] Hungary is gradually becoming an important hub in the global value chain of EVs, especially batteries, attracting large FDI investments, not only from incumbent players such as German automobile manufacturers (e.g. Audi)[30], but also new companies from Asian countries from other sectors, such as South Korea (e.g. Samsung and LG)[31] and China (e.g. CATL and BYD).[32] In fact, the automotive and electrical equipment sectors combined currently account for almost 50% of GFCF in manufacturing (12% of total GFCF), mainly from foreign companies and FDI. According to the Central Bank of Hungary (MNB), the FDI as share of GDP has been increasing in the automotive and, more recently, in the batteries sectors, averaging 9% between 2017 and 2023.

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[26] NACE code C29 - Manufacture of motor vehicles, trailers and semi-trailers

[27] NACE code C27 - Manufacture of electrical equipment

[28] "Orbán turns to China to boost recession-hit economy". Financial Times (2024) https://www.ft.com/content/ca5f5ce6-46ad-4a34-80b1-b0f7d4b17d58. "Hungary's Orbán courts China and wins a surge of clean car investments". Politico (2023) https://www.politico.eu/article/hungary-pm-viktor-oran-china-ties-ev-clean-car-investments-tensions-eu/

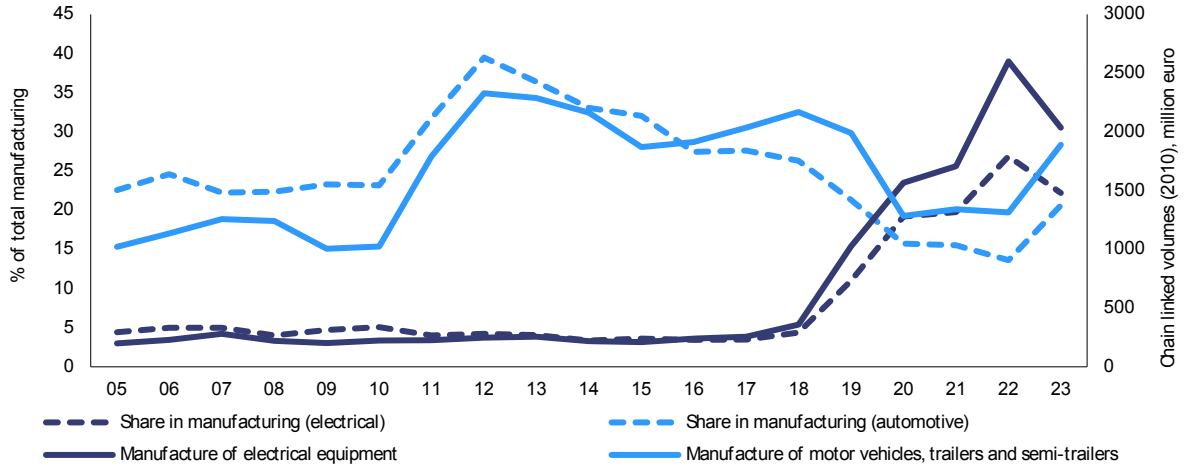
[29] "German car giants and Asian battery kings chose Hungary for multi-billion deal". Euroactiv (2022). https://www.euractiv.com/section/batteries/news/german-car-giants-and-asian-battery-kings-chose-hungary-for-multi-billion-deal/

[30] "Audi to invest $320.2 million to boost electric engine output in Hungary". https://www.reuters.com/business/autos-transportation/audi-invest-3202-mln-boost-electric-engine-output-hungary-2022-06-21/

[31] "In December 2017, Samsung SDI decided to invest €1.2 billion to expand the production capacity of its existing battery cells production facility for EVs in the region of Göd." https://ec.europa.eu/commission/presscorner/detail/en/ip_23_1265 or "LG Magna e-Powertrain Expands Footprint with New Facility in Hungary". https://www.magna.com/stories/news-press-release/2023/lg-magna-e-powertrain-expands-footprint-with-new-facility-in-hungary

[32] "CATL announces its second European battery plant in Hungary", https://www.catl.com/en/news/983.html or "BYD to Build A New Energy Passenger Vehicle Factory in Hungary for Localised Production in Europe". https://www.byd.com/eu/news-list/BYD_to_Build_A_New_Energy_Passenger_Vehicle_Factory_in_Hungary_for_Localised_Production_in_Europe

Graph A1.1: **Gross fixed capital formation, in chain linked volumes and share in total manufacturing**

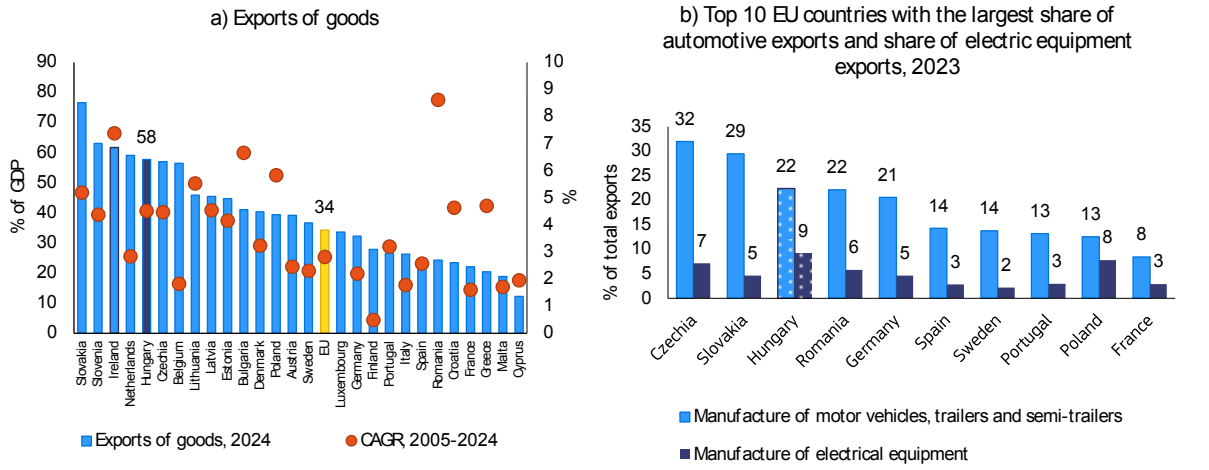


Source: Eurostat.

The robust investment has driven an increase in competitiveness and exports, particularly in the automotive industry. Between 2005 and 2024, Hungary's goods exports grew at an average annual rate of 5%, outpacing the EU average of 3%. Exports of goods accounted for 58% of GDP in 2024, the fifth highest share in the EU (Graph A1.2a). The automotive sector (NACE code 29), in particular, plays a dominant role in Hungary's export economy, accounting for 22% of total exports in 2023, the third highest share in the EU. The electric sector (NACE code 27) accounts for a further 9% of total exports, the highest in the EU, up from 4% in 2020 (Graph A1.2b). These sectors, along with the broader manufacturing sector, drive around 80% of the country's exports. However, exports from the automotive sector are characterised by low domestic value-added content. OECD data for 2020 shows only 33% of domestic value-added content on exports from this sector, unchanged compared to 2015. This figure is equally low in Slovakia (31%), but significantly higher in Czechia (50%) and especially in Germany (74%). Moreover Hungary has a high level of trade integration with Germany, and, the largest shares of total value added in the Hungarian economy are generated to satisfy domestic demand in Germany.[33]

[33] See: European Commission (2024): In-Depth Review 2024 Hungary

Graph A1.2: **Selection of graphs about exports**



Source: Eurostat. European Commission.

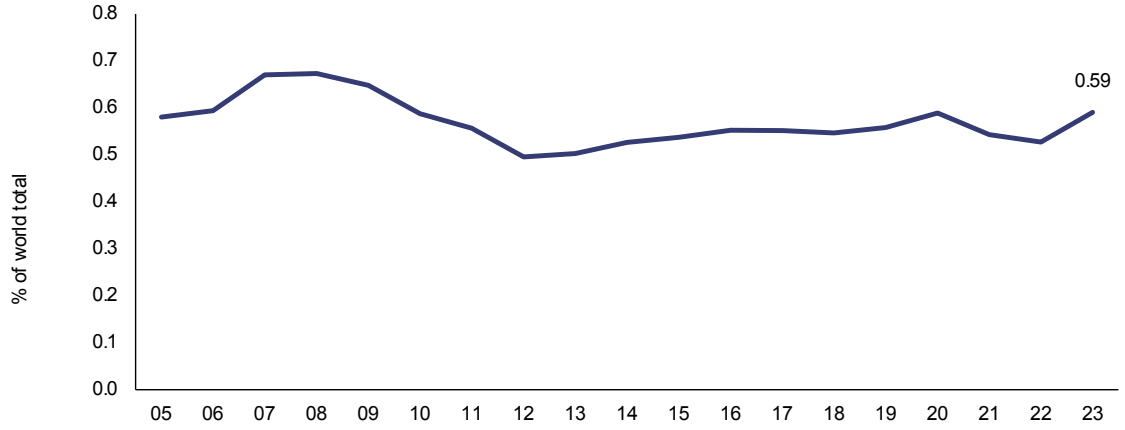
Despite challenges, the automotive sector in Hungary has shown resilience, with new growth opportunities on the horizon. The recent fluctuations in the sectors associated with the automotive industry highlight the economy's significant dependence on this industry and a lack of diversification, as well as the reliance on FDI, which exposes the economy to external factors and to changes in global value chains. However, the automotive industry remains resilient, and the national authorities see the shift towards EVs, sustained by the influx of mainly non-EU FDI, as providing new growth opportunities, and the recent drop in GFCF as a temporary setback. A study carried out by the MNB[(34)] provides estimates on the positive impacts on exports and GDP from the recent investments mentioned above, and a recent paper from the IMF highlights the upsides of the strategy adopted by Hungary to attract FDI for EV production as a way to offset losses in the internal combustion engine production chain.[(35)]

In contrast with the automotive sector, the overall export market share has stagnated in recent years, and challenging external conditions and domestic policy uncertainty continue to put pressure on exports and investments. Hungary's global export market share has remained relatively unchanged in recent years, standing at 0.59% in 2023, suggesting that other sectors may be struggling to compete globally. After reaching a peak of 0.67% in 2008, it declined between 2008 and 2012 and has failed to recover (Graph A1.3). This contrasts with other regional peers, which have recovered from the slump registered in the same period (+0.51 p.p. for Poland, +0.05 p.p. for Czechia, and 0.01 p.p. for Slovakia between 2008 and 2023). The divergence between Hungary and other CEE Member States underscores idiosyncratic factors that are affecting the Hungarian economy. In particular, monetary policy was much tighter, and despite government measures to boost investment (such as new lending schemes or R&D spending incentives), business confidence has remained low. The uncertainty about the disbursement of the RRF funds has negatively affected investor confidence.

(34) See also Box 1-3 in MNB (2024): Inflation Report December 2024

(35) Wingender, P., Yao, J., Zymek, R., Carton, B., Cerdeiro, D., & Weber, A. (2024). Europe's Shift to EVs Amid Intensifying Global Competition.

Graph A1.3: **Export market share of goods in the world, 2005-2023**



Source: Eurostat

Minimum wage increases have been significant in the past decades but have been on par with regional peers. Minimum wages In Hungary are set by a tripartite agreement between the government, the largest trade unions, and employers' associations in the private sector. Besides the statutory minimum wage that has universal application, the parties set the 'guaranteed minimum wage' applying to those whose jobs require at least a high school diploma or equivalent level of vocational training. Hungary's statutory minimum wage in both nominal euro values and adjusted by the purchasing power standard (PPS) was among the lowest in the EU in 2024, but it was comparable to regional peers in terms of purchasing power (Graph A2.1.a). Over the past decade, minimum wages have seen an average annual increase of 12% since the introduction of the six-year wage agreement in 2016 while the flat income tax regime, applicable to both minimum wage earners and higher-income employees, has remained in place.

To achieve the government target of a 50% minimum-wage-to-average-wage ratio by 2027 minimum wages are set to increase much more than average wages. The government aims to phase out the guaranteed minimum wage and increase the minimum-to-average wage ratio, from 41% in 2024 to 50% by 2027.[36] In November 2024, the government and social partners agreed on a three-year deal, which includes minimum wage increases of 9%, 13%, and 14% for 2025, 2026, and 2027, respectively. To offset the costs, employers will pay reduced social contributions for minimum wage workers for those years. This is an ambitious plan, given that the minimum-to-average wage ratio hovered around 40% as a result of the strong average wage dynamics in the past 10 years (Graph A2.1.b). The foreseen minimum wage increases would need to be accompanied by a decelerating average wage increase to attain the 50% ratio by 2027.

The three-year plan to increase the minimum wage is expected to boost wages of low-wage earners and household consumption. According to the MNB's estimate, administrative wage setting directly affected 17% of employees in 2023, down from 21% in 2022.[37] This shows that a significant proportion of workers are affected by minimum wage increases. A substantial minimum wage increase could also have spillover effects, putting pressure on the wages of low-wage earners up to the average wages level.[38] Employees earning minimum wages tend to have a higher marginal propensity to consume, implying that in response to a larger wage increase, they would spend more of their disposable income on consumption, with possible impact on aggregate demand, external balance and consumer prices.

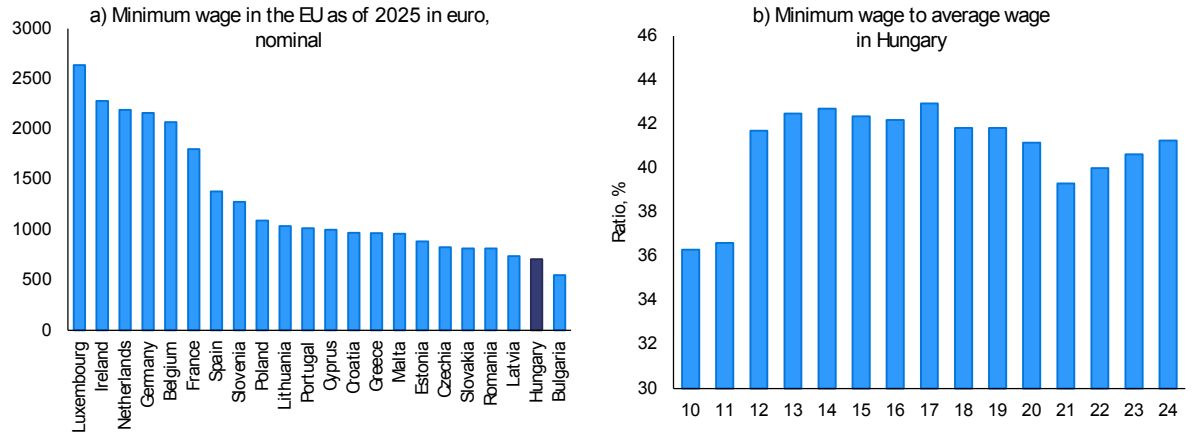
[36] See the interview with the minister for national economy in August 2024 (in Hungarian, here)

[37] This includes wages of workers under the public work scheme. The statutory minimum wage directly affected 5% of total employees in 2023, according to MNB.

[38] See Box 1-5 in MNB(2024): Inflation Report. December 2024

Minimum wage policy needs to balance the need to protect the low paid against the risks to employment, firms' costs, and inflation. Historical evidence from minimum wage increases in the early 2000's suggests that firms responded to minimum wage increases by cutting non labour costs and passing on rising wage costs to consumers, rather than laying off employees.[39] A gradual increase of the minimum wage from its relatively low level would help keeping skilled labour force in the domestic labour market. However, the current context of sluggish external demand, persistent inflationary pressures, high labour hoarding, and tight fiscal and monetary policies (as opposed to the accommodative economic policy stance between 2017 and 2022) may amplify the adverse effects of very large minimum wage increases, including on labour costs beyond the low wages, inflationary pressures and employment losses. At the same time, the fact that the agreement can be renegotiated if actual data significantly deviates from the underlying macroeconomic assumptions mitigates this risk.

Graph A2.1: **Minimum wage**



Source: Eurostat, KSH (Central Statistical Office)

[39] Harasztosi, P. and Lindner. A. (2019) "Who pays for the minimum wage?" American Economic Review, 109 (8), 2693–2727) on the effects of an unexpected 57% minimum wage increase in Hungary in 2001 and a further 25% increase in 2002 showed that minimum wage hikes passed through mostly into consumer inflation. A more recent (Bodnár et al. (2018) How do firms adjust to rises in the minimum wage? Survey evidence from Central and Eastern Europe. IZA Journal of Labor Policy) showed that firms in Central-Eastern Europe employing a larger share of employees on minimum wages respond to rises in the minimum wage mostly by cutting non-labour costs, while other firms adjust by raising productivity.

The relationship between banks and the sovereign has attracted a lot of attention in the policy debate since the global financial crisis. Over the years, some governments in advanced economies encouraged domestic financial institutions to hold government debt as a debt management tool.[40] In Hungary, increasing reliance on households and the domestic financial sector helped to decrease reliance on foreign exchange (FX) and external financing in the aftermath of the global financial crisis, which was also welcomed by credit rating agencies.[41] A sizable retail bond programme and the self-financing policies of the central bank helped to reduce the share of FX debt to total public debt from 48% to 33% between 2010 and 2024 (Graph A3.1.a-b).[42] However, excessive exposure of the domestic banking sector to the government poses well-documented risks.[43] This section aims to provide a deeper look into the bank-sovereign nexus and the policies that are affecting this in Hungary.

A new scheme offering tax incentives to domestic banks in return for purchasing government debt strengthened the bank-sovereign nexus in 2024. Domestic banks' government bond holdings increased to 15.6% of banks' total assets at the end of 2024 from 13.9% a year before, which is among the highest shares in the EU (Graph A3.1.c-d). The increase was driven by a tax incentive that allows banks to reduce their windfall tax liability by 10% of the increase in their government bond holdings, up to a maximum of 50% in 2024 and 2025.[44] To put this into perspective, the government expects to collect a windfall tax from banks equivalent to 0.4% of GDP in 2025. To maximise the tax exemption, which could reach up to 0.2% of GDP, domestic banks would need to increase their government securities portfolio by approximately 2.0% of GDP. The tax relief is based on their average bond holdings between January and November 2025, suggesting that banks may frontload their government bond demand to meet the requirement more easily.

More government bonds are expected to be absorbed by the banking sector in 2025, based on the financing plans of the government. Net domestic wholesale bond issuance is projected to rise to 2.3% of GDP, a significant increase from the -1.5% planned for 2024. In contrast, planned net FX issuance and retail bond issuance are expected to decline substantially.[45] This shift is already evident as wholesale bond issuance in January-February 2025 increased by 76% compared to the same period in 2024. Furthermore, any additional financing needs beyond the planned amount would likely be met through the banking sector, given that the FX ratio of central government debt stood close to the government's 30% threshold. This suggests that the government may be constrained in its ability to issue

(40) See: Reinhart, C. M., and B. Sbrancia. 2015. "The Liquidation of Government Debt." Economic Policy 30 (82): 291-333

(41) See eg: Moody's (2016) link here

(42) See: Bodnár et al (2016): Results of the Self-financing Programme, Magyar Nemzeti Bank, 2016 link here

(43) For an overview see e.g. C. Borio, M. Farag, F. Zampinoli (2023): Tackling the fiscal policy-financial stability Nexus BIS Working Papers No. 1090 April 2023

(44) The tax relief is calculated based on the difference in average bond stock between two periods. For 2024, the calculation uses the average stock from January to November 2024 compared to the average stock from January to April 2023. For 2025, the calculation uses the average stock from January to November 2025 compared to the higher of two reference periods: either January to November 2024 or January to April 2023.

(45) See: AKK (2024): Debt Management Outlook 2025

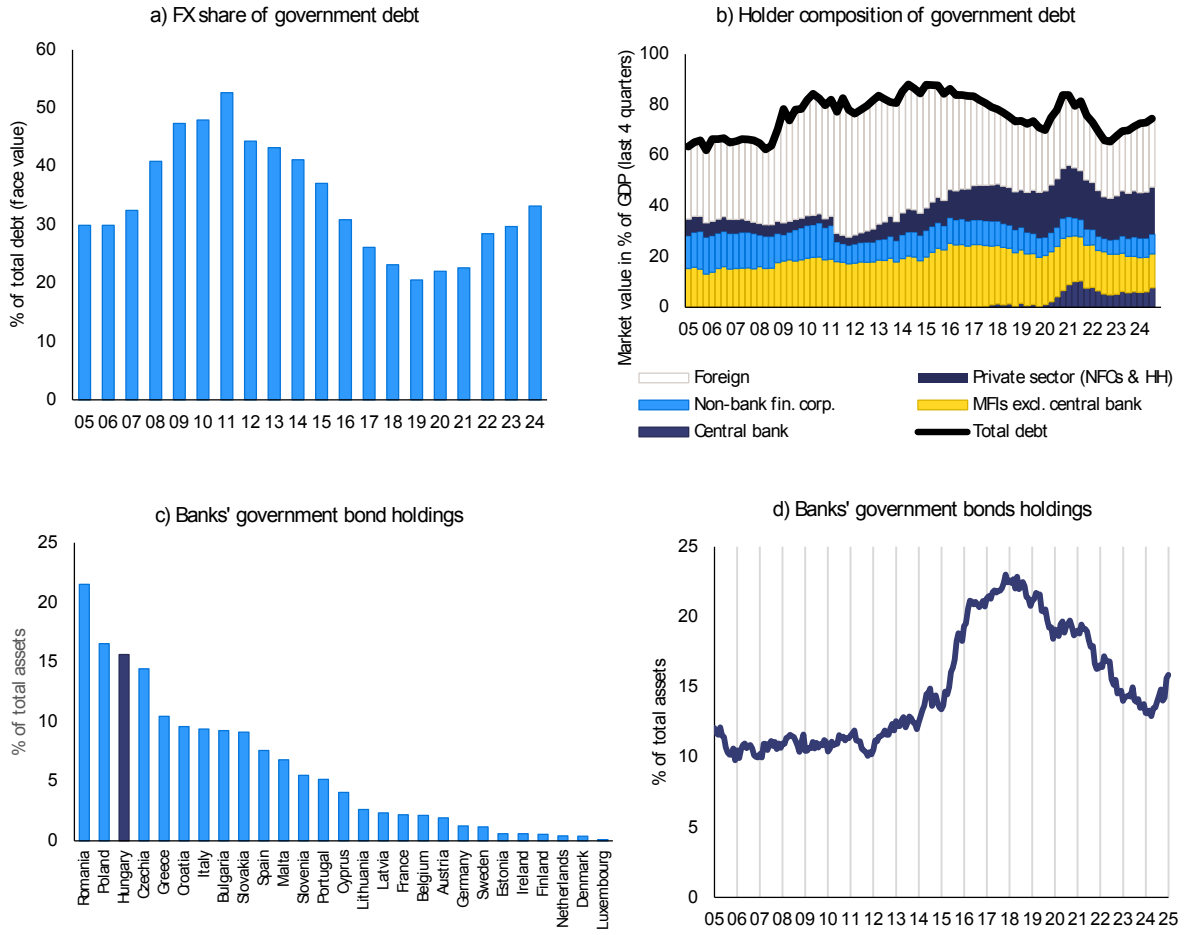
FX-denominated debt, making the domestic banking sector an increasingly important source of financing.

The bank-sovereign link has further deepened as the state has significantly increased guarantees provided to the financial sector. In 2023, total government guarantees reached 13% of GDP, with 4% directed towards the financial sector, marking the fourth-highest rate in the EU. These guarantees to the financial sector increased in 2022 and 2023, compared to a more stable level of around 2.6% of GDP from 2017 to 2021. The government introduced subsidised loan guarantee programs for firms in response to rising energy prices, along with loan guarantees for SMEs to support subsidised loans.[46] This arrangement implies that if a corporation defaults on its loan, the government assumes the debt obligation. Consequently, a significant rise in non-performing loans during an economic downturn could increase government financing needs and further intensify the interdependence between the government and domestic banks.

Full implementation of Hungary's medium-term fiscal-structural plan could pave the way for more diversified financing and reduce the bank-sovereign nexus risks. Currently, government financing relies on a combination of retail bonds issued to households, FX issuance, and national currency wholesale bonds issued to the financial sector. However, pension funds and insurance corporations play a relatively minor role in government financing. Fiscal consolidation efforts based on permanent measures from both the expenditure and revenue sides would reduce the public debt and thus sovereign risk. This, together with a withdrawal of government interventions in the financial sector, could ultimately lead to a broader range of investors participating in the market, further diversifying the government's financing sources.

[46] The figures reflect state guarantees to the mainly state owned Guarantiqa Plc. and Start Garancia Plc. that provide guarantees to debtors up to 80% of debt obligations.

Graph A3.1: **Selected graphs**



Source: ECB, Eurostat, IMF, AKK (Government Debt Management Agency), MNB (Central Bank of Hungary).