INTERNATIONAL MONETARY FUND

IMF Country Report No. 24/268

HUNGARY

2024 ARTICLE IV CONSULTATION—PRESS RELEASE; AND STAFF REPORT

August 2024

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 2024 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 June 21, 2024, 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 July 18, 2024.
- 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

PR 24/300

IMF Executive Board Concludes 2024 Article IV Consultation with Hungary

FOR IMMEDIATE RELEASE

Washington, DC – **August 2, 2024:** The Executive Board of the International Monetary Fund (IMF) concluded the Article IV Consultation[1] with Hungary and considered and endorsed the staff appraisal on a lapse-of-time basis without a meeting.[2]

A modest recovery is underway, while the disinflationary process remains on track. Following a contraction of 0.9 percent in 2023, real GDP growth is projected at 2.3 percent in 2024, driven by domestic consumption. Growth is expected to accelerate to 3.3 percent in 2025 as investment gradually picks up, and then converges to its potential of around 3 percent over the medium term. Headline inflation has fallen to 3.7 percent in June, within the MNB's one percentage point tolerance band of the 3 percent target and is projected to increase to 4.2 percent year on-year in Q4 2024 before durably converging to 3 percent in 2026. A modest current account surplus is expected in 2024 with gradual improvement over the medium term in line with the anticipated increase in battery and electric vehicle exports.

The recession in 2023, elevated borrowing costs, and spending pressures are weighing on public finances. Despite a less expansionary fiscal stance than in 2022, the headline deficit stood at 6.7 percent of GDP in 2023, as the recession reduced revenues and spending on interest and energy subsidies increased. The public debt ratio declined slightly but remained well above pre-pandemic levels. In the absence of additional measures, the deficit will reach 5 percent this year, above the authorities' 4.5 percent revised budget target, and exceed the Maastricht limit of 3 percent of GDP through 2026, while the public debt ratio will remain above 70 percent of GDP through 2028.

The outlook is clouded by uncertainty, with risks tilted to the downside for growth and upside for inflation. The absence of measures to address still sizeable fiscal imbalances and structural policy challenges could weaken investor confidence and deter needed private investment. Lack of progress in governance reforms could result in the prolonged suspension of important EU funds. A resultant increase in risk premia and forint depreciation could prolong tight monetary policy and weaken growth. Inflation could increase again in the event of further disruptions to energy supply caused by an escalation of geopolitical risks, which would also adversely affect the external balance, or if Hungarian wages grow faster than expected. Furthermore, monetary policy miscalibration by major economies could impact Hungary's macroeconomic and financial stability.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team 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.

[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.

Executive Board Assessment

In concluding the 2024 Article IV consultation with Hungary, Executive Directors endorsed staff's appraisal, as follows:

Hungary is emerging from a period of shocks. The pandemic, Russia's war in Ukraine, and crisis-related stimulus widened fiscal and external imbalances and triggered double-digit inflation in 2022. Thanks to an effective monetary policy response aided by falling commodity prices and a tighter fiscal stance in 2023, inflation has declined rapidly. A large current account deficit in 2022 turned into a surplus in 2023, labor markets and the financial sector have remained resilient, and output is starting to recover.

However, significant challenges remain. Fiscal imbalances, windfall taxes, interest rate caps and subsidized lending, and delays in the disbursement of EU funds create investor uncertainty. Mutually reinforcing challenges are holding back Hungary's productivity, including a strong presence of state-owned enterprises in some key sectors, inequalities of opportunities, and lagging digitalization. Policy uncertainty has also constrained investment, contributing to an external position stronger than implied by fundamentals (Annex III).

A credible fiscal adjustment would help safeguard fiscal sustainability. In the absence of measures, staff projects that the authorities will miss the targets set in their latest EU Convergence Program. Measures should aim at achieving a deficit of below 3 percent of GDP by 2026, while bringing the structural deficit to 1.5 percent of GDP by 2029, in line with the preliminary assessment of what the new EU fiscal framework would require. This fiscal path should be anchored in a credible medium-term framework.

Tax reforms should focus on improving the efficiency and equity of the tax system. A universal VAT rate with fewer exemptions would simplify administration. Higher marginal personal income tax rates for high earners would enhance progressiveness. Taxation of corporates could be made more equitable by rationalizing tax incentives and increasing the tax rate, while using the additional revenues to eliminate distortive windfall taxes. There is also scope for raising more revenue from property taxes. Hungary should reduce its reliance on distortive taxes such as financial transaction taxes and windfall taxes that create uncertainty and undermine investment.

Reducing subsidies and rationalizing other current spending would create room for a more growth-friendly spending mix. Retail utility subsidies should be limited to a basic subsistence amount to protect vulnerable households. A rationalization of the public wage bill and goods and services spending would provide further savings and free room for more productive spending, including on investment and education. Reforms are also needed to contain long-term spending pressures, and to improve monitoring of contingent liabilities stemming from the rapid expansion of SOE assets and government guarantees.

Policy rates should remain in restrictive territory into next year to deliver a sustainable return of inflation to target. The loosening of the monetary policy stance has been broadly appropriate so far. But there is limited scope for further rate cuts this year as underlying inflation pressures remain elevated, particularly for services. The exchange rate is likely to also be a binding constraint on the pace of loosening given its importance for inflation dynamics. The flexible exchange rate regime and maintaining adequate reserves can help

Hungary manage external shocks. Central bank autonomy should be protected by appropriate legal frameworks.

Now is still an opportune time to bolster financial sector resilience, while distortions to market-based credit allocation should be removed. The introduction of a positive neutral countercyclical capital buffer, of 1 percent from July 2025, represents an important step to further mitigate systemic risks. While the MNB should play an active role in climate-risk supervision, initiatives should be consistent with its core mandate of price and financial stability. Hungary should prioritize implementing the EU's AML/CFT 2024 legislative package and enhancing risk-based measures for non-profit organizations. State-owned banks' subsidized lending should be better targeted, while remaining interest rate caps should be phased out. Scaling back the various fiscal incentives for house ownership would help moderate future house price growth and safeguard financial stability.

Deeper reforms are needed to drive more balanced growth. Investment in STEM education, implementation of the new EU AI Act, reduced fossil fuel subsidization coupled with transfers for the vulnerable, and targeted incentives for investment in disadvantaged areas would have mutually reinforcing benefits. Further progress on governance reforms would foster a growth-friendly environment and unlock EU financing. The state’s strong presence in some sectors, including through recent telecom and airport acquisitions, should be guided by legal, regulatory and policy frameworks that ensure fair competition.

Table 1. Hungary: Selected Economic Indicators, 2019-2029

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
						Projections					
Real economy					(Percent change, unless otherwise indicated)						
Real GDP (percentage change)	4.9	-4.5	7.1	4.6	-0.9	2.3	3.3	3.0	3.0	3.2	3.2
Total domestic demand (contribution to growth)	6.8	-2.5	6.2	4.0	-5.4	1.4	4.6	2.7	2.5	2.8	2.7
Private consumption	2.7	-1.1	2.4	4.0	-0.6	1.8	1.6	1.4	1.4	1.4	1.4
Government consumption	0.9	0.4	0.3	0.1	-0.2	0.1	0.3	0.3	0.2	0.2	0.2
Gross fixed investment	3.1	-1.9	1.5	0.4	-1.8	-0.5	1.6	1.1	1.1	1.2	1.2
Foreign balance (contribution to growth)	-2.1	-2.2	0.9	0.7	4.9	0.8	-1.3	0.3	0.5	0.4	0.5
CPI inflation (average)	3.4	3.3	5.1	14.6	17.1	3.8	3.5	3.1	3.0	3.0	3.0
CPI inflation (end year)	4.0	2.7	7.4	24.5	5.5	4.2	3.3	3.0	3.0	3.0	3.0
Core CPI inflation (average)	3.1	3.7	3.9	15.8	17.7	4.7	4.6	3.6	3.1	3.0	3.0
Core CPI inflation (end year)	3.2	3.2	6.4	24.8	7.6	4.9	4.2	3.2	3.0	3.0	3.0
Unemployment rate (average, ages 15-74)	3.3	4.1	4.1	3.6	4.1	4.4	4.2	4.1	3.9	3.8	3.7
Gross fixed capital formation (percent of GDP)	27.0	26.5	27.2	27.9	26.3	25.0	25.8	26.1	26.5	26.9	27.2
Gross national saving (percent of GDP, from BOP)	26.2	25.4	23.0	19.5	26.5	25.9	26.1	26.5	27.3	28.0	28.6
General government [1/]											
Overall balance (percent of GDP)	-2.0	-7.6	-7.2	-6.2	-6.7	-5.0	-4.5	-3.3	-2.9	-2.8	-2.6
Primary balance (percent of GDP)	0.1	-5.4	-5.1	-4.0	-3.0	-0.8	-0.6	-0.1	0.4	0.5	0.6
Structural primary balance (percent of potential GDP)	-1.4	-4.3	-5.4	-4.8	-2.6	-0.2	-0.3	0.1	0.5	0.5	0.6
Public debt (percent of GDP)	65.3	79.3	76.7	74.1	73.5	73.9	73.5	72.5	71.3	70.0	68.6
Money and credit (end-of-period)											
Broad money	8.1	21.1	16.3	7.1	1.4	4.6	7.2	6.6	6.7	6.8	7.3
Lending to the private sector, flow-based	15.3	11.8	12.8	12.0	4.5	3.4	7.1	6.1	5.9	6.1	6.1
Interest rates											
T-bill (90-day, average)	0.0	0.4	0.9	7.6	11.0	6.7	6.6	6.6	6.5	6.5	6.5
Government bond yield (5-year, average)	1.6	1.5	2.4	8.1	8.0	6.5	6.6	6.6	6.6	6.7	6.7
Balance of payments											
Current account (percent of GDP)	-0.8	-1.1	-4.3	-8.4	0.2	0.8	0.3	0.4	0.7	1.1	1.4
Reserves (billions of Euros)	28.4	33.7	38.4	38.7	41.3	50.8	57.6	65.9	70.5	77.6	84.9
Gross external debt (percent of GDP) [2/]	73.1	81.3	87.0	91.8	85.5	79.9	76.9	74.9	72.4	70.3	68.1
Gross official reserves in percent of the IMF ARA metric	104.5	120.2	117.4	107.0	104.8	113.2	126.8	135.2	138.6	145.7	151.3
Exchange rate											
Exchange rate, HUF per euro, period average	325.2	351.2	358.5	390.9	381.8	…	…	…	…	…	…
Nominal effective rate (2000=100, average)	121.5	130.5	133.0	145.5	141.3	…	…	…	…	…	…
Real effective rate, CPI basis (2000=100, average)	80.4	84.2	84.1	87.5	77.0	…	…	…	…	…	…
Memorandum items:											
Nominal GDP (billions of Forints)	47,674	48,444	55,205	65,952	74,992	79,770	85,411	90,658	96,032	101,921	108,157
Per capita GDP (EUR)	14,999	14,119	15,827	17,411	20,463	21,809	23,413	24,913	26,454	28,147	29,942
Output gap (percent of potential GDP)	3.3	-2.9	0.3	1.7	-1.2	-1.4	-0.7	-0.4	-0.2	0.0	0.2
Potential GDP growth (percentage change)	3.5	1.6	3.6	3.2	2.0	2.5	2.6	2.7	2.8	2.9	3.0

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.

INTERNATIONAL MONETARY FUND

HUNGARY

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION

July 18, 2024

KEY ISSUES

Context. Hungary is emerging from a period of shocks. The pandemic, Russia's war in Ukraine, and crisis-related stimulus widened fiscal and external imbalances and triggered double-digit inflation in 2022. Thanks to an effective monetary policy response aided by falling commodity prices and a tighter fiscal stance in 2023, inflation came down significantly, while the labor market and financial sector remained resilient. A large current account deficit in 2022 turned into a surplus, and output is starting to recover. However, significant challenges remain. The fiscal deficit and public-debt-to GDP ratios are well above 2019 levels, and various windfall taxes have created investor uncertainty. Interest rate caps and subsidized lending measures have distorted market rates, and a significant state presence in key sectors impedes competition. Despite some progress, the ongoing negotiations on the "super milestones,"[1] including the Commission's assessment of governance conditions, are delaying the disbursement of EU funds, which are vital for digitalization, regional integration, and the green transition.

Outlook and risks. Growth of 2.3 percent is expected in 2024, accelerating to 3.3 percent in 2025. Inflation is projected to increase to 4.2 percent in Q4 2024 before durably converging to the authorities' 3 percent target in 2026. Risks remain tilted to the downside for growth and upside for inflation: a failure to address fiscal imbalances, a lack of progress in governance reforms resulting in the prolonged suspension of EU funds, stickier-than-expected inflation, commodity price shocks, and adverse spillovers from major economies' monetary policy could undermine macroeconomic stability.

Key Policy Recommendations:

- **Fiscal policy**. A credible and growth-friendly fiscal adjustment plan is needed to safeguard macroeconomic stability. A more balanced tax structure with fewer VAT and CIT exemptions and higher rates on personal income and property taxes could raise additional revenue and facilitate the reduction of distortive windfall and financial transaction taxes. Phasing out utility subsidies and reducing high public wage bill and goods and services spending would yield savings and provide room for more productive spending, including on investment and education. These measures should be rooted in a reinvigorated medium-term budget process. Reforms are also needed to address longer-term spending pressures.

[1] Super milestones are quantifiable achievements that EU member states must implement to access the next tranche of funding from the EU's Recovery and Resilience Facility.

- **Monetary and financial sector policies.** Monetary policy should remain in restrictive territory to deliver a sustainable return of inflation to target. Central bank autonomy is vital for price and financial stability, and should be protected by adequate legal frameworks. The flexible exchange rate regime and maintaining adequate reserves can help Hungary manage external shocks. Locking in high bank profits into capital buffers would enhance financial sector resilience while phasing out interest rate caps and more selective use of subsidized lending would allow market forces to drive credit allocation. While the MNB should play an active role in climate-risk supervision, its initiatives should be consistent with its price and financial stability mandates.
- **Structural reforms.** A coordinated policy approach is needed to improve Hungary's productivity, reduce regional inequality, strengthen governance, and advance the green transition. Enhancing competition, while removing fossil fuel subsidies and investing in digital innovations, will help to boost productivity and promote sustainable growth, including in disadvantaged regions. Targeted spending on reskilling workers to facilitate their transition to emerging digital and green opportunities will strengthen social cohesion and broaden political support for structural transformations. Further progress on governance reforms will enhance policy predictability, improve the business environment, and facilitate the release of needed EU funds.

Approved By
Kristina Kostial (EUR) and Fabian Bornhorst (SPR)

The meetings took place in Budapest from June 11-21, 2024. The staff team comprised Anke Weber (head), Jakree Koosakul, Augustus Panton, Atticus Weller (all EUR), and Chris Jackson (RES), with assistance from Estefania Cohn Bech and Ninfa Gonzales. Significant contributions to the staff report were made by Thomas Benninger, Alessia De Stefani, and Shafik Hebous. Gábor Meizer and Dániel Palotai (OED) participated in the meetings. The mission held discussions with State Secretaries Benő Péter Banai and Tibor Tóth (Ministry of Finance), Máté Lóga and Anikó Túri (Ministry of National Economy), Ágnes Hornung (Ministry of Culture and Innovation), Szabolcs Ágostházy (Ministry of Public Administration and Regional Development), Deputy Central Bank Governors Barnabás Virág and Csaba Kandrács, Zoltán Kurali (CEO, AKK), Gábor Horváth (President of the Fiscal Council), Viktor Horváth (Deputy State Secretary, Ministry of Energy), and other officials, representatives from the Parliamentary Economic Committee, banks, companies in energy, pharmaceutical and agricultural sectors, trade chambers, employer and employee associations and research institutions.

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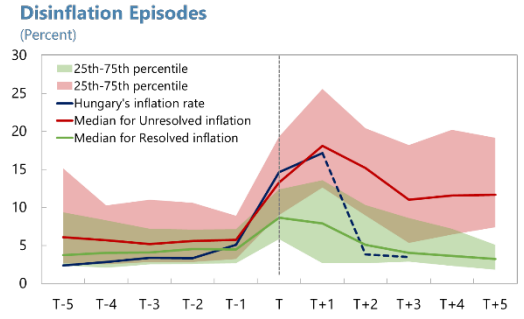
TABLES

ANNEXES

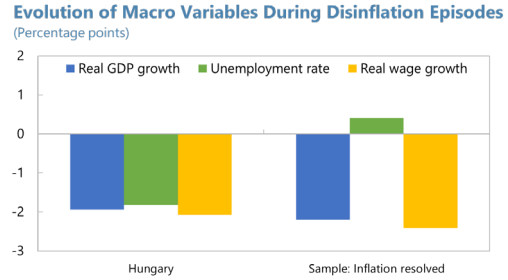
AT A GLANCE

1. Hungary is emerging from a period of shocks. The pandemic, Russia's war in Ukraine, and crisis-related policy stimulus widened the fiscal and current account deficits and triggered double digit inflation in 2022. The Magyar Nemzeti Bank (MNB) responded effectively with a monetary policy stance that was among the tightest in Europe and—aided by falling commodity prices and a less expansionary fiscal stance than in 2022—inflation came down forcefully, while the labor market and financial sector remained resilient. A large current account deficit in 2022 turned into a surplus.

Figure 1. Hungary's Recent Disinflation in Historical Perspective



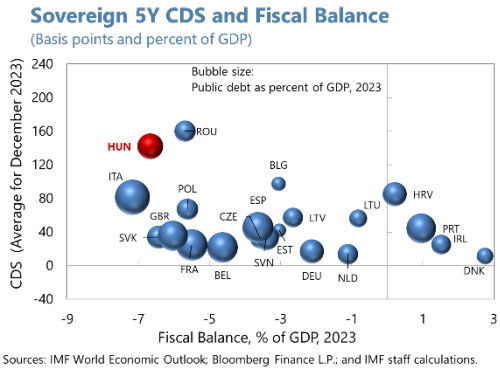
Sources: Hungarian Central Statistical Office, Haver Analytics, IMF WEO, IMF WP/23/190, and IMF staff calculations.
Note: Green=inflation resolved and red=inflation unresolved, sample of 33 AEs and 9 EMEs. The dotted line shows IMF's current projections for 2024 and 2025.



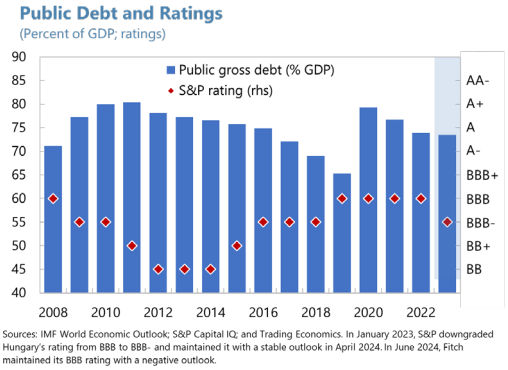
Source: Hungarian Central Statistical Office, Haver Analytics, IMF WEO, IMF WP/23/190, OECD, and IMF staff calculations.
Note: For Hungary, the bars show each indicator's growth rate difference between 2022-2023 average and 2013-2019 average. RHS group bars: median at a 5-year horizon post-shock for 33 AEs and 9 EMEs.

2. The period has left some economic scars, while structural policy trends are clouding growth prospects. The fiscal deficit and public debt-to-GDP ratios remain well above 2019 levels and sovereign spreads exceed those of most peers. Various windfall taxes created investor uncertainty. Regulatory and subsidized lending measures, some of which have been phased out, have distorted market rates. A significant state presence in key sectors impedes competition, holding back productivity.[2] The ongoing negotiations on the "super milestones," including the Commission's assessment of governance conditions, delay the disbursement of EU funds, which are vital for regional integration and the green transition. There have been concerns about policies that could undermine central bank autonomy. Take-up of past IMF advice has been mixed (Annex I & II).

Figure 2. Sovereign Risk Premia and Public Debt



Sources: IMF World Economic Outlook; Bloomberg Finance L.P.; and IMF staff calculations.



Sources: IMF World Economic Outlook; S&P Capital IQ; and Trading Economics. In January 2023, S&P downgraded Hungary's rating from BBB to BBB- and maintained it with a stable outlook in April 2024. In June 2024, Fitch maintained its BBB rating with a negative outlook.

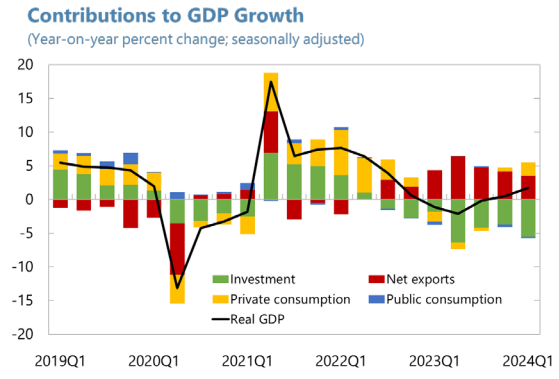
[2] OECD 2024. Hungarian SOEs are found less productive than privately-owned firms (Muraközy et al., 2018).

THE SETTING

A. Recent Developments

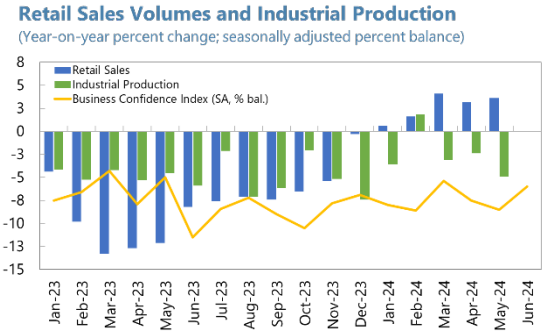
3. The economy has begun to recover. Output declined by 0.9 percent in 2023 driven by a contraction in corporate investment and delays in public investment projects while private consumption fell on the back of negative real wage growth. Net exports partially offset these developments as imports contracted amid weak domestic demand. Since Q4, quarterly growth has turned positive as real wage dynamics improved. GDP growth data for 2024:Q1 and high-frequency indicators point to a continued modest recovery in consumption, amid weak investment, and a positive contribution of net exports given import compression.

Figure 3. GDP and Labor Market Developments

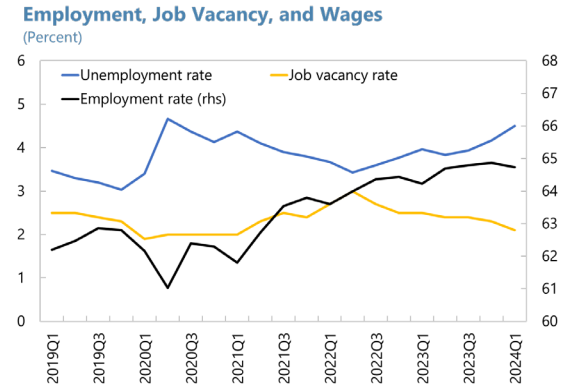


Sources: Hungarian Central Statistical Office (CSO); Haver Analytics; and IMF staff calculations.

Sources: Hungarian Central Statistical Office; Haver Analytics; and IMF staff calculations.



Sources: Hungarian Central Statistical Office (CSO); GKI Economic Research Co.; Haver Analytics; and IMF staff calculations.
Note: The business confidence index is the weighted average of the industrial, trade, construction and services confidence indices. Each index is the average of the responses to questions on perceptions in each sector. Percent balance equals percent of respondents reporting an increase minus the percent of respondents reporting a decrease.

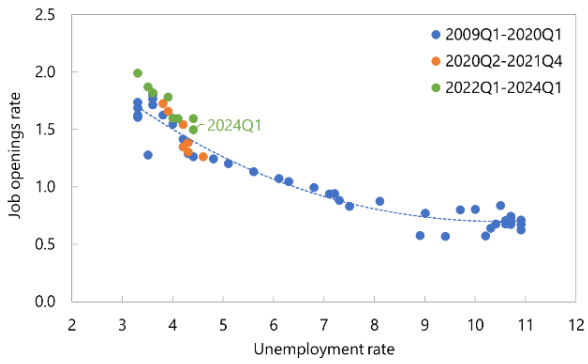


Sources: Hungarian Central Statistical Office (CSO); Haver Analytics; and IMF staff calculations.

4. The tight labor market has recently started to ease. After declining to reach an almost historic low yearly average of 3.6 percent in 2022, unemployment rose above staff's estimated natural rate of 3.8 percent to 4.3 percent in 2024:M5, while the job vacancy rate declined. The implied movement down the Beveridge curve suggests a modest loosening in the labor market, though it remains tight by historical standards. The employment rate further increased in 2023 as the rising cost of living increased labor force participation and companies engaged in labor hoarding, but stabilized in 2024:Q1.

Figure 4. Beveridge Curve

(Percent)



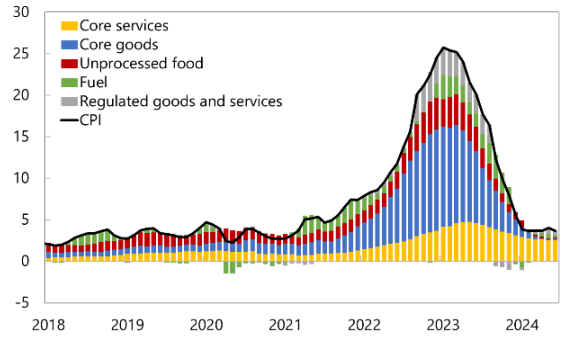
Sources: Hungarian Central Statistical Office; Haver Analytics; and IMF staff calculations.

5. Inflation has fallen to within the MNB's tolerance band. Inflation has declined from over 25 percent in January 2023 to 3.7 percent in June 2024, within the one percentage point tolerance band of the 3 percent target. This has been driven by lower goods and commodity price inflation and appreciation of the forint in 2023. Disinflation has also been aided by an increase in slack and well-anchored longer-term inflation expectations. Weaker domestic inflation pressures have been supported by a drop in unit profits inflation. Sequential inflation has picked up in recent months, however, driven by services and energy inflation. Services inflation remains above target-consistent rates, reflecting backward-looking price setting and high labor cost growth.

Figure 5. Indicators of Inflation

Headline and Core CPI Inflation

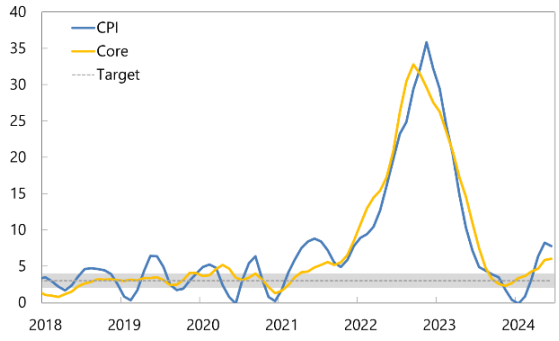
(Year-on-year percent change)



Sources: Hungarian Central Statistical Office; Magyar Nemzeti Bank; Haver Analytics; and IMF staff calculations.

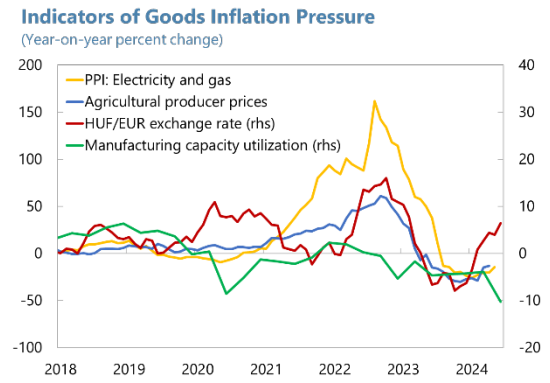
Headline and Core Inflation

(3-month on 3-month annualized percent change)

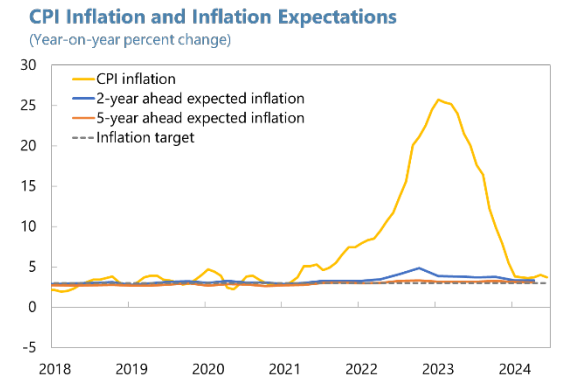


Sources: Hungarian Central Statistical Office; Magyar Nemzeti Bank; Haver Analytics; and IMF staff calculations.

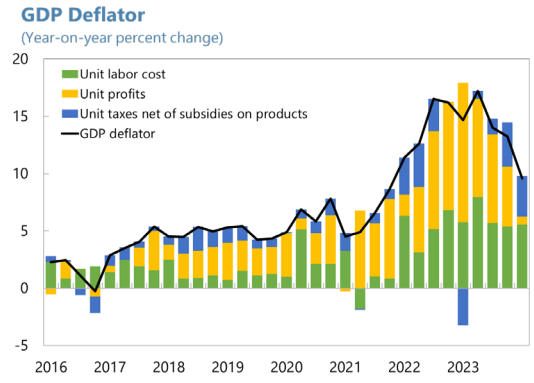
Figure 5. Indicators of Inflation (Concluded)



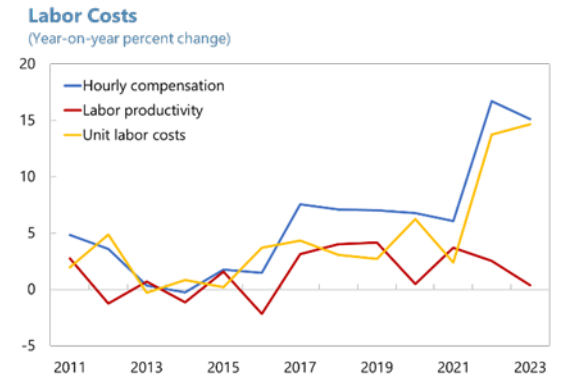
Sources: Hungarian Central Statistical Office; Haver Analytics; and IMF staff calculations.



Sources: Hungarian Central Statistical Office; Consensus Economics; Haver Analytics; and IMF staff calculations.



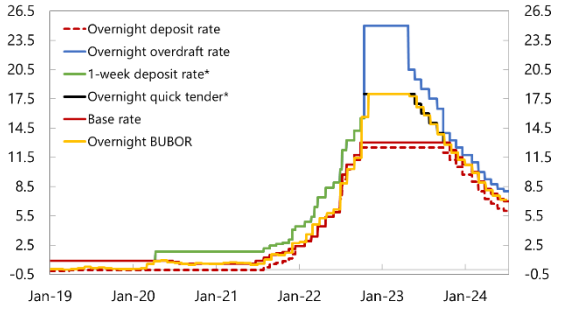
Sources: Eurostat; Haver Analytics; and IMF staff calculations.



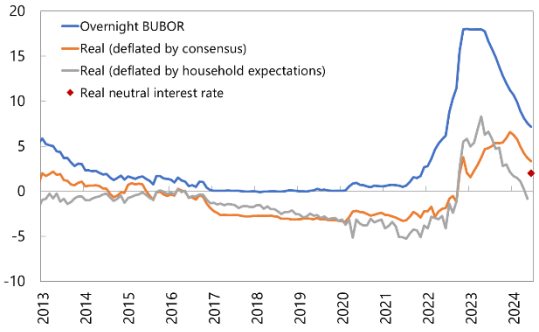
Sources: Eurostat; Haver Analytics; and IMF staff calculations.

6. The central bank has cut policy rates, but the policy stance generally remains tight overall. Between mid-2021 and October 2022, the MNB substantially tightened monetary policy with the effective policy rate peaking at around 18 percent. In May 2023, given an improvement in risk perception and stabilization of the forint, the MNB started narrowing the interest rate corridor and reducing the interest rate on one-day quick deposit and foreign exchange swap tenders. In September 2023, the MNB also began cutting its base rate from 13 percent to 7 percent in June 2024. At the same time, the MNB simplified its toolkit, remunerating excess reserves at the base rate and phasing out the quick deposit tender such that the base rate became the effective interest rate. The stance of monetary policy generally remains restrictive relative to staff's estimated real neutral interest rate of around 2 percent. Elevated short-term household inflation expectations—which have lagged the fall in actual inflation—imply, however, that some measures of real interest rates are below neutral.

Figure 6. Interest Rates



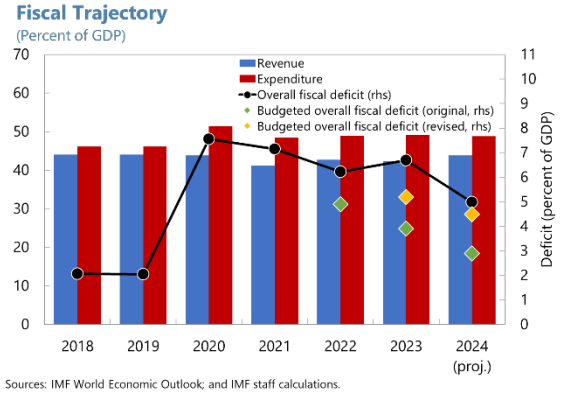
Sources: Magyar Nemzeti Bank; and Haver Analytics.
Note: Quick deposit tenders have been suspended by the central bank from 2 October 2023. The optional required reserve ratio has been phased out from 1 January 2024.



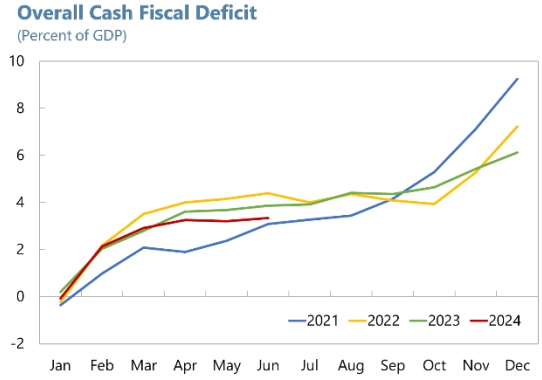
Sources: Magyar Nemzeti Bank; and Haver Analytics.

7. The authorities missed their 2023 budget target by a wide margin despite a less expansionary stance than in 2022. The headline deficit widened to 6.7 percent of GDP in 2023, driven by weak VAT revenues and higher spending on interest and energy subsidies. The structural primary deficit improved relative to 2022 by about 2¼ percent of GDP, however, mostly due to delays in capital spending. The public debt-to-GDP ratio marginally declined to 73.5 percent. The cumulative cash deficit through June already reached 73 percent of the government's revised 2024 ESA-based budget target (4½ percent of GDP). The EC recently proposed that Hungary be put under the EU's excessive deficit procedure (EDP) as a result of exceeding the relevant deficit and debt thresholds.

Figure 7. Fiscal Deficits and Hungarian Government Budget Targets



Sources: IMF World Economic Outlook; and IMF staff calculations.
Note: Overall fiscal deficit (black dot) in 2024 is IMF staff's projection.

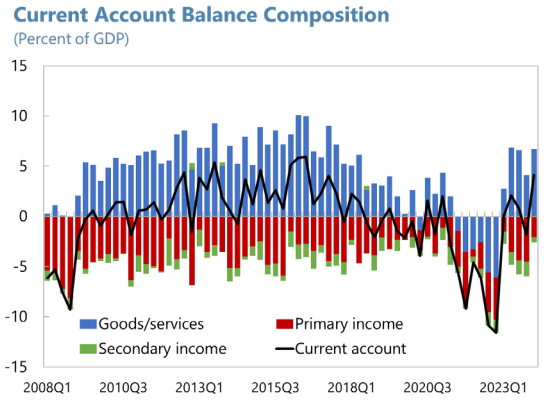


Sources: Hungary's Ministry of Finance; and IMF staff calculations.

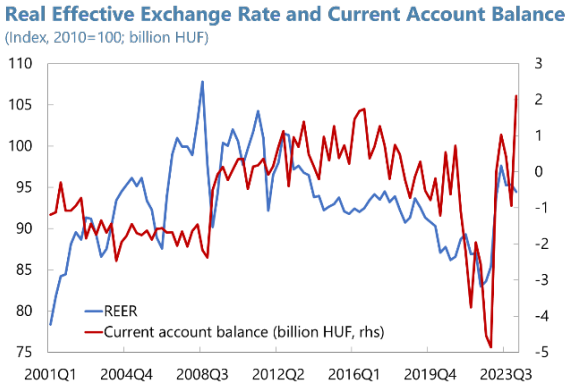
8. The external balance improved significantly in 2023. The current account shifted from a deficit of 8.4 percent of GDP in 2022 to a surplus of 0.2 percent of GDP in 2023 as falling energy prices and weak private domestic demand led to an improvement in the trade balance. Reserve coverage increased to 3.3 months of imports and 105 percent of the IMF's reserve metric in 2023, while reserve accumulation continued through Q1 2024. €12.2 billion of Hungary's Cohesion Fund allocation, a significant component of capital account flows, were made available in December 2023 and March 2024, upon completion of judicial reforms. But €19 billion in funds remain on hold (Text Table 1) pending implementation of reform conditions set by the EU. Hungary's external balance in

2023 is assessed as stronger than implied by fundamentals and desirable policy settings (Annex III). The external debt ratio fell to 85½ percent in line with the current account improvement.

Figure 8. External Sector Indicators



Sources: Eurostat; Haver Analytics; and IMF staff calculations.



Sources: European Commission; Eurostat; Haver Analytics; and IMF staff calculations.

Text Table 1. Hungary: Status of Planned EU Funding

	EUR bn	% 2024 GDP	Conditions/Comments
Cohesion policy (2021-27)	**21.7**	**10.4**	
Available	12.2	5.8	• EUR 10.2 billion was released by the EC in Dec 2023 upon completion of reforms. Another EUR 2 billion was released in March 2024. 1/
On hold	9.5	4.5	• Rule of law conditionality, child protection act, thematic enabling conditions.
RRF	**5.8**	**2.8**	• All on hold pending implementation of 27 super milestones set by EU.
RePower	**4.6**	**2.2**	
Available	0.9	0.4	• Pre-financing has been transferred.
On hold	3.7	1.8	• Implementation of 27 super milestones set by EU.
Smaller programs: CEF, REACT-EU	**2.5**	**1.2**	• No limiting factors.

Source: Hungary Ministry of Finance.
Note: Table excludes common agricultural policy financing of €12.6 billion which is not directed through the budget.
1/ Reforms related to the EU Charter of Fundamental Rights notably judicial independence, the rule of law, and combatting corruption in the management of EU funds.

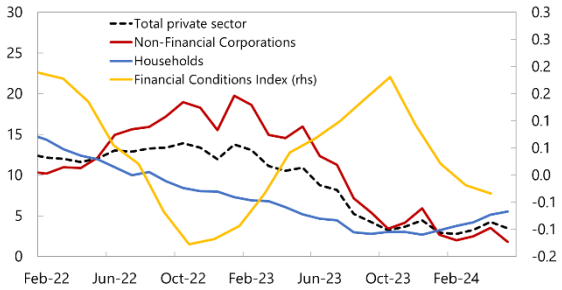
9. Private sector credit and real estate prices grew at a significantly lower pace compared to recent years. The moderation in credit growth was seen for both households and non-financial corporations and reflected the uncertain economic outlook, declining real wages, and tight monetary policy, amid a relatively stable non-performing loan (NPL) ratio. As the economy has begun to recover since end-2023, new credit to households and house price growth picked up,

while credit to firms remains subdued. House prices remain elevated, and affordability decreased on the back of rising interest rates.

Figure 9. Credit and Housing Market Developments

Credit Transactions Growth

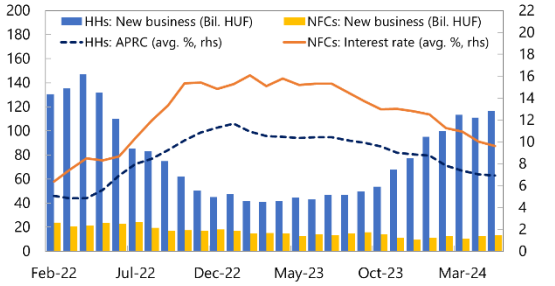
(Year-on-year percent change; Index)



Sources: Magyar Nemzeti Bank; Haver Analytics; and IMF staff calculations.
Note: The drop in household transactions in 2015 is related to the drop in transactions in foreign currency. The Financial Conditions Index is in quarterly frequency. A negative value of the FCI represent smaller contribution to economic growth compared to the cyclical position of the economy.

Rates and New Business Volumes to Households and Non-Financial Corporations

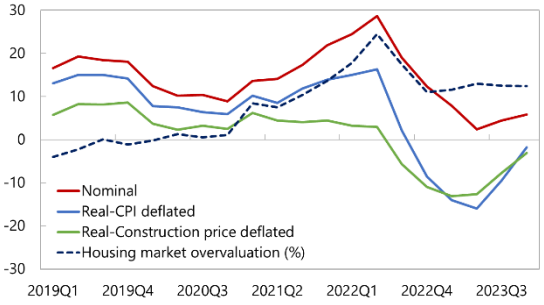
(Billion HUF; percent)



Source: Magyar Nemzeti Bank.
Note: APRC=annual percentage rate of charge. New business volumes are seasonally adjusted. New business volumes for HHs are housing loans. New business volumes for NFCs are up to the equivalent of EUR 1 million.

House Price Growth

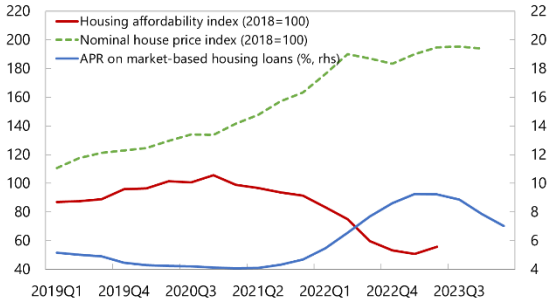
(Year-on-year percent change; percent)



Sources: Magyar Nemzeti Bank; Hungarian Central Statistical Office (CSO); and IMF staff calculations.
Note: Housing market overvaluation for Hungary shows the average of estimates of deviation of house prices from the estimated equilibrium level justified by fundamentals calculated by the MNB.

Housing Affordability and APR on Housing Loans

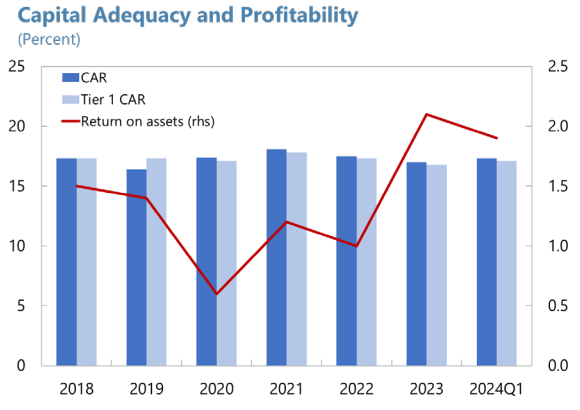
(Index, 2018=100; percent)



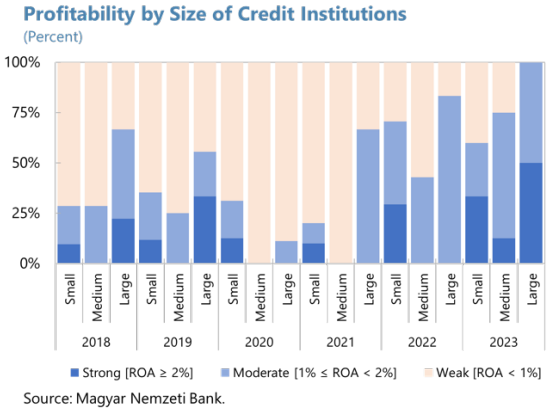
Sources: Biljanovska, Chen, and Igan (2023); Magyar Nemzeti Bank; and IMF staff calculations.
Note: APR=annual percentage rate. HAI=house affordability index. A HAI index below 100 indicates that a household does not have the sufficient income to qualify for a mortgage on an average-priced house.

10. The banking system is well-capitalized and profitable, though there is variation between institutions. The overall capital adequacy and Tier 1 capital ratios—19 and 17 percent respectively at end-2023—were above regulatory thresholds. The banking sector enjoyed record profits in 2023, despite the impact of discretionary taxes on bank profits and other government measures. This reflected higher interest income earned from liquidity deposited with the central bank and limited pass-through of policy rates to deposit rates, although the gains accrued disproportionately to large and medium-sized banks.

Figure 10. Banking System Indicators



Source: Magyar Nemzeti Bank.



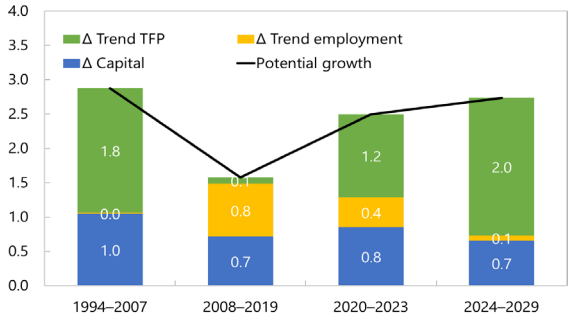
Source: Magyar Nemzeti Bank.

B. Outlook and Risks

11. A modest growth rebound is expected in 2024. The economy is projected to expand by 2.3 percent, driven by private consumption. But private investment is expected to remain relatively subdued due to the lagged effects of monetary policy tightening. Net exports are projected to contribute positively to GDP growth as import growth returns to positive territory but continues to lag that of exports.

12. Growth is expected to accelerate in 2025 and converge to potential in the medium term. The economy is projected to expand by 3.3 percent in 2025 driven by private consumption and a recovery in private investment. Public investment is also expected to contribute positively, with staff's baseline assuming the full disbursement of currently withheld EU funds. In the medium term, growth is projected to converge to its potential of around 3 percent, with the output gap broadly closed by 2028. A modest current account surplus is expected in 2024 and projected to gradually improve over the medium term in line with the anticipated increase in battery and electric vehicle exports. From a structural perspective, growth prospects are increasingly reliant on productivity gains given the anticipated decline in the working-age population.

Figure 11. Potential Growth and Components
(Percent)



Sources: National authorities; and IMF staff calculations.
Note: Numbers are in terms of average across years for each sub-sample period. A multivariate filter (MVF) approach, which incorporates empirical relationships between actual and potential GDP, unemployment, and inflation, is used to estimate potential output. The decomposition of the underlying growth contributors is then estimated using additional information on capital formation and depreciation, labor force participation, and working age population.

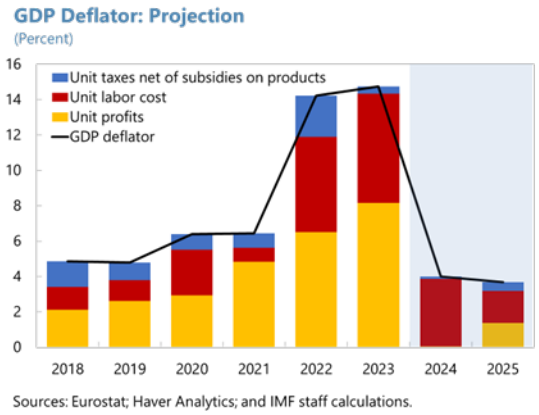
Text Table 2. Hungary: Macroeconomic Projections, 2024–2026

(Percent)

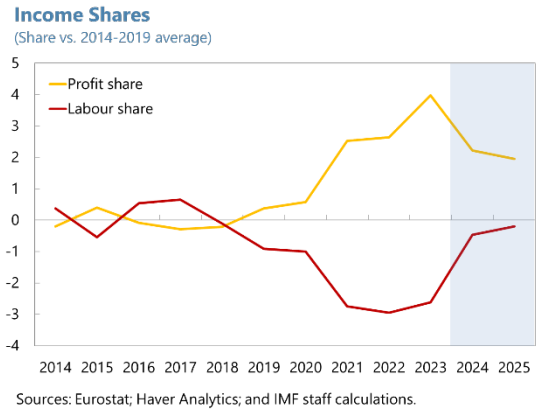
	GDP Growth			Inflation		
	2024	2025	2026	2024	2025	2026
Staff projections (July 2024)	2.3	3.3	3.0	3.8	3.5	3.1
MNB (June 2024)	2.0 - 3.0	3.5 - 4.5	3.0 - 4.0	3.0 - 4.5	2.5 - 3.5	2.5 - 3.5
European Commission (May 2024) 1/	2.4	3.5	...	4.1	3.7	...
OECD (May 2024)	2.1	2.8	...	4.0	3.9	...
Consensus Forecasts (June 2024) 2/	2.3	3.3	3.4	4.0	3.6	3.3

Source: Consensus Forecasts; European Commission; MNB; OECD; and IMF staff projections.
1/ European Commission inflation forecast is based on the HICP.
2/ Forecasts for 2026 from the April 2024 long-term macroeconomic forecasts survey.

Figure 12. GDP Deflator and Income Share



Sources: Eurostat; Haver Analytics; and IMF staff calculations.



Sources: Eurostat; Haver Analytics; and IMF staff calculations.

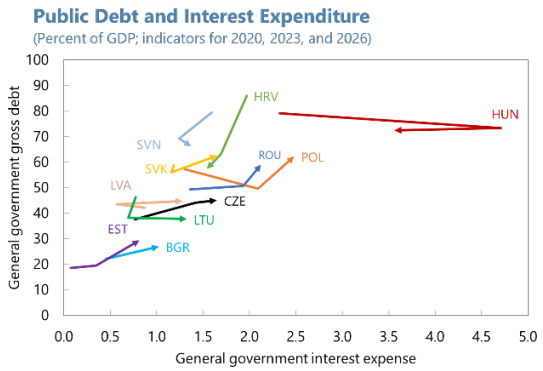
Note: Forecast based on July 2024 projections. Wage projections based on wage model from Chapter 2 of the November 2023 Regional Economic Outlook: Europe. Unit profits calculated as a residual.

13. Inflation is projected to increase above the tolerance band of the MNB towards the end of the year, and durably reach the target by 2026. Conditioned on market participants' expectations that the policy rate falls to 6¼ percent by the end of year, inflation is projected to increase to 4.2 percent y/y in 2024:Q4. This reflects past increases in the fuel tax, but also elevated rates of services inflation given high wage growth and fading disinflationary impulses from commodities and the exchange rate. As wage growth and services inflation slow, inflation would fall back to target in 2026.

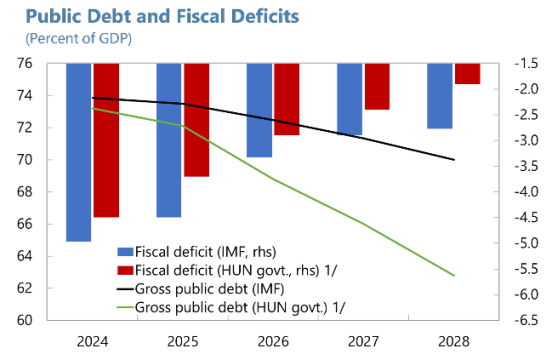
14. The recession in 2023, elevated borrowing costs, and spending pressures are weighing on public finances. Based on legislated and clearly defined measures, staff projects the fiscal deficit to reach 5 percent of GDP in 2024 and exceed the Maastricht limit of 3 percent through 2026 while the debt ratio will remain above 70 percent through 2028. Staff's projections incorporate the "defense fund" that was set up by the authorities in July to reduce the deficit. This is financed by an increase in the financial transactions tax (FTT) rate effective on August 1; an extension of the FTT to FX conversions (on October 1); modifications to existing windfall taxes on banks and the energy

sector; as well as cuts in investment spending.[3] Gross financing needs (GFNs) in 2024 are estimated at 15.2 percent of GDP and are expected to continue in double digits through 2029. The DSF indicates a "moderate" risk of sovereign debt stress and fiscal space at risk (Annex IV).

Figure 13. Public Debt, Interest Expenditure, and Deficits



Sources: IMF WEO and IMF staff calculations.



Sources: Convergence Program of Hungary; IMF World Economic Outlook; and IMF staff calculations.
1/ Data from Convergence Program of Hungary.

15. Risks remain tilted to the downside for growth and to the upside for inflation. Relative to end-2022, the projected distribution of growth as of end-2023 shifted significantly to the right indicating lower tail risks, owing to easing domestic financial conditions. Nevertheless, significant risks remain (Annex V). A failure to put in place a coherent policy mix to address large fiscal imbalances and structural policy challenges could weaken investor confidence and deter needed private investment. Lack of progress in governance reforms could result in the prolonged suspension of EU funds, an important source of fiscal and external financing. A resultant increase in risk premia and forint depreciation could prolong tight monetary policy and weaken growth. Inflation could increase again if Hungarian wages grow faster than expected or in the event of further disruptions to energy supply caused by an escalation of Russia's war in Ukraine and the conflict in Israel and Gaza, which would also adversely affect the external balance. Lastly, monetary policy miscalibration by major economies amid high uncertainty could have implications for Hungary's macroeconomic and financial stability, potentially requiring adjustments in the domestic monetary policy path.

Authorities' Views

16. The authorities broadly shared staff's views on the outlook and balance of risks, albeit with higher growth expectations. The MOF projects growth of 4 percent in 2025 and in the medium term, based on the expectation that battery and electric vehicle production would start contributing significantly to exports. The MNB is broadly aligned with staff's growth and inflation projections, though it expects inflation to return durably to target in 2025, one year earlier than staff, based on a larger negative output gap that they believe will weigh on services inflation. The

[3] Staff estimates these measures to yield 0.3 percent of GDP in 2024. The authorities also indicated that windfall taxes on the pharmaceutical and telecommunications sectors would be phased out at the end of 2024 while those on banking, energy, insurance and retail would continue through the end of 2025.

authorities share staff's views of external risks. They stressed that they had made significant progress on the 27 EU super milestones and hope to access the RRF funds later this year.

POLICY DISCUSSIONS

17. With the right policies, sustainable and inclusive growth is well within Hungary's reach. Additional fiscal consolidation to reduce sovereign risk should be rooted in a more diversified revenue structure and more growth-friendly spending mix, in the context of a reinvigorated medium-term budget process. Stability-oriented macro-financial policies should raise countercyclical capital buffers and allow market forces to drive credit allocation. Coordinated structural reforms are key to address Hungary's lagging productivity and accelerate progress toward the green transition.

A. Strengthening Fiscal Sustainability

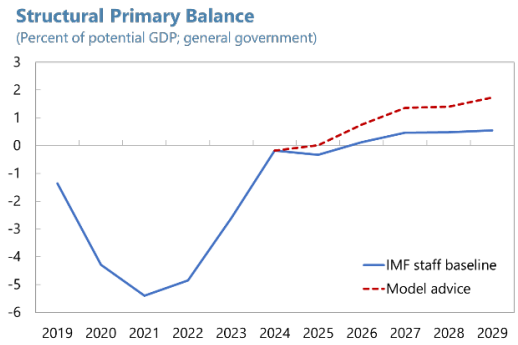
18. A more significant adjustment than under staff's baseline would safeguard macroeconomic stability. The 2024 projected fiscal stance (a contraction of about 2½ percent in the structural primary balance) is appropriate given elevated debt and GFNs. As the output gap closes, staff proposes additional cumulative net adjustment measures of about 1½ percent of GDP between 2025-2029, resulting in a debt-to-GDP ratio of 64½ percent in 2029 (Box 1). Such a path would bring the deficit below 3 percent of GDP by 2026 and support an exit from the EDP, while the structural deficit would fall below 1.5 percent of GDP by 2029, bringing Hungary in compliance with the deficit resilience safeguard under the new EU fiscal governance framework. Staff proposes to root the adjustment in (i) tax reforms (2¼ percent of GDP, ¶19); (ii) expenditure rationalization (1¼ percent of GDP, ¶20-21); and (iii) increased productive spending (2 percent of GDP).

19. Revenue reforms should improve the efficiency and equity of the tax system (Annex VI). The application of a universal standard VAT rate with few exemptions would enhance efficiency and simplify administration. Introducing a higher marginal PIT rate for high earners—above the current 15 percent flat rate—would increase revenue and enhance social cohesion. Similarly, taxation of corporates could be made more equitable and efficient by rationalizing tax incentives and increasing the tax rate to 15 percent. Hungary should reduce its reliance on distortive taxes such as financial transaction taxes and retrospective windfall taxes that can undermine tax certainty and hence investment. Finally, there is scope for raising more revenue from property taxes.[4]

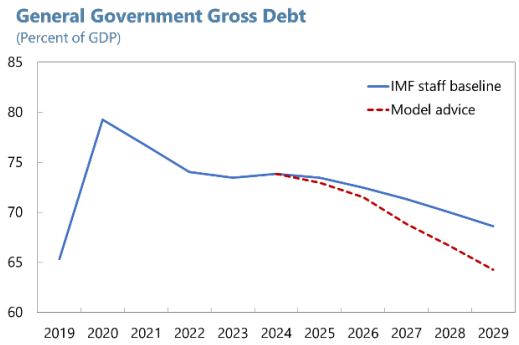
[4] OECD Economic Surveys: Hungary 2024.

Box 1. Hungary: Model-based Optimal Fiscal Consolidation Paths

A buffer-stock optimization model for the government based on Fournier (2019) derives fiscal paths that reflect the policy tradeoff between supporting output stabilization and medium-term debt sustainability. The key channels include interest costs and a probability of losing market access that increases with the public debt level. Calibrated with data for Hungary, a model baseline simulation suggests an optimal medium-term structural primary balance (SPB) of about 1¾ percent of GDP by 2029.

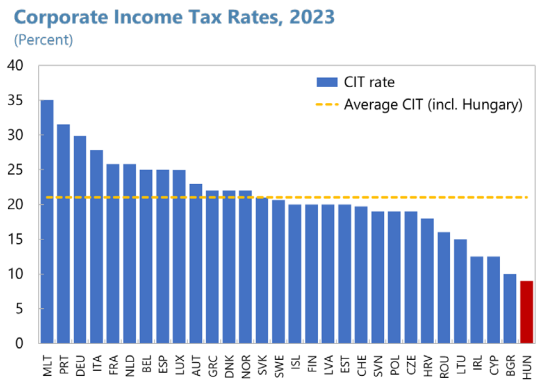


Sources: IMF World Economic Outlook; and IMF staff calculations.
Note: For details, see Armendariz et al (forthcoming) "Public Debt and Financing Prospects and Optimal Fiscal Paths in Europe."

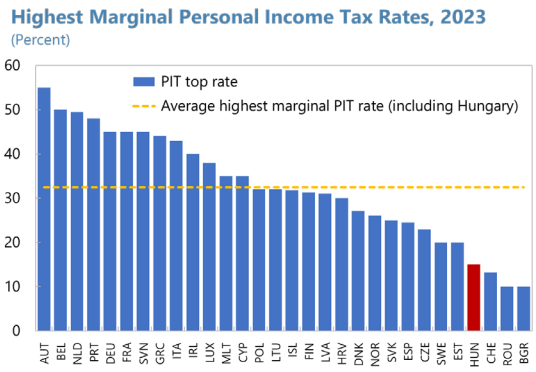


Sources: IMF World Economic Outlook; and IMF staff calculations.
Note: For details, see Armendariz et al (forthcoming) "Public Debt and Financing Prospects and Optimal Fiscal Paths in Europe."

Figure 14. Corporate and Personal Income Taxes



Sources: Eurostat; OECD; KPMG; PWC; IBFD; and IMF staff calculations.



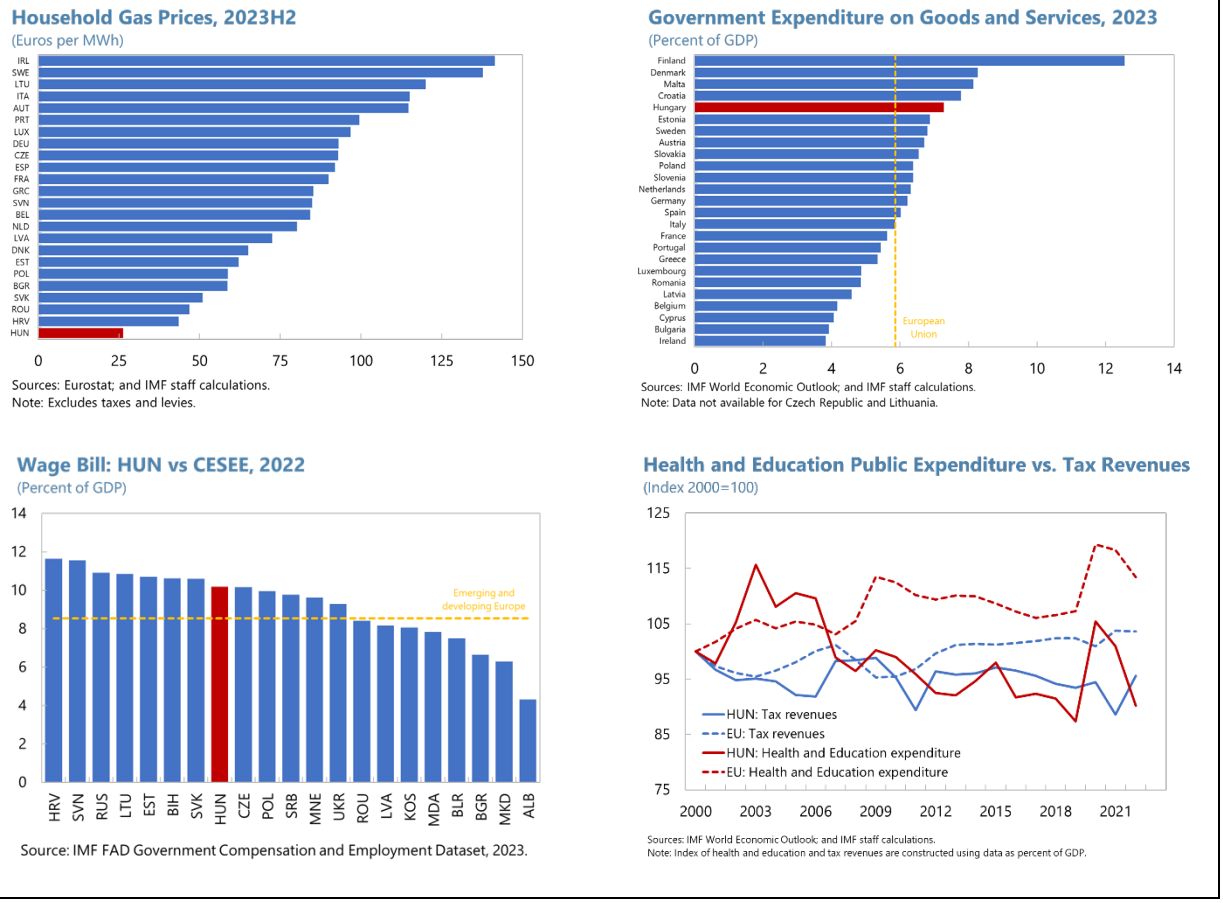
Sources: Eurostat; OECD; KPMG; PWC; IBFD; and IMF staff calculations.
Note: PIT rates exclude social security contributions.

20. Reduced subsidies could yield savings and improve efficiency. Three quarters of the 2.7 percent of GDP overall subsidy spending in 2023 was on retail utility subsidies, primarily gas. A reduction of the subsidy bill by roughly half through 2029 by lowering the threshold for subsidized utility rates per household to a basic subsistence amount, with compensatory cash transfers to the most vulnerable, could save 0.8 percent of GDP relative to the 2029 baseline. Replacing energy price caps with targeted cash transfers would also induce greater energy conservation and increase the attractiveness of the Hungarian retail electricity market for new investors, since low regulated prices discourage competitors from entering the market.[5] Increased competition, in turn, may contribute to efficiency gains and reduce government outlays on targeted cash transfers.

[5] Felsmann et al. 2021.

21. Additional savings could be achieved by reducing spending on the wage bill and goods and services. Rationalization of the public wage bill, including via a graduated COLA structure based on income or reduced 13th month payments, could help moderate spending. A public expenditure review could identify areas for efficiency gains on goods and services to generate fiscal space that could be channeled to more productive spending including on education, where Hungary lags OECD spending averages and on relevant social outcomes.[6] The authorities should avoid significant cuts to investment, such as their postponement of HUF 675 billion (0.7 percent of GDP) announced in April, which undermines growth.

Figure 15. Government Expenditure



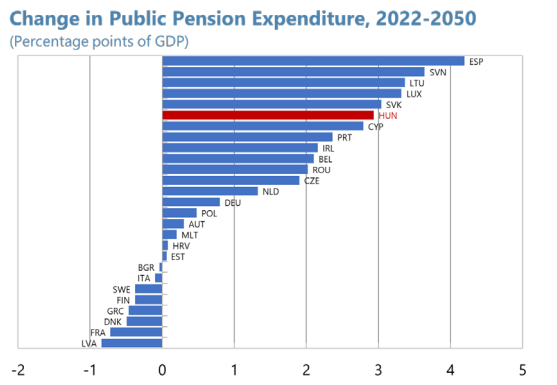
22. Fiscal risks should be carefully monitored and managed. Hungary has two development banks (one of which, Eximbank, is classified as part of general government) with assets equivalent to around 10 percent of GDP, up from 5 percent in 2019, and over 200 other registered public corporations (over 450 including subsidiaries), all with varying degrees of transparency. Statements for the 60 largest companies prepared by the MNB, comprising 90 percent of SOE assets, point to their financial assets tripling between 2019 and 2023 to around 20 percent of GDP. Relatedly, the total stock of government guarantees increased from 6½ percent of GDP in 2019 to 12½ percent of

[6] Hungary's student-to-teacher ratio is well above the OECD average. Its PISA score in reading is below the OECD average and while scores in math and science are in line with averages, they have declined more rapidly than OECD averages over the last ten years (OECD PISA 2022 results).

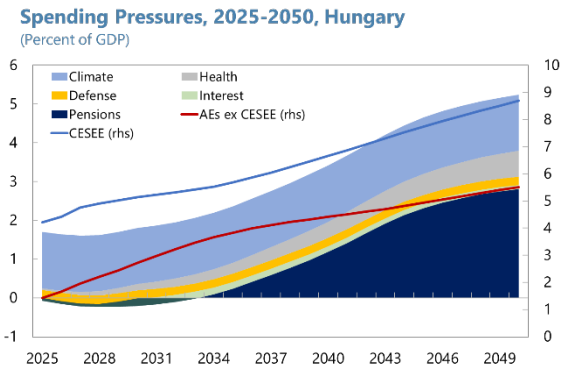
GDP in 2023. Guarantees should be prudently managed, centrally monitored and well provisioned, keeping the stock of outstanding guarantees on a downward path. The development of a comprehensive centralized fiscal risk management framework would improve the assessment of fiscal risks.

23. Reforms are needed to contain long-term spending pressures. An increase in the social security contribution rate, retirement age and/or minimum contribution years, and indexing the retirement age to life expectancy could help to contain the increase in pension costs until 2050, which is well above the EU average.[7] Long-term healthcare costs could be managed in part through improved digitalization and further procurement reform. Increased revenues—up to 2.7 percent of GDP by 2030 (Annex VII)—could be sourced from phasing out fossil fuel subsidies and making greater use of tax-based carbon pricing instruments. These revenues can help finance climate mitigation investments, which amount to about 2 percent of GDP, including renewable energy compatible grids, electric charging stations, and increased low-carbon energy generation.

Figure 16. Long-Term Spending Pressures



Sources: Eurostat; European Commission; The 2021 Ageing Report; and IMF staff calculations.



Sources: European Commission; European Investment Bank; IMF World Economic Outlook; Eble et al. (2024), forthcoming; and IMF staff calculations.
Note: Annual spending needs beyond baseline. Weighted by GDP. Excludes AND, ISR, and SMR.

24. A more effective fiscal framework would anchor prudent policymaking. Hungary's medium-term fiscal framework (MTFF) ranks among the lowest in the EC's fiscal governance database[8] and the requirement to issue MT budget plans has been suspended since 2020, though the authorities recently announced their intention to reinstate the MTFF starting with next year's budget.[9] To provide an effective anchor, the MT budget should be linked to the annual budgeting process, EU and national fiscal rules, and tied to a strong enforcement mechanism, including an appropriately resourced Fiscal Council and protection of its statutory independence to veto budgets. It is encouraging that the government has moved the preparation of the 2025 budget from the spring to fall 2024, which should improve the reliability of fiscal forecasting and become a permanent feature of the budgeting process.

[7] European Commission: 2024 Ageing Report.

[8] European Commission Hungary: In-Depth Review 2023.

[9] The suspension was triggered by the government's declaration in 2020 of a "state of danger emergency," which remains in effect.

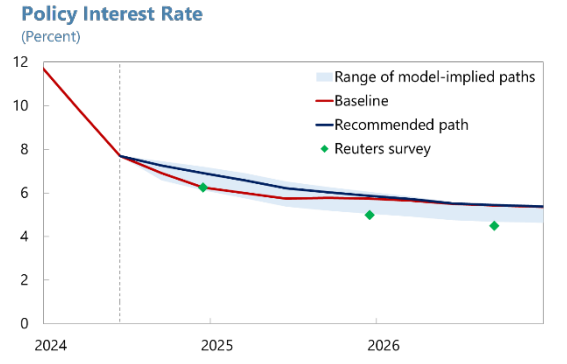
Authorities' Views

25. The authorities are committed to their fiscal targets. They noted that windfall taxes are levied on companies profiting from extraordinary circumstances. Moreover, they estimate high-income households to be more sensitive to marginal tax rates and noted that the skewness of the wage distribution decreases the potential revenue gain from a higher top PIT rate. They believe that increasing the CIT rate would not be appropriate as the total tax burden on corporations is not low given local business taxes. The authorities see fiscal risks associated with guarantees and subsidized lending activity as low, given that borrowers are carefully screened. They noted that their debt management strategy is sufficiently flexible to accommodate changing market demands.

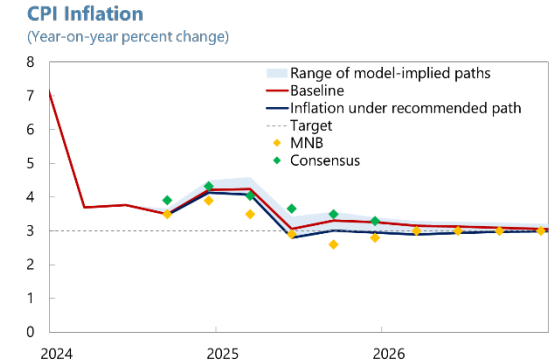
B. Bringing Inflation Durably Back to Target

26. Policy will need to remain in restrictive territory into next year to deliver a sustainable return of inflation to target. The loosening of the monetary policy stance thus far has been broadly appropriate. The simplification of the monetary policy toolkit will make policy communication easier. Going forward, staff's recommended path sees limited scope for further rate cuts this year as underlying inflation pressures remain elevated (see Selected Issues Paper on Monetary Policy). This partly reflects elevated wage growth, even though some is projected to be absorbed by a fall in the profit share. Staff's recommended path would bring inflation back to target more quickly than the path currently expected by market participants and reduce risks of high inflation becoming embedded in expectations. Should risk premia deteriorate, leading to a depreciation in the exchange rate, monetary policy would need to stay tight for longer.

Figure 17. Monetary Policy Paths and Inflation

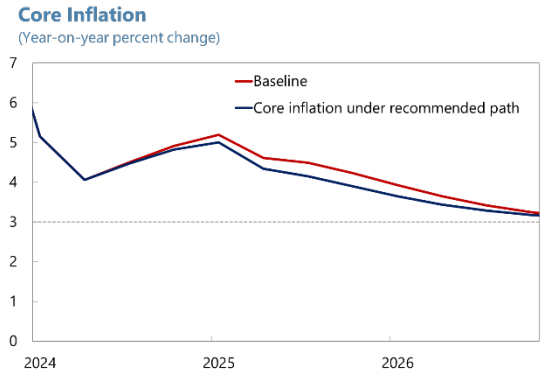


Sources: National authorities; Haver Analytics; Refinitiv Datastream; and IMF staff calculations.
Note: Baseline conditioned on market participants' expectations for the first year of the projection and then m
implied path afterwards.

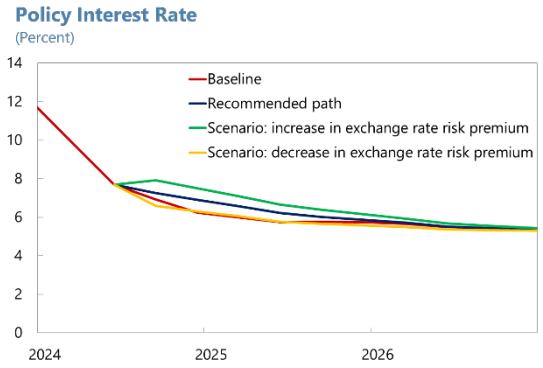


Sources: National authorities; Consensus; Haver Analytics; MNB; and IMF staff calculations.

Figure 17. Monetary Policy Paths and Inflation (Concluded)



Sources: National authorities; and IMF staff calculations.

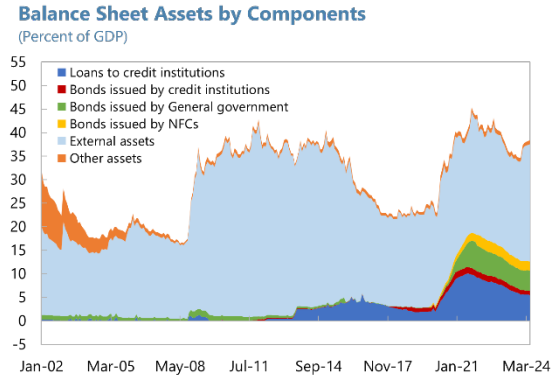


Sources: National authorities; and IMF staff calculations.
Note: scenarios assume a temporary +/- 2.5pp shock to the exchange rate risk premium.

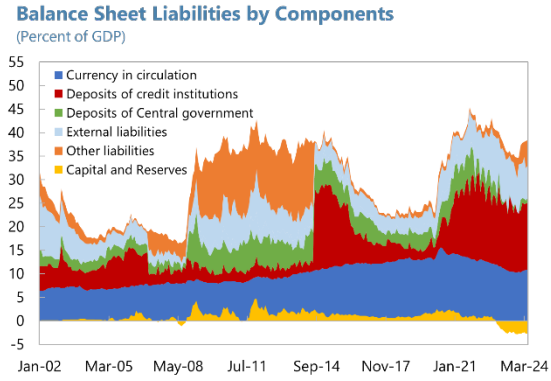
See 'Hungary: Selected Issues (2024)' for further details.

27. Central bank autonomy is vital for price and financial stability and should be protected by appropriate legal frameworks. The recent amendment to the central bank law no longer mandates recapitalization from the budget within a specific timeframe, thereby providing room for the MNB to offset current losses against future income. Staff projects that the MNB's balance sheet position will improve gradually over time as assets mature and policy rates fall. To ensure that the MNB is well capitalized in the medium term, it is important that—as specified in the law—the MNB does not pay out advanced dividends and that no dividends are distributed until the minimum capital required by the law is reached. As it is unclear how existing rights to create a business or foundation relate to the MNB's price stability objective, such activities should be scaled back.

Figure 18. MNB Balance Sheet



Source: Magyar Nemzeti Bank.



Source: Magyar Nemzeti Bank.

28. The flexible exchange rate regime and reserve adequacy can help Hungary manage external shocks. In the absence of material frictions that would warrant regular foreign exchange interventions (FXI) in Hungary (see Box 2), the policy rate should remain the primary instrument for anchoring inflation expectations and maintaining inflation at the 3 percent target. FXI could serve as a complementary tool during irregular periods of disorderly market conditions (e.g., high hedging or financing premia or FX rollover problems). Reserves are assessed as adequate, although further reserve accumulation especially during risk-on periods would help bolster the country's external buffers.

Authorities' Views

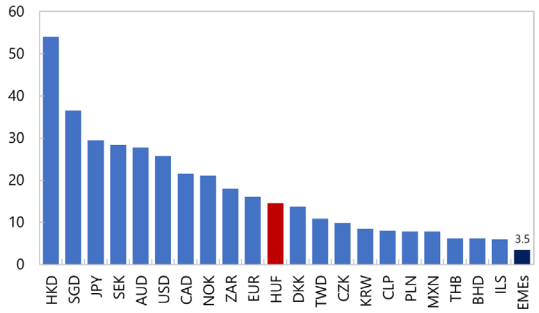
29. The MNB agreed that room for further rate cuts this year is limited and that the policy rate should remain the primary instrument for bringing inflation back to target. It noted that it intends to keep real interest rates in positive territory considering the level of such rates in major advanced economies, while stressing that the outlook is still uncertain. The MNB emphasized that running negative equity should not impede its ability to set monetary policy independently. While acknowledging that its pandemic-related programs have exposed its balance sheet to interest rate risk, it stressed that they were very effective in reducing corporate sector defaults and improving monetary policy transmission. The MNB concurred with staff's assessment on the absence of material frictions in the spot foreign exchange market, while emphasizing the monetary policy importance of the FX swap market and stressing that consideration should be given to expanding swap lines of major central banks to smaller emerging markets given the volatile environment.

Box 2. Hungary: Foreign Exchange Intervention Under the IPF

The Integrated Policy Framework (IPF) provides policy guidance in the presence of market imperfections, including principles on the use of FXI. While allowing the exchange rate to play a stabilizing role remains a key principle, the framework shows that FXI may be appropriate under certain frictions and sources of shocks, provided reserves are adequate and such intervention is not a substitute for needed macroeconomic adjustments. Key IPF frictions under which FXI may be appropriate relate to 1) the degree of FX market shallowness and 2) unhedged currency exposures in domestic balance sheets.[1]

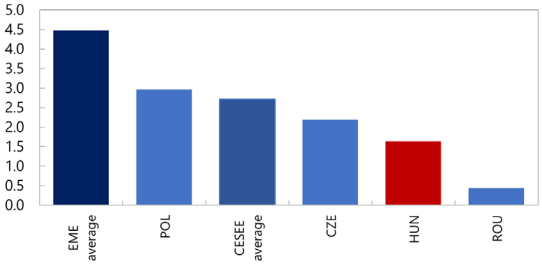
Hungary does not appear to meet the conditions that would justify regular interventions.[2] Hungary's FX markets can be seen as relatively liquid, especially among emerging market economies (EMEs). Their depth is also reflected by the observed lower exchange rate volatility relative to other EMEs. Hungary's uncovered interest parity (UIP) premia have fallen rapidly as monetary policy continues to loosen. In addition, the relationship between such premia and net portfolio flows appears to be relatively weak, with positive premia associated with both inflows and outflows (although in rare stress episodes, these premia do become large). Unhedged currency exposures for most agents have fallen substantially over the past decade (see section C). While FX loans have declined for non-financial corporations, many of which have FX revenue that provides a form of natural hedge, residual FX risks appear to remain in certain segments of the corporate sector, notably commercial real estate. This calls for continued monitoring and potentially additional macroprudential measures to tackle remaining exposures.

OTC Foreign Exchange Turnover, 2022
(Percent of GDP)



Sources: Bank of International Settlements; and IMF staff calculations.
Note: EMEs= Average of emerging markets and middle-income economies.

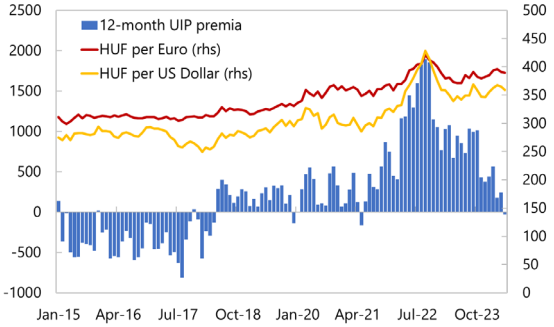
Exchange Rate Volatility
(Percent)



Sources: National central banks; Haver Analytics; and IMF staff calculations.
Note: Exchange rate volatility is calculated by taking the coefficient of variation of the exchange rate against the Euro, normalized by the sample mean, for the time period February 2023-February 2024. CESEE=Central eastern and southeastern Europe; EMEs=Emerging markets and middle-income economies. BGN and BAM are excluded due to their perfect co-movement with the euro during the sample period. Both aggregates are PPP-weighted.

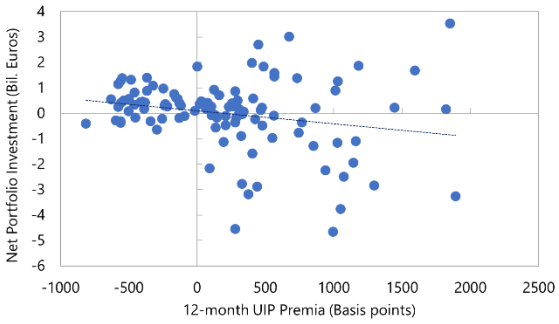
Box 2. Hungary: Foreign Exchange Intervention Under the IPF (Concluded)

UIP Premia, 12-Month, Hungary
(Basis points; Forints per Euro, Forints per US dollar)



Sources: Refinitiv; Consensus Forecast; and IMF staff calculations.

UIP Premia and Net Portfolio Investment, Hungary
(Basis points; billion Euros)



Sources: Refinitiv; Consensus Forecast; Magyar Nemzeti Bank; Haver Analytics; and IMF staff calculations.
Note: Correlation coefficient is statistically significant at 5% significance level.

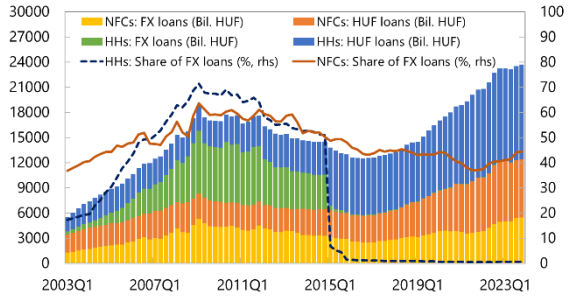
[1] The risk of de-anchoring of inflation expectations arising from exchange rate movements also justifies the use of FXI under the IPF. Given that inflation expectations remain well-anchored in Hungary, this "use case" appears to have limited relevance for Hungary.
[2] Though the MNB does not publish data on FXI, it has intervened in the past, including to provide liquidity to energy importers in 2022.

C. Deepening Financial Sector Resilience

30. The financial sector has proven resilient, despite the sharpest monetary policy tightening in decades. The MNB's enhanced macroprudential policy frameworks since 2012 played a key role in reducing systemic risk. The foreign exchange coverage ratio and currency-specific borrower-based measures significantly reduced FX exposures for banks, households, and corporates. Structural changes such as a much higher share of fixed rate mortgages, and lower household leverage, have dampened the effects of tightening on the housing market compared to previous tightening cycles (Box 3).

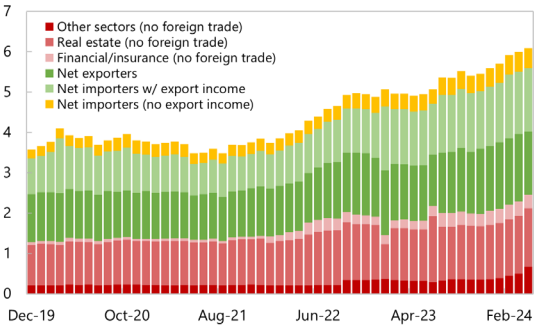
Figure 19. FX Loans to the Real Sector

HUF and FX Loans to Households and Non-Financial Corporations
(Billion HUF; percent)



Sources: Magyar Nemzeti Bank; and IMF staff calculations.
Note: FX loans to NFCs are from domestic banks.

NFC Foreign Currency Loans by Foreign Trade Activity
(Trillions of HUF)



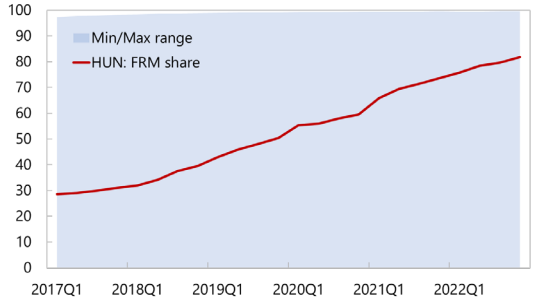
Source: Magyar Nemzeti Bank.

Box 3. Hungary: Tracing the Effects of Monetary Policy Through the Housing Market

Structural changes in the Hungarian housing market may have affected monetary policy transmission compared to previous tightening cycles. The April 2024 WEO Chapter 2 finds that monetary policy has weaker effects when (i) fixed rate mortgages (FRMs) are common, (ii) household debt is low, and (iii) house prices are less overvalued. The share of FRMs in Hungary increased considerably since 2017, together with the average fixation period of new issuances. While in 2016 mortgages with rates fixed for 10 years or more were only 30 percent of the total issued, in late 2023, they accounted for 80 percent of the total. Hence, the cash flow channel of transmission will likely be dampened for a relatively long period of time, supporting financial stability. While the aggregate effects may not be large, given that household debt outstanding is very low by international standards, on the margin, this matters for transmission to existing borrowers.

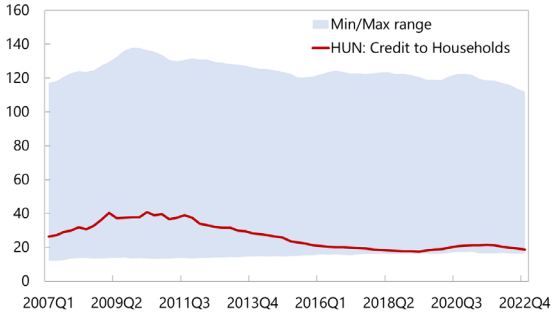
There are likely differences in transmission across regions. Overall, there are signs that price-income ratios have increased considerably since 2018. A correlation of ex-ante price-to-income ratios and regional house price growth confirms that regions with more overvaluation experienced less house price growth, suggesting a stronger dampening impact of the recent tightening in those regions. As rural areas have recently experienced stronger increases in price-to-income ratios than urban areas, the potential for price corrections in these regions should be closely monitored both from a financial stability and a distributional standpoint.

Share of Fixed-Rate Mortgages in Outstanding Stock
(Percent of total)



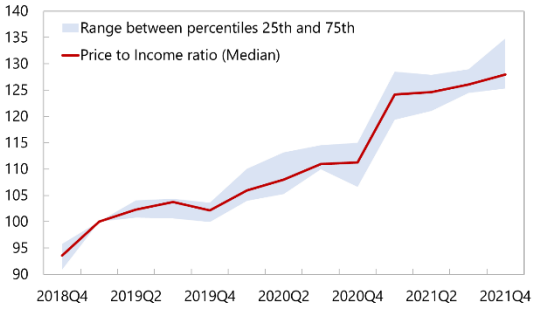
Sources: Magyar Nemzeti Bank; IMF World Economic Outlook Chapter 2, April 2024; and IMF staff calculations.
Note: Fixed-rate mortgages (FRM) are loans for which nominal payments do not reset for at least 12 months.
Min/Max range refers to the sample of countries included in IMF World Economic Outlook Chapter 2, April 2024.

Credit to Households
(Percent of GDP)



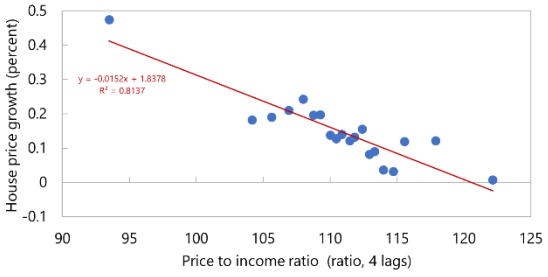
Source: Bank for International Settlements.
Note: Min/Max range refers to the sample of countries included in IMF World Economic Outlook Chapter 2, April 2024

Regional Price to Income Ratio
(Percent)



Source: IMF World Economic Outlook Chapter 2, April 2024.
Note: The range refers to the distribution of price-to-income ratios across NUTS2 Hungarian regions. For further details on this measure, see IMF World Economic Outlook Chapter 2, April 2024.

Correlation Between Regional House Price Growth and Ex-ante Overvaluation
(Percent; ratio)



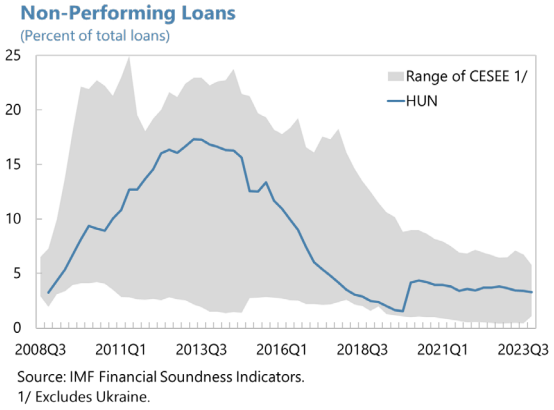
Sources: IMF World Economic Outlook Chapter 2, April 2024; and IMF staff calculations.
Note: Sample includes data for 8 NUTS2 regions, 2018Q1 to 2022Q4. Chart represents the slope of an OLS regression, with regional house price growth as an outcome variable and regional price to income ratio (lagged four quarters) as a dependent variable. Region and quarter fixed effects are included. Each dot represents 50 data points.

Contributor: Alessia De Stefani

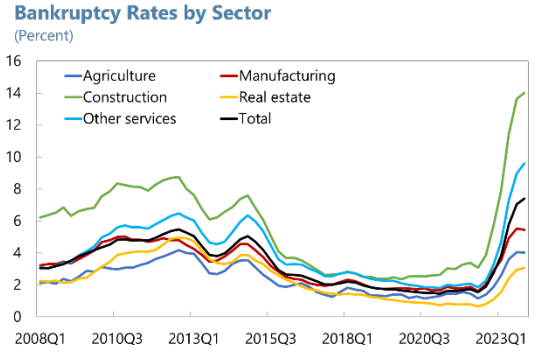
31. While systemic financial stability risks appear to be limited, continued vigilance is needed given some emerging risks, including:

- **Bank profitability and asset quality**. Current high levels of profitability are likely temporary. As monetary policy normalizes, interest rate margins and hence banks' profits will decline amid heightened competition for deposits, particularly for small- and medium-sized banks. There may also yet be lagged effects of the tightening, leading to an increase in NPLs, including from corporates and related to commercial real estate. Corporate bankruptcy rates have also increased sharply across sectors, although this was largely driven by recent legal changes.

Figure 20. Non-Performing Loans and Corporate Bankruptcies



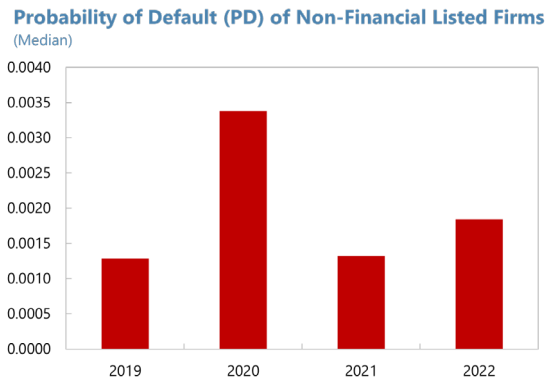
Source: IMF Financial Soundness Indicators.
1/ Excludes Ukraine.



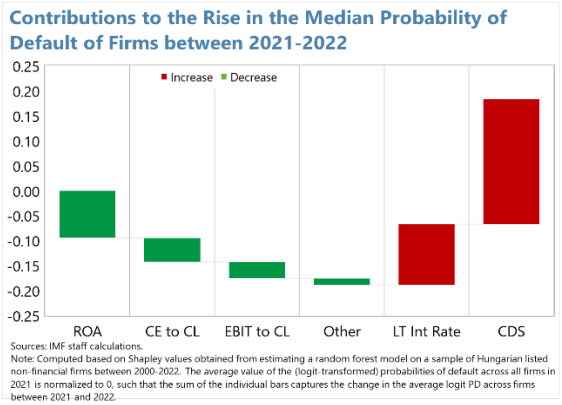
Sources: Opten; Magyar Nemzeti Bank; and Hungarian Central Statistical Office.
Note: The recent increase in bankruptcy rates may be partly related to the resorption of the backlog of forced deletions temporarily suspended and therefore accumulated during the pandemic.

- **Corporate sector.** Corporates' credit risk moderately increased in 2022 as monetary policy tightened and sovereign risk premia surged, despite continued improvements in firms' financial ratios (See Selected Issue Paper on Hungary's Corporate Sector Risk). The share of foreign currency corporate loans, while declining significantly compared to historical levels, remains sizable (Figure 19). Natural hedging mitigates FX risks for firms to some extent, especially for those with export revenue, though residual risks remain, notably in commercial real estate. Maturity and related interest risks could also be a potential area for concern, as half of the corporate HUF loans and over a third of foreign currency loans are set to mature within the next few years.

Figure 21. Credit Risk of Non-Financial Corporations



Sources: NUS-CRI; and IMF staff calculations.

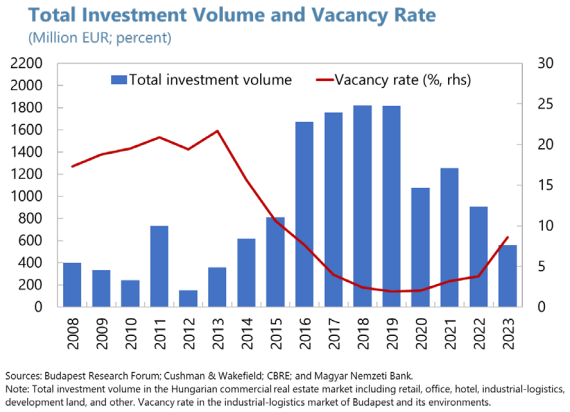


Sources: IMF staff calculations.
Note: Computed based on Shapley values obtained from estimating a random forest model on a sample of Hungarian listed non-financial firms between 2000-2022. The average value of the (logit-transformed) probabilities of default across all firms in 2021 is normalized to 0, such that the sum of the individual bars captures the change in the average logit PD across firms between 2021 and 2022.

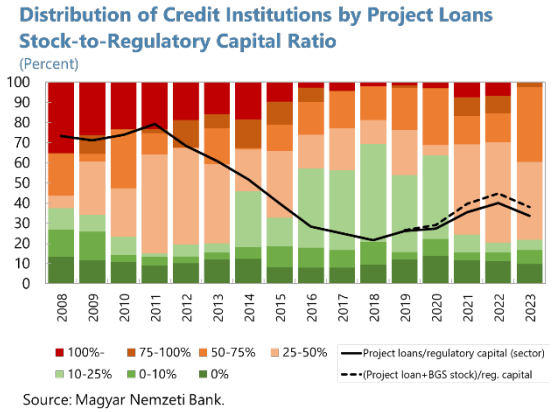
- **Commercial real estate (CRE).** Vacancy shares have risen amid much lower investment volumes, while prime yields point to a depreciation in the office market of about 20 percent y/y in H12023. Some banks have significant exposures including through CRE-related loans, with most of these loans being variable-rate FX loans, though repayments are concentrated after 2026.

- **Residential real estate (RRE).** Key vulnerabilities identified by the ESRB in 2021 related to house price overvaluation, high credit growth and high household indebtedness, with government subsidized schemes identified as a key factor in driving demand for owner-occupied housing. While the market has slowed, changes to government programs in 2024 and an easing of financial conditions could again fuel more housing demand and price increases.

Figure 22. Commercial Real Estate Indicators



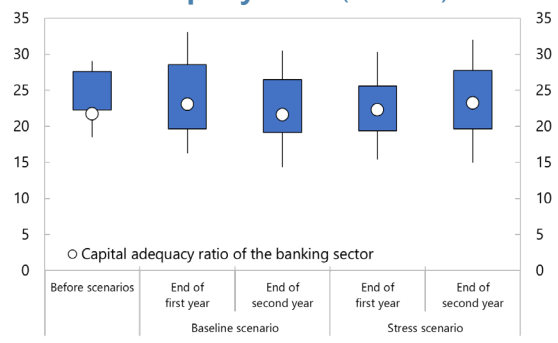
Sources: Budapest Research Forum; Cushman & Wakefield; CBRE; and Magyar Nemzeti Bank.
Note: Total investment volume in the Hungarian commercial real estate market including retail, office, hotel, industrial-logistics, development land, and other. Vacancy rate in the industrial-logistics market of Budapest and its environments.



Source: Magyar Nemzeti Bank.

32. The banking sector should be able to withstand downside scenarios. This is confirmed by MNB stress tests. In the event of a severe shock, most banks are found to still meet regulatory liquidity requirements, with only two smaller banks facing compliance problems. Similarly, at the sectoral level only a small capital shortage would arise in the event of a severe stress event, but there is significant heterogeneity.

Figure 23. Distribution of Banks by Capital Adequacy Ratio (Percent)

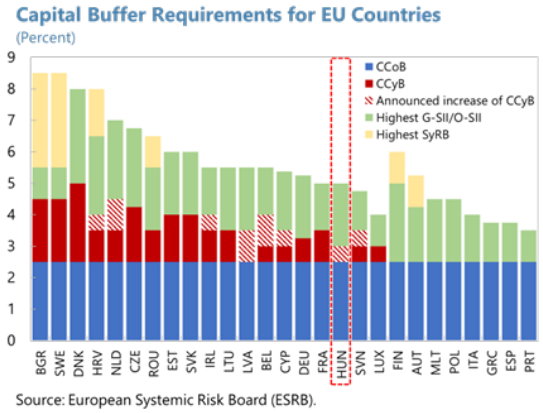


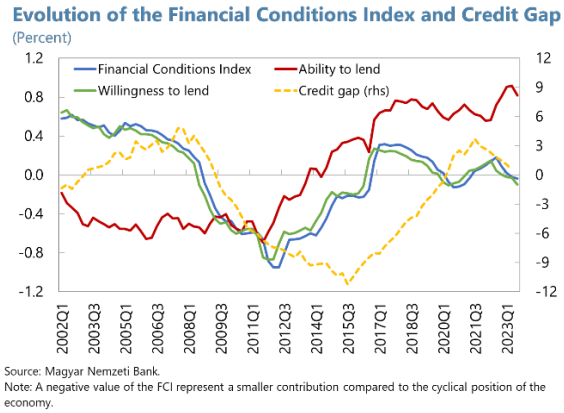
Source: Magyar Nemzeti Bank.

33. Now is still an opportune time to build resilience, including to lock in high bank profits into capital buffers. The scheduled increase to 0.5 percent of the countercyclical capital buffer (CCyB) and reactivation of the systemic risk buffer for CRE in July 2024 are appropriate. Prudence in profit distribution should be encouraged, and ad-hoc discretionary taxes on bank profits could be substituted by further increases in capital buffers to lock in unusual high profits. The introduction of a positive neutral CCyB, initially set at 1 percent starting in July 2025, represents an important step

to further mitigate systemic risk and strengthen financial sector resilience.[10] Care should be taken to minimize migration of risks to non-bank institutions, which thus far account for a small share of Hungary's financial sector (around 20 percent of total assets), through continued robust surveillance and supervision.

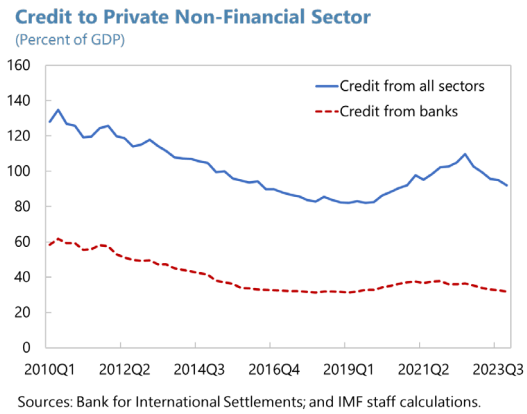
Figure 24. Capital Buffer Requirements and Financial Conditions

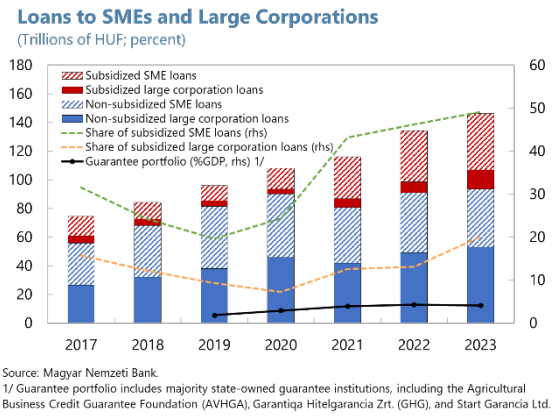




34. Distortions to market-based credit allocation should be removed, with better targeting of subsidized lending schemes. Interest rate caps, which have artificially eased financial conditions beyond the stance of monetary policy, are likely regressive, and may encourage credit rationing. While caps on deposits and SME lending ended in April 2024, those on mortgages remain, together with various voluntary caps. These should be fully phased out. Scaling back the various fiscal incentives would help moderate future house price growth and thus safeguard financial stability. The increased use of subsidized lending by state-owned banks should be carefully monitored and targeted to addressing market failures.

Figure 25. Outstanding Non-Financial Sector Credit and New Loans

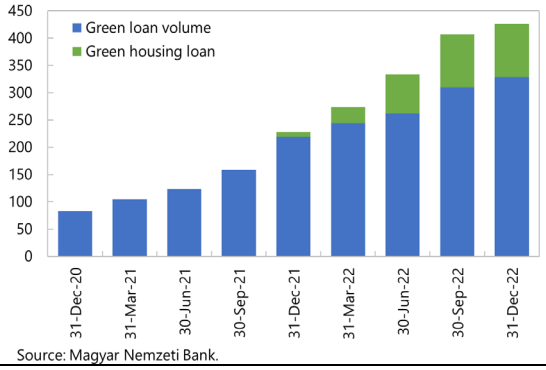




[10] Miettinen, P. and E. Nier, 2024, "Rethinking Macroprudential Buffers," forthcoming, IMF Departmental Paper, Monetary and Capital Markets Department.

35. While the MNB should play an active role in climate-risk supervision, any initiative should be consistent with the price and financial stability mandates. Over the last few years, the MNB has introduced green prudential tools aimed at promoting its secondary environmental sustainability objective. For instance, preferential capital requirements since 2020 were intended to deepen the local green loan and bond market, together with the MNB's green mortgage purchase and home program. To be effective, prudential regulation should remain risk focused, carefully adapting existing tools to evolving risks without attempting to drive investments. Using prudential regulation as a substitute for effective government policy on climate is likely to be ineffective and can generate unintended consequences.[11]

Figure 26. Evolution of Green Loan Portfolio
(Billion HUF)



Source: Magyar Nemzeti Bank.

36. The authorities should continue to strengthen the AML/CFT framework. Hungary has made progress in strengthening its AML/CFT frameworks, including relating to risk assessment, supervision, and application of risk-based measures for virtual asset service providers. Further efforts should prioritize implementing the EU's AML/CFT legislative package agreed in April 2024 and enhancing risk-based measures for non-profit organizations, as recently highlighted by MONEYVAL.

Authorities' Views

37. The MNB broadly agreed with staff's assessment of systemic risk and macroprudential policies. It concurred that the current high level of bank profitability should be used to further build up countercyclical capital buffers. The MNB noted that given the nature of NBFIs in Hungary, risks were limited, and that, unlike in other jurisdictions, there are no significant data gaps. The MNB stressed its focus on deepening the domestic green asset market while ensuring that financial institutions incorporate climate-risk expectations into their operations. The government indicated that the subsidized lending schemes to SMEs have been an important lifeline during crisis times and would be scaled back starting this year. It also noted that the new family housing program was subject to stricter eligibility requirements than previous schemes and was not expected to have a major impact on house prices.

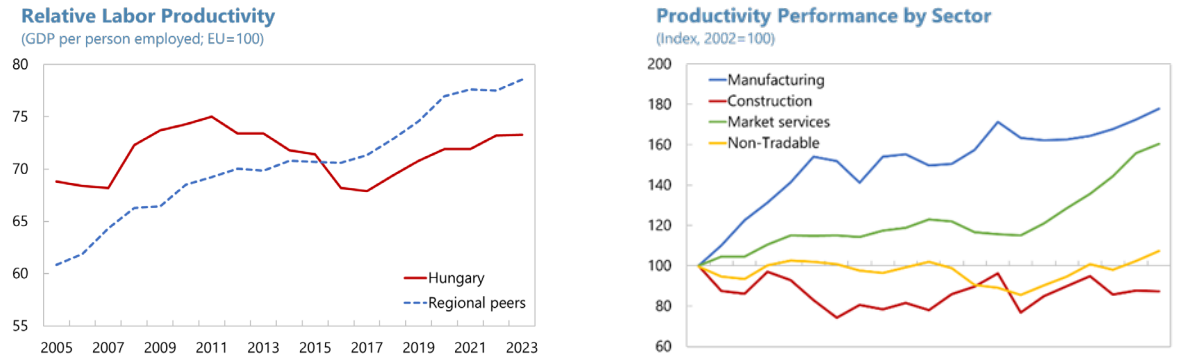
D. Boosting Potential Growth and Remaining Agile in a Changing Environment

38. Deeper reforms are needed to drive stronger and more balanced growth and to accelerate the green transition. Several long-standing mutually enforcing impediments are holding back productivity. These include the strong presence of state-owned enterprises in some key sectors, rigid industry structures including related to the insolvency framework, governance

[11] EBA/REP/2023/34.

weaknesses, inequalities of opportunities, and lagging digitalization.[12] At the same time, Hungary is facing structural changes such as the green transition and emergence of AI. Boosting growth, therefore, will require a sustained implementation of a reform program that tackles all these issues. The right policies would help Hungary upskill its workforce to adapt to the digital and low-carbon economy, and translate the opportunities of the transition to electric vehicles into higher living standards (Box 4).

Figure 27. Labor Productivity

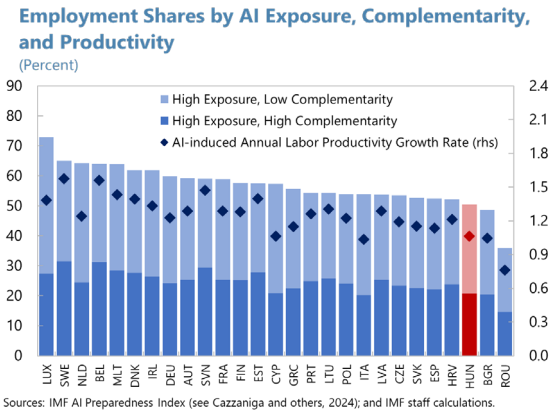


Sources: Eurostat; and IMF staff calculations.
Note: Regional peers shows the average of Bulgaria, Czech Republic, Estonia, Poland, Romania, Slovakia, and Slovenia.

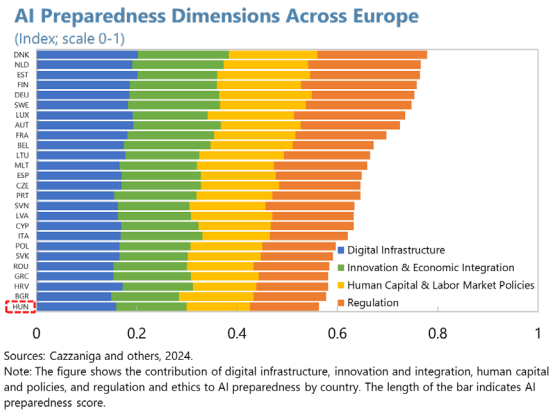
Sources: Eurostat; and IMF staff calculations.

39. Strengthening digital competitiveness amid the emergence of AI could improve productivity. With up to 30 percent of Hungarian jobs currently in occupations that are highly exposed but not complementary to AI, it is time to prioritize and speed up reforms as outlined in the National Digitalization Strategy and implement the new EU AI Act. Further targeted measures, including investment in reskilling and STEM education, can prepare the Hungarian workforce and economy to adapt in the digital era.

Figure 28. AI Exposure, Complementarity, and Preparedness



Sources: IMF AI Preparedness Index (see Cazzaniga and others, 2024); and IMF staff calculations.

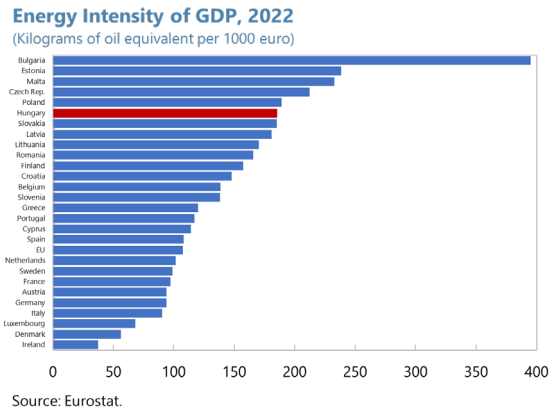


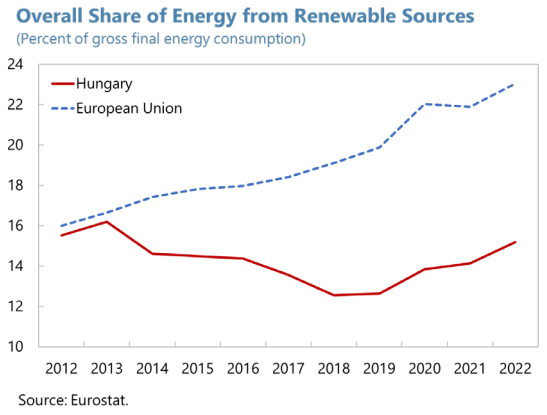
Sources: Cazzaniga and others, 2024.
Note: The figure shows the contribution of digital infrastructure, innovation and integration, human capital and policies, and regulation and ethics to AI preparedness by country. The length of the bar indicates AI preparedness score.

[12] See OECD (2024), Chapter 3, for a detailed discussion and reform options.

40. Climate policy can promote sustainable growth, but large energy subsidies send counterproductive price signals. Hungary is committed to the EU Green Deal, aiming to cut its absolute emissions by 50 percent (relative to 1990) by 2030. However, Hungary's implicit fossil fuel subsidies amounted to 4 percent of GDP in 2023, while its share of renewables in the energy mix remains one of the lowest in the EU. Phasing out these subsidies (and the explicit subsidies noted in ¶20) while providing more targeted support where needed would improve economic resilience (see Annex VII). Greater renewable energy capacity would also help Hungary build on recent progress in diversifying its energy sources.[13]

Figure 29. Energy Intensity





41. Targeted policies can ameliorate regional disparities. Despite progress in speeding up regional income convergence, regional disparities remain persistently high, largely driven by divergence in productivity and labor force participation across regions. The digital and green transitions could widen these inequities without targeted policy interventions.[14] Means-tested social transfers for vulnerable households and reskilling of workers for the green and digital transitions can promote social cohesion and inclusion. Policies, including investments in broad-based digital access and R&D, must be carefully calibrated to support regional economic agility during structural transformations.

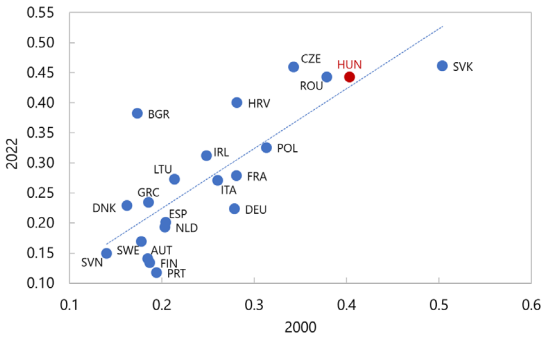
[13] The authorities have opened new supply routes for natural gas from Azerbaijan and Croatia and are negotiating new deliveries from Romania, Qatar, and Algeria (via Slovenia) while new oil contracts have been secured through Croatia and Slovakia. Hungary remains significantly dependent on Russia and in April 2023 signed a new agreement to buy additional natural gas supplies.

[14] See Selected Issues Paper "Regional Disparities in Hungary: Drivers and Implications of the Digital and Green Transitions".

Figure 30. Regional Disparities

Within-Country Coefficient of Variation

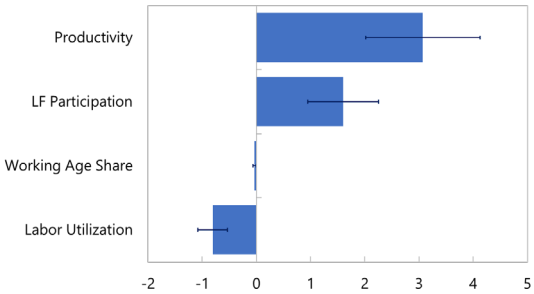
(Standard deviation/mean NUTS 3 GDP per capita, PPS)



Sources: Eurostat; and IMF staff calculations.

Drivers of Per Capita Regional Income Disparities

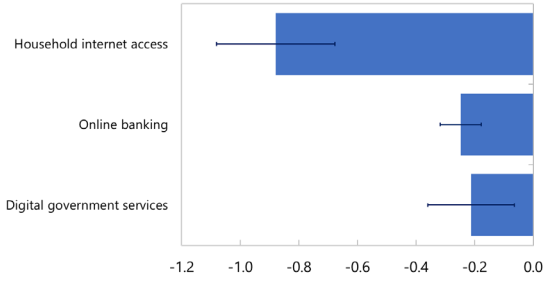
(Percent)



Sources: Eurostat; OECD; and IMF staff calculations.
Note: Error bars show 90% confidence interval; positive values indicate increased disparities. Estimates are based on a regional (NUTS 3) beta convergence framework, regressing the growth of each variable on its initial level, time, and region fixed effects.

Impact of Digital Access on Regional Income Disparities

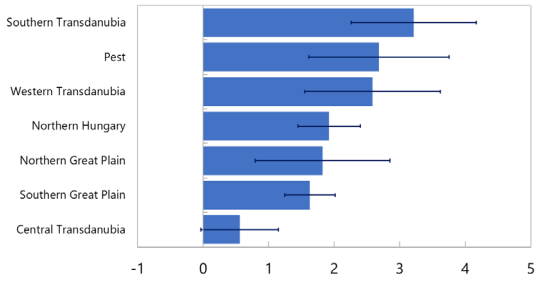
(Percent)



Source: IMF staff calculations.
Note: Coefficient estimates from regressing ratio of Budapest's real GDP per capita to that of other regions' on individual digital access variables, region-time fixed effects, and other controls. Error bars show 95% confidence interval.

Impact of R&D on Green Job Share of Total Employment

(Percent)



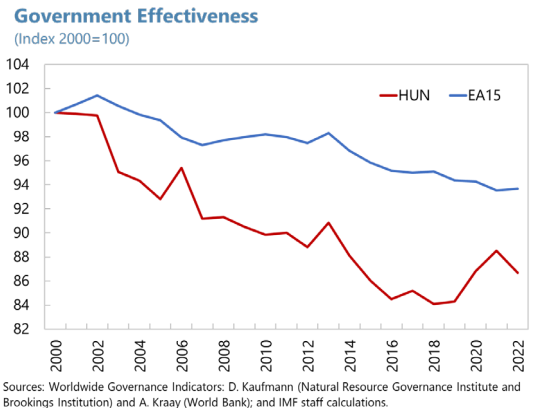
Source: IMF staff calculations.
Note: Coefficient estimates from regressing regional green jobs share of total jobs on regional R&D spending, GHG emissions intensity, and region-time fixed effects. Error bars show 90% confidence interval.

42. Industrial policy (IP) and state aid can facilitate structural transformation, but the bar to get them right is high. Spending on state aid—which is definitionally different from but overlaps with IP—is the highest in Europe as a percentage of GDP, with subsidies a preferred tool (Annex VIII). To be effective, IP measures must be appropriately targeted to address market failures, time-bound, and transparent. As a small and open economy, Hungary would benefit most from a coordinated approach to state aid and IP at the EU-level. It is important that the state's expanding corporate ownership in what the authorities consider strategic sectors, underscored by the recent acquisitions of two major telecommunications companies and the stake in the Budapest airport, be guided by legal, regulatory and policy frameworks that ensure a level playing field and fair competition in the marketplace.[15]

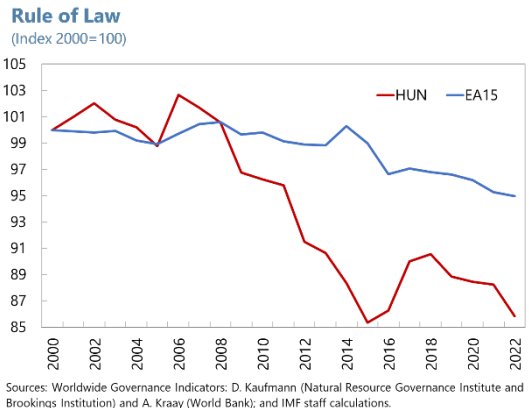
[15] See *OECD Guidelines on Corporate Governance of State-Owned Enterprises.*

43. Good governance is the foundation for successful structural transformation. Hungary has lagged peers in perceptions of rule of law, government effectiveness, and quality of governance as well as anti-corruption. Reforms aimed at closing these gaps have the potential to promote a growth-friendly environment by enhancing policy predictability, reduce regional inequities, and unlocking EU financing for digitalization, and the green transition.

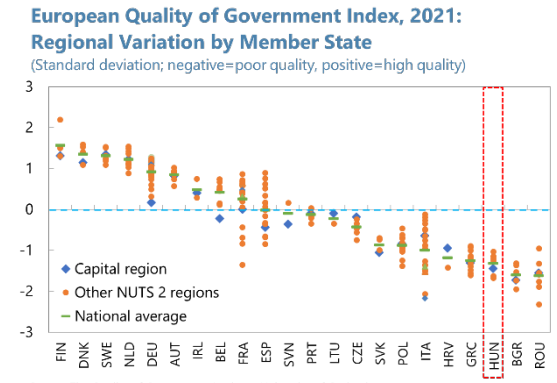
Figure 31. Governance Indicators



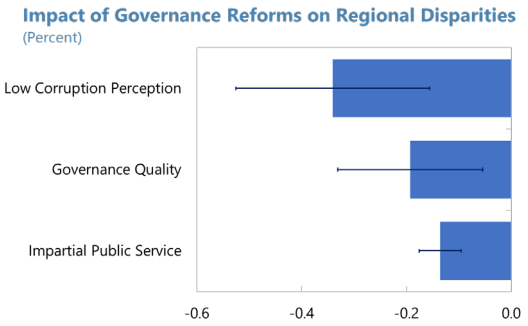
Sources: Worldwide Governance Indicators: D. Kaufmann (Natural Resource Governance Institute and Brookings Institution) and A. Kraay (World Bank); and IMF staff calculations.



Sources: Worldwide Governance Indicators: D. Kaufmann (Natural Resource Governance Institute and Brookings Institution) and A. Kraay (World Bank); and IMF staff calculations.



Source: The Quality of Government Institute, University of Gothenburg.
Note: Light blue dash line at zero shows the EU average.



Sources: Eurostat; OECD; and IMF staff calculations.
Note: Estimates are based on a NUTS 2 panel, regressing the ratio of Budapest's real GDP per capita to that of other regions on each governance indicator, and region-fixed fixed effects. Error bars show 95% confidence interval.

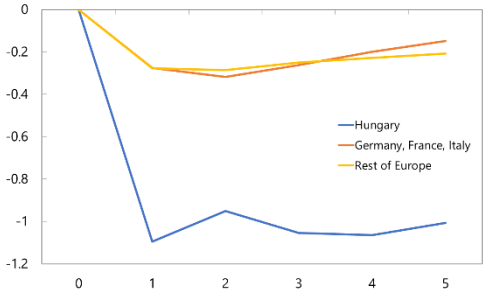
Box 4. Hungary: Automotive Sector—Impact from the Green Transition[1]

Two large, compounding structural shifts are looming for the automotive sector, which has long been a driver of growth in Hungary. First, the green transition. Europe's current climate regulations imply that by 2035 all new passenger vehicle sales should be electric (EVs). Second, there is a simultaneous structural change stemming from China's increasing dominance in the EV sector.

This box presents possible scenarios for the sector drawing on parallels between the current juncture and the 1970s, when oil price shocks and a growing dominance from Japanese manufacturers prompted a shift to more fuel-efficient cars. The economic implications are assessed through the IMF's Global Integrated Monetary and Fiscal Model with Global Value Chains (focusing on the short-to-medium term) and a dynamic quantitative trade model (assessing longer-term implications).[2] A combined shock entailing an increase in TFP in China and a policy-induced shift in demand toward EVs is calibrated so that China's EV market share in Europe increases by around 15 percent of total domestic production over a period of around 5 years (in line with the 1970s rise of Japanese market shares in the U.S.).

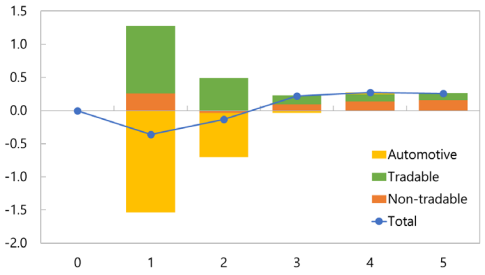
The results are threefold. First, the impact of the combined shocks would reduce the level of Hungary's GDP by about 1 percentage point in the short-to-medium term (a larger effect than in more diversified European economies, such as Germany), with reallocation of employment across sectors. The results from the trade model, are broadly similar, with a long-run negative consumption effect of 0.5 percent. Second, the imposition of a tariff on final goods on all automotive sector imports from China, would be detrimental in both models, as tariffs would prevent consumers from benefitting from cheaper Chinese cars and increase output costs—which could potentially lead to more resistance to retain climate ambitions, and thus be detrimental to the green transition. Third, an FDI scenario in which Chinese firms produce directly in Europe, that assumes that about half of Chinese EVs sold in Europe are eventually manufactured there, would result in smaller output losses over the medium-term.

GDP Impacts of Combined EV Shocks
(Percent of GDP, deviation from steady state)



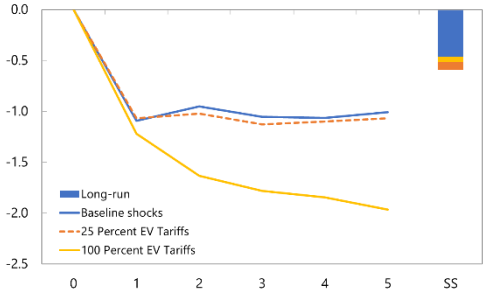
Source: IMF staff calculations.

Employment Impacts of Combined EV Shocks in Hungary, by Sector
(Percent of total, deviation from steady state)



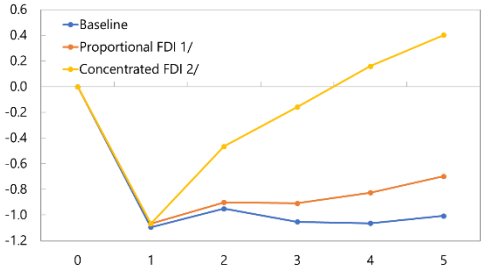
Source: IMF staff calculations.

Hungary GDP: Impacts of Automotive Sector Tariffs
(Percent of GDP, deviation from steady state)



Source: IMF staff calculations.

Hungary GDP: Impacts of Foreign Direct Investment
(Percent of GDP, deviation from steady state)



Source: IMF staff calculations.
1/ FDI inflows allocated proportionally to Hungary's share in EU auto sector value added.
2/ FDI inflows allocated in line with recent Chinese FDI inflow patterns.

[1] See Wingender, P., J. Yao, R. Zymek, B. Carton, D. Cerdeiro, and A. Weber, "Europe's Shift to Electric Vehicles Amid More Intense Global Competition", forthcoming, IMF Working Paper.
[2] On GIMF-GVC, see e.g., 2023 WEO Chapter 3 and Cuñat and Zymek (2024) for the trade model.

Authorities' Views

44. The authorities agreed on the need for broad-based structural reforms. They are committed to creating an enabling environment for AI and related technologies, including through educating SMEs on the legal requirements of the new EU AI Act. On the green transition, they believe the biggest challenge lies in decreasing energy consumption and reindustrializing in a sustainable way, with limited scope for cutting energy subsidies or pricing externalities through higher tax rates. They stressed the important role of nuclear energy alongside investment in the grid and electric charging infrastructure. They aim to tackle regional inequities by enhancing infrastructure, directing FDI to lagging regions, and allocating 65 percent of EU cohesion funds to the four most deprived regions. Through industrial policy, the authorities seek to support the most productive Hungarian firms—so-called "national champions"—while reiterating their commitment to the EU state aid framework. Finally, they stressed that governance perception indices were differing from reality and that in many aspects, including public procurement, Hungary is already outperforming peers.

STAFF APPRAISAL

45. Hungary is emerging from a period of shocks. The pandemic, Russia's war in Ukraine, and crisis-related stimulus widened fiscal and external imbalances and triggered double-digit inflation in 2022. Thanks to an effective monetary policy response aided by falling commodity prices and a tighter fiscal stance in 2023, inflation has declined rapidly. A large current account deficit in 2022 turned into a surplus in 2023, labor markets and the financial sector have remained resilient, and output is starting to recover.

46. However, significant challenges remain. Fiscal imbalances, windfall taxes, interest rate caps and subsidized lending, and delays in the disbursement of EU funds create investor uncertainty. Mutually reinforcing challenges are holding back Hungary's productivity, including a strong presence of state-owned enterprises in some key sectors, inequalities of opportunities, and lagging digitalization. Policy uncertainty has also constrained investment, contributing to an external position stronger than implied by fundamentals (Annex III).

47. A credible fiscal adjustment would help safeguard fiscal sustainability. In the absence of measures, staff projects that the authorities will miss the targets set in their latest EU Convergence Program. Measures should aim at achieving a deficit of below 3 percent of GDP by 2026, while bringing the structural deficit to 1.5 percent of GDP by 2029, in line with the preliminary assessment of what the new EU fiscal framework would require. This fiscal path should be anchored in a credible medium-term framework.

48. Tax reforms should focus on improving the efficiency and equity of the tax system. A universal VAT rate with fewer exemptions would simplify administration. Higher marginal personal income tax rates for high earners would enhance progressiveness. Taxation of corporates could be made more equitable by rationalizing tax incentives and increasing the tax rate, while using the additional revenues to eliminate distortive windfall taxes. There is also scope for raising more

revenue from property taxes. Hungary should reduce its reliance on distortive taxes such as financial transaction taxes and windfall taxes that create uncertainty and undermine investment.

49. Reducing subsidies and rationalizing other current spending would create room for a more growth-friendly spending mix. Retail utility subsidies should be limited to a basic subsistence amount to protect vulnerable households. A rationalization of the public wage bill and goods and services spending would provide further savings and free room for more productive spending, including on investment and education. Reforms are also needed to contain long-term spending pressures, and to improve monitoring of contingent liabilities stemming from the rapid expansion of SOE assets and government guarantees.

50. Policy rates should remain in restrictive territory into next year to deliver a sustainable return of inflation to target. The loosening of the monetary policy stance has been broadly appropriate so far. But there is limited scope for further rate cuts this year as underlying inflation pressures remain elevated, particularly for services. The exchange rate is likely to also be a binding constraint on the pace of loosening given its importance for inflation dynamics. The flexible exchange rate regime and maintaining adequate reserves can help Hungary manage external shocks. Central bank autonomy should be protected by appropriate legal frameworks.

51. Now is still an opportune time to bolster financial sector resilience, while distortions to market-based credit allocation should be removed. The introduction of a positive neutral countercyclical capital buffer, of 1 percent from July 2025, represents an important step to further mitigate systemic risks. While the MNB should play an active role in climate-risk supervision, initiatives should be consistent with its core mandate of price and financial stability. Hungary should prioritize implementing the EU's AML/CFT 2024 legislative package and enhancing risk-based measures for non-profit organizations. State-owned banks' subsidized lending should be better targeted, while remaining interest rate caps should be phased out. Scaling back the various fiscal incentives for house ownership would help moderate future house price growth and safeguard financial stability.

52. Deeper reforms are needed to drive more balanced growth. Investment in STEM education, implementation of the new EU AI Act, reduced fossil fuel subsidization coupled with transfers for the vulnerable, and targeted incentives for investment in disadvantaged areas would have mutually reinforcing benefits. Further progress on governance reforms would foster a growth-friendly environment and unlock EU financing. The state's strong presence in some sectors, including through recent telecom and airport acquisitions, should be guided by legal, regulatory and policy frameworks that ensure fair competition.

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

Table 1. Hungary: Selected Economic Indicators, 2019–2029

(Percent of GDP, unless otherwise indicated)

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
								Projections			
					(Percentage change, unless otherwise indicated)						
Real economy											
Real GDP (percentage change)	4.9	-4.5	7.1	4.6	-0.9	2.3	3.3	3.0	3.0	3.2	3.2
Total domestic demand (contribution to growth)	6.8	-2.5	6.2	4.0	-5.4	1.4	4.6	2.7	2.5	2.8	2.7
Private consumption	2.7	-1.1	2.4	4.0	-0.6	1.8	1.6	1.4	1.4	1.4	1.4
Government consumption	0.9	0.4	0.3	0.1	-0.2	0.1	0.3	0.3	0.2	0.2	0.2
Gross fixed investment	3.1	-1.9	1.5	0.4	-1.8	-0.5	1.6	1.1	1.1	1.2	1.2
Foreign balance (contribution to growth)	-2.1	-2.2	0.9	0.7	4.9	0.8	-1.3	0.3	0.5	0.4	0.5
CPI inflation (average)	3.4	3.3	5.1	14.6	17.1	3.8	3.5	3.1	3.0	3.0	3.0
CPI inflation (end year)	4.0	2.7	7.4	24.5	5.5	4.2	3.3	3.0	3.0	3.0	3.0
Core CPI inflation (average)	3.1	3.7	3.9	15.8	17.7	4.7	4.6	3.6	3.1	3.0	3.0
Core CPI inflation (end year)	3.2	3.2	6.4	24.8	7.6	4.9	4.2	3.2	3.0	3.0	3.0
Unemployment rate (average, ages 15-74)	3.3	4.1	4.1	3.6	4.1	4.4	4.2	4.1	3.9	3.8	3.7
Gross fixed capital formation (percent of GDP)	27.0	26.5	27.2	27.9	26.3	25.0	25.8	26.1	26.5	26.9	27.2
Gross national saving (percent of GDP, from BOP)	26.2	25.4	23.0	19.5	26.5	25.9	26.1	26.5	27.3	28.0	28.6
General government 1/											
Overall balance (percent of GDP)	-2.0	-7.6	-7.2	-6.2	-6.7	-5.0	-4.5	-3.3	-2.9	-2.8	-2.6
Primary balance (percent of GDP)	0.1	-5.4	-5.1	-4.0	-3.0	-0.8	-0.6	-0.1	0.4	0.5	0.6
Structural primary balance (percent of potential GDP)	-1.4	-4.3	-5.4	-4.8	-2.6	-0.2	-0.3	0.1	0.5	0.5	0.6
Public debt (percent of GDP)	65.3	79.3	76.7	74.1	73.5	73.9	73.5	72.5	71.3	70.0	68.6
Money and credit (end-of-period)											
Broad money	8.1	21.1	16.3	7.1	1.4	4.6	7.2	6.6	6.7	6.8	7.3
Lending to the private sector, flow-based	15.3	11.8	12.8	12.0	4.5	3.4	7.1	6.1	5.9	6.1	6.1
Interest rates											
T-bill (90-day, average)	0.0	0.4	0.9	7.6	11.0	6.7	6.6	6.6	6.5	6.5	6.5
Government bond yield (5-year, average)	1.6	1.5	2.4	8.1	8.0	6.5	6.6	6.6	6.6	6.7	6.7
Balance of payments											
Current account (percent of GDP)	-0.8	-1.1	-4.3	-8.4	0.2	0.8	0.3	0.4	0.7	1.1	1.4
Reserves (billions of Euros)	28.4	33.7	38.4	38.7	41.3	50.8	57.6	65.9	70.5	77.6	84.9
Gross external debt (percent of GDP) 2/	73.1	81.3	87.0	91.8	85.5	79.9	76.9	74.9	72.4	70.3	68.1
Gross official reserves in percent of the IMF ARA metric	104.5	120.2	117.4	107.0	104.8	113.2	126.8	135.2	138.6	145.7	151.3
Exchange rate											
Exchange rate, HUF per euro, period average	325.2	351.2	358.5	390.9	381.8	...	...	...	...	...	...
Nominal effective rate (2000=100, average)	121.5	130.5	133.0	145.5	141.3	...	...	...	...	...	...
Real effective rate, CPI basis (2000=100, average)	80.4	84.2	84.1	87.5	77.0	...	...	...	...	...	...
Memorandum Items:											
Nominal GDP (billions of Forints)	47,674	48,444	55,205	65,952	74,992	79,770	85,411	90,658	96,032	101,921	108,157
Per capita GDP (EUR)	14,999	14,119	15,827	17,411	20,463	21,809	23,413	24,913	26,454	28,147	29,942
Output gap (percent of potential GDP)	3.3	-2.9	0.3	1.7	-1.2	-1.4	-0.7	-0.4	-0.2	0.0	0.2
Potential GDP growth (percentage change)	3.5	1.6	3.6	3.2	2.0	2.5	2.6	2.7	2.8	2.9	3.0

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.

Table 2. Hungary: Consolidated General Government, 2019–2029

(Percent of GDP, unless otherwise indicated)

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
								Projections			
Revenue	44.0	43.8	41.2	42.7	42.4	43.8	43.5	44.1	44.5	44.2	44.1
Tax revenue	24.5	24.7	23.2	25.1	25.0	25.5	24.7	24.6	24.7	24.6	24.8
Taxes on goods and services	17.9	18.0	17.6	18.1	17.5	17.8	17.5	17.4	17.6	17.5	17.5
VAT	9.5	9.7	9.9	10.1	9.4	9.6	9.5	9.4	9.5	9.5	9.5
Excises and other	8.4	8.3	7.7	8.0	8.1	8.2	8.0	8.0	8.0	8.0	8.0
Taxes on income, profits and capital gains	6.5	6.7	5.6	6.9	7.5	7.7	7.1	7.1	7.1	7.1	7.2
Personal income tax	5.1	5.2	4.1	5.3	5.4	5.4	5.4	5.4	5.4	5.4	5.4
Corporate taxes	1.1	1.2	1.2	1.3	1.7	1.7	1.4	1.4	1.4	1.4	1.4
Other	0.3	0.3	0.3	0.2	0.3	0.5	0.3	0.3	0.3	0.3	0.4
Capital taxes	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Social contributions	11.7	11.1	10.5	9.9	10.0	10.1	10.1	10.1	10.1	10.0	10.0
Current non-tax revenue	4.7	4.6	4.5	5.2	5.8	5.8	5.5	5.5	5.5	5.5	5.5
o/w interest revenue	0.1	0.1	0.2	0.6	1.0	0.5	0.3	0.3	0.3	0.3	0.3
Current grants	1.4	1.5	1.1	1.2	1.0	1.5	1.5	1.7	1.7	1.7	1.6
Capital revenues and grants	1.8	1.9	2.0	1.4	0.8	1.0	1.8	2.3	2.5	2.4	2.3
Expenditure	46.1	51.4	48.4	48.9	49.1	48.8	48.0	47.4	47.4	46.9	46.7
Compensation of employees 1/	10.5	11.0	10.6	10.3	9.7	10.2	10.2	10.2	10.1	10.0	9.8
Goods and services	8.7	8.8	8.7	8.6	8.1	8.3	8.3	8.3	8.2	8.2	8.2
Interest	2.2	2.3	2.3	2.8	4.7	4.7	4.2	3.6	3.6	3.6	3.5
Subsidies	1.1	1.3	1.2	1.8	2.7	2.2	2.1	2.1	2.1	2.1	2.1
Current transfers to households	12.1	12.5	12.2	11.7	12.2	12.2	12.0	11.8	11.7	11.7	11.6
Social security	10.1	10.4	10.3	9.9	10.3	10.3	10.2	10.1	10.1	10.1	10.0
Other	2.0	2.1	1.9	1.8	1.9	1.9	1.9	1.7	1.7	1.6	1.6
Other current transfers	3.2	4.0	3.9	4.0	4.4	4.3	4.2	4.1	4.1	4.1	4.1
Capital expenditures	6.5	7.5	6.6	7.1	5.4	4.6	4.7	5.1	5.4	5.2	5.2
Capital transfers	1.8	3.9	3.0	2.6	1.9	2.2	2.3	2.3	2.3	2.2	2.2
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
General government balance	-2.0	-7.6	-7.2	-6.2	-6.7	-5.0	-4.5	-3.3	-2.9	-2.8	-2.6
Primary balance	0.1	-5.4	-5.1	-4.0	-3.0	-0.8	-0.6	-0.1	0.4	0.5	0.6
Memorandum items:											
Structural balance (% of potential GDP)	-3.7	-6.5	-7.6	-7.2	-6.3	-4.4	-4.3	-3.2	-2.9	-2.9	-2.8
Structural primary balance (% of potential GDP)	-1.4	-4.3	-5.4	-4.8	-2.6	-0.2	-0.3	0.1	0.5	0.5	0.6
Cyclically-adjusted primary balance (% of potential GDP)	-1.4	-4.0	-5.3	-4.9	-2.5	-0.2	-0.3	0.1	0.5	0.5	0.6
Gross public debt (Maastricht definition)	65.3	79.3	76.7	74.1	73.5	73.9	73.5	72.5	71.3	70.0	68.6
Nominal GDP (billions of Forints)	47,674	48,444	55,205	65,952	74,992	79,770	85,411	90,658	96,032	101,921	108,157

Sources: Hungarian authorities; and Fund staff estimates.
1/ Includes social security contributions.

Table 3. Hungary: Central Bank Survey, 2019–2025

(Billions of HUF, unless otherwise indicated)

	2019	2020	2021	2022	2023	2024	2025
						Projections	
Net foreign assets	8,764	9,389	7,985	7,582	8,343	11,677	12,208
Foreign Assets	10,040	12,988	14,900	16,297	16,585	19,918	20,825
Foreign Liabilities	1,276	3,599	6,915	8,715	8,242	8,242	8,617
Net domestic assets	-587	-109	2,305	8,300	9,984	7,552	6,768
Net claims on government	-907	-1,631	1,596	1,711	1,778	464	462
Assets	39	1,114	3,303	3,312	3,307	3,306	3,304
Liabilities (Govt Deposits at MNB)	946	2,745	1,706	1,601	1,528	2,842	2,842
HUF	603	1,733	1,361	993	686	...	...
FX	343	1,012	346	608	843	...	...
Net claims on banks 1/	1,006	1,900	39	5,099	4,482	3,175	2,526
Assets	1,749	5,144	6,323	6,194	5,124	3,850	3,235
Liabilities	742	3,244	6,284	1,095	642	675	710
Deposits & CDs excl. current & overnight deposits	742	3,244	6,244	1,092	111	111	106
Securities Issued by MNB 2/	0	0	40	3	530	564	604
Net claims on the economy 3/	197	547	1,322	1,593	2,101	2,059	1,853
Other items, net	-883	-925	-652	-102	1,622	1,855	1,927
Base money (M0)	8,177	9,280	10,290	15,882	18,327	19,229	18,976
Currency in Circulation	6,641	7,332	7,856	8,411	8,218	8,739	9,436
Banks' Reserves	1,536	1,948	2,434	7,471	10,109	10,490	9,540
Current Account Balances	258	339	371	2,807	10,107	10,490	9,540
Overnight Deposits	1,278	1,608	2,062	4,664	2	...	...
Memorandum items :							
International Reserves (billions of Euros)	28.4	33.7	38.4	38.7	41.3	50.8	57.6
Base Money (yoy percent change)	12.7	13.5	10.9	54.4	15.4	4.9	-1.3
NFA (contribution to change)	1.0	7.6	-15.1	-3.9	4.8	18.2	2.8
NDA (contribution to change)	11.7	5.8	26.0	58.3	10.6	-13.3	-4.1
Government Deposits at Central Bank (percent of GDP)	2.0	5.7	3.1	2.4	2.0	3.6	3.3
HUF	1.3	3.6	2.5	1.5	0.9	...	...
FX	0.7	2.1	0.6	0.9	1.1	...	...
Reserve Requirement Ratio (percent of select liabilities)	1.0	1.0	1.0	5.0	10.0	10.0	10.0

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

1/ Excluding swaps. Revaluation 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 4. Hungary: Monetary Survey, 2019–2025

(Billions of HUF, unless otherwise indicated)

	2019	2020	2021	2022	2023	2024	2025
						Projections	
Net foreign assets	10,242	11,916	10,765	8,577	8,348	9,457	9,279
Central Bank	8,764	9,389	7,985	7,582	8,343	11,677	12,208
Commercial Banks	1,478	2,527	2,780	995	5	(2,219)	(2,929)
Net domestic assets	17,078	21,647	28,252	33,195	34,011	34,849	38,219
Domestic credit	24,699	28,977	35,295	39,681	40,393	41,129	44,399
Net claims on government	7,525	8,894	11,392	12,876	11,970	11,861	13,412
From Central Bank	(907)	(1,631)	1,596	1,711	1,778	464	462
From Commercial Banks	8,432	10,525	9,796	11,165	10,191	11,397	12,950
Gross Credit to the economy	17,174	20,083	23,902	26,805	28,423	29,269	30,987
From Commercial Banks	16,977	19,536	22,580	25,212	26,322	27,209	29,133
Other items, net	(7,621)	(7,330)	(7,043)	(6,486)	(6,382)	(6,280)	(6,180)
Broad money (M3)	27,724	33,563	39,017	41,771	42,359	44,307	47,498
M2	27,610	33,496	38,870	41,160	40,820	42,685	45,779
M1	24,531	30,264	34,915	33,969	32,326	33,649	36,105
Currency in circulation	6,188	6,969	7,507	8,019	7,893	8,393	9,062
Overnight Deposits	18,343	23,295	27,408	25,949	24,433	25,256	27,042
Deposits with Maturities up to 2 years	3,079	3,232	3,955	7,191	8,495	9,036	9,675
Repos	9	-	35	11	242	242	242
Money Market Fund Shares/Units	68	42	22	315	542	576	617
Debt Securities	38	25	91	285	755	803	860
Memorandum items:							
			Percentage change by contribution, y-o-y				
Broad Money	8.1	21.1	16.3	7.1	1.4	4.6	7.2
NFA	-0.5	6.0	-3.4	-5.6	-0.5	2.6	-0.4
NDA	8.7	15.0	19.7	12.7	2.0	2.0	7.6
			Percentage change, y-o-y				
Credit to Private Sector	15.3	11.8	12.8	12.0	4.5	3.4	7.1
HUF	15.0	16.6	16.1	9.9	...	...	...
FX	16.3	-4.2	1.0	20.6	...	...	...
Bank Deposits	9.6	22.5	17.1	5.1	-0.8	16.4	2.6
Bank Holdings of Government Paper (percent of GDP)	17.0	21.0	18.5	16.4	13.9	14.8	15.4

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

Table 5. Hungary: Balance of Payments, 2019–2029

(Percent of GDP, unless otherwise indicated)

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
						Projections					
Current Account	-0.8	-1.1	-4.3	-8.4	0.2	0.8	0.3	0.4	0.7	1.1	1.4
Goods and service (GS), net	2.3	1.9	0.2	-4.4	5.1	5.4	5.0	5.3	5.7	6.0	6.2
Exports	81.5	78.7	79.9	90.2	81.2	78.2	78.4	78.9	79.7	80.6	81.8
Imports	-79.2	-76.8	-79.7	-94.6	-76.1	-72.8	-73.4	-73.5	-73.9	-74.6	-75.6
Primary Income, net	-2.5	-2.6	-3.4	-3.0	-3.6	-3.5	-3.6	-3.8	-3.9	-3.7	-3.7
Secondary Income/Current transfers, net	-0.6	-0.5	-1.1	-1.0	-1.3	-1.1	-1.0	-1.1	-1.1	-1.1	-1.1
Capital Account	1.9	2.1	2.5	2.1	1.0	1.9	1.9	1.9	1.7	1.7	1.6
Financial Account 1/	-0.1	-6.0	-6.9	-9.5	-1.9	-1.8	-0.8	-1.3	0.7	0.1	0.4
Direct investment, net	-0.6	-1.6	-2.4	-3.0	-1.2	-1.6	-1.9	-1.9	-1.6	-1.3	-1.3
Net acquisition of assets	1.3	0.6	3.3	5.4	0.5	2.6	2.4	2.3	2.4	2.7	2.6
Net incurrence of liabilities	1.9	2.2	5.7	8.3	1.8	4.2	4.3	4.2	4.1	3.9	4.0
Portfolio investment, net 2/	1.1	-2.1	-0.1	-3.9	-3.0	0.7	1.1	1.1	2.9	1.9	2.3
Other investment	-0.6	-2.3	-4.4	-2.7	2.4	-1.0	0.0	-0.4	-0.6	-0.6	-0.6
Net errors and omissions	-0.9	-2.6	-2.7	-2.8	-1.7	0.0	0.0	0.0	0.0	0.0	0.0
Overall Balance	0.2	4.3	2.5	0.5	1.3	4.6	3.0	3.5	1.8	2.7	2.6
Financing	-0.2	-4.3	-2.5	-0.5	-1.3	-4.6	-3.0	-3.5	-1.8	-2.7	-2.6
Gross Reserves ("-": increase)	-0.2	-4.3	-2.5	-0.5	-1.3	-4.6	-3.0	-3.5	-1.8	-2.7	-2.6
Memorandum Items:											
Exports volume (percentage change)	5.4	-6.1	8.3	11.4	0.9	1.0	6.8	5.9	6.0	6.1	6.2
Imports volume (percentage change)	8.2	-3.9	7.3	10.8	-4.3	0.2	8.9	5.9	5.9	6.1	6.1
Terms of trade (percentage change)	0.6	2.1	-3.4	-6.9	6.5	-0.2	0.7	0.5	0.3	0.3	0.2
Gross external debt (percent of GDP) 3/	73.1	81.3	87.0	91.8	85.5	79.9	76.9	74.9	72.4	70.3	68.1
Net International Investment Position	-49.3	-45.8	-52.1	-50.9	-45.5	-40.8	-36.3	-32.7	-30.3	-27.0	-23.9
Gross official reserves (billion Euros)	28.4	33.7	38.4	38.7	41.3	50.8	57.6	65.9	70.5	77.6	84.9
In percent of s-t debt at remaining maturity	160.6	150.7	131.9	110.3	122.5	103.3	126.5	127.1	130.8	137.4	142.3
In months of next year's imports of G&S	3.2	3.3	2.9	3.1	3.3	3.7	4.0	4.3	4.2	4.3	4.4
In percent of IMF metric	104.5	120.2	117.4	107.0	104.8	113.2	126.8	135.2	138.6	145.7	151.3

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.

Table 6. Hungary: Financial Soundness Indicators for the Banking Sector, 2019–2024Q1

(Percent, end-of-period, unless otherwise indicated)

	2019	2020	2021	2022				2023				2024
				Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Capital												
Regulatory capital to risk-weighted assets	18.0	18.3	19.6	18.7	18.2	17.6	19.1	18.3	18.7	19.2	19.0	19.3
Regulatory Tier 1 capital to risk-weighted assets	15.9	16.2	18.1	17.3	16.7	16.2	17.5	16.3	16.7	17.2	17.0	17.3
Asset Quality												
NPLs (90 days overdue) net of provisions to capital	2.0	10.1	10.8	10.9	11.2	11.9	10.6	10.5	9.4	9.0	8.4	7.4
NPLs (90 days overdue) to gross loans	1.5	4.0	3.6	3.4	3.7	3.7	3.8	3.7	3.4	3.4	3.3	3.1
Profitability												
ROA	2.0	0.9	1.3	0.6	0.7	1.1	1.2	1.8	2.6	2.8	2.5	2.3
ROE	19.5	9.7	11.7	4.6	6.5	10.5	10.8	16.4	24.1	25.0	20.2	18.3
Net interest income to gross income	46.8	52.1	53.4	54.7	57.4	59.2	61.3	59.6	57.3	57.7	59.1	61.9
Noninterest expenses to gross income	68.1	64.7	64.8	65.5	69.6	64.5	62.6	71.5	57.5	55.3	55.6	63.5
Liquidity												
Liquid assets to total assets	24.9	27.7	15.6	15.5	14.4	14.9	21.1	23.1	22.7	23.6	25.8	26.5
Liquid assets to short term liabilities	39.7	34.4	17.9	17.7	16.7	23.9	34.6	37.6	37.9	39.2	42.5	44.0

Sources: IMF's Financial Soundness Indicators Database.

Annex I. Authorities' Response to Past IMF Policy Recommendations

IMF 2022 Article IV Recommendations	Authorities' Response
Fiscal Policies	
1. Implement the authorities' proposed adjustment to rebuild fiscal buffers: reduce the deficit from 6.1 percent of GDP in 2022 to 3.9 percent of GDP in 2023 and 2.5 percent in 2024. 2. Create fiscal space by reducing operational spending, including on goods and services, and better target energy subsidies. Rollback windfall taxes. 3. Implement governance reforms to unlock EU financing.	1. **Limited progress.** The structural primary deficit improved by about 2¼ percent of GDP in 2023 but the headline deficit slipped substantially to 6.7 percent. 2. **Limited progress.** Goods and services spending fell as a percentage of GDP in 2023, though partly as a result of a decline in EU co-financing. This was more than offset by higher subsidy (and interest) spending and lower VAT receipts. Existing windfall taxes were extended from end-2022 to end-2024 in June 2023 and in July 2024, the government announced further modifications to increase revenues associated with these taxes in 2024, while extending some (including on insurance companies and banks) to 2025. 3. **Limited progress.** In December 2023, the EC released €10.2 billion in cohesion funds allotted for 2021-27 and an additional €2 billion in March. €9.5 billion in cohesion funds, €5.8 billion in RRF financing and €3.7 billion in RePower funding remain frozen pending implementation of reforms, including 27 super milestones related to governance.
Monetary and Financial Policies	
1. Maintain a tight monetary policy stance until inflation converges to target. 2. Abolish interest rate caps. 3. Limit exchange rate intervention to disorderly market conditions. End FX provision to energy importers. 4. Implement remaining Moneyval recommendations and the new European Banking Authority AML/CFT requirements to strengthen AML framework.	1. **Substantial progress.** The MNB raised its policy rates to increase the effective overnight rate by over 17 percentage points between June 2021 and October 2022. Real interest rates generally remain positive despite nominal loosening since May 2023, providing disinflationary momentum. Inflation reached 3.7 percent y/y in June 2024 down from a peak of 25.7 percent in January 2023. 2. **Some progress.** SME loan and deposit caps were eliminated in April 2024, but mortgage rate caps and various voluntary caps remain. 3. **Limited progress.** FXI is not published, but FX provision for energy importers has stopped. 4. **Ongoing.**
Structural Reforms	
1. Improve energy security through demand adjustment, supply diversification and improvements in energy efficiency. 2. Strengthen governance and anticorruption frameworks.	1. **Some progress.** Hungary has diversified sources of gas and oil, but energy subsidies impede efficiency gains. 2. **Limited progress.** Some progress on rule of law reforms but implementation of milestones related to Cohesion and RRF financing remain pending.

Annex II. Windfall Taxes, Price/Rate Caps, and Subsidized Lending Programs

Measure	Duration	Description
I. WINDFALL TAXES		
Windfall tax on pharmaceutical producers	Dec. 24, 2022-Dec. 31, 2024	The tax base was first calculated on net sales revenue with rates of 1 percent for revenues up to HUF 50 billion, 3 percent for revenues between HUF 50 and 150 billion, and 8 percent for revenues above HUF 150 billion. In 2024, these tax bands are halved to 0.5 percent for up to HUF 50 billion, 1.5 percent for between HUF 50 and 150 billion, and 4 percent for above HUF 150 billion. The tax can be further reduced in 2024 with the 2024 investment and research and development costs, up to a maximum of 50 percent of the tax payable for the tax year. The windfall tax will be phased out at the end of 2024. In addition, for the year 2024, a new special tax on pharmaceutical producers was introduced. The tax base is calculated on net sales revenue with deductions. The tax bands are 0.5 percent for up to HUF 50 billion, 4 percent for between HUF 50 and 150 billion, and 7 percent for above HUF 150 billion. The amount of this special tax is deductible from the windfall tax on pharmaceutical producers.
Windfall tax on the banking sector	Jul. 1, 2022-Dec. 31, 2025	In 2022, banks faced a 10 percent tax on interest margin and fee revenue, dropping to 8 percent in early 2023. From July 1, 2023, the tax shifted to income, with rates of 13 percent for income up to HUF 10 billion and 30 percent above, for the second half of 2023. In 2024, the threshold increases to HUF 20 billion, maintaining the same rates. Banks can deduct 10 percent of their government bond portfolio growth from their windfall tax, up to a maximum of 50 percent of the bank's windfall profits tax, in 2024. The tax collected €640M in its first year, 0.6 percent of RWA. Effective August 1, 2024, eligibility for the maximum tax reduction is only available to banks that increase both their holdings of government bonds expiring beyond January 1, 2027 and their total government bond holdings.
Windfall taxes on the energy sector:	Mid-2022-Dec. 31, 2025	
i. Income tax on energy suppliers		Income tax on energy suppliers extended to bioethanol, starch, and sunflower oil production in 2022-2024 and income tax rate on energy suppliers changes to 41 percent in 2023-2025.
ii. Windfall tax on the spread between Ural-Brents		New windfall tax where the tax base is the product of refined oil quantity and the price spread with a 25 percent flat rate from January 1 to July 31 and with a 40 percent tax rate from August 1, 2022 to December 7, 2022, and from December 8, 2022 with a 95 percent tax rate till end 2025. In order to improve the incentives, from April 1, 2023, the differential amount can be reduced by USD 7.5 US dollars per barrel. The tax was modified in July 2024 to reduce this deduction to USD 5 effective August 1.
iii. Special tax on power plants providing balancing power		New extraordinary tax on power plants providing balancing power, where the tax base is the financially realized sales revenue received from the service, with a tax rate of 13 percent in 2022 and a tax rate of 10 percent in 2023 and 2024.

Measure	Duration	Description
iv. Special tax on electricity providers **v. Windfall tax of the Ural-Brents spread's taxpayers**		Extraordinary temporary tax on electricity producers in 2022-2024 with a 65 percent rate on the extra profit earned over the regulatory price. Extraordinary tax of the Ural-Brent spread in 2023 at 2.8 percent on tax base of net sales in 2022 with tax rate changed to 1 percent in 2024.
Special tax on retail sector	Jul. 1, 2022-Dec. 31, 2025	Extraordinary tax in 2022 equal to 80 percent of retail tax paid in 2021. In 2023, retail tax rates will be temporarily increased as follows: HUF 0,5-30 Bn. from 0.1 percent to 0.15 percent, HUF 30-100 Bn. from 0.4 percent to 1 percent and above HUF 100 Bn. from 2.7 percent to 4.1 percent then 4.5 percent for 2024. Furthermore, in 2024, in contrast to the general rules, the tax rate for the retail sale of motor vehicle fuel will remain unchanged at 0 percent up to HUF 500 million, but above that it will be uniformly 3 percent.
Special tax on telecommunication services	Jul. 1, 2022-Dec. 31, 2024	Based on net sales revenues of telecommunication services: HUF 0-1 Bn.: 0 percent, HUF 1-50 Bn.: 1 percent, HUF 50-100 Bn.: 3 percent, above HUF 100 Bn.: 7 percent.
Special tax on the insurance sector	Jul. 1, 2022-Dec. 31, 2025	Tax levied on the insurance premium on the top of existing tax in 2nd half of 2022. Tax rate bands were different for life and non-life insurances and for 2022 those were different from 2023 and 2024. For non-life insurances in 2022, tax rates were the following: 4 percent up to HUF 1 billion, 8 percent between HUF 1 billion and HUF 18 billion and 14 percent over HUF 18 billion. For life insurances, these were 2 percent, 3 percent, and 6 percent respectively. Originally for the following year these rates were half of that of 2022: for life insurances 1 percent, 1.5 percent, 3 percent and for non-life insurances 2 percent, 4 percent, and 7 percent respectively. In December 2022 the upper rates were increased from 3 percent (life) and 7 percent (non-life) to 5 percent and 12 percent respectively. In May 2023 the period of special tax liability was extended to the end of 2024 with the tax rates of 2023. Starting in 2025, a 50 percent reduction in the special tax is available to insurers that increase both their holdings of government bonds expiring beyond January 1, 2027 and their total government bond holdings.
II. PRICE CAPS		
Food Price Cap/ Supermarket Food	2022-24	Prices of several food products (granulated sugar, wheat flour, sunflower oil, pork leg, chicken breast, chicken tail, and 2.8 percent cow milk) capped at the October 15, 2021, retail price levels (later extended to potatoes and eggs fixed at September 2022 retail price). Food price caps were phased out in August 2023. Retailers were required to discount selected food products in a number of categories by 10% from June 1, 2023 and 15% from August 1, 2023 on a regular basis from the lowest price in the proceeding 30 days, on one food product of each of the 20 categories, to be applied on a weekly basis.
Utility Price Caps	2014-	Prices under threshold consumption levels for households have been fixed at 99.9 HUF/m^3 for gas and 36.2 HUF/KWh for electricity since April 2023. Prices beyond threshold consumption are 747 HUF/ m^3 for gas and 70,1 HUF/KWh for electricity.

Measure	Duration	Description
Motor fuel caps	Nov. 15, 2021-Dec. 6, 2022	Initially universal price cap at HUF 480 per liter, later only for residents, phased out due to supply pressures and closures of petrol stations.
III. INTEREST RATE CAPS		
Large deposit interest rate cap	Nov. 22, 2022-Apr. 1, 2024	Interest rates on large retail deposits and institutional and deposits of the non-bank financial institutions capped at the average 3-month T-bill yield. It applied on retail deposits as well as deposits of institutional investors, pension funds, building societies, insurers and investment funds as well as on retail deposits exceeding HUF 20M. As of December 1, 2023, the deposit interest rate cap was extended to all corporate deposits.
Mortgage interest rate cap and voluntary APR cap	Jan. 2022-Dec. 31, 2024 (in case of mortgage interest rate cap) Oct. 9, 2023- (in case of voluntary APR ceiling)	*Mortgage interest rate cap*: Reference interest rates on outstanding mortgage loans with fixation periods of up to 5 years and repricing within the eligibility period are capped at October 27, 2021 reference interest rate levels. *Voluntary APR ceiling*: Since October 9, 2023, at the request of the government, banks have voluntarily agreed on an APR ceiling on newly disbursed market-based HUF housing loans. The APR ceiling was initially set at 8.5 percent, then reduced to 7.3 percent from January 2024.
SME interest rate cap, voluntary interest rate ceiling and 0-percentage point interest rate spread	Nov. 15, 2022-Apr. 1, 2024 Oct. 9, 2023- Feb. 1, 2024-May 1, 2024	*SME interest rate cap*: Interest rates on outstanding HUF-denominated variable interest rate (or up to 1-year initial rate fixation corporate) loans to SMEs were capped at the reference interest rate as of June 28, 2022. *Voluntary interest rate ceiling:* Since October 9, 2023, at the request of the government, banks have voluntarily agreed on an interest rate ceiling on newly disbursed HUF working capital loans for businesses. The interest rate ceiling was initially set at 12 percent, then reduced to 11.5 percent from November 2, 2023. From January 2024, the level of the interest rate ceiling is 9.9 percent. *0-percentage point interest rate spread*: As a result of an additional agreement between the government and the banking sector, lenders have voluntarily agreed to reduce, temporarily, their spreads on all types of newly disbursed corporate loans for the first six months of the loan over the BUBOR to 0 percent from February 1, 2024 for a period of three months. After that six-month period, the spread will revert to the 'normal' level.
Student loan interest rate cap	2023-	The interest rate on interest-bearing student loans for some 100,000 borrowers capped at 4.99 percent until July 2023, and then increased to 7.99 percent starting from July 2023 until July 1, 2024. Based on a recent government decree, the interest rate cap on student loans has been extended until end-2024.

Measure	Duration	Description
IV. SUBSIDIZED LENDING SCHEMES		
Home Purchase Subsidy for Families (HPS, Hungarian abbreviation: CSOK)	2015-	2024 saw modifications of the pre-existing family-based scheme that provides a subsidized housing loan plus grant. Starting from January 2024, the *urban HPS* program was replaced by a new scheme, *HPS Plus*, and the rural HPS was modified.
	2015-	The *HPS Plus* tightens the eligibility criteria, providing larger loan amounts coupled with partial debt forgiveness for families upon having children. The *HPS Plus* is available to married couples who are planning to have at least one child and where the wife is under 41 years of age (or until the end of 2025, if the wife is over 41 but at least 12 weeks pregnant). Specifically, the new scheme offers a maximum 3 percent client interest rate subsidized loan of up to HUF 15-50 mn based on total number of children. As a general rule, below 41-year-old first-time homebuyers contribute at least 10 percent in self-financing (20 percent for existing homeowners) from 2024 January onwards. Loans mature in 10-25 years with a property price cap of HUF 80mn for first joint homes and HUF 150mn for other cases. Families buying their home with HPS Plus, do not have to pay the real estate transfer tax. In the first year, debtors only pay interest rate, and there is a one-year grace period on payments with the birth of the first child, and the loan balance is reduced by HUF 10mn in case of the birth of the 2nd and 3rd children, respectively. The *Rural HPS* is now available to disadvantaged, small settlements with less than 5,000 people, but the terms are more generous: uncapped property value, unified non-repayable amount ranging from HUF 1mn for one child to HUF 15mn for three or more children. In these small settlements, families can apply for a tax refund support up to HUF 5mn and they do not have to pay the 4 percent duty on transfer of property regardless of the price of the real estate.
Prenatal Baby Support Loan	2019-	Subsidized non-mortgage loans to young married couples who have the intention to have at least one additional child within 5 years from the disbursement of the loan. Based on a recent government decision, the original 5-year deadline has been extended to 7 years. From 2024 onwards the government increased the loan size from HUF 10 to 11 million per couple effective January 1, 2024, with the age limit for women applying reduced from 41 to 30 (in 2024, women above 30 and below 41 are still eligible if they are already in at least the 12th week of their pregnancy). On July 9, 2024, the government announced, that for those couples whose deadline for delivering the first child has been or should be due between July 1, 2024 and June 30, 2026, the deadline will be prolonged to July 1, 2026. Overall, the 2-year relief applies to contracts concluded between July 2019 and June 30, 2021.
MNB Funding for Growth Scheme	2013-2022	Launched in 2013, variants (Phase 1, Phase 2, and Phase 3 of the FGS, FGS+, FGS Fix, FGS Go!) since then were aimed at deepening the SME lending market. The Green Home version of the scheme (Funding for Growth Scheme Green Home Programme), introduced in 2021, extended green consumer loans for energy efficiency projects (by providing 0 percent refinancing to credit institutions for onward lending to SMEs with a maximum 2.5 percent interest spread).

Measure	Duration	Description
Subsidized SME Loan Programs by Development banks	2022-	*MFB (Hungarian Development Bank)*: To help mitigate the economic impact of the COVID-19 pandemic and the global energy crisis, businesses were able to apply for zero-interest funds from 2020 for liquidity as well as investment purposes. The Interest-Free Quick Start Loan and the SME Technology Loan Programme (GINOP-8.3.5-18/B) were the corporate loan programmes that generated considerable interest. The latter was re-launched in December 2022 with an original budget of HUF 100 billion, which was raised by the Government to HUF 313 billion as a result of the huge demand. Companies could sign the contracts of the fixed, zero interest-rate loans until July 31, 2023. *Eximbank*: *Baross Gábor Reindustrialisation Loan Programme*: the programme was initially launched with a budget of HUF 700 billion, and due to the large loan demand of corporates, it was increased later to HUF 1000 billion. From the total budget, HUF 600 billion was dedicated for working capital loans with an interest rate capped at 6 percent on HUF loans, 3.5 percent on EUR loans. HUF 400 billion could be used for investment, 'green' investment and leasing purposes with an interest rate capped at 5–6 percent on HUF loans and 3–3.5 percent on EUR loans. *Eximbank—Baross Gabor Reindustrialisation Loan Programme Plus 2024*: An additional HUF 200 billion loan facility set up to finance re-industrialization and green investments for companies and their suppliers operating the following industries: automotive industry, food industry, pharmaceutical industry, construction, logistics, tourism and hospitality, telecommunication, green industry through low-interest HUF (5–11 percent) and EUR (3–8 percent) loans and leasing facilities.
Széchenyi Card Programme	2002-	**Széchenyi Card Programme**: A longstanding scheme updated in 2023 to provide subsidized loans for individual entrepreneurs and micro businesses for whom the government believed it would be difficult to obtain affordable market-based lending and to support cheaper financing (loans with a fixed interest rate of 5 percent are typically available in the program) and refinance loans from MNB Funding for Growth Scheme.

Annex III. External Sector Assessment

Overall Assessment: *The external position in 2023 was stronger than implied by fundamentals and desirable policy settings.* This was driven primarily by a significant improvement in Hungary's current account balance from a deficit of 8.4 percent of GDP to a surplus of 0.2 percent resulting from a sharp decline in imports caused by the fall in energy prices and weak domestic demand. The CA surplus is expected to expand slightly in 2024 as import growth continues to trail that of exports, reflecting imports lagging the incipient recovery in domestic demand. In 2025, a recovery in consumption and investment will drive a rebound in imports, reducing the surplus, before EV and battery exports come on line leading to a gradual improvement in the trade and current account balances over the medium term. A downside risk is that these exports could take longer to materialize while further delays or a decline in EU transfers below expected levels could worsen the primary and secondary income balances, causing a deterioration in the current account.

Potential Policy Responses: If the external position remains stronger than implied by fundamentals, the authorities could implement policies to reduce the uncertainties that have constrained investment (see Policy Discussions section of the staff report), stimulating imports and thus shrinking the current account surplus. If the external position becomes weaker than implied by fundamentals, including in the event of an energy price shock, the authorities could accelerate the pace of fiscal consolidation to reduce the imbalance.

Foreign Assets and Liabilities: Position and Trajectory

Background. The net international investment position (NIIP) improved from -50.9 percent of GDP in 2022 to -45.5 percent of GDP in 2023 as the growth of assets outpaced liabilities driven by an increase in FDI and financial derivative assets and a reduction in other liabilities (loans, deposits and trade credits). Gross assets, 282 percent of GDP, are predominantly overseas direct investment with smaller amounts of portfolio and other investment holdings while liabilities, 328 percent of GDP, are ¾ composed of FDI in Hungary. The NIIP is projected to further improve over the medium term as asset growth outpaces that of liabilities driven by higher FDI outflows (assets) and reserve accumulation from an improving current account balance. Gross external debt (85 percent of GDP in 2023) declined relative to 2022 levels and is expected to continue this trajectory.

Assessment. The NIIP is sustainable. Liabilities are predominantly composed of FDI implying a low rollover risk. Foreign portfolio liabilities are only 9 percent of the total though capital outflows in the event of global risk-off sentiment could cause disorderly market conditions.

2023 (% GDP)	NIIP:	Gross Assets:	Res. Assets:	Gross Liab.:	Debt Liab.:
	-45.5	282	21.0	328	85.5

Current Account

Background. The current account (CA) improved significantly in 2023 to 0.2 percent of GDP from a deficit of -8.4 percent in 2022 as weak private domestic demand contributed to a contraction of goods and services imports, more than offsetting slightly larger primary income and transfers deficits. In 2024, the CA surplus is expected to expand slightly as net exports increase reflecting imports lagging the incipient recovery in domestic demand. Over the longer term, the operationalization of export-oriented EV and battery plants is expected to lead to a gradual improvement in the trade and current account balances as capacity comes online. A downside risk is that these exports could take longer to materialize while further delays or a decline in EU transfers below expected levels could worsen the primary and secondary income balances, causing a deterioration in the current account. From a savings-investment perspective, the projected medium-term improvement in the current account is in line with the expected path of fiscal consolidation driving increased public savings, while investment rises more slowly with EV-related FDI inflows partially offset by FDI outflows related to overseas expansion of Hungary's national champions.

Assessment. For 2023, the EBA CA model estimates a cyclically adjusted CA of 0 percent of GDP against a cyclically adjusted CA norm of -3.3 percent. This implies a EBA model CA gap of 3.3 percent of GDP reflecting a

small policy gap (-0.2 percent, driven in part by a fiscal policy gap of 0.1 percent) and an unidentified residual of (3.5 percent).

2023	CA:	Cycl. Adj.	EBA CA	EBA CA	Prim. inc.	Trade bal.	Staff CA Gap:
(% GDP)	0.2	CA: 0.0	Norm: -3.3	Gap: 3.3	Adj.: N/A	Adj.: N/A	

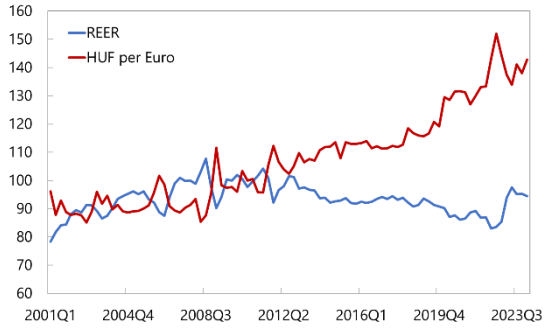
Real Exchange Rate

Background. In 2023, the real effective exchange rate (REER) appreciated 13.2 percent, mostly reflecting inflation differentials relative to trading partners and nominal appreciation including a 4.5 percent appreciation against the euro driven by a narrowing current account deficit. By contrast, there was a 5.2 percent depreciation in the REER in 2022.

Assessment. The IMF staff CA gap implies a REER undervaluation of 5.2 percent vs. an overvaluation of 10.2 percent in the REER index model and 12.8 undervaluation in the REER level model. The staff's overall assessment, based on the CA gap approach, is a REER undervaluation in the range of 3.6 to 6.8 percent with a midpoint of 5.2 percent though this assessment is subject to high uncertainty due to large unidentified CA model residuals.

Real Effective Exchange Rate and Nominal Exchange Rate

(Index 2010=100)



Sources: European Commission; Magyar Nemzeti Bank; Haver Analytics; and IMF staff calculations.

Capital and Financial Accounts: Flows and Policy Measures

Background. The financial account shifted to -1.9 percent of GDP in 2023 from -9.5 percent in 2022. This was driven by a decline in inward direct investment relative to exceptionally high levels in 2022 and a decline in loan and trade credit liabilities, which offset an increase in bond issuance. Relatively small financial account deficits of 1-2 percent of GDP are expected through the medium term due to somewhat lower net FDI inflows and lower FX portfolio debt issuance. The capital account surplus declined from 2.1 percent of GDP in 2022 to 1 percent in 2023 driven primarily by a reduction in capital transfers from the EU as certain disbursements were withheld due to delayed implementation of rule of law reforms.

Assessment. The relatively long maturity of sovereign debt, about 6 years, helps to mitigate rollover risk though elevated GFNs, further delays in EU funds, commodity price shocks and fiscal slippage could lead to a loss of investor confidence, pressure on the forint and potential rollover risk.

FX Intervention and Reserves Level

Background. Gross international reserves increased to €41.3 billion (21 percent of GDP) in 2023 from €38.7 billion in 2022 as a result of an improvement in the current account balance, which more than offset lower net FDI inflows. Reserves are expected to increase in 2024 while reserve coverage will remain adequate. The forint is floating and largely market determined. The authorities do not publish FX intervention data.

Assessment. Reserves were equivalent to 3.3 months of next year's imported goods and services and 105 percent of the ARA metric in 2023 and are assessed to be sufficient to buffer against external shocks and disorderly market conditions.

Annex IV. Debt Sustainability Analysis

Annex IV. Table 1. Hungary: Risk of Sovereign Stress

Horizon	Mechanical signal	Final assessment	Comments
Overall	…	Moderate	The overall risk of sovereign stress is **"moderate"**. The deficit, debt ratio and gross financing needs are expected to remain elevated through the medium-term despite gradual improvement. Hungary's high risk premia relative to peers and recent exchange rate depreciation suggest that it is vulnerable to a reversal of risk sentiment which could lead to capital flight and increased borrowing costs. The rapid increase in government guarantees and assets of state development banks also highlights a risk of contingent liabilities. Long-term risks stem from higher healthcare and pension costs caused by an aging population, costs associated with the green transition, and adapting to new global value chains.
Near term 1/			
Medium term	Moderate	Moderate	Medium-term risks are assessed as moderate. Debt is expected to decline over the medium term though will remain at elevated levels and fiscal space is at risk. GFNs are higher than those in most cohort countries and banks are more exposed to the general government compared to peers. The GFN module points to moderate risks stemming from low buffers and high financing needs.
Fanchart	Moderate	…	
GFN	Moderate	…	
Stress test		…	
Long term	…	Moderate	Long-term risks are considered moderate because of relatively high amortization levels and an aging population which could lead to higher healthcare- and pension-related spending, and higher debt.
Sustainability assessment 2/	Not required for surveillance countries	…	…
Debt stabilization in the baseline			Yes

DSA summary assessment

The overall risk of sovereign stress is "moderate". The deficit, debt ratio and gross financing needs are elevated and are expected to remain so through the medium-term despite gradual improvement. Hungary's high risk premia relative to peers and recent exchange rate depreciation suggest that it is vulnerable to a reversal of risk sentiment which could lead to capital flight and increased borrowing costs. The rapid increase in government guarantees and assets of state development banks and state-owned enterprises also underscores the risk of contingent liabilities. Long-term risks stem from higher healthcare and pension costs caused by an aging population, costs associated with the green transition, and adapting to new global value chains.

Source: Fund staff.
Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.
1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.
2/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases where there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases with IMF arrangements with normal access, the qualifier indicating probability of sustainable debt ("with high probability" or "but not with high probability") is deleted before publication.

Annex IV. Table 2. Hungary: Debt Coverage and Disclosures

							Comments
1. Debt coverage in the DSA: 1/			CG	GG	NFPS	CPS	Other	
1a. If central government, are non-central government entities insignificant?							n.a.	
2. Subsectors included in the chosen coverage in (1) above:								
			Subsectors captured in the baseline				Inclusion	
CPS	NFPS	GG: expected	CG	1	Budgetary central government		Yes	
				2	Extra budgetary funds (EBFs)		Yes	
				3	Social security funds (SSFs)		Yes	
				4	State governments		Yes	
				5	Local governments		Yes	
				6	Public nonfinancial corporations		No	
				7	Central bank		No	
				8	Other public financial corporations		No	
3. Instrument coverage:					Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	IPSGSs 3/	
4. Accounting principles:					Basis of recording		Valuation of debt stock			
					Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/	
5. Debt consolidation across sectors:						Consolidated	Non-consolidated			

Color code: chosen coverage | Missing from recommended coverage | Not applicable

Reporting on intra-government debt holdings

				Holder / Issuer	Budget. central govt	Extra-budget. funds (EBFs)	Social security funds (SSFs)	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
CPS	NFPS	GG: expected	CG	1	Budget. central govt								0
				2	Extra-budget. funds								0
				3	Social security funds								0
				4	State govt.								0
				5	Local govt.								0
				6	Nonfin pub. corp.								0
				7	Central bank								0
				8	Oth. pub. fin. corp								0
					Total	0	0	0	0	0	0	0	0	0

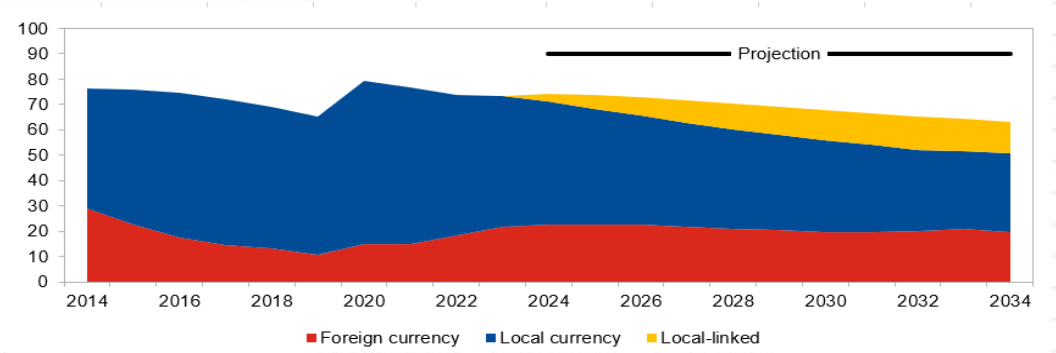
1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.
2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.
3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.
4/ Includes accrual recording, commitment basis, due for payment, etc.
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.
7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

The coverage in this SRDSF is for the general government including state/local governments and social security funds. The central government comprises about 92 percent of total debt with the remainder mostly composed of liabilities belonging to the Eximbank and HUSA (the Hungarian Hydrocarbon Stockpiling Association). Local government debt is de minimis.

Annex IV. Table 3. Hungary: Public Debt Structure Indicators

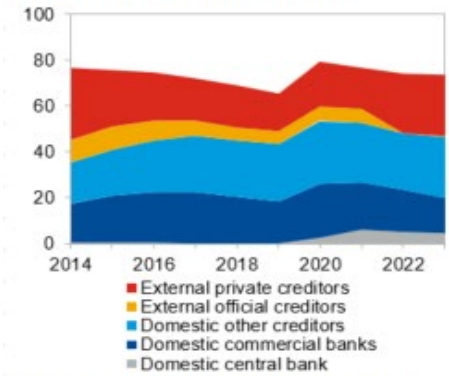
Debt by currency (Percent of GDP)

Debt by currency (percent of GDP)



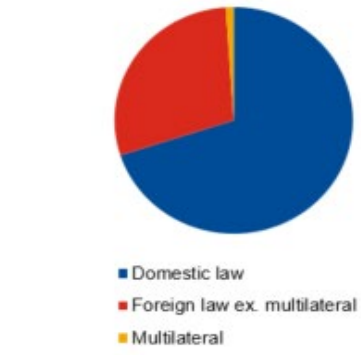
Note: The perimeter shown is general government.

Public debt by holder (percent of GDP)



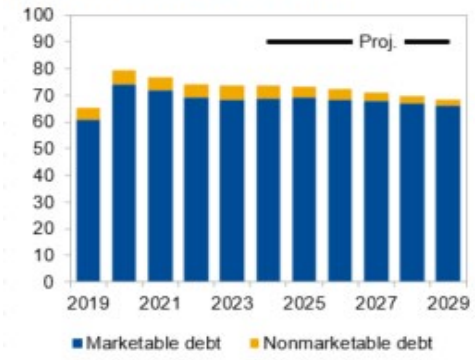
Note: The perimeter shown is general government.

Public debt by governing law, 2023 (percent)



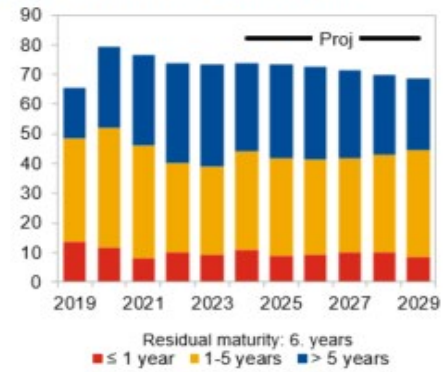
Note: The perimeter shown is general government.

Debt by instruments (percent of GDP)



Note: The perimeter shown is general government.

Public debt by maturity (percent of GDP)



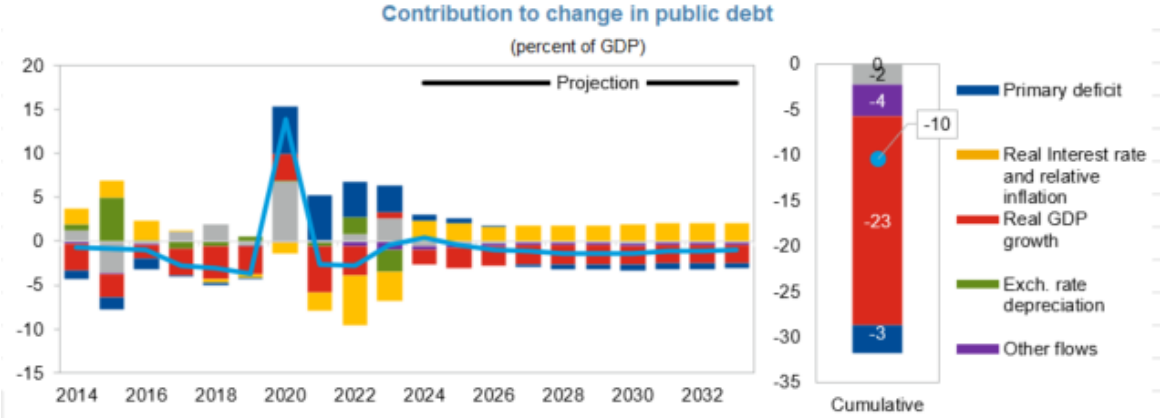
Note: The perimeter shown is general government.

The bulk of Hungary's financing needs are expected to be met through the issuance of medium- and long-term debt in local currency, with a portion composed of inflation-linked retail bonds, consistent with the goals of the debt management agency. Borrowing will be concentrated in marketable securities (bonded debt) and FX borrowing will remain 30 percent or less of total borrowing, in line with debt management guidelines. To date, public debt has been held in largest measure by domestic other creditors (mostly retail holders) followed by external private creditors and domestic commercial banks.

Annex IV. Table 4. Hungary: Baseline Scenario

(Percent of GDP Unless Indicated Otherwise)

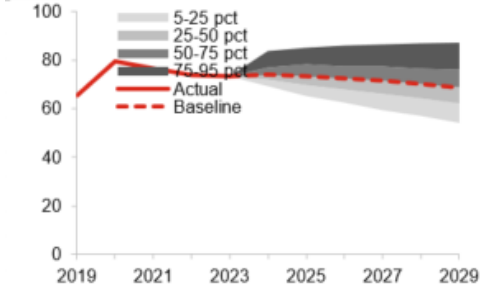
	Actual	Medium-term projection						Extended projection			
	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
Public debt	73.5	73.9	73.5	72.5	71.3	70.0	68.6	67.3	66.1	65.1	64.0
Change in public debt	-0.5	0.4	-0.4	-1.0	-1.1	-1.3	-1.4	-1.3	-1.1	-1.1	-1.0
Contribution of identified flows	-3.1	0.9	0.0	-0.7	-1.0	-1.2	-1.3	-1.1	-1.0	-0.9	-0.9
Primary deficit	3.0	0.8	0.6	0.1	-0.4	-0.5	-0.6	-0.6	-0.6	-0.6	-0.6
Noninterest revenues	41.4	43.3	43.2	43.8	44.2	43.9	43.8	43.8	43.8	43.8	43.8
Noninterest expenditures	44.4	44.1	43.8	43.8	43.9	43.4	43.2	43.2	43.2	43.2	43.2
Automatic debt dynamics	-5.1	0.6	-0.3	-0.5	-0.3	-0.4	-0.3	-0.2	-0.1	0.0	0.0
Real interest rate and relative inflation	-3.2	2.3	2.0	1.7	1.8	1.8	1.8	1.9	2.0	2.0	2.1
Real interest rate	-4.9	2.0	1.6	1.4	1.6	1.6	1.7	1.8	1.9	1.9	1.9
Relative inflation	1.7	0.3	0.4	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Real growth rate	0.6	-1.7	-2.4	-2.1	-2.1	-2.2	-2.2	-2.1	-2.1	-2.1	-2.0
Real exchange rate	-2.5	...	...	...	...	...	...	...	...	...	...
Other identified flows	-1.0	-0.5	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(minus) Interest Revenues	-1.0	-0.5	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3
Other transactions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Contribution of residual	2.7	-0.5	-0.4	-0.3	-0.2	-0.1	-0.1	-0.2	-0.1	-0.2	-0.2
Gross financing needs	14.7	15.2	14.5	11.6	11.8	12.2	12.0	10.5	10.8	11.7	12.9
of which: debt service	12.7	14.9	14.2	11.8	12.5	13.0	12.9	11.4	11.7	12.6	13.9
Local currency	10.4	11.4	11.2	9.5	8.7	9.7	9.6	8.0	9.2	10.1	9.3
Foreign currency	2.3	3.5	2.9	1.9	3.3	2.6	2.6	2.6	1.8	1.7	1.6
Memo:											
Real GDP growth (percent)	-0.9	2.3	3.3	3.0	3.0	3.2	3.2	3.2	3.2	3.2	3.2
Inflation (GDP deflator; percent)	14.5	4.0	3.7	3.1	2.8	2.8	2.8	2.8	2.8	2.8	2.8
Nominal GDP growth (percent)	13.5	6.4	7.1	6.1	5.9	6.1	6.1	6.1	6.1	6.1	6.1
Effective interest rate (percent)	6.9	6.8	6.0	5.1	5.2	5.3	5.4	5.6	5.8	5.9	5.9



Public debt will gradually decline over the medium-term reflecting favorable debt dynamics and a lower contribution from primary deficits due to fiscal consolidation. Weighed against this, GFNs are expected to remain elevated averaging 13 percent through 2029 and the inflation-linked portion of public debt could become more expensive to service if inflation rises. Despite fiscal consolidation, the debt ratio will remain above the EU target of 60 percent through 2038 and above Hungary's own 50 percent target through the entire projection period.

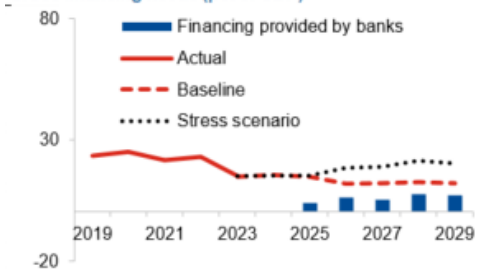
Annex IV. Table 5. Hungary: Medium-Term Risk Assessment

Final fanchart (pct of GDP)



Debt fanchart module	Value	Contrib [1/]	Percentile in peer group [2/]
Fanchart width *(percent of GDP)*	32.7	0.5	
Probability of debt non-stabilization *(percent)*	27.6	0.2	
Terminal debt-to-GDP x institutions index	30.6	0.7	
Debt fanchart index (DFI)		1.4	
Risk signal: [3/]		**Moderate**	

Gross financing needs (pct of GDP)

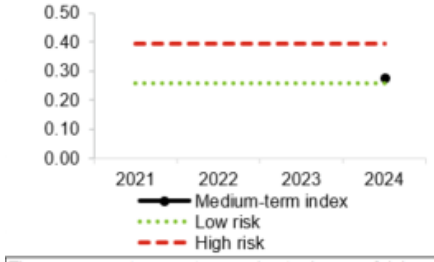


Gross financing needs (GFN) module	Value	Contrib [1/]	Percentile in peer group [2/]
Average baseline GFN *(percent of GDP)*	12.9	4.4	
Initial Banks' claims on the gen. govt *(pct bank assets)*	15.6	5.1	
Chg. In banks' claims in stress *(pct banks' assets)*	10.7	3.6	
GFN financeability index (GFI)		13.0	
Risk signal: [4/]		**Moderate**	

Triggered stress tests (stress tests not activated in gray)

Banking crisis | Commodity prices | Exchange rate | Contingent liab. | Natural disaster

Medium-term index (index number)



Medium-term risk analysis

	Value	(normalized)	Weight	Contribution
Debt fanchart index	1.4	0.3	0.5	0.2
GFN finaceability index	13.0	0.3	0.5	0.1
Medium-term index		0.3		
Risk signal: 5/		**Moderate**		
Final assessment:		**Moderate**		

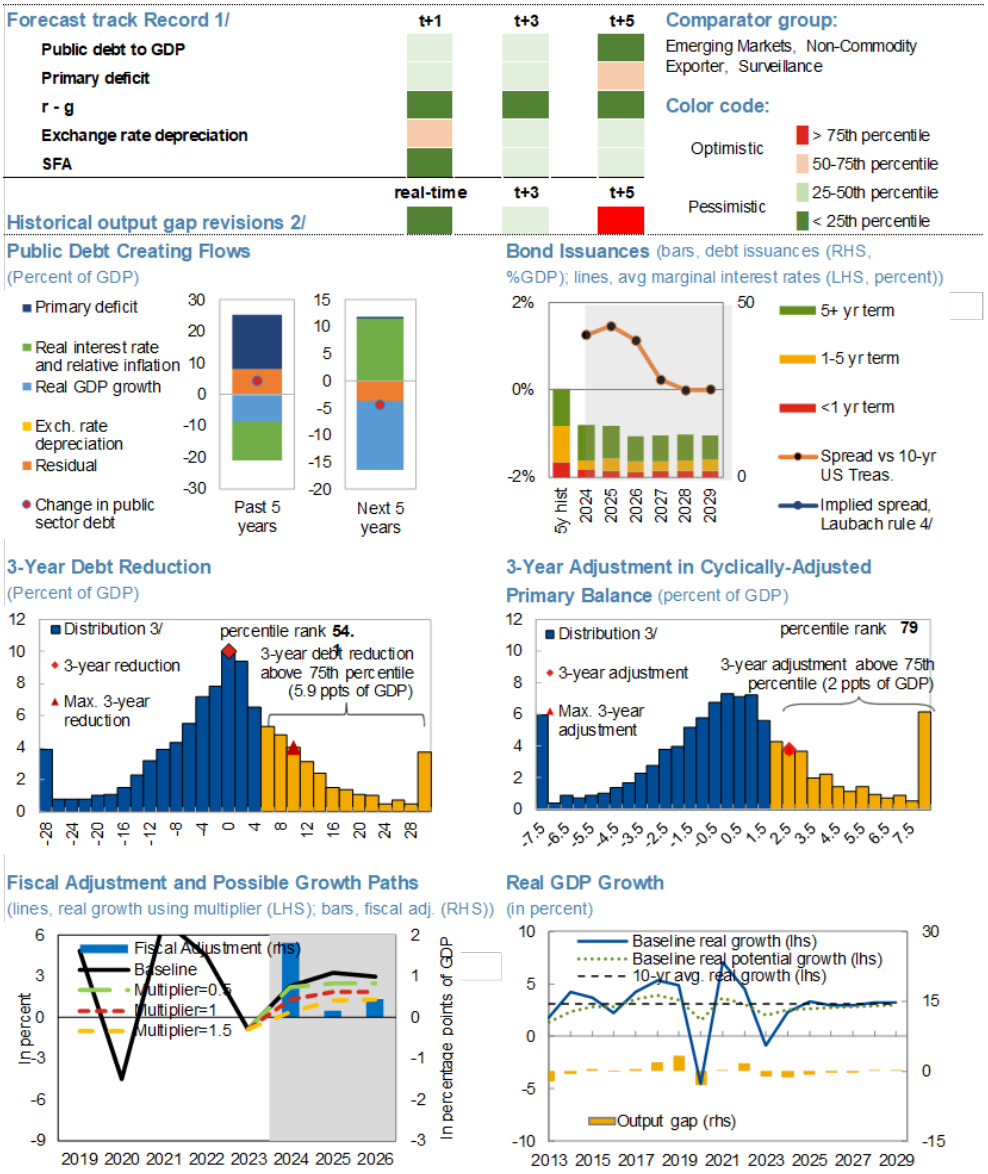
Prob. of missed crisis, 2024-2029, if stress not predicted: 18.2 pct.
Prob. of false alarms, 2024-2029, if stress predicted: 35.2 pct.

The assessment suggests a moderate degree of risk over the medium-term. The debt ratio is likely to decline gradually but will remain elevated through the medium-term. GFNs are also expected to decline though will remain above the median relative to peers. As bank claims on the government are already fairly high, their capacity to absorb more debt in a shock scenario may be limited. The rapid increase in government guarantees and assets of state-owned enterprises also underscores the potential risk of contingent liabilities and related fiscal liabilities for the state.

Source: IMF staff estimates and projections.

1/ See Annex IV of IMF, 2022, Staff Guidance Note on the Sovereign Risk and Debt Sustainability Framework for details on index calculation.
2/ The comparison group is emerging markets, non-commodity exporter, surveillance.
3/ The signal is low risk if the DFI is below 1.13; high risk if the DFI is above 2.08; and otherwise, it is moderate risk.
4/ The signal is low risk if the GFI is below 7.6; high risk if the DFI is above 17.9; and otherwise, it is moderate risk.
5/ The signal is low risk if the GFI is below 0.26; high risk if the DFI is above 0.40; and otherwise, it is moderate risk.

Annex IV. Table 6. Hungary: Realism of Baseline Assumptions



The 3-year debt reduction assessment is broadly in line with the median though the adjustment in the cyclically-adjusted primary balance, which is at the 79th percentile, is relatively ambitious vs. peers. The historical output gap revisions indicate an optimism bias while the reduction in spreads to the 10-year U.S. treasury over the medium-term may also be somewhat optimistic. With respect to debt creating flows, real GDP growth is expected to pick up over the next five years, helping to reduce debt, compared to the past five years which were marked by the COVID pandemic, Russia's invasion of Ukraine, and a subsequent recession in 2022-23. As inflation has declined, however, real interest rates have turned positive, adding to debt accretion.

Source : IMF Staff.

1/ Projections made in the October and April WEO vintage.

2/ Calculated as the percentile rank of the country's output gap revisions (defined as the difference between real time/period ahead estimates

3/ Data cover annual obervations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.

4/ The Laubach (2009) rule is a linear rule assuming bond spreads increase by about 4 bps in response to a 1 ppt increase in the projected debt-to-GDP ratio.

Annex IV. Table 7. Hungary: Triggered Modules

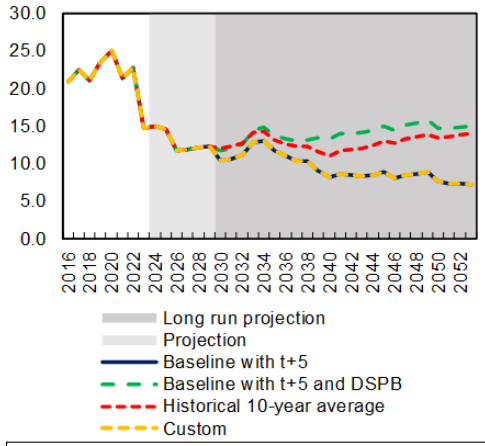
Large amortizations	Pensions	Climate change: Adaptation	Natural Resources
	Health	Climate change: Mitigation	

Annex IV. Table 8. Hungary: Long-Term Risk Assessment: Large Amortization Incl. Custom Scenario

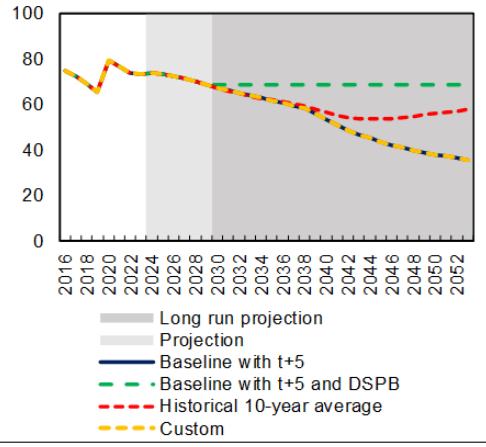
Projection	Variable	Risk Indication
Medium-term extrapolation	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Medium-term extrapolation with debt stabilizing primary balance	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Historical average assumptions	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Overall Risk Indication		

Variable	2029	2033 to 2037 average	Custom Scenario
Real GDP growth	3.2%	3.2%	3.2%
Primary Balance-to-GDP ratio	0.6%	0.6%	0.6%
Real depreciation	-2.5%	-2.8%	-2.7%
Inflation (GDP deflator)	2.8%	2.8%	2.8%

GFN-to-GDP ratio

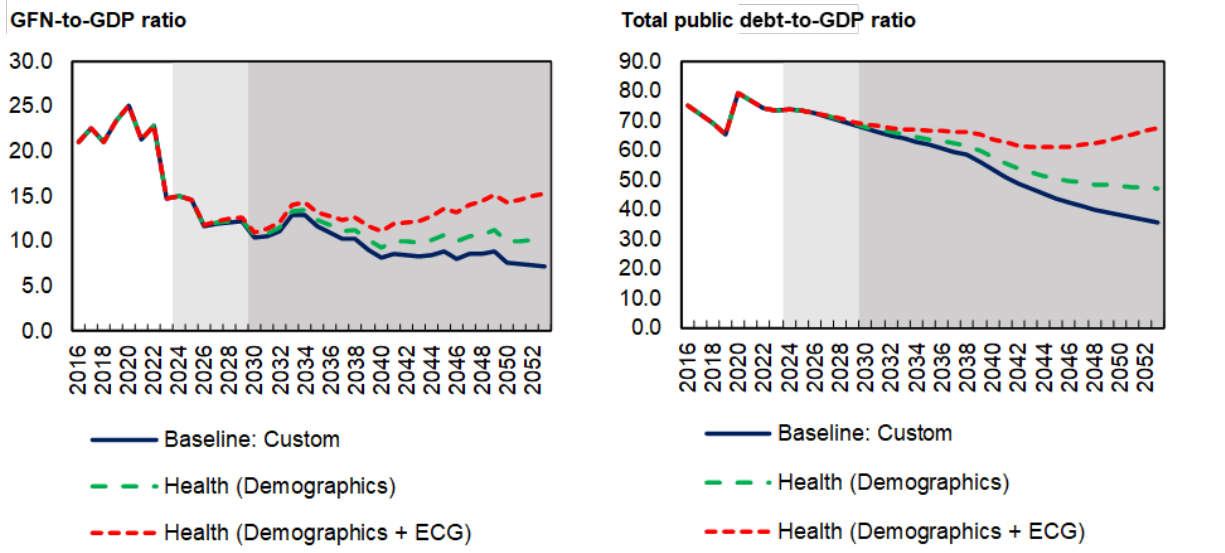


Total public debt-to-GDP ratio



The debt ratio is expected to decline gradually in the LT with GFNs following a similar trajectory through 2030 and then rising in the early 2030s in line with larger maturities before leveling off. The primary deficit at the end of the projection period is below the debt stabilizing primary deficit. The 10-year average debt-to-GDP reduction is below the baseline suggesting a feasible adjustment. However, the model indicates high amortization levels in the MT debt stabilizing PB scenario.

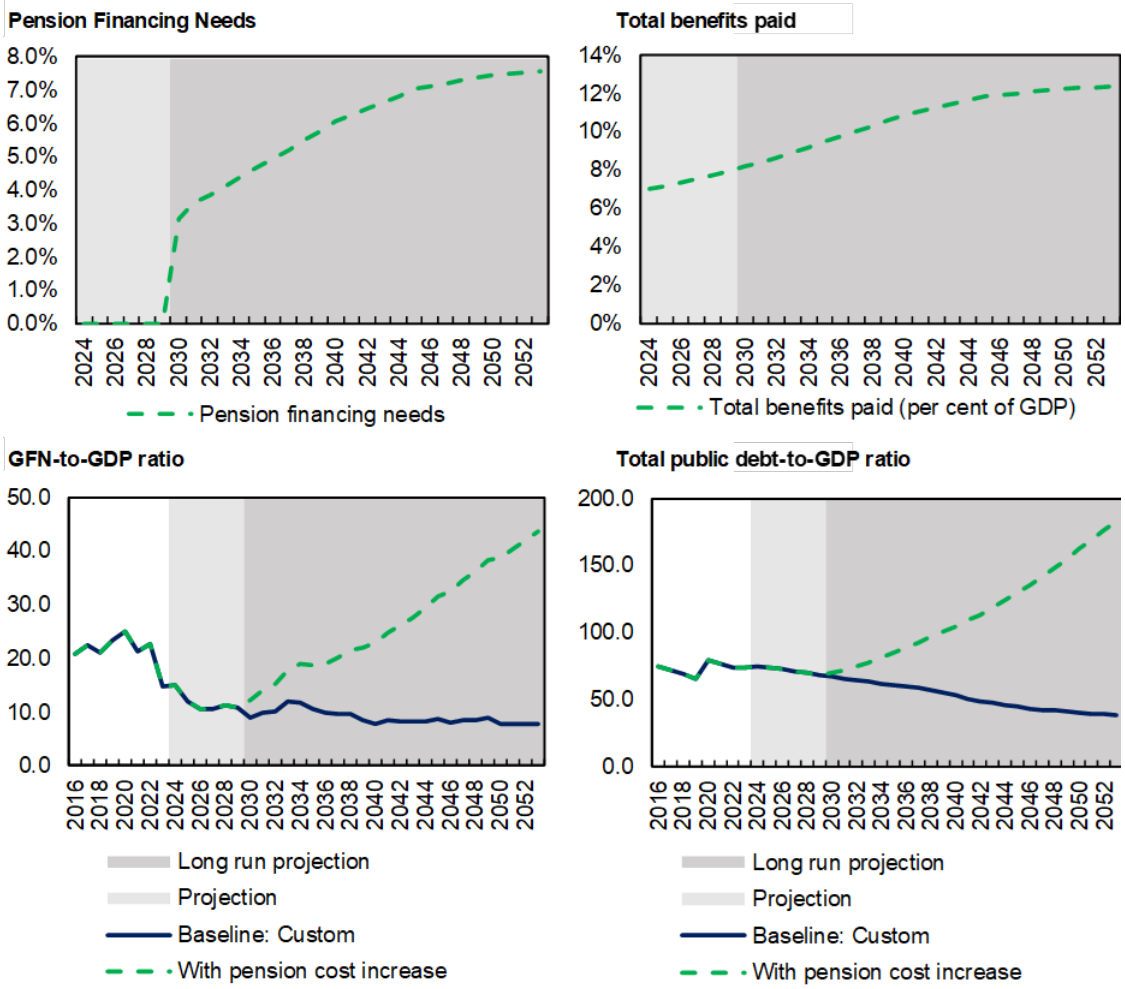
Annex IV. Table 9. Hungary: Demographics: Health



Hungary's aging population is expected to have a negative impact on debt sustainability. The effect of aging demographics, estimated via a comparison of the ratio of health expenditure per demographic group and growth rates of spending, is projected to add 9 percent of GDP to debt and 2.5 percent of GDP to GFNs by 2050 relative to the baseline. The demographics + ECG (Excess Cost Growth of Health) scenario refers to the number of percentage points by which the growth of annual health care spending per beneficiary is assumed to exceed the growth of nominal gross domestic product per capita and shows an even more pronounced increase with debt to GDP 26 percentage points and GFNs to GDP 6.8 percentage points higher in 2050 vs. the baseline.

Annex IV. Table 10. Hungary: Demographics: Pensions

Permanent adjustment needed in the pension system to keep pension assets positive for:	30 years	50 years	Until 2100
(pp of GDP per year)	4.9%	6.0%	6.6%



Hungary's ageing population will drive an increasing gap between benefits paid and expected contributions to the system. The additional financing needed to maintain system solency is substantial and over the long-term would lead to explosive growth of GFNs and public debt to GDP. Without reforms such as increasing the social security contribution rate, tightening eligibility, and/or making benefits less generous, the debt ratio and GFN would increase to 184 percent and 45 percent, respectively, by 2052.

Annex V. Risk Assessment Matrix[1]

Risks	Likeli-hood	Impact of Risk	Policy Response
Global risks			
Intensification of regional conflicts. Escalation or spread of the conflict in Gaza and Israel, Russia's war in Ukraine, and/or other regional conflicts or terrorism disrupt trade (e.g., energy, food, tourism, supply chains), remittances, FDI and financial flows, payment systems, and increase refugee flows.	**High**	**High:** Commodity price volatility would likely intensify terms of trade deterioration and inflationary pressures, as well as increase fiscal and external imbalances that could affect investor confidence.	In light of inflationary pressures, fiscal policy should not be loosened, while making room for additional support for the vulnerable. The central bank should tighten monetary if needed to mitigate second-round effects on inflation and to address capital outflows resulting from weakened investor confidence.
Commodity price volatility. A succession of supply disruptions (e.g., due to conflicts, export restrictions, and OPEC+ decisions) and demand fluctuations causes recurrent commodity price volatility, external and fiscal pressures in EMDEs, cross-border spillovers, and social and economic instability.	**High**	**High** (same as above)	Same as above.
Abrupt global slowdown. Global and idiosyncratic risk factors cause a synchronized sharp growth downturn, with recessions in some countries (China, Europe, U.S.), adverse spillovers through trade and financial channels, and market fragmentation triggering sudden stops in EMDEs.	**Medium**	**Medium:** Negative global spillover through trade, capital flows and confidence effects on financial markets and investment, worsening fiscal and external imbalances and putting pressure on yields and currency.	Allow fiscal automatic stabilizers to operate but affirm commitment to medium-term targets and debt reduction. Monetary policy could be calibrated to respond to shocks depending on severity and relative importance of different channels, with potential tightening in response to sudden stops.
Monetary policy miscalibration. Amid high economic uncertainty, major central banks loosen policy stance prematurely, hindering disinflation, or keep it tight for longer than warranted, causing abrupt adjustments in financial markets and weakening the credibility of central banks.	**Medium**	**Medium:** Re-calibration of major economies' monetary policy could affect Hungary's macroeconomic performance through trade and financial channels. Resultant adjustments in domestic	The adjustment of domestic monetary policy should proceed cautiously, with the central bank remaining vigilant to potential external developments and data-dependent to avoid miscalibration. Ensure fiscal policy supports monetary policy, which may require further adjustment.

[1] The risk assessment matrix (RAM) shows events that could materially alter the baseline path. 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).

Risks	Likeli-hood	Impact of Risk	Policy Response
		monetary policy could risk de-anchoring inflation expectations. Abrupt adjustments in financial markets could have financial stability implications.	
Deepening geoeconomic fragmentation. Broader conflicts, inward-oriented policies, and weakened international cooperation result in a less efficient configuration of trade and FDI, supply disruptions, protectionism, policy uncertainty, technological and payments systems fragmentation, rising shipping and input costs, financial instability, a fracturing of international monetary system, and lower growth.	**High**	**High:** Reduced FDI and disruption of critical value chains, including in the auto industry, lowers actual and potential output and employment, with negative effects on the fiscal balance. Energy supply security deteriorates and supply chain interruptions spur inflation.	Prioritize structural reforms and investments that support potential output and productivity. Calibrate monetary and fiscal policy to address imported inflation.
Disorderly energy transition. A disorderly shift to net-zero emissions (e.g., owing to shortages in critical metals) and climate policy uncertainty cause supply disruptions, stranded assets, market volatility, and subdued investment and growth.	**Medium**	**Medium:** Delayed progress, for example with respect to Hungary's carbon reduction commitment, could result in eventual abrupt policy changes to ensure compliance. This could result in supply disruptions, disorderly price adjustments, and subdued investment and growth.	Prioritize timely implementation of policies and reforms to ensure an orderly energy transition toward committed targets.
Domestic risks			
Weakening of investor confidence arising from a failure to tackle structural policy issues, including governance shortcomings, and fiscal imbalances. Failures to address governance issues result in further delays in or cancellation of EU Cohesion, RFF and RePower funds, leading to weakened market confidence, higher risk premia, and a reduction or cutoff of an important source of fiscal and external financing. A lack of fiscal discipline leads to further slippages and higher debt levels.	**Medium**	**Medium:** Loss of investor confidence results in delayed or reduced FX inflows / increased capital outflows, increased external borrowing needs and costs, and larger fiscal and external imbalances.	A strong fiscal framework anchored in the EU Stability and Growth pact is important for ensuring debt sustainability. Phaseout of distortionary fiscal and regulatory measures and acceleration in the pace of reform to unlock EU funds would provide reassurance to markets. The central bank should stand ready to respond with appropriate monetary policy.

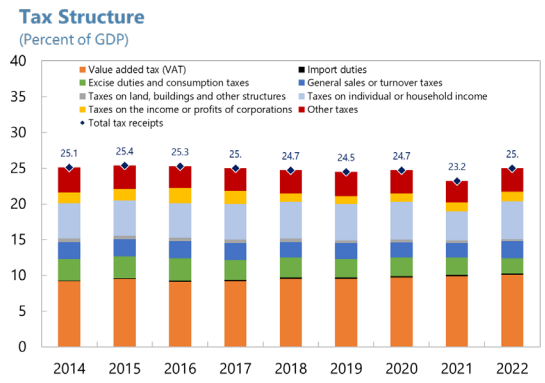
Annex VI. Tax Reforms to Support Revenue, Efficiency, and Equity[1]

1. There is scope to raise revenue and improve the efficiency and equity of the tax system. With a tax-to-GDP ratio at around 25 percent, Hungary is slightly below the European Union (EU) average of 27 percent. Following the COVID-19 pandemic, Hungary introduced various windfall taxes on specific sectors or goods, which contributed in part to a rebound of tax revenues from 23.4 percent in 2021 to around 25 percent in 2023. In July 2024, the authorities modified energy and banking sector windfall taxes and increased the financial transaction tax rate to mobilize additional revenue. However, an alternative approach—as discussed below—can potentially bring revenues to the EU average and support equity objectives in a growth-friendly manner.

2. Considerations should be given to strengthening consumption, income, and property taxation. Consumption taxes currently comprise the major share in the tax mix in Hungary; 64.4 percent versus the EU average of 40.7 percent. The VAT's share is 39.9 percent, while personal and corporate income taxes (PIT; CIT) together comprise 26.6 percent (Figure VI.1, panel 1). This tax structure mirrors the standard tax rates, with VAT at 27 percent (the highest in the EU), a flat PIT at 15 percent, and CIT at 9 percent (the lowest in the EU).

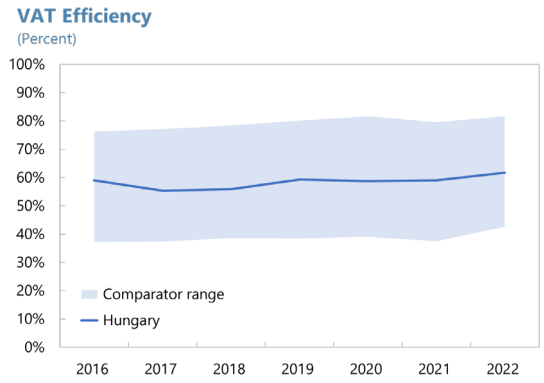
Annex VI. Figure 1. Tax Structure and VAT Efficiency

Hungary relies heavily on consumption taxes.



Source: Eurostat; and IMF staff calculations.

Hungary c-efficiency is in-line with peer countries.



Sources: Eurostat; and IMF staff calculations.

VAT

3. Hungary's VAT efficiency (at 0.6)[2] is in-line with EU peers, although scope remains to lower VAT gaps. The resulting 40 percent VAT gap is driven by compliance and policy gaps. Remarkable efforts (including introducing real time reporting of invoices) resulted in a gradual improvement in VAT compliance during the last decade (from around 22 percent to 5 percent). Building on this success, efforts should continue to further reduce the compliance gap. In contrast,

[1] Prepared by Thomas Benninger (FAD).

[2] The VAT efficiency is defined here as: VAT collected / (consumption – VAT collected) × VAT rate. It is an indicator of how close the VAT is from a perfectly enforced tax levied at a uniform rate on all consumption.

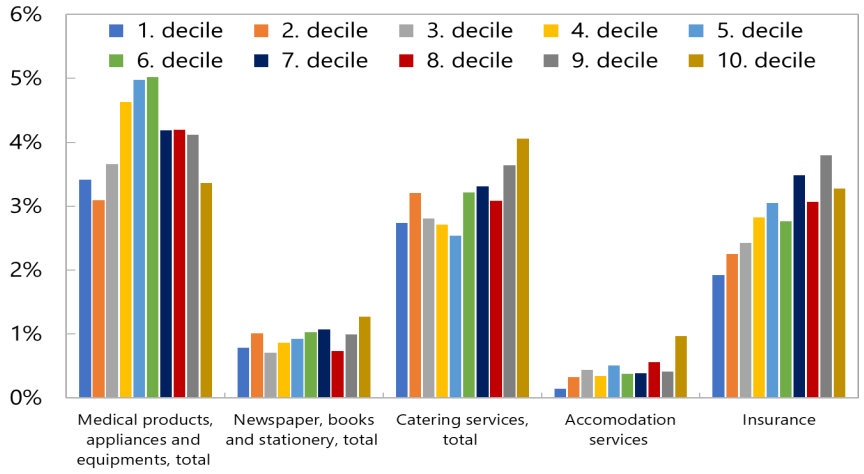
the policy gap, indicating the additional VAT revenues that could be collected if the VAT applied at a uniform rate on all final domestic consumption, is estimated at 3.1 percent of GDP. In particular, the gap between the standard VAT rate and the effective VAT rate (accounting for lower rates and exemptions) is one of the largest in the EU and is estimated at 14.4 percent by the EC (2023).[3]

4. Exemptions or lower rates, as instruments to support poorer households, are inferior to well-targeted spending measures in terms of cost-effectiveness. A large number of goods and services are either exempt or subject to one of the two reduced VAT tax rates (5 or 18 percent). Despite their general distortive effect on consumption and high cost in terms of foregone revenues, some targeted exemptions or reduced rates could be justified if the goods or services are consumed nearly exclusively by poor households. However, an analysis of household consumption reveals that some exemptions and application of lower rates are regressive (Figure VI.2). Household survey data suggest that exemptions or reduced rates on insurance, medical products, newspapers and books, dining out and accommodation services, benefit the affluent more. This suggests that targeted spending can be more effective and less costly. Thus, scaling back regressive exemptions and moving low rates closer to the standard rate, would improve efficiency and equity of the VAT.

Annex VI. Figure 2. Consumption of Goods and Services by Income Decile

(Percent of total consumption)

Goods and services exempt from VAT or subject to lower taxes where share of consumption by more affluent households is higher than for poorer households.



Sources: Hungarian Central Statistical Office; and IMF staff calculations.

Income Taxation

5. The PIT can be strengthened on equity and revenue grounds. The current PIT yields revenue of 5.6 percent of GDP, below the EU average of 9.6 percent. Importantly, the income share of the bottom 50 percent of the working population has decreased from over 30 percent in the

[3] European Commission (2023): *VAT Gap in the EU*.

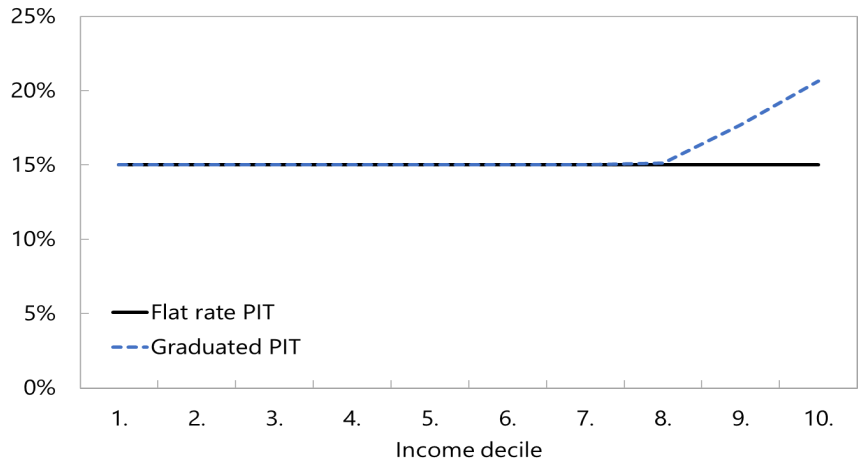
1990s to around 21 percent in 2022,[4] raising concerns about inequality and whether Hungary should adopt a more progressive PIT.

6. Introducing a new PIT bracket at the top of the income distribution is an option to make the PIT more productive and more progressive. Faced with structurally low employment rates, Hungary embarked on reforms to reduce the tax wedge on labor income,[5] from over 50 percent in 2009 to 41.2 percent in 2023. But this wedge remains above the OECD average of 34.6 percent. Introducing a new marginal top tax rate at the top of the income distribution can increase revenue and the progressivity of the PIT, with a modest impact on the labor market since the tax response at the top is likely low. For illustration, a tax schedule with marginal tax rates of 15 percent for most incomes and 25 percent for income over 3 million HUF would increase the effective tax rate only for the top 3 deciles of individuals, while increasing total tax revenue by an estimated 0.7 percent of GDP (Figure VI.3).[6]

Annex VI. Figure 3. Average Effective Tax Rate by Income Decile

(Percent)

Average effective tax rate by decile under current flat rate PIT and alternative graduated PIT.



Sources: Hungarian Central Statistical Office; and IMF staff calculations.

7. Hungary can raise more revenue from excess corporate profits while remaining attractive to investment. The 2022/2523 EU Directive (following the Inclusive Framework agreement) on a global minimum tax (at an effective rate of 15 percent) is an opportunity for Hungary to reconsider its CIT design. Hungary adopted the minimum tax into its domestic law, entering into effect in 2024. However, with a statutory rate of 9 percent, the Hungarian CIT becomes

[4] World Inequality Database.

[5] The tax wedge is a measure of the difference between labor costs to the employer and the corresponding net take-home pay of the employee – which is calculated by expressing the sum of personal income tax, employee and employer social security contributions plus any payroll taxes, minus any benefits received by the employee, as a percentage of labor costs.

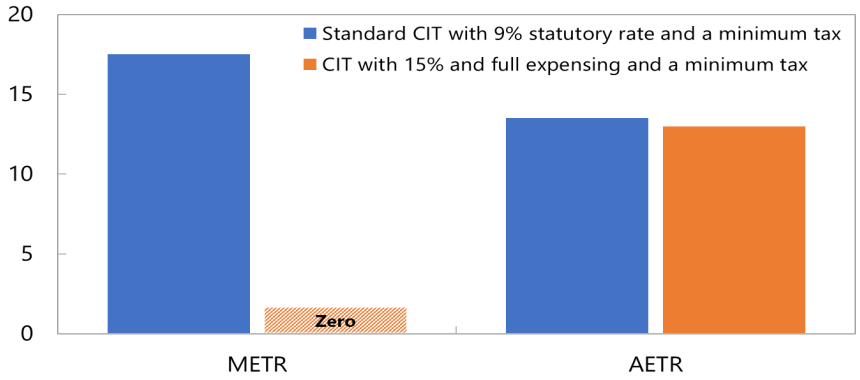
[6] The simulation is for illustrative purposes only. Due to the lack of information on capital income of individuals, only labor income was used for the simulation.

a two-tiered system: one with an effective rate of 15 percent for in-scope multinationals, and one for companies that are out of scope of the minimum tax. A more efficient alternative is one that avoids the top-up tax[7] by raising the CIT rate to (at least) 15 percent and providing for full expensing of investment (i.e., 100 percent depreciation immediately) to offset the opportunity cost of the investment from taxation (Hebous and others, 2024). This system would be applied to all companies, rendering the two-tiered approach redundant, and resulting in lower effective tax rates on investment than the combination of a 9-percent rate and a top-up tax (Hebous and Mengistu, 2024).[8] Under this proposal, which would also replace the existing windfall tax, the effective tax rate on marginal investment is zero, in contrast to the existing CIT (Figure VI.4). Moreover, the rate increase to 15 percent can yield about 0.9 percent of GDP in additional tax revenues—full expensing somewhat lowers this estimate.

8. Taxation of real property can raise more revenue and improve progressivity of the tax system. Property taxes are an efficient tool of raising revenue, especially for local governments. Hungary raises 0.4 percent of GDP through taxes on immovable property, compared to an OECD average of 1 percent of GDP—implying some scope for improving the design and collection of property taxes.

Annex VI. Figure 4. Effective Tax Rates on Investment (Hypothetical Project)

(Percent)



Source: IMF staff calculation.
Note: METR=marginal effective tax rate, computed for the marginal investment that just breaks even. AETR=average effective tax rate (computed here for an investment with profitability of 20%). The figure assumes an inflation rate of 5%, a real interest rate of 5%, an economic depreciation rate of 25%, and a depreciation rate for tax purposes of 25% under the CIT and 100% under full expensing.

The computation method is in Hebous and Mengistu (2024). The calculation does not consider the temporary excess profit taxes or the local business tax.

[7] The "top-up tax" under the OECD Global Minimum Tax refers to an additional tax that multinational enterprises (MNEs) may be required to pay to ensure that their global profits are taxed at a minimum effective rate.

[8] Municipalities currently have the right to impose a local business tax of up to 2 percent of sales after deducting cost of goods sold, material, subcontracts, and R&D expenditures. The tax varies across municipalities that can also provide preferential treatments like exemptions or reductions. This local business tax is additionally deductible against the CIT. Considerations could be given to reforming the local business tax. Allowing for the deduction of labor costs would reduce labor taxes and bring the local business tax closer to the CIT. The local business tax appears to be considered as a 'covered tax' for Pillar Two.

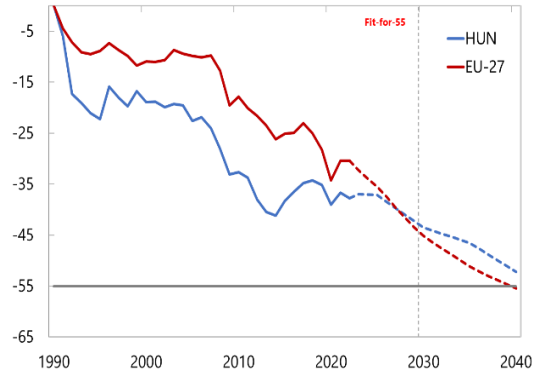
Annex VII. The Green Transition in Hungary: Challenges and Opportunities[1]

Hungary aims to achieve carbon neutrality by 2050, supported by national and EU policies. Yet, ongoing reliance on subsidized fossil fuels complicates mitigation efforts. The goal of this annex is twofold. First, it provides an overview of Hungary's energy mix and sectoral contributions to national greenhouse gas (GHG) emissions, updating the findings in IMF (2021[2]). Second, it examines how the removal of fossil fuel subsidies could serve as a complementary instrument in promoting energy efficiency and leveling the playing field for low-carbon investment while putting Hungary on track to carbon neutrality.

A. Background

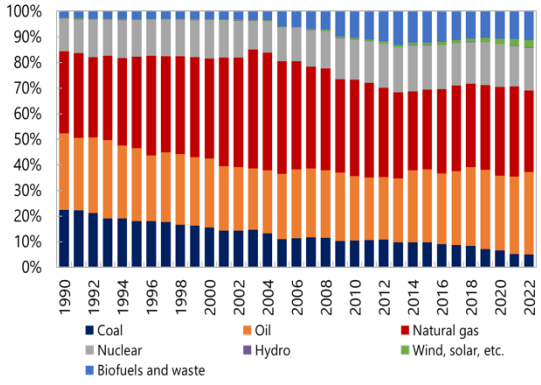
1. Hungary has made progress on climate mitigation aimed at promoting sustainable growth in a low carbon environment. In both absolute and per capita terms, Hungary's contribution to EU's GHG emissions remains low and continues to fall—thanks to post-communist reforms (see Krueger and Lutz, 1995) and recent climate mitigation efforts anchored by several national and EU-wide policy instruments. As a member state, Hungary is committed to cutting its absolute emissions by 50 percent (relative to 1990 by 2030) and becoming carbon neutral by 2050. However, the achievement of these goals requires significant structural transformation and costs for greening the economy, with the green transition accounting for 67.1 percent of *Hungary's Recovery and Resilience Plan* funding envelope. The high costs of adapting to a warming world also mount amid Hungary's exposure to climate extremes,[3] requiring carefully designed policies for an inclusive green transition.

Annex VII. Figure 1. Historical and Projected GHG Emissions (Percent change relative to 1990)



Sources: EU Environmental Agency; and IMF staff calculations.

Annex VII. Figure 2. Total Energy Supply by Source, Hungary (Percent)



Sources: International Energy Agency (IEA); and IMF staff calculations.

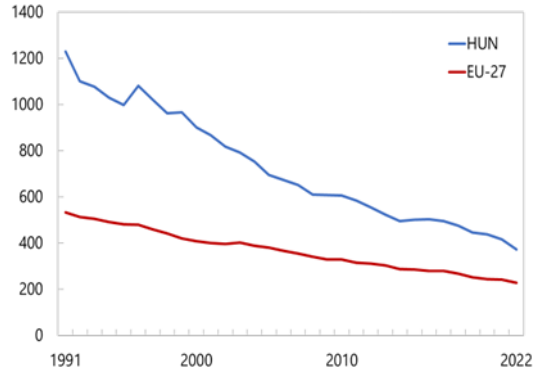
[1] Prepared by Augustus J. Panton.

[2] Hungary Selected Issues, 2021, IMF Country Report No. 21/136.

[3] Hungary faces increasing climate risks, including drought, which affects over 20 percent of arable land in 2022 (EU Environmental Agency, 2023), and severe flooding which caused annual average economic damages up to 1 percent of GDP (Koks and others, 2019).

2. But Hungary's energy mix remains fossil-fuel dominant, while the economy is highly emission-intensive. Although coal, the most-carbon intensive fossil fuel, is being gradually phased out of the energy mix, Hungary's total energy supply is largely fossil fuel sourced. Over the period 2012-2022, fossil fuel sources accounted for an average of 70 percent of total energy supply. While the share of solar in electricity generation has been increasing, the share of renewables in total energy supply remains low—at only 15 percent of gross final energy consumption in 2022, compared to 25 percent in the EU. It therefore no surprise that the Hungarian economy is one of the highly emission intensive economies in the EU, especially amid the increasing size of energy-intensive sectors, including manufacturing. For example, in 2022, a unit of output produced in Hungary was 63 percent more carbon intensive (at 371.5 kt of CO2 equivalent) than the EU average (227.9 kt of CO2 equivalent).

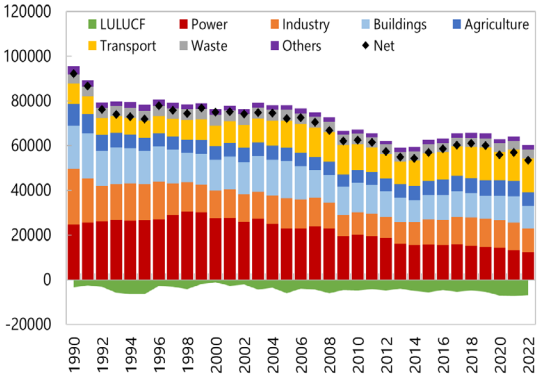
Annex VII. Figure 3. GHG Emissions per Unit of GDP (ktCO2eq)



Sources: EU Environmetal Agency; and IMF staff calculations.

3. Hungary's GHG emissions are becoming concentrated in hard-to-decarbonize sectors. Transport and industry accounted for 48 percent of Hungary's total GHG emissions in 2022 (from 35 percent in 2012), followed by the energy (23 percent) and buildings (19 percent) sectors. This composition could slow down Hungary's green transition absent appropriately targeted policies, especially in the oil-dependent transport sector where electric mobility remains low. Investment in low-carbon infrastructure, including charging stations and renewable-compatible energy grids, remains vital.

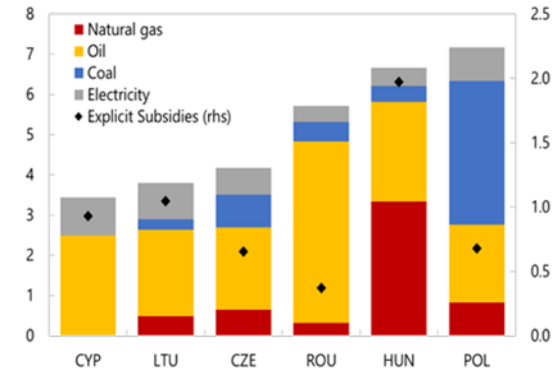
Annex VII. Figure 4. Sectoral Decomposition of GHG Emissions, Hungary (ktCO2eq)



Sources: International Energy Agency (IEA); and IMF staff calculations.

4. Several national measures are complementing the EU ETS in supporting Hungary's green transition agenda. The 2020 Carbon Neutrality Law (Law no. XLIV 2020) made Hungary one of the first countries to legally commit to carbon neutrality by 2050, with several underlying national instruments complementary to the EU-wide ETS and the Green Deal. These include sectoral schemes for promoting increased renewable energy generation (e.g., the National Hydrogen

Annex VII. Figure 5. Fossil Fuel Subsidies by Fuel, 2023 (Percent of GDP)

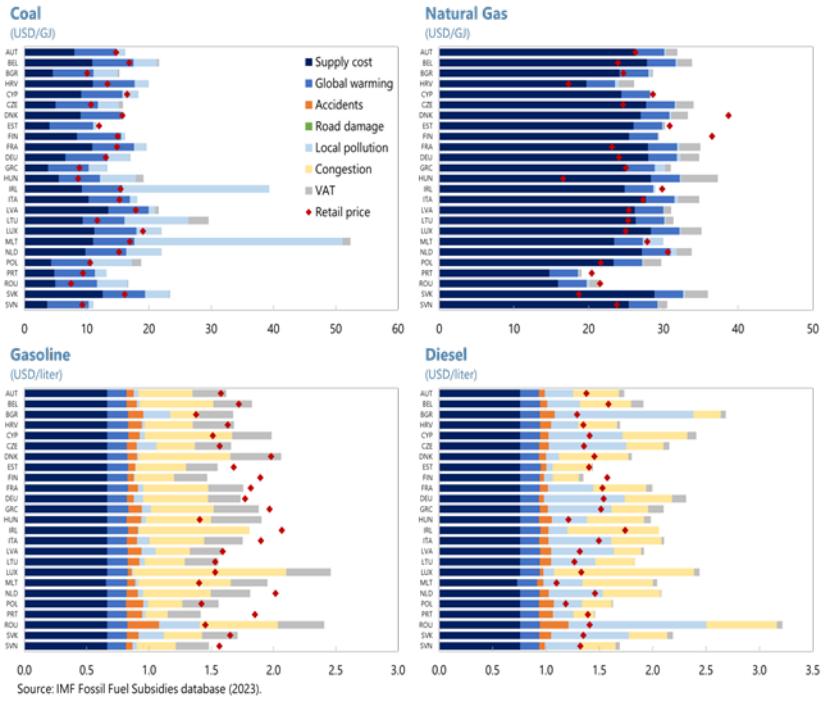


Sources: Black and others, 2023; and IMF staff calculations.

Strategy), enhancing energy efficiency standards (e.g., the District Heating Program), particularly in the buildings sector (e.g., National Long-Term Renovation Strategy), and advancing a just climate transition (via the National Adaptation Strategy).

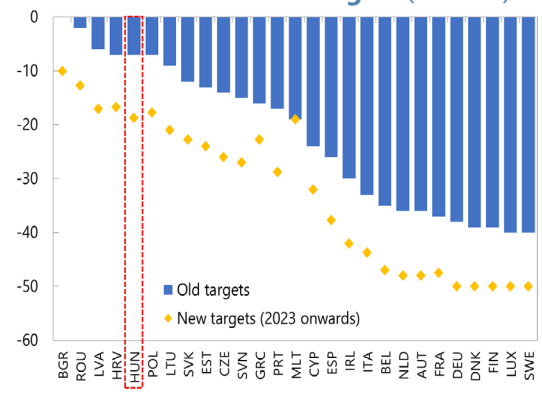
5. However, subsidized fossil fuel consumption is counteracting decarbonization efforts on several fronts. First, these subsidies promote carbon-intensive energy use, jeopardizing the attainment of energy efficiency targets. This is particularly concerning as the EU[1] has deemed Hungary's current goal of reducing energy demand by 6 percent by 2030 (relative to 2021 levels) inadequate. Second, the underpricing of fossil fuels, especially natural gas, both explicitly and implicitly[2], gives these energy sources a pricing edge, deterring investments in low-carbon alternatives like solar and wind power. The EU also finds Hungary's renewable energy target of 21 percent by 2030 insufficient compared to the regional requirement of 23 percent.

Annex VII. Figure 6. Explicit and Implict Fossil Fuel Subsidies in the EU, 2023



Source: IMF Fossil Fuel Subsidies database (2023).

Annex VII. Figure 7. EU Effort Sharing GHG Emissions Reduction Targets (Percent)



Source: EU Environmental Agency.

6. Recent and upcoming EU policy changes pose further challenges to Hungary's green transition agenda. The Fit-for-55 package's new Effort Sharing Regulation (ESR) mandates binding annual GHG emissions reduction targets for sectors not currently covered by the ETS (i.e., transport, buildings, agriculture, waste management, and small industries). Hungary must reduce emissions in these sectors by up to 18.7 percent (from 7 percent

[1] https://www.europarl.europa.eu/RegData/etudes/BRIE/2021/698060/EPRS_BRI(2021)698060_EN.pdf.

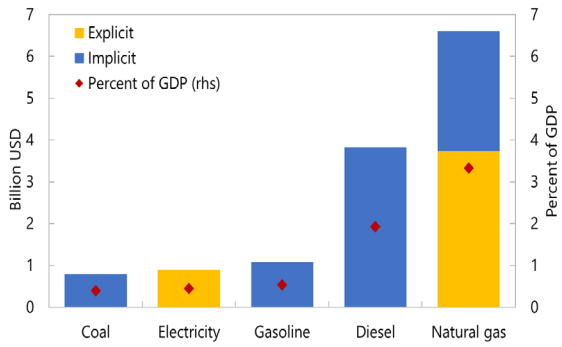
[2] Implicit subsidies including the underpricing the externalities associated with fossil fuel consumption, including air pollution, global warming, etc.

under the old directive) relative to 2005, highlighting the need for stringent decarbonization efforts. Additionally, the separate ETS for transport, buildings, and select small industries (ETS 2) scheduled to roll out in 2027-28 will harmonize carbon pricing across the EU. Gradual carbon pricing in these sectors can prepare the Hungarian economy and people for the transition to ETS 2 and generate early revenues for further decarbonization efforts. Furthermore, the gradual introduction of the Carbon Border Adjustment Mechanism (CBAM) from 2026, alongside the phaseout of free ETS allowances, aims to prevent carbon leakage and promote global emissions reduction. Hungary's recent carbon tax—of up to a €36 per ton carbon tax on major emitters receiving free EU ETS allowances— is a commendable step in the right direction.

B. Fossil Fuel Subsidies Reform

7. A model-based exercise is employed to assess the impact of fossil fuel subsidies reform in Hungary. The extensive use of fossil fuel subsidies, especially for natural gas, significantly weakens the price signals of Hungary's decarbonization policies. Using the IMF-World Bank Climate Policy Assessment tool (CPAT),[3] the simulated effect of fossil-fuel subsidies reform is analyzed. The simulation, as an illustrative exercise, involves the full removal of fossil fuel subsidies, energy price caps, and exemptions effective 2025—complementing and strengthening the price signals of existing decarbonization policies (e.g., EU ETS, national carbon tax). It is worth noting that the resulting impacts, as summarized below, are largely illustrative and should not be interpreted as optimal policy paths.

Annex VII. Figure 8. Fossil Fuel Subsidies by Fuel, 2023 (Billion USD)



Source: IMF Fossil Fuel Subsidies database.
Note: Implicit subsidies include underpricing the external costs of each's fuel use, including air pollution, GHG emissions, road congestion, etc.

8. Impacts: Phasing out Hungary's extensive energy subsidies would reduce fiscal costs by up to 3.7 percent of GDP and generate additional excise revenues of up to 2.7 percent of GDP by 2030. These fiscal savings can help finance climate-related long-term spending needs, including low-carbon energy infrastructure and renewable energy expansion. There are several other benefits from phasing out fossil fuel subsidies:

- First, GHG emissions are projected to decline by up to 20 and 27 percent by 2030 and 2035 respectively relative to baseline, primarily due to decreased power consumption in the industrial and buildings sectors. This reflects the disproportionately large share of natural gas—

[3] See Black and others (2023) for details of CPAT, a tool jointly developed by IMF-World Bank staff for analyzing alternate climate policy options for over 200 countries.

predominantly used for power generation—in Hungary's total fossil fuel subsidies. The minimal impact on transport emissions is due to the currently low scale of electric mobility as the transport sector remains oil dependent. Reduced fossil fuel demand would incentivize investment in low-carbon energy sources and production processes, underpinning the cuts in emissions in the energy and agriculture sectors.

- Second, the optimal pricing of fossil fuels creates a level playing field for renewable energy producers, gradually incentivizing divestment in the former and investment in the latter consistent with evidence in the literature (see Budina and others, 2023).

- Third, current policies are not likely to meet Hungary's decarbonization goals, with GHG emissions projected to diverge from the path to carbon neutrality. Complementing existing measures with fossil fuel subsidies reform is projected to drive emissions downward, narrowing the gap between current level of emissions and the desired net-zero emissions pathway. Furthermore, subsidies reform would enhance energy security by increasing fossil fuel prices, thus promoting energy efficiency (see Kim and others, 2024). Also, increased domestic renewable energy production would lessen energy import dependency, particularly for natural gas. Although oil supply is relatively more diversified, eliminating subsidies and investing in electric mobility (not modeled here), including by expanding the 'Green Bus Program' and developing charging infrastructure, would further reduce oil demand.

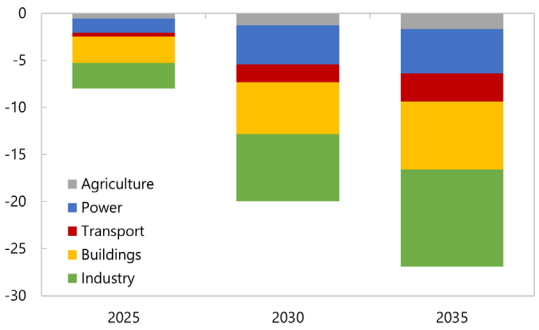
- Fourth, beyond the energy sector, stringent energy price signals could position Hungary as a competitive destination for green investments, providing an opportunity to leverage existing competitiveness in low-carbon technology production, including electric batteries.

- Finally, reduced fossil fuel dependence would also generate substantial co-benefits. For example, fossil fuel subsidies reform could improve economic efficiency and induce cleaner production processes economywide as firms and households become more energy efficient. Other meaningful co-benefits include less air pollution as well as reductions in traffic congestion and accidents. Clearly, the need to broaden political support for and maintaining social cohesion during the green transition cannot be overemphasized. To this end, phasing out energy subsidies while providing means-tested transfers to vulnerable households can help make the reform progressive in both urban and rural areas while promoting competition in the local energy market.

Annex VII. Figure 9. Simulated Impact of Fossil-Fuel Subsidies Removal

GHG Emissions Reduction by Sector

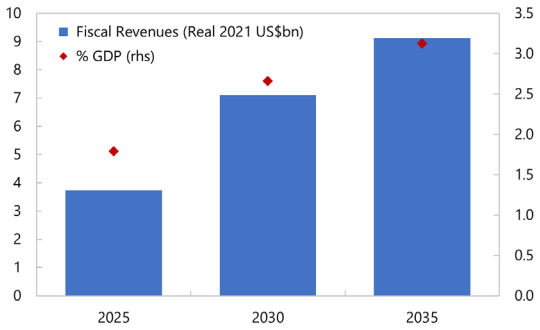
(Relative to baseline; metric tones of carbon dioxide equivalent [mt CO2eq])



Sources: IMF-WB Climate Policy Assessment Tool (CPAT) Model.

Additional Fiscal Revenues from Subsidies Removal

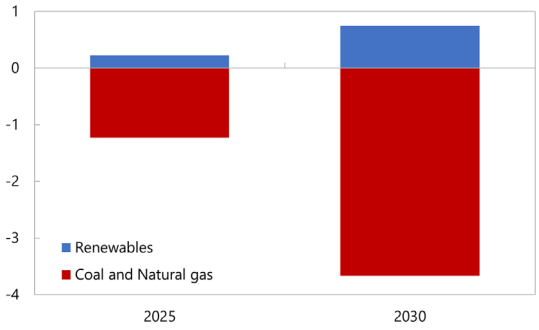
(Relative to baseline)



Source: IMF-WB Climate Policy Assessment Tool (CPAT) Model.

Change in Power Generation by Source

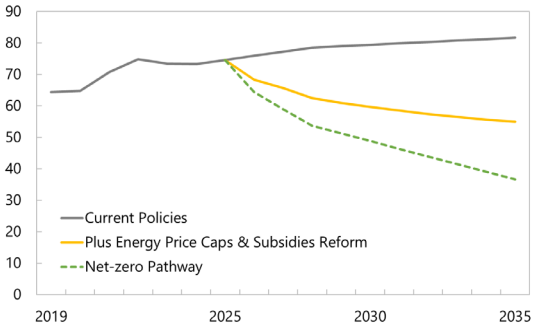
(Relative to baseline; in terawatt hours)



Source: IMF-WB Climate Policy Assessment Tool (CPAT) Model.

GHG Emission Pathways, Hungary

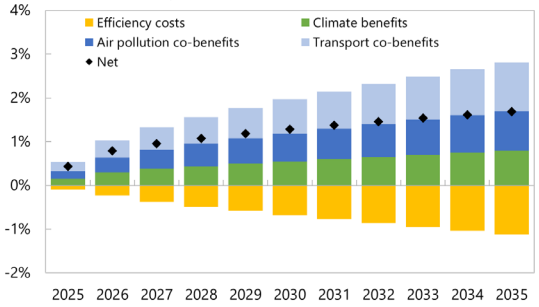
(Metric tones of carbon dioxide equivalent; excluding LULUCF)



Source: IMF staff calculations using CPAT.

Total Monetized Welfare Benefits from Fossil-fuel Subsidies Reform

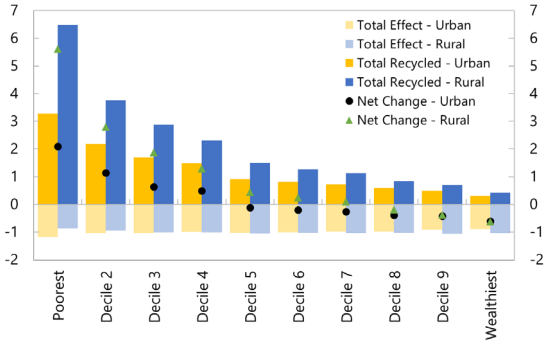
(Welfare benefits/costs; percent of GDP)



Source: IMF-WB Climate Policy Assessment Tool (CPAT) Model.

Relative Mean Consumption Effect: Urban vs Rural HHS

(Percent of consumption due to Fossi-Fuel Subsidies Reform)



Source: IMF-WB Climate Policy Assessment Tool (CPAT) Model.

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Annex VIII. Industrial Policy in Hungary[1]

1. Industrial policy has experienced a resurgence as a tool to address national priorities. This happened as governments have increased use of targeted policies to tackle emerging challenges, including the green transition, competitiveness, technological change, and supply chain security. In the EU, spending on state aid increased from 0.6 percent of GDP in 2012 to 2.3 percent in 2021. Hungary has also increased state aid for these emerging challenges, but most of it goes to other purposes (see below). Weighed against the recent surge of IP are concerns that a unilateral and uncoordinated approach could lead to economic distortions, increased protectionism and an unraveling of global trade and economic integration.

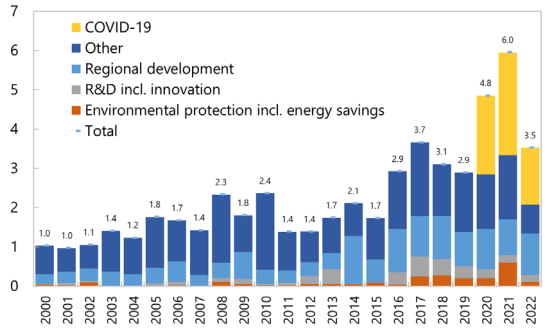
2. Hungary has had national plans to advance development and promote selective industries. In the 2014–2020 industrial policy "Irinyi-plan", the authorities set a target of expanding the share of industry in the Hungarian economy. The plan also affirmed Hungary's important role in the European motor vehicle manufacturing while seeking to strengthen competitiveness in the electronics, logistics and health industries. In 2017, Hungary subsequently embarked on an initiative to shift from a "manufacturing hub" to an "advanced manufacturing and innovation center." Cash incentives and tax grants were introduced to stimulate corporate R&D activities and technology-intensive investments and to subsidize the cost of training.

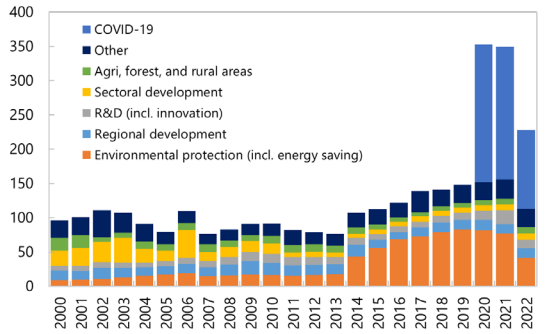
3. Hungary's new industrial strategy for 2024-30 seeks to enhance the country's competitiveness in key sectors. The Competitiveness Strategy, released in March 2024, highlights six key sectoral areas for development including the transformation of the automotive industry; strengthening critical domestic industries like food and basic materials; and improving education, innovation, and research and development to support structural transformation. Environmental sustainability and energy efficiency are cross-cutting themes. Aligned with these goals, the government has sought to promote national champions – firms with the potential to expand internationally and generate dividends.

4. The state aid increase since 2012 was driven predominantly by outlays on regional development. Eurostat's State Aid Scoreboard, which tracks state aid across countries, shows that Hungary's spending has evolved over the last two decades with an increasing share of resources channeled to environmental protection and research and development beginning in the late 2010s, consistent with emerging strategic priorities. The lion's share of non-emergency state aid, however, continues to be directed to regional development and "other" (predominantly cultural initiatives), reflecting long-standing economic and political priorities. This contrasts with state aid in the EU as a whole where environmental protection, including energy efficiency, became the single largest category of spending in the late 2010s until substantial COVID-related expenditures began in 2020. State aid as a percentage of GDP declined across the EU in 2022, including in Hungary, as pandemic-related spending was phased out.

[1] Prepared by Atticus Weller (EUR).

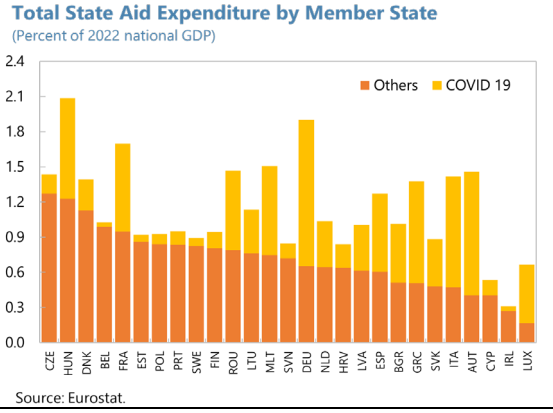
Annex VIII. Figure 1. State Aid Objectives

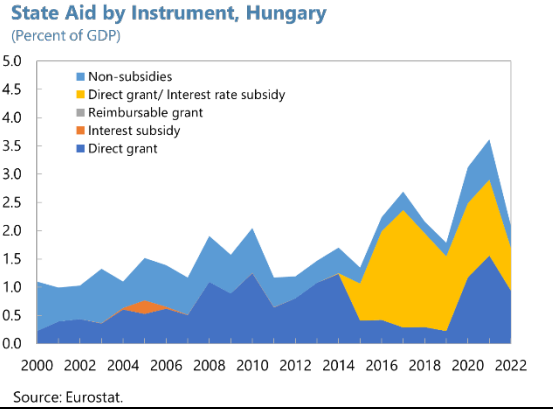




5. Hungary's state aid has been high as a share of GDP compared to other European countries. In 2022, expenditure as a percentage of GDP was the highest in the EU, or second highest subtracting COVID-related financing. Operationally, Hungary has relied predominantly and increasingly on subsidized instruments to deliver state aid. In the early 2000s, non-subsidized aid predominated but over time direct grants and interest rate subsidies (used separately or in combination) have increased and, in 2022, accounted for 80 percent of state aid.

Annex VIII. Figure 2. State Aid Expenditure and by Instrument



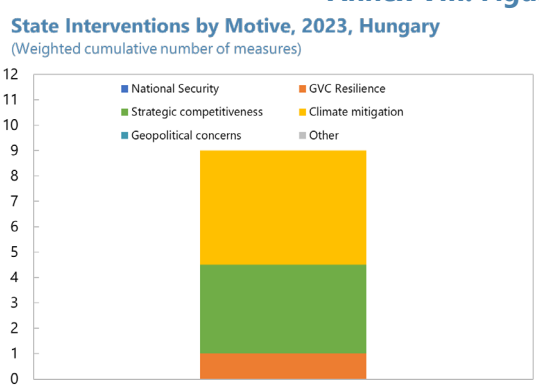


6. An alternative database—the IMF's new IP database—highlights Hungary's policy focus on climate mitigation and strategic competitiveness in 2023. The New Industrial Policy Observer (NIPO)[2], an IMF project to track and analyze industrial policy interventions, is not directly comparable with the EC's State Aid Scoreboard though it shows that IP in 2023 was geared to some of the same emerging challenges noted above. The most common areas of policy focus were on climate mitigation and strategic competitiveness—consistent with Hungary's promotion of the EV sector—and, secondarily, value chain resilience. From a product perspective, the most commonly

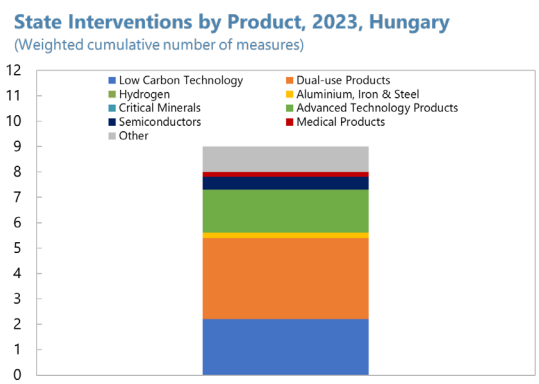
[2] The EU's State Aid Scoreboard provides aggregate country-level data on state aid expenditure but comes with a significant lag. The IMF's NIPO database provides more timely information but is currently only available for 2023 and is not directly comparable with the Scoreboard, which generally excludes distortionary interventions unless exempted or notified to the EC.

targeted areas were dual-use products (those with civilian and military applications), low carbon technology and advanced technology products. Total subsidy spending on IP was equivalent to almost US$7 billion or 3.3 percent of GDP in 2023, a number that is slightly higher than the reported number for *total* subsidy spending in the budget, suggesting that some IP-related spending is categorized under different items or perhaps off-budget. The most common instruments used were subsidized state loans or grants.

Annex VIII. Figure 3. State Interventions



Source: IMF New Industrial Policy Observer.



Source: IMF New Industrial Policy Observer.

7. Getting IP right requires a comprehensive assessment of its benefits and costs to prevent inefficiencies and adverse international spillovers. In the presence of externalities, coordination failures or public input under-provision, the use of IP may be justified. But to be effective, IP measures, including targeted support to nurture national champions, must be appropriately focused to address market failures, time-bound, cost-effective, transparent, and deliver on their objectives, while preserving domestic macroeconomic stability, fiscal and external sustainability. Policymakers also need to avoid IP measures that violate their international commitments, generate negative cross-border spillovers, and harm trading partners. Good governance is critical in policy design and implementation to prevent rent-seeking by industry lobbying and to preserve the benefits of competition and transparency. To ensure an even and competitive playing field, it's particularly important to avoid favoring existing firms and domestic firms over new entrants and/or foreign-owned firms.

8. EU countries, and especially small and open economies like Hungary's, would benefit from a coordinated approach at the EU-level. Smaller EU countries like Hungary lack the fiscal capacity to match the support provided by larger ones, and costly subsidies for favored industries may just end up subsidizing consumption in other countries. A coordinated approach at the EU level that leverages the single market would avoid collective action problems and mitigate the welfare losses from a fragmented approach to IP.

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Annex IX. Data Issues

Annex IX. Table 1. Hungary: Assessment of Data Adequacy for Surveillance

Data Adequacy Assessment Rating 1/
B

Questionnaire Results 2/

Assessment	National Accounts	Prices	Government Finance Statistics	External Sector Statistics	Monetary and Financial Statistics	Inter-sectoral Consistency	Median Rating
	A	B	B	B	A	A	B

Detailed Questionnaire Results

Data Quality Characteristics						
Coverage	A	B	B	B	B	
Granularity 3/	A		C	C	A	
			B		A	
Consistency			C	B		A
Frequency and Timeliness	A	A	B	B	A	

Note: When the questionnaire does not include a question on a specific dimension of data quality for a sector, the corresponding cell is blank.
1/ The overall data adequacy assessment is based on staff's assessment of the adequacy of the country's data for conducting analysis and formulating policy advice, and takes into consideration country-specific characteristics.
2/ The overall questionnaire assessment and the assessments for individual sectors reported in the heatmap are based on a standardized questionnaire and scoring system (see IMF *Review of the Framework for Data Adequacy Assessment for Surveillance*, January 2024, Appendix I).
3/ The top cell for "Granularity" of Government Finance Statistics shows staff's assessment of the granularity of the reported government operations data, while the bottom cell shows that of public debt statistics. The top cell for "Granularity" of Monetary and Financial Statistics shows staff's assessment of the granularity of the reported Monetary and Financial Statistics data, while the bottom cell shows that of the Financial Soundness indicators.

A	The data provided to the Fund is adequate for surveillance.
B	The data provided to the Fund has some shortcomings but is broadly adequate for surveillance.
C	The data provided to the Fund has some shortcomings that somewhat hamper surveillance.
D	The data provided to the Fund has serious shortcomings that significantly hamper surveillance.

Rationale for staff assessment. Overall, the data provided to the Fund is broadly adequate for surveillance. For fiscal data, monthly cash data has sufficient granularity and is reported in a timely fashion but is not consistent with the Maastricht accrual standard and uses different revenue and expenditure categories. Quarterly accrual data is published with a 3 month lag; revenue and expenditure categories are not easily comparable between annual and quarterly data and generally incompatable with monthly data. EU funds flows are not reported with sufficient disaggregation. Central government debt stock and flow data is available on a quarterly basis. General government debt data is available on a similar schedule but with much less granularity and lacks breakdown of LCY vs FCY debt, and scheduled amortization and interest payments. In the past, data on central government revenue and expenditure arrears as well as that on local government revenues and expenditures was 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. For the external sector, quarterly data is published with a 2-3 month lag but preliminary monthly data is available a few days after the end of the month through the Central Statistical Office, though it is not BPM6-compliant. Quarterly goods trade data is not disaggregated to enable an analysis of individual goods' performance. Quarterly data on primary and secondary income and capital account flows is not broken down to show ED funds. Preliminary data is often issued with large E&Os.

Changes since the last Article IV consultation. No change.

Corrective actions and capacity development priorities. Greater consistency between annual and quarterly fiscal data; automatic provision of arrears and local government fiscal data; and disaggregation of goods trade data.

Use of data and/or estimates in Article IV consultations in lieu of official statistics available to staff. Staff do not use data and/or estimates different from official statistics. For fiscal and external sectors, market and press data is used to supplement understanding of official data, particularly with respect to EU funds flows, but it is not a substitute. For structural indicators, including governance and climate, supplementary external data sources are used.

Other data gaps. Foreign exchange intervention data is not made available.

Annex IX. Table 2. Hungary: Data Standards Initiatives

Hungary adheres to the Special Data Dissemination Standard (SDDS) Plus since July 2022 and publishes the data on its National Summary Data Page. The latest SDDS Plus Annual Observance Report is available on the Dissemination Standards Bulletin Board (https://dsbb.imf.org/).

Annex IX. Table 3. Hungary: Table of Common Indicators Required for Surveillance

As of July 18, 2024

	Data Provision to the Fund				Publication under the Data Standards Initiatives through the National Summary Data Page			
	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Expected Frequency[6,7]	Hungary[8]	Expected Timeliness[6,7]	Hungary[8]
Exchange Rates	17-Jul-24	18-Jul-24	D	D	D	...	...	...
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Jun-24	Jul-24	M	M	M	M	1W	NLT 7D
Reserve/Base Money	May-24	Jul-24	M	M	M	M	2W	12D
Broad Money	May-24	Jul-24	M	M	M	M	1M	1M
Central Bank Balance Sheet	May-24	Jul-24	M	M	M	M	2W	12D
Consolidated Balance Sheet of the Banking System	May-24	Jul-24	M	M	M	M	1M	1M
Interest Rates[2]	17-Jul-24	18-Jul-24	D	D	D	...	...	...
Consumer Price Index	Jun-24	Jul-24	M	M	M	M	1M	11D
Revenue, Expenditure, Balance and Composition of Financing[3]–General Government[4]	2024Q1	Jul-24	Q	Q	A/Q	Q	2Q/12M	3M
Revenue, Expenditure, Balance and Composition of Financing[3]–Central Government	2024Q1	Jul-24	Q	Q	M	M	1M	1M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	2024Q1	Jun-24	Q	Q	Q	Q	1Q	NLT 30D
External Current Account Balance	2024Q1	Jun-24	Q	Q	Q	Q	1Q	1Q
Exports and Imports of Goods and Services	Apr-24	Jun-24	M	M	M	M	8W	40D
GDP/GNP	2024Q1	Jun-24	Q	Q	Q	Q	1Q	45D
Gross External Debt	2024Q1	Jun-24	Q	Q	Q	Q	1Q	NLT 1Q
International Investment Position	2024Q1	Jun-24	Q	Q	Q	Q	1Q	NLT 1Q

[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.

[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] Frequency and timeliness: ("D") daily; ("W") weekly or with a lag of no more than one week after the reference date; ("M") monthly or with lag of no more than one month after the reference date; ("Q") quarterly or with lag of no more than one quarter after the reference date; ("A") annual.; ("SA") semiannual; ("I") irregular; ("NA") not available or not applicable; and ("NLT") not later than.

[7] Encouraged frequency of data and timeliness of reporting under the e-GDDS and required frequency of data and timeliness of reporting under the SDDS and SDDS Plus. Any flexibility options or transition plans used under the SDDS or SDDS Plus are not reflected. For those countries that do not participate in the IMF Data Standards Initiatives, the required frequency and timeliness under the SDDS are shown for New Zealand, and the encouraged frequency and timeliness under the e-GDDS are shown for Eritrea, Nauru, South Sudan, and Turkmenistan.

[8] Based on the information from the Summary of Observance for SDDS and SDDS Plus participants, and the Summary of Dissemination Practices for e-GDDS participants, available from the IMF Dissemination Standards Bulletin Board (https://dsbb.imf.org/). For those countries that do not participate in the Data Standards Initiatives, as well as those that do have a National Data Summary Page, the entries are shown as "..."

INTERNATIONAL MONETARY FUND

HUNGARY

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

July 18, 2024

Prepared By

European Department
In Consultation with Other Departments

CONTENTS

FUND RELATIONS

(As of June 30, 2024)

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

General Resources Account:

	SDR Million	Percent Quota
Quota	1,940.00	100.00
Fund holdings of currency (Holdings Rate)	1,640.76	84.58
Reserve tranche position	301.18	15.52

SDR Department:

	SDR Million	Percent Allocation
Net cumulative allocation	2,850.45	100.00
Holdings	1,663.25	58.35

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			
	2024	2025	2026	2027	2028
Principal					
Charges/Interest	23.94	47.65	47.68	47.68	47.70
Total	23.94	47.65	47.68	47.68	47.70

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. Hungary has accepted the obligations of Article VIII, Sections 2(a), 3, and 4 of the IMF's Articles of Agreement and maintains an exchange rate system free of multiple currency practices and restrictions on the making of payments and transfers for 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 February 1, 2023. The associated staff report is available at https://www.imf.org/en/Publications/CR/Issues/2023/02/02/Hungary-2022-Article-IV-Consultation-Press-Release-Staff-Report-and-Statement-by-the-529090.

Technical Assistance: See the table below.

Hungary: Technical Assistance from the Fund, FY2010–2024

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 Management Company	January 2015 and June 2015
FAD	Workshop on Revenue Forecasting and Micro-simulation Analysis	January 2016
FAD	PIT and CIT Micro-Simulation	January 2018
FAD	VAT Gap Analysis	February 2018
FAD	Revenue Administration	January 2020 and February 2020