Hungary

Country note, June 2017

Fiscal Council of Hungary, Secretariat

Key messages:

- **Broad-based economic growth to continue in 2017-18**
- **2.4% deficit target of the government is feasible in 2017 and 2018**
- **Debt remains on a downward track**
- **Policies should aim to boost competitiveness to offset the impact of the six-year wage agreement on unit labour costs**

Macroeconomic outlook

The cyclical slowdown of EU fund inflows and one-off effects slowed down economic growth in 2016 but Q1 data indicate a significant acceleration in 2017. Growth is broad-based, supported by strong income growth, recovering bank lending, resuming EU fund absorption and a favourable external environment. The six-year tripartite wage agreement will continue to drive income and consumption growth. Thus, GDP growth may remain in the range of 4% in 2017 and 2018. For 2019 some slowdown is expected as EU fund absorption and public investments reach a plateau.

Short-term fiscal outlook

Strong revenue collection, some one-off revenue items, falling interest expenditure and continuing discipline in non-interest spending led to a favourable deficit outturn in 2016 (1.8% of GDP). Excluding the impact of one-off spending in December 2016, a deficit below 1% would have been feasible; 17Q1 budget data also confirm a strong underlying position. The robust labour market, rapid wage and consumption growth continue to support tax revenues, offsetting much of the effect of tax cuts (to social security contributions, corporate income tax and VAT) introduced in 2017. Meanwhile, spending on social benefits, public wages and interest relative to GDP is set to decrease (Chart 1). Thus, the 2.4% deficit target of the government can be achieved in both 2017 and 2018.

Medium-term fiscal outlook

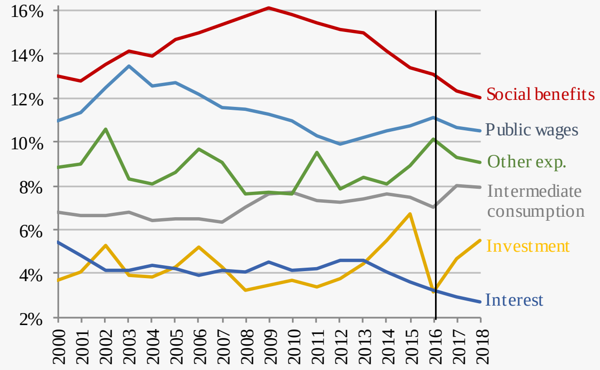
Gross debt remains on a decreasing track, fulfilling national and EU debt rules until 2019. Structural deficit is expected to rise temporarily in 2017-18 but should decrease subsequently towards the medium-term objective (1.5% of GDP). The Fiscal Council recalls that the methodology of the European Commission to separate the cyclical and structural components of the budget balance has been debated; and revisions to estimates of the structural balance have been significant historically.

In the medium term, two further effects merit consideration. First, the six-year wage agreement will lead to a material increase in nominal wages; higher investments and competitiveness-boosting policy measures will be required for a matching rise in labour productivity. Second, the expected expansion of the Paks nuclear plant can shift the debt path upwards, although it may still remain on a downward trajectory.

Fiscal framework and national fiscal rules

The national fiscal rule stipulates that public debt must eventually decrease below 50% of GDP. The current debt level is significantly higher than this reference value, therefore fiscal policy needs to remain prudent in the medium term, even though there remain adequate buffers for debt reduction should GDP growth turn out lower than planned in 2017-2018.

Chart 1 - Government expenditures by type 2000-2018
(% of GDP)



Key indicator forecast

		2016	2017 f	2018 f	2019 f	2020 f	2021 f
Real GDP growth rate – Mof est.	[% y-to-y]	2.0	4.1	4.3	3.8	3.7	3.6
Real GDP growth rate – EC est.	[% y-to-y]		3.6	3.3	-	-	-
GG balance – targets	[% of GDP]	-1.8	-2.4	-2.4	-1.8	-1.5	-1.2
GG balance – EC est.	[% of GDP]		-2.3	-2.4	-	-	-
GG debt - MoF est.	[% of GDP]	74.1	72.0	70.5	67.3	64.0	61.2
GG debt – EC est.	[% of GDP]		72.6	71.2	-	-	-
GG structural balance – MoF est.	[% of GDP]	-1.6	-2.5	-2.4	-1.8	-1.5	-1.2
GG structural balance – MoF est.	[% of GDP]	-1.9	-3.4	-3.7	-	-	-

f – forecast

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