Hungary

Secretariat of Hungarian Fiscal Council

Country note, January 2018

Key messages:

- **Broad-based economic growth to continue**
- **2.4% deficit target of the government is feasible, but the pre-financing of EU funds strains short-term funding**
- **Debt remains on a downward track, but uncertainties loom**
- **Policies should aim to keep debt on its downward track and to boost long-term growth potential**

Macroeconomic outlook

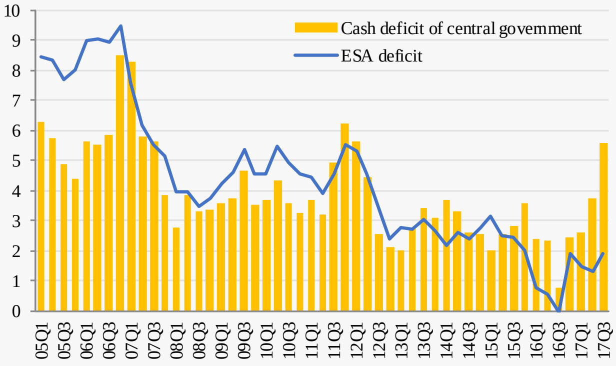
Economic growth rebounded after a weak 2016, GDP growth accelerated to 3.8% in the first three quarters of 2017. Growth is broad-based, supported by strong real wage growth, recovering bank lending, accelerating EU fund absorption and a favourable external environment. The six-year tripartite wage agreement 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

The 2.4% accrual-based deficit target of the government remains within reach in both 2017 and 2018. The four-quarter rolling deficit stood at 1.9% in 17Q3 according to preliminary financial accounts. Revenue collection remains robust, while falling interest payments and restrained social spending moderate expenditure growth.

The government is making great efforts to speed up the absorption of structural and cohesion funds. To this end, national pre-financing has increased substantially, outpacing the inflow of funds from the EU budget. This has increased the cash-flow based central government deficit to 5.6% of GDP by 17Q3 (on a 12-month rolling basis). A higher financing requirement slows down debt reduction in the near term. The situation is expected to reverse in the coming years, when actual (accrual-based) use of EU funding will rise while pre-financing will moderate.

Chart 1 - ESA deficit and central government cash deficit, 2005-2017 (% of GDP, 4-quarter rolling)



Medium-term fiscal outlook

Revised data show that gross debt remains on a decreasing path, but the margin relative to the Maastricht debt reduction rule has narrowed. Methodological changes and long-term fiscal commitments should be monitored closely. Eurostat and the national authorities dispute the status of state-owned export-import bank, Eximbank, which may be reclassified into the public sector next year. This reclassification could lead to an even flatter debt profile. Looking ahead, large public investment projects involving heavy public borrowing (the expansion of the Paks nuclear plant and the reconstruction of the Budapest-Belgrade railway) may also raise government debt. Efforts to reduce public debt should be maintained to offset these risks.

In addition, the six-year wage agreement will lead to a sustained increase in labour costs, which needs to be accompanied by capital deepening and higher productivity to avoid overheating pressures. Economic policy can facilitate this process with competitiveness-boosting policy measures.

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; in light of upside risks to the debt trajectory, efforts should be maintained to achieve national and EU debt targets.

Key indicator forecast

		2016	2017 f	2018 f	2019 f	2020 f	2021 f
Real GDP growth rate - MoF est.	[% y-to-y]	2.2	4.1	4.3	3.8	3.7	3.6
Real GDP growth rate - EC est.	[% y-to-y]		3.7	3.6	3.1	-	-
GG balance – targets	[% of GDP]	-1.9	-2.4	-2.4	-1.8	-1.5	-1.2
GG balance - EC est.	[% of GDP]		-2.1	-2.6	-2.3	-	-
GG debt - MoF est.	[% of GDP]	73.9	72.0	70.5	67.3	64.0	61.2
GG debt - EC est.	[% of GDP]		72.6	71.5	69.4	-	-
GG structural balance - MoF est.	[% of GDP]	-1.6	-2.5	-2.4	-1.8	-1.5	-1.2
GG structural balance - EC est.	[% of GDP]	-2.0	-3.2	-3.6	-3.5	-	-

f – forecast. Sources: Convergence Program of Hungary 2017-2021, European Commission Economic Forecast, Autumn 2017.

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