Hungary

FISCAL COUNCIL
REPUBLIC OF HUNGARY

Country note, July 2019

Key messages:

- **The government's deficit target for 2019 is most likely to be slightly undershot on account of moderating expenditures, a strong economy and whitening measures. The 2020 target seems achievable assuming further whitening measures are substantiated and/or parts of free budgetary reserves are cancelled.**
- **Government debt declined sharply to 70.8% of GDP by end-2018. Debt could reach 65.4% of GDP by 2020.**

Macroeconomic outlook

The economy performed remarkably well in 2018. GDP growth rate turned out at 4.9%, above initial expectations. Growth was broad-based, supported by double-digit boom in investments and wages as well as a vivid expansion in household consumption. Growth is expected to weaken slightly to 4.5% this year, while 2020 could bring a more visible slowdown, driven by both, a weakening foreign demand and tightening capacities in the Hungarian economy.

Fiscal outlook

Strong revenue collection, on account of a favourable cyclical position of the economy and tax-whitening measures, has supported the budget in 2018. Overall, the 2018 ESA deficit reached 2,2% of GDP, undershooting the target by 0.2 ppts.: both robust revenues growth and the contained increase in expenditure contributed to the outcome.

Partly on account of a favourable base year, we expect the 2019 on target, at 1.6% of GDP. Savings are expected in most expenditure items to GDP with the exception of investments, while on the revenue side, only indirect taxes and other revenues (related to EU transfers) could increase to GDP. Current taxes could remain relatively stable, while social security contributions will decrease if compared to GDP on account of cuts in the contribution rate. The submitted 2020 budget envisages an ambitious 1% deficit target, nonetheless, it does not contain major new measures to achieve the target. Previously announced measures in the form of the New program on Demography and the Economy Protection Action Plan contained rather loosening measures in the form of current and capital transfer spending and tax cuts. Better-than-expected real economy data as well as successful whitening measures, could form a solid base for next year. Furthermore, the Ministry seems more cautious about expected capital spending for 2020. However, there is a remaining 0.3 pp to be delivered, as in our assessment, lower tax and EU related revenues and higher other expenditures are roughly balanced by less spending to GDP on intermediate consumption, financial transfers, interest rates and investment. The draft Budget Law assumes an unchanged macroeconomic outlook compared to 2019, better than our expectation. Additionally, it admits to reckon further whitening gains related to yet-to-be adopted measures in the field of enhancing electronic payments and the further utilization of online company data.

Gross debt reached 70.8% of GDP substantially undershooting the 73.2% on account of higher-than-expected cash revenues from the EU Commission. Pre-financing of EU co-financed expenditures was a significant burden on the budget throughout 2017-2018, however we expect the balance of EU related cash deficit to moderate this year, and turn to surplus afterwards. This helps quick debt reduction to 65.4% of GDP by 2020 year-end.

Fiscal framework and national fiscal rules

The expected path of debt reduction is in line with both national and EU level requirements, according to the Fiscal Council. The Council issued its assessment to the draft 2020 budget law, stressing that the budget plan was realistic, although indicated that the macroeconomic assumptions underpinning the draft were rather optimistic, and further whitening measures needed to be substantiated. It also pointed out the importance of the unusually large, 1% of GDP budgetary reserves to cover potential risks.

In May 2018, the EU Council issued a warning on a significant deviation of the 2018 budget deficit from the MTO. In December 2018, it EC found that Hungary did not take effective action to comply with the recommendation. The Commission suggested newer recommendations expected to be adopted by the Council in July 2019. The Commission also suggested Hungary should adopt corrective measures consistent with a structural adjustment of 0.6% of GDP for 2019 and 0.2% of GDP in 2020. However this latter recommendation does not contain the recent draft 2020 budget, 0.5 pp. of GDP below previous plans.

Chart 1: Government expenditures, revenues and balance

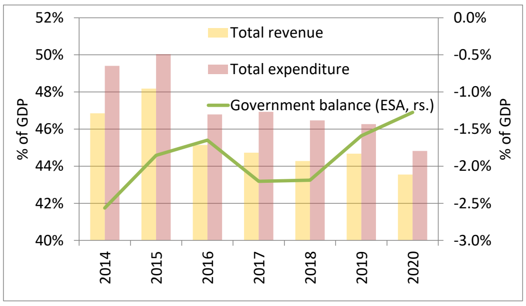


Chart 2: Government expenditures

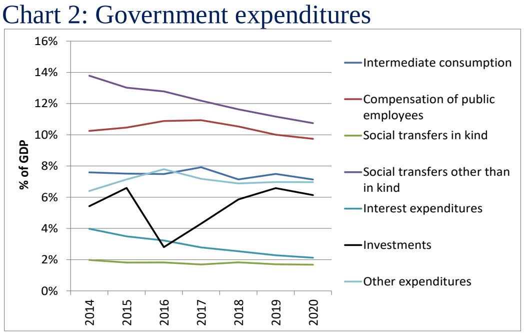
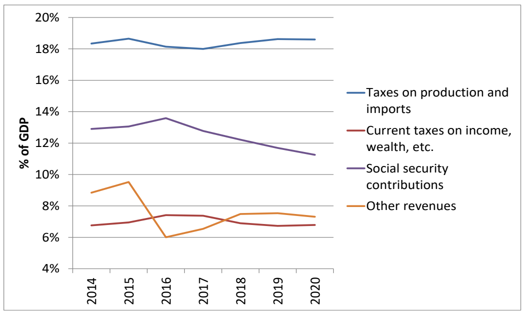


Chart 3: Government revenues



Key indicator forecast

		2015	2016	2017	2018	2019 f	2020 f	Source
Real GDP growth rate	[% y-to-y]	3.5	2.3	4.1	4.9	4.0	4.0	1
Output Gap	[%]	-0,7	-0,2	0,2	0,2	0,3	0,2	1
GG balance – targets or outcome	[% of GDP]	-1,9	-1.6	-2,2	-2,0	-1,8	-1,0	1
GG balance -CBR est.	[% of GDP]	-1,9	-1.6	-2,2	-2,0	-1,6	-1,3	2
GG debt - MoF est.	[% of GDP]	76,7	76,0	73,4	70,8	68,6	65,5	1
GG debt - CBR est.	[% of GDP]	76,7	76,0	73,4	70,8	68,7	65,4	2
GG structural balance – CBR est.	[% of GDP]	-2,0	-1,8	-3,1	-3,8	-3,3	-3,0	3
Adjusted real GG expenditure growth	[% y-to-y]	4.6	-4.3	3.5	4.7	4.0	-0.1	2,3
Discretionary revenue measures	[% of GDP]	0.3	-0.5	-1.5	-0.3	-0.3	-0.2	3

Sources:

1-Ministry of Finance, Hungary, December 2018 forecast

2 – CBR

3- European Commission

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