Hungary

Country note, January 2019

FISCAL COUNCIL
REPUBLIC OF HUNGARY

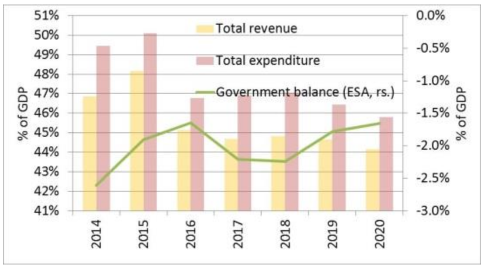
Key messages:

- **The government's deficit target for 2018 is most likely to be undershot on account of moderating expenditures, a strong economy and whitening measures. The 2019 target is feasible but the deficit reduction could slow by 2020, given the ambitious plans for public wage hikes and a slowing economy.**
- **Government debt declined sharply to 71% of GDP by end-2018. Debt could reach 66.4% of GDP by 2020.**
- **Planned growth enhancing measures could affect the budgetary path from 2019 but details are yet unknown.**

Macroeconomic outlook

The economy performed remarkably well in 2017 and 2018Q1-Q3. GDP growth rates turned out at 4.1% and 4.8% respectively. Growth was broad-based, supported by double-digit boom in investment as well as a vivid expansion in household consumption. Growth is expected to remain at a solid 4% this year as well, nonetheless 2019 and 2020 could bring a gradual slowdown, driven by both a weakening foreign demand and tightening capacities in the Hungarian economy. Still, domestic demand remains the primary growth driver.

Chart 1: Government revenues, expenditures and balance



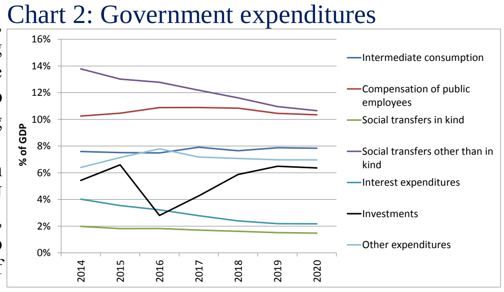
Fiscal outlook

Strong revenue collection, on account of a favourable cyclical position of the economy and tax-whitening measures, has supported the budget. In particular, VAT revenues grew stronger than expected, related to the introduction of online cash registers, while other revenues increased on account of increasing EU fund payments. Overall, the 2018 ESA deficit could have been undershot by 0.4% of GDP primarily on account of a lower-than-expected expenditure-to-GDP ratio. (Expenditure to GDP ratio is expected to be 1.2 pp. lower, while revenues 0.5 pp lower than envisaged in the Convergence Program).

Despite the expectation of a below-target outcome for 2018, we still expect the 2019 on target, at 1.8% of GDP, as we think expenditures will gradually speed-up on account of new spending plans (e.g. Hungarian village program). As regards the deficit outlook afterwards, given the slowing economy, and ambitious plans for wage increases, we foresee the deficit decline to practically halt under no policy change. Nonetheless, the recent promise of growth-enhancing measures from the government could alter this picture.

Gross debt could have undershot the 73.2% of GDP target by end-2018 by a 2 pp. margin 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 from 2020, when debt could reach 66.4% of GDP by the year-end.

Chart 2: Government expenditures

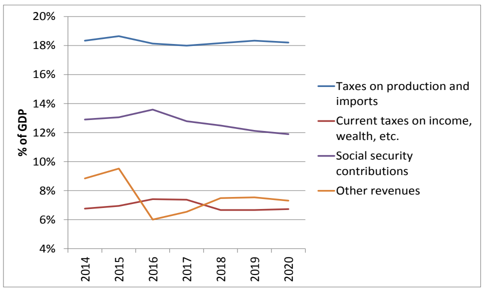


Fiscal framework and national fiscal rules

The national fiscal rule stipulates that until government debt falls below 50% of GDP, the budget should be planned in line with a decreasing debt path. The expected path of debt reduction is in line with both national and EU level requirements. As regards the 2019 budget, the Fiscal Council issued its assessment to the draft law, stressing that the budget plan was realistic, although indicated that the macroeconomic assumptions underpinning the draft were rather optimistic, and revenue projections are subject to downside risks. Therefore the Council pointed out the importance of keeping budgetary reserves at the planned level until it seems clear that the deficit is safely in line with the target.

In May 2018, the European Commission issued a warning on a significant deviation of the 2018 budget deficit from the MTO. In November, the EC found that Hungary did not take effective action to comply with the Commission recommendation. The EC also suggested that the Government should adopt corrective measures consistent with a structural adjustment of 1% of GDP for 2019. The Fiscal Council notes that the European Commission's methodology on cyclical adjustment of the budget balance and hence, the assessment on the structural deficit in relation to the MTO, is debated by the Authorities.

Chart 3: Government revenues



Key indicator forecast

		2015	2016	2017	2018 f	2019 f	2020 f	Source
Real GDP growth rate	[% y-to-y]	3.4	2.2	4.0	4.3	3.9	4.0	1
Output Gap	[%]	-0,7	-0,2	0,2	na	na	na	1
GG balance – targets or outcome	[% of GDP]	-1,9	-1.6	-2,2	-2,0	-1,8	-1,5	1
GG balance -CBR est.	[% of GDP]	-1,9	-1.6	-2,2	-2,0	-1,8	-1,7	2
GG debt - MoF est.	[% of GDP]	76,6	76,6	75,9	71,0	69,9	66,4	1
GG debt - CBR est.	[% of GDP]	76,6	76,6	75,9	71,0	70,6	66,4	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]	3.3	-5.4	6.5	5.4	3.1	0.8	2,3
Discretionary revenue measures	[% of GDP]	0.3	-0.5	-1.5	-0.7	-0.4	-0.2	3

Sources:

1-Ministry of Finance, Hungary, December 2018 forecast

2 – CBR

3- European Commission

f - forecast

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