PUBLIC FINANCE REPORT

2019

JULY

"Intending to ensure the benefit of the general public ... and the good condition of the country by useful remedies..."

(from a charter of King Charles Robert - February 1318)

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Analysis of the 2020 budget bill

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To support the fulfilment of its fundamental duties set forth in Act CXXXIX of 2013 on the Magyar Nemzeti Bank, in particular the tasks related to the determination and implementation of monetary policy, the Magyar Nemzeti Bank analyses developments in the budget deficit and debt, monitors the financing of the general government, analyses the impact of financing on monetary developments, capital markets and liquidity, and researches fiscal policy issues.

Pursuant to Act CXCIV of 2011 on the Economic Stability of Hungary, the Governor of the MNB is a member of the Fiscal Council (FC), and thus the professional expertise and accumulated information available in the MNB can indirectly support the work of the FC. The MNB prepares background analyses for the duties of the FC stipulated in the Stability Act and makes them available for the FC.

The analyses in this report were prepared under the general direction of Dániel Palotai, Executive Director for Economic Sciences and Priority Matters. This report was prepared by the staff of the Directorate for Fiscal and Competitiveness Analysis and the Directorate Economic Forecast and Analysis. It was approved for publication by Governor György Matolcsy.

The analysis is based on information available for the period ending on 30 June 2019.

Contents

1 Summary

The subject of this analysis is the bill on Hungary's 2020 central budget, submitted to the Parliament on 4 June, which we assess in the light of the MNB's fiscal forecast. As part of this analysis, the MNB prepared its own projection for the 2020 budget balance based on the available information, and this projection is compared with the appropriation in the bill.

According to the budget bill, the ESA budget deficit in 2020 may be 1 percent of GDP. This deficit target is 0.8 percentage point lower than the 2019 appropriation of 1.8 percent and 0.5 percentage point lower than the deficit path indicated in the Convergence Programme. In 2020, the budget deficit may decline to historic lows. According to the data available since 1995, the accrual-based budget deficit may be the lowest in 2020 if the 1-percent deficit target is met.

According to our forecast, the deficit target for 2020 can be achieved if the reserves are partially preserved. Based on our projection prepared by taking into account the detailed bill, some revenues may fall short of the appropriation. However, the co-financing related to EU funds and the expenditure related to the prenatal baby support (due to the different estimates on its distribution between years) may be lower than foreseen in the bill. Accordingly, with using the reserves, next year's deficit is estimated to amount to 1.4 percent of GDP, which, however, may be reduced to the targeted 1.0 percent by saving some of the reserves.

In 2020, the amount of fiscal reserves is planned to be 1 percent of GDP, i.e. higher than in the past years. The Country Protection Fund and the extraordinary government reserves will amount to HUF 378 billion and HUF 110 billion, respectively, in 2020. Accordingly, their combined amount will grow to HUF 488 billion, i.e. some HUF 260 billion higher than these reserves' amount of HUF 225 billion in 2019. The great amount of the Country Protection Fund may ensure the achievement of the deficit target even if revenues fail to reach the appropriations, as its absorption is only possible if the deficit does not exceed 1 percent.

As a result of the declining deficit, fiscal policy accumulates countercyclical reserves. Similar to 2019, the fiscal policy may cause a contraction in demand in 2020 as a result of the low deficit, which on the whole will result in a countercyclical fiscal policy.

Assuming an unchanged exchange rate, according to the bill, the debt-to-GDP ratio is expected to decline considerably, by 3.1 percentage points in 2020, while according to our forecast a decrease of 2.6 percentage points can be expected under a more moderate economic growth. Calculating, as a rule, with an unchanged end-2018 exchange rate of EUR/HUF 321.51, the gross general government debt-to-GDP ratio according to the EDP methodology is forecasted to decline from 70.8 percent at the end of 2018 to around 68.1 percent in 2019, and then decrease further to 65.4 percent by the end of 2020. The debt rule of the Fundamental Law, which is in the focus of the Fiscal Council's decision, is expected to be safely satisfied.

In the macro path of the bill, **the economic growth projection (4 percent) significantly exceeds the projection prepared for the central bank's June Inflation Report (3.3 percent) and it is above the range of the market analysts' expectations**. The higher GDP dynamics compared to the MNB's forecast is mainly due to the different growth path of household consumption, which is primarily attributable to the income developments shaped by the dynamic expansion of real wages and the growth in employment. The budget's macro path forecasts greater wage bill growth for 2020 compared to the June Inflation Report, chiefly on account of the larger expansion in employment. **The inflation projection in the bill is lower than the MNB's forecast for this year and next year as well.** If the inflation exceeds the value expected in the bill, a supplemental pension increase will become necessary in November (the impact of this on the budget is already included in our forecast).

If the high investment, employment and consumption growth expected for 2020 are not realised, the feasibility of certain tax revenue appropriations may be jeopardised. The budget planned the labour and consumption tax revenues based on the fast-growing tax bases. The MNB's macroeconomic forecast for 2020 contains lower gross fixed capital formation by 1.8 percentage points, lower employment growth by 0.7 percentage points and lower consumption growth by 0.9 percentage points, and thus lower tax revenues.

The bill that was submitted contains various tax measures, which, inter alia, serve the further reduction of taxes on labour as well as the stimulation of corporate investment and household savings. Depending on real earnings, during 2020 the social contribution tax rate may decline by a further 2 percentage points, following its fall this year, in line with the 6-year wage agreement. The VAT on accommodation services will decrease from the current 18 percent to 5 percent, which will partly be offset by the extension of the tourism development contribution to the aforementioned group of services. The simplified entrepreneurial tax will be terminated, the rate of the advertising tax will decline to zero, while the rate of the small business tax will decrease from 13 percent to 12 percent from the beginning of 2020. In addition to these tax measures, pursuant to the Economy Protection Action Plan, which contains 13+1 measures, it will also be possible to apply for a VAT refund of up to HUF 5 million for residential properties in rural CSOK settlements for construction as well as expansion and renovation. The lower limit of investments that can be supported by development tax allowances will gradually be reduced from HUF 500 million to HUF 50 million for small enterprises and to HUF 100 million for medium-sized companies by 2022. In addition, the bill takes into account the interest tax exemption of government securities as well as the complete personal income tax exemption of women raising at least 4 children.

In 2020, the reduction of the budget deficit as compared to 2019 will primarily be implemented by cutting expenditures. The deficit reduction will mainly be supported by a decline in government investment, which rose to a very high level in 2018–2019, as well as a decline in personnel expenditures and financial transfers relative to GDP. In addition, tax revenues as a percentage of GDP will only decline slightly. This is because the impact of the announced tax cuts will be offset by a rise in tax revenues due to significant increases in wages and consumption.

The budget bill complies with the debt rule outlined in the Fundamental Law, as the expected decline in the debt-to-GDP ratio is well above the prescribed rate of 0.1 percentage point. The bill also satisfies the European Union's requirement concerning the change in government debt, which at present requires the annual reduction of the debt ratio to be at 0.5−0.6 percentage points on average. The anticipated change in the accrual-based balance is in line with the relevant rules of the EU and Hungary.

The 1.1-percent structural deficit in the bill does not fulfil the medium-term budgetary objective yet, however, the rapid contraction of the deficit may satisfy the relevant European Union rules. The medium-term objective (MTO) framework stipulates that all Member States should reach the structural balance determined jointly with the European Commission, or approximate it to a sufficient degree. This year, Hungary's 2020 MTO was set at -1.0 percent of GDP. According to the bill, the 2020 structural balance will be 1.1 percent of GDP, which is a major shift from the -1.9 percent expected for 2019 in this year's Convergence Programme, but it does not fulfil the medium-term objective yet. The European Union's fiscal rules require a 0.75-percentage point decrease in the structural deficit for 2020, which may be fulfilled by achieving the 1.0-percent ESA deficit, although the exact extent of the change in the structural balance is surrounded by large computational uncertainties

2 General government balance

The bill sets the ESA deficit of the general government at 1.0 percent of GDP for 2020, representing a 0.8 percentage point decrease compared to the 2019 appropriation of 1.8 percent. According to our forecast, the cash-based deficit of the central budget may be higher than the appropriation, while the balance of the local governments and the ESA bridge containing the statistical corrections may be the same as in the bill (Table 1).

Table 1
ESA balance of the general government sector in 2020
(as a percentage of GDP)

	2020		
	Statutory appropriation	MNB forecast	Difference
1. Balance of the central subsector	–0.7	–1.1	–0.4
2. Balance of local governments	–0.1	–0.1	0.0
3. Cash flow balance of central-subsector and local governments (1+2)	**–0.8**	**–1.2**	**–0.4**
4. GFS-ESA difference	–0.2	–0.2	0.0
5. ESA balance of the general government sector (3+4)	**–1.0**	**–1.4**	**–0.4**
6. ESA balance with cancellation of the Country Protection Fund	**–0.2**	**–0.6**	**–0.4**

Note: Amounts and differences may differ due to rounding.

According to our forecast, the deficit target stipulated in the bill can be achieved with the partial preservation of the reserves. Our projection suggests that the tax and contribution revenues of the budget may fall short of the appropriations specified in the bill by 0.5 per cent of GDP. The difference is mostly attributable to the lower revenue expected from income and consumption taxes, which is primarily explained by the different macro paths. The budget bill forecasts a 4.0 per cent GDP growth for 2020, contrary to the MNB's expectation of 3.3 per cent, included in the June Inflation Report. The tax bases are heavily influenced by the fact that the bill expects higher consumption growth by approximately 0.9 percentage points, higher employment growth by 0.7 percentage points and higher gross fixed capital formation by 1.8 percentage points for 2020 than the MNB's projection. Furthermore, the surplus revenues expected in the bill from the reduction of the shadow economy may require additional measures. Nevertheless, the revenues falling short of the appropriations are partly offset by the fact that according to our forecast, the EU expenditure co-financing and the expenditure related to the prenatal baby support may be lower than foreseen in the budget bill (Table 2).

The ESA bridge containing statistical corrections reduces the ESA balance by 0.2 per cent of GDP according to the budget bill. Our forecast estimates a similar correction, albeit with a slightly different structure. In the case of the statistical corrections related to EU funds, a smaller deficit-increasing effect is expected by us than the by the government. The difference is attributable to the varying schedule of the utilisation and absorption of EU funds, however, our corrections used for the companies classified into the government sector and financial transactions point towards a higher deficit than the ESA bridge accounting prepared for the bill.

Table 2
Difference between the MNB forecast and the budget bill
(on ESA basis, as a percentage of GDP)

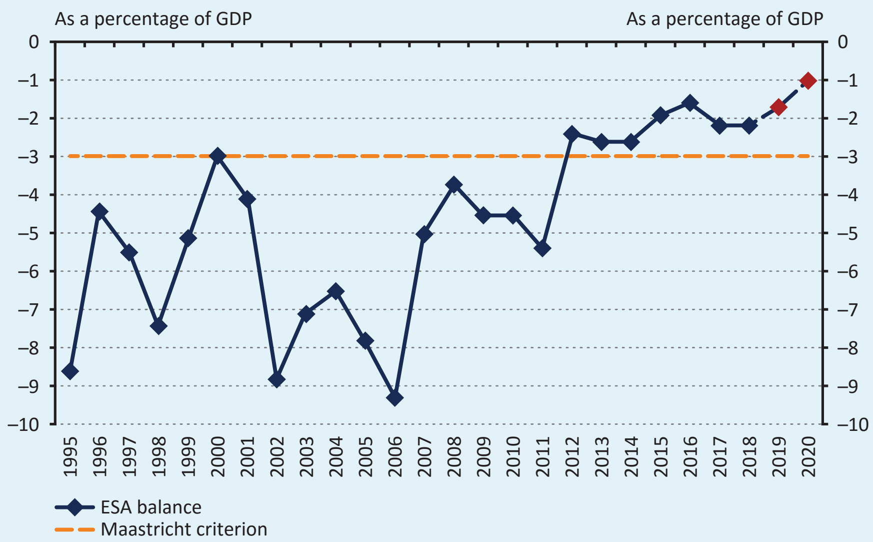
	Deviation from appropriation
I. Central government revenues	**–0.5**
Payments by economic organisations	–0.1
Consumption taxes	–0.3
Taxes on labour	–0.1
II. Central government expenditures	**0.1**
Pension expenditures	–0.1
Prenatal baby support	0.1
EU funds co-financing	0.1
III. Other effects	**0.1 – 0.8**
Cancellation of the Country Protection Fund	0.0 – 0.8
Other	0.1
Total (I+II+III)	**(–0.4) – 0.4**

Note: The positive and negative signs indicate deficit-reducing and deficit-increasing effects, respectively, compared to the appropriations. Amounts and differences may differ due to rounding.

In 2020, the budget deficit may decline to historic lows. According to the data available since 1995, the accrual-based budget deficit may be the lowest in 2020 if the 1 per cent deficit target is met (Chart 1). Similar to 2019, the fiscal policy may cause a contraction in demand in 2020 as a result of the low deficit, which on the whole will result in a countercyclical fiscal policy.

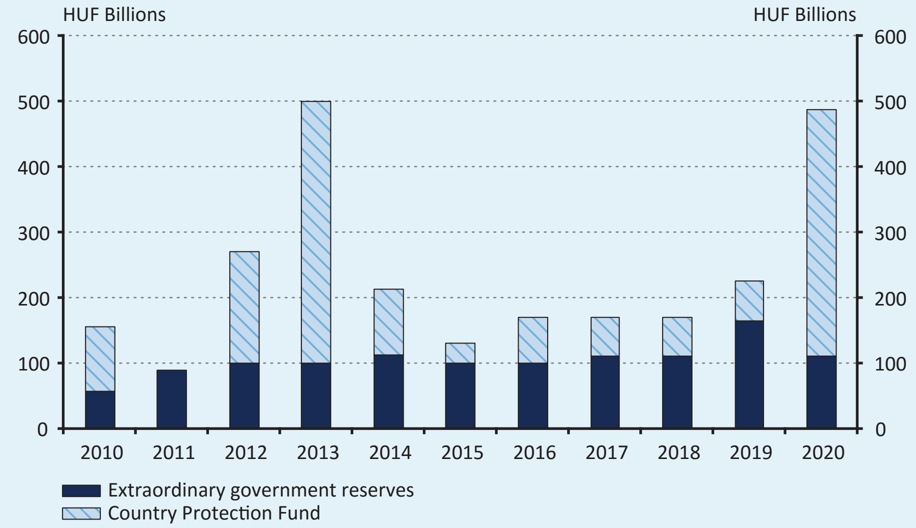
According to the bill, the amount of fiscal reserves will be 1 per cent of GDP in 2020, i.e. higher than in the past years. The Country Protection Fund and the extraordinary government reserves will amount to HUF 378 billion and HUF 110 billion, respectively, in 2020. Accordingly, their combined amount will increase to HUF 488 billion, i.e. some HUF 260 billion higher than these reserves' amount of HUF 225 billion in 2019. The large size of the Country Protection Fund plays a significant part in the feasibility of the deficit target because it may be spent only if the deficit does not exceed 1 per cent (Chart 2).

Chart 1
Budget balance in 1995–2020



Note: The 2019 and 2020 point estimates assumes the cancellation or utilisation of the Country Protection Fund depending on the feasibility of the government's deficit target. This is because the Country Protection Fund may be spent only if the deficit does not exceed the designated deficit target. The point estimate assumes the utilisation of the Country Protection Fund in 2019 and its partial saving in 2020.
Source: Eurostat and MNB forecast for 2019–2020.

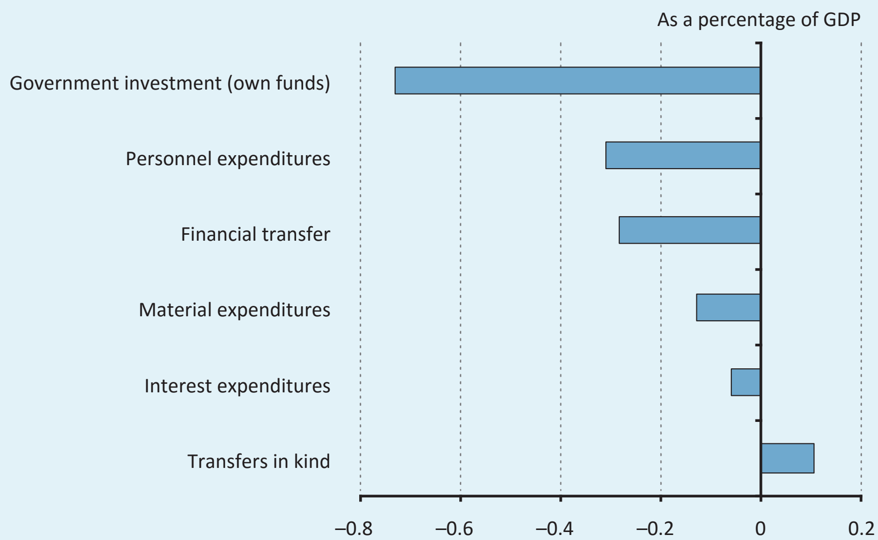
Chart 2
Fiscal reserves (extraordinary government reserves and the Country Protection Fund) between 2010 and 2020



Source: 2010–2019 Budget Acts and 2020 budget bill.

In 2020, the reduction of the budget deficit as compared to 2019 will primarily be implemented by cutting expenditures. The deficit reduction will mainly be supported by government investment, which rose to a very high level in 2018–2019, as well as a decline in staff expenditures and financial transfers as a proportion of GDP (Chart 3). In addition, tax revenues as a percentage of GDP will only decline slightly. This is because the impact of the announced tax cuts will be offset by a rise in tax revenues due to significant increases in wages and consumption.

Chart 3
Changes in expenditures relative to GDP between 2019 and 2020
(by the expenditure categories in the national accounts)



Source: MNB, 2020 budget bill.

3 Expected developments in government debt

Calculating, as a rule, with unchanged end-2018 exchange rate of EUR/HUF 321.51, the **gross general government debt-to-GDP ratio according to the EDP methodology** is forecast to decline from 70.8 percent at the end of 2018 to 68.1 percent in 2019, and then decrease further to 65.4 per cent by the end of 2020 (Table 3). The substantial contraction in the debt ratio is supported by the low budget deficit and dynamic economic growth.

Table 3
Government debt calculated using the EDP methodology

	HUF billions	as a percentage of GDP
1. End-2019 EDP government debt	31 150	68.1
2. 2020 cash-based deficit of the central budget	547	1.1
3. Other effects	277	0.6
4. 2020 expected EDP government debt (1+2+3)	31 974	65.4
5. Change in public debt-to-GDP ratio in 2020 (4-1)		**–2.6**

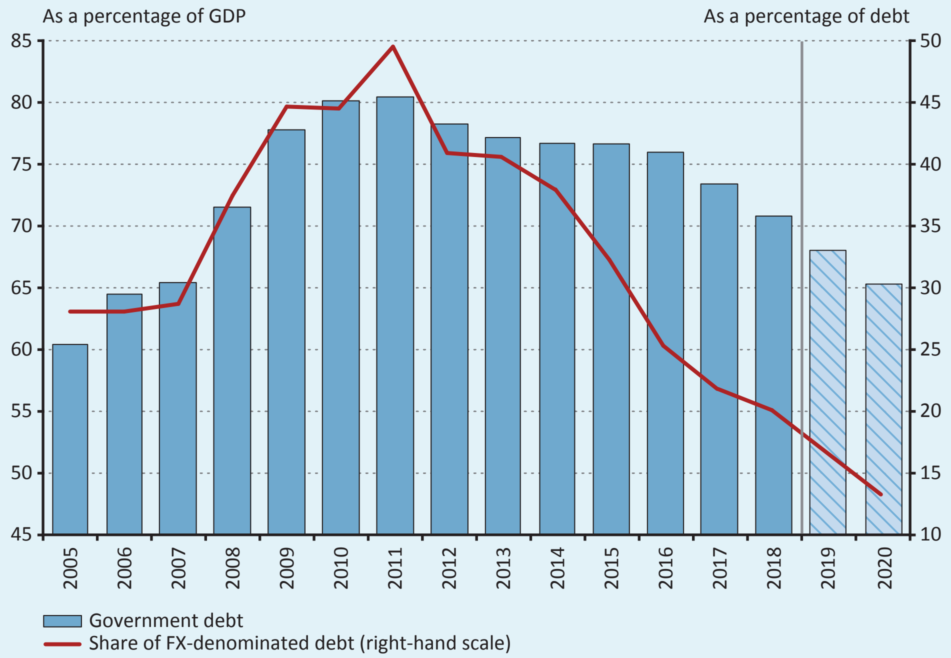
Note: The sum of the items may differ from the aggregate values because of rounding.
Source: MNB forecast.

In addition to the cash-based deficit of the central sub-sector the absorption of the EU advances that were received earlier by local governments and state-owned enterprises and held on their accounts with the State Treasury represents a surplus financing need.[1] Due to the 2017 and 2018 government measures, the advances related to EU funding were transferred or paid to the payment accounts of the economic actors belonging to the sub-sectors of the general government held with the Hungarian State Treasury. This considerably boosted the balances of local governments and state-owned enterprises held at the State Treasury, and at the same time reduced the financing need arising from the advance payments of EU funds. Looking forward, the absorption of these advances will present a surplus financing need in addition to the cash-based deficit. Of course, the reimbursement of the utilised transfers from the EU's structural funds covers this financing need. Therefore, within the year, the overall financing impact of the utilisation of the EU advances held on the accounts with the State Treasury (taking into account the cash-based deficit and other effects) does not exceed the national co-financing.

As a result of negative net FX issuance, the foreign currency ratio of government debt is expected to continue to decline dynamically, contributing to a decrease in the external vulnerability of the economy. The foreign currency ratio of the central debt fell from 50 percent at the end of 2011 to around 20 percent by the end of 2018, and according to our forecast it will shrink to 14 percent by the end of 2020. In parallel with the major decline in foreign currency debt, the government debt's exchange rate sensitivity and the share of external debt will also diminish substantially.

[1] For more on this topic, see Subchapter 7.3 Financing impact of the pre-financing of EU transfers.

Chart 4
Government debt forecast – calculated with an unchanged (end-2018) exchange rate over the forecast horizon



Source: MNB, Government Debt Management Agency.

4 Evaluation of the macroeconomic assumptions underlying the bill

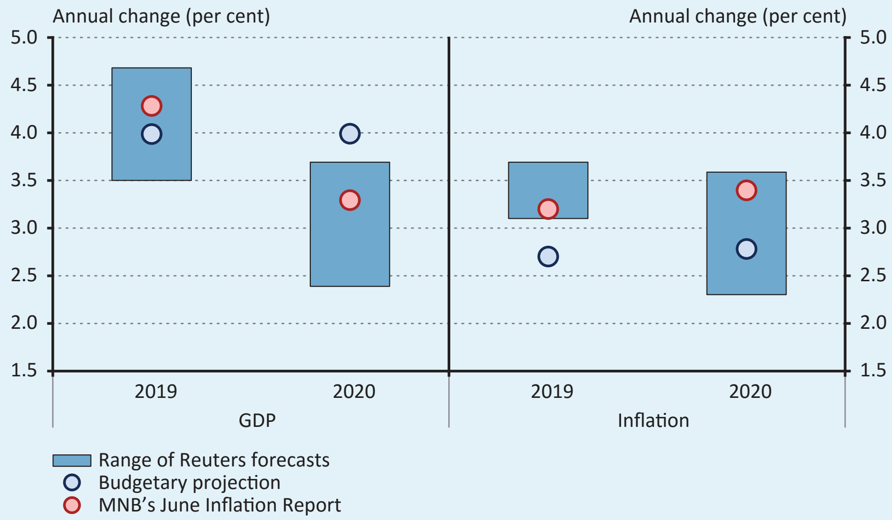
The 2020 budget bill forecasts economic growth of 4 per cent for the years ahead. This year's growth forecast slightly falls short of the projection in the MNB's June Inflation Report, whereas the **2020 GDP growth is significantly higher** than the median of the expectations by the MNB and market analysts (Chart 5).

The difference from the MNB's forecast as regards GDP growth is mainly due to **household consumption and gross fixed capital formation**. This year's higher consumption as compared to the macro path of the budget is explained by the income developments consisting of the **dynamic expansion of real wages and rising employment**. However, partly due to the different distribution over years, the MNB's forecast expects lower consumption growth by 0.9 percentage points. The macro path of the bill **forecasts lower gross fixed capital formation** for 2019 and higher for next year **as compared to the MNB's projection.** Investments considerably support GDP growth over the whole horizon, which is helped by the investment activity of the corporate sector and households as well as government projects. The budget's macro path assumes a slower growth rate both in exports and imports than the projection in the Inflation Report. The MNB expects export growth to be slightly higher than foreseen in the budget in 2019 and considerably more so in 2020. **According to the forecasts, net exports may have a negative contribution to GDP growth in 2019.**

The macro path of the budget bill projects lower employment and wage growth for this year than the June Inflation Report. For 2020, the bill expects a significant increase in employment. The bill foresees a continued expansion in the headcount of the private sector, while according to the MNB's assumptions, employment growth in the next year will experience a slowdown due to supply-side constraints. The wage forecast of the budget bill projects a slightly lower value for 2019 than the MNB's June expectations, while the two are approximately the same for 2020. The central bank anticipates more dynamic wage developments in the private sector in the years ahead.

The inflation projection in the bill is lower than the MNB's forecast for this year and the next. The GDP deflator growth included in the budget bill corresponds with the central bank's expectations.

Chart 5
Comparison of GDP and inflation forecasts



Source: 2020 budget bill, Inflation Report (June 2019), Reuters (May 2019).

Table 4
Comparison of the macroeconomic forecasts
(percentage change compared to the previous year)

	2018	2019			2020		
	Actual	**Budget**	**MNB**	**Differ-ence**	**Budget**	**MNB**	**Differ-ence**
GDP	**4.9**	**4**	**4.3**	**0.3**	**4**	**3.3**	**–0.7**
Consumption expenditure of households	5.3	4.8	5.1	0.3	4.8	3.9	–0.9
Public consumption	–2.1	1.6	0.6	–1	1.7	1.3	–0.4
Gross fixed capital formation	16.5	10.3	14.9	4.6	3.8	2	–1.8
Exports	4.7	5.1	5.4	0.3	5.2	6.2	1
Imports	7.1	6.5	6.5	0	5.4	5.7	0.3
GDP deflator	4.5	3.8	3.8	0	3.2	3.3	0.1
Inflation	**2.8**	**2.7**	**3.2**	**0.5**	**2.8**	**3.4**	**0.6**
Gross wage bill	**12.5**	**10.6**	**12.1**	**1.4**	**9.6**	**9.3**	**–0.3**
Gross average earnings	11.3	9.4	10.5	1.1	8.3	8.5	0.2
of which: private sector	10.9	9.8	10.9	1.1	8.9	9.6	0.7
Number of employees	1.1	1.1	1.4	0.2	1.3	0.6	–0.7
of which: private sector*	1.3 (2.0)	1.7	1.7 (1.1)	–0.6	1.6	0.7 (0.4)	–1.2

*Note: * The budget bill defines the private sector differently; due to this, the headcount projection comparable with the budget's macro path is shown in brackets, and the difference is also calculated from that.*

Source: 2020 budget bill, Inflation Report (June 2019).

5 Detailed evaluation of the budget bill

5.1 PRIMARY REVENUES

According to our forecast, the **primary revenues of the central subsector of the budget** may be lower than the appropriations in the bill for 2020 by HUF 319 billion in total (Table 5). Within this, the tax and contribution revenues may fall short of the appropriations by HUF 257 billion or 0.5 per cent of GDP, a major part of which will be reflected in labour and consumption taxes, caused primarily by the bill's projection related to higher consumption and the rise in the wage bill. Furthermore, the surplus revenues expected in the bill from the reduction of the shadow economy may require additional measures. Moreover, according to our forecast, the cash-based revenues related to EU funds may come in lower than the appropriation in the bill.

Our forecast with regard to the **payments by economic organisations** falls short of the appropriation by HUF 30 billion. The appropriations expect **corporate tax** revenues to be HUF 29 billion higher than in our forecast, which may be attributable to the different assumptions related to cash-based outgoing transfers in the context of the greater economic growth foreseen by the bill. The tax package submitted in parallel with the 2020 budget stipulated that the year-end tax advance top up requirement be eliminated, however, since this measure is introduced this year, its impact on the 2020 revenues is negligible, it only modifies the intra-year development of revenues. In case of revenues from the **income tax on energy providers**, the appropriation is HUF 19 billion higher than the MNB's forecast. Here, the difference may be attributable to the varying projections on payments made by taxpayers. In case of the **special tax on financial institutions**, our forecast is lower than the appropriation by HUF 5 billion. With this tax type, the difference is in the extent of the tax allowances used.

In the case of the **lump sum tax of small entrepreneurs (KATA)**, our projection falls short of the appropriation by HUF 6 billion. The difference is explained by the fact that the bill estimates higher growth in the number of taxpayers for 2020 than the MNB's assumption. With respect to **small business tax (KIVA)** revenues, the appropriation is HUF 11 billion higher than our forecast, also due to the different assumptions regarding the growth in the number of taxpayers. The tax package reduces the rate of this tax type by 1 percentage point from 1 January 2020, which may be completely offset by the effect of the growing number of taxpayers. In the case of the **e-road toll**, the bill foresees HUF 8 billion higher revenues than the MNB, as a result of more favourable economic conditions. Revenues from **mining royalties** may be higher than the appropriation by HUF 10 billion, while among the items within the other centralised revenues, penalty revenues may come in higher by HUF 22 billion, and the **environmental product levies** may exceeds the appropriation by HUF 10 billion. In all four cases, the difference may be due to the base effect, because the revenues from these items expected by us are considerably higher than the 2019 appropriation. The **simplified entrepreneurial tax (EVA)** will be phased out, while the **advertising tax** rate is expected to be 0 per cent from 2020, therefore the revenues of the State Treasury from these items may be lower by HUF 44 billion and 15 billion, respectively, as compared to 2019.

On a cash basis, the bill expects revenues of HUF 4,968 billion from **value added tax,** which exceeds our projection by HUF 186 billion. Part of the difference is explained by the dissimilarities in macroeconomic forecasts. Within this, the most important factor from the perspective of the tax type is that according to our projection, household consumption expenditure will increase by 3.9 per cent in 2020, whereas the bill expects a 4.8-per cent rise and assumes more dynamic growth than the central bank in the case of public consumption and gross fixed capital formation as well. In addition to the above, the difference between the two forecasts is also influenced by the fact that the bill probably anticipates additional surplus tax revenues from the developments related to the reduction of the shadow economy, which may require further measures. Our forecast has taken into account that the VAT rate on commercial accommodation services will drop from the current 18 per cent to 5 per cent next year, which is estimated to result in HUF 35 billion lower revenues.

The 2020 appropriation for the **excise duty** revenues is HUF 1,226 billion, which is HUF 30 billion lower than our forecast. The difference is the result of opposing effects: the bill expects lower excise duty revenues from tobacco and other sources (alcoholic beverages, spirits), whereas it foresees higher excise duty revenues from fuel. The excise duty on tobacco will increase in January and July 2020, which is forecast to raise revenues by HUF 25 billion as compared to 2019.

Next year's appropriation for the **financial transaction levy** (FTL) amounts to HUF 226 billion, just like in our forecast. The newly introduced measures include the elimination of the levy for the State Treasury transactions, and the levy on the transactions conducted through the Post will also decline, reducing revenues by HUF 11 billion. The elimination of the FTL for State Treasury transactions is budget-neutral, since it is recognised as an expenditure cut at the State Treasury.

Next year's appropriation for **duties and levies** amounts to HUF 229 billion in the bill, which is in line with our forecast. Compared to this year's statutory appropriation, which is expected to be exceeded by far, duty and levy revenues may grow by 20 per cent, and they may increase by 4 per cent as compared to this year's forecast. With respect to their composition, duties and levies are heavily influenced by the amount of levy payments on properties, which was 31 per cent higher in the first five months of this year than in the same period of the previous year.

The budget bill's appropriation for **personal income tax** includes revenues of HUF 2,609 billion, which is more than 10 per cent higher than the 2019 budgetary appropriation. Our forecast expects revenues to be lower by HUF 54 billion, which is probably due to the slightly different wage bill growth assumptions. The difference arising from the varying gross wage bill and earnings growth is mitigated by the fact that the personal income tax allowances may be somewhat lower in our forecast than the values in the bill's annex. The budget bill contains the lifetime tax exemption of mothers raising at least four children as part of the Family Protection Action Plan as well as the interest tax exemption of government securities issued from June this year. Our projection for the budgetary impact of the tax allowance for mothers with four or more children is approximately the same as the HUF 22 billion in the bill, while we estimate that the interest tax exemption of retail government securities may cause a revenue shortfall of HUF 6 billion.

The combined appropriation for **tax and contribution revenues from social insurance and extra-budgetary funds** for 2020 is HUF 5,967 billion, which is practically the same as our forecast. The social contribution tax rate is expected to decline as set forth in the budget bill, however, the bill does not include the timing of this in 2020. Our forecast included the tax cut related to the wage agreement in the last, fourth quarter of next year, therefore after this half year, the social contribution tax rate may drop by another 2 percentage points to 15.5 per cent. Our projection for the taxes and contributions on labour is roughly the same as the appropriation, however, there is some difference in their structure as regards the employers' taxes and employee contributions. This difference may be attributable to the somewhat divergent wage growth assumption, the fact that we expect this year's base to be lower than the appropriation and the differing perception on the effect of the employers' tax cut this year and the next. Most of the tax revenue appropriations for social security funds are in line with our forecast, the only major difference is in the case of the public health product tax, where the appropriation is HUF 20 billion higher than our expectation.

Table 5
Revenues of the central subsector – comparison of the forecasts
(HUF billion)

	2019			2020		
	Statutory appropriation	MNB forecast	Difference	Statutory appropriation	MNB forecast	Difference
TAX AND CONTRIBUTION REVENUES OF THE CENTRAL SUBSECTOR	**15 651**	**15 970**	**319**	**17 191**	**16 934**	**-257**
Payments by economic organisations	**1 444**	**1 440**	**-4**	**1 690**	**1 660**	**-30**
Corporate income tax	400	296	-103	501	472	-29
Special tax of financial institutions	53	55	2	65	60	-5
Simplified entrepreneurial tax	45	44	-1	0	0	0
Mining royalty	36	48	12	38	48	10
Gambling tax	31	32	1	36	36	0
Income tax on energy providers	59	30	-29	74	55	-19
Lump sum tax of small entrepreneurs	136	161	25	193	187	-6
Small business tax	50	64	14	88	77	-11
E-road toll	198	218	21	235	227	-8
Utility tax	55	55	0	54	55	1
Other taxes and payments	366	420	54	406	443	37
Advertising tax	15	15	0	1	0	0
Consumption taxes	**5 822**	**6 191**	**369**	**6 635**	**6 484**	**-151**
Value added tax	4 290	4 546	256	4 968	4 782	-186
Excise duties	1 141	1 204	63	1 226	1 256	30
Registration tax	28	27	-1	27	27	0
Telecommunication tax	52	57	4	54	57	3
Financial transaction levy	228	246	18	226	225	-2
Insurance tax	67	88	20	98	103	5
Tourism development contribution	16	24	9	36	35	-1
Payments by households	**2 608**	**2 658**	**50**	**2 899**	**2 844**	**-55**
Personal income tax	2 361	2 380	19	2 609	2 555	-54
Duties and levies	199	229	30	238	238	0
Motor vehicle tax	48	50	2	52	51	-1
Tax and contribution revenues of extra-budgetary funds	**468**	**481**	**13**	**451**	**454**	**3**
Tax and contribution revenues of social security funds	**5 310**	**5 200**	**-110**	**5 516**	**5 492**	**-24**
Social contribution tax and contributions	5 124	5 006	-118	5 344	5 340	-4
Other contributions and taxes	186	194	8	172	153	-20
REVENUES RELATED TO EU FUNDS	**1 494**	**1 162**	**-332**	**1 513**	**1 448**	**-65**
OTHER REVENUES	**304**	**345**	**41**	**350**	**353**	**3**
Other revenues of the central budget	**180**	**210**	**30**	**217**	**220**	**3**
Other revenues of social security funds	**34**	**31**	**-3**	**33**	**32**	**-1**
Other revenues of extra-budgetary funds	**90**	**104**	**14**	**99**	**101**	**2**
TOTAL REVENUES	**17 449**	**17 477**	**28**	**19 054**	**18 735**	**-319**

Note: Partly consolidated data.

The bill plans the **cash-based revenues related to EU subsidies** to be HUF 1,513 billion (out of which HUF 1,482 billion is foreseen to come from EU programme revenues, which is HUF 130 billion higher than the 2019 appropriation, while Other EU revenues amount to HUF 17 billion, and the Other revenues for the EU chapter-administered appropriations amount to HUF 14 billion). The bill does not detail its expectations regarding the structure of payments and the anticipated utilisation of the advances, which form the basis of the expected cash-based revenues. According to our projection, the sum of the invoice payments and the use of the advances, in other words, the effective utilisation may be around HUF 1,800 billion in 2020. Thus if the corresponding incoming invoices are submitted in the year concerned and nothing hindering absorption arises, revenues may come in around HUF 1,450 billion according to our calculations, falling short of the appropriation by HUF 65 billion.

5.2 PRIMARY EXPENDITURES

The appropriation for **housing subsidies** is HUF 55 billion higher than in the 2019 budget bill. The considerable growth is primarily due to the expenditure related to the Family Protection Action Plan and the Hungarian Village Programme adopted during the year (measures of the rural CSOK and the extension of the loan with interest subsidy). Compared to the appropriation, in 2020 housing subsidy expenditures are expected to bring in roughly similar savings as in previous years (HUF 20 billion). The cost of the subsidies extended for the construction and purchase of new and used homes as well as the interest subsidy provided for the related preferential loan will also increase. Due to the elimination of the preferential housing VAT rate outside the preferred small settlements, the expenditure on tax rebates declines, and building savings fund expenditures will also diminish on account of the lack of new members and the termination of the existing contracts.

Among the key items of the **National Family and Social Policy Fund**, out of the **family benefits**, the 2020 appropriation for family allowance is consistent with our projection, expected to be around HUF 305 billion. Similar to the income substitute and supplementary social benefits and reimbursements given for various reasons, the appropriations for the other items of the family allowances are also considered well-established. The fact that the appropriation is HUF 25 billion higher than in earlier years is mainly linked to the larger appropriation for the performance of social tasks in the country districts. Among other things, the increased home care allowance is recognised here.

With respect to the expenditures of the **extrabudgetary funds**, our forecast related to the passive expenditures of the **National Employment Fund** is almost identical to the appropriation, while in the case of active expenditures we forecast slightly lower numbers than the appropriation. In the case of the Start labour scheme, the developments from the previous year are expected to persist in 2020, i.e. the average number of the workers employed in the scheme will continue to fall. This is influenced by the fact that labour market tightness will not slacken next year, and the government continues to encourage the scheme's participants to find work in the private sector.

The **net own expenditure of the central budgetary institutions and chapters** is foreseen in the budget bill to be HUF 6,027 billion. Our forecasts estimates HUF 140 billion higher net expenditure than the appropriation, mainly because we expect the HUF 160 billion from the provisions to be used as institutions' wage appropriation. We forecast to see the uncapped appropriations for language camps and the car purchases of large families under the Family Protection Action Plan to be exceeded by HUF 23 billion, on account of the higher expected utilisation. Compared to the government's plans, the advance revenues related to EU programmes received in the year concerned by institutional- and professional-administered appropriations and the utilisation of the advances received earlier in the year concerned may reduce the net cash-based expenditure of these bodies by net HUF 67 billion, in line with our projection for EU programme expenditures. In 2020, we expect the budgetary institutions to utilise HUF 230 billion from the EU advances received in earlier years. The combined impact of the above-mentioned items results in HUF 140 billion higher net cash-based expenditure than the bill's appropriation, however, the reserve appropriations in our analysis are HUF 160 billion lower than in the bill. Therefore in the cash accounting, the net own expenditure of budgetary institutions is estimated to be HUF 20 billion lower than in the bill, taking into account the utilisation of the wage provision.

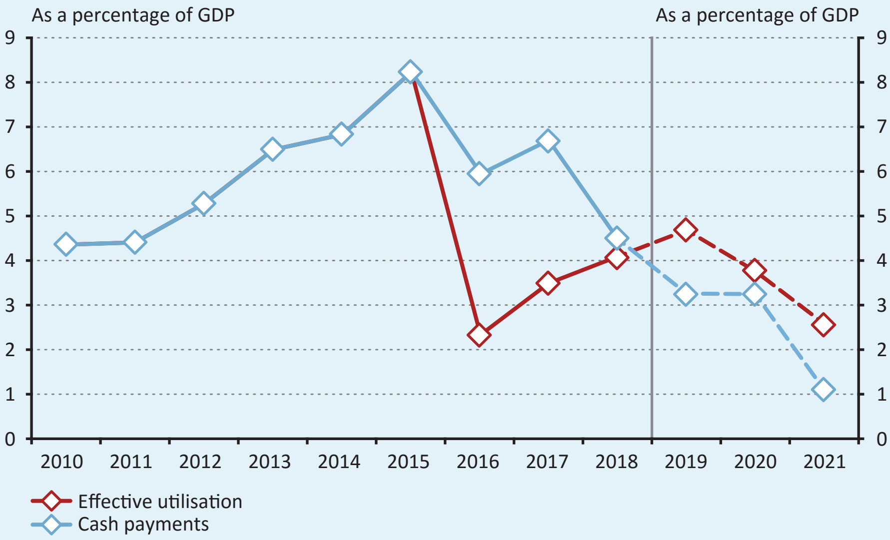
Table 6
Expenditures of the central subsector – comparison of the forecasts
(HUF billion)

	2019			2020		
	Statutory appropriation	MNB forecast	Difference	Statutory appropriation	MNB forecast	Difference
PRIMARY EXPENDITURE ITEMS	**17,511**	**17,530**	**19**	**18,375**	**18 241**	**–134**
Special and normative subsidies and support to the public media	**448**	**448**	**0**	**487**	**487**	**0**
Social policy fare subsidy	**91**	**90**	**0**	**91**	**91**	**0**
Housing grants	**242**	**257**	**15**	**297**	**278**	**–19**
Family allowances, social benefits	**551**	**551**	**0**	**575**	**575**	**0**
Early retirement benefits	**89**	**90**	**1**	**86**	**90**	**4**
Net expenditures of central budgetary institutions and chapters	**7,816**	**7,843**	**27**	**7,722**	**7,753**	**31**
Net own expenditures	5,861	6,353	492	6,027	6,168	140
Expenditures related to EU transfers	1,956	1,490	–466	1,694	1,585	–109
Support to local governments	**729**	**737**	**8**	**736**	**736**	**0**
Contribution to the EU budget	**352**	**322**	**–30**	**398**	**386**	**–12**
Central reserves	**381**	**231**	**–150**	**663**	**503**	**–160**
Other expenditures	**469**	**516**	**47**	**596**	**593**	**–3**
Expenditures of extra-budgetary funds	**531**	**508**	**–23**	**549**	**541**	**–8**
NEF – Passive expenditure	75	70	–5	83	83	0
NEF – Active allowances	180	144	–36	140	132	–8
Other expenditures	276	294	18	326	326	0
Expenditures of social security funds	**5,812**	**5,937**	**125**	**6,178**	**6,210**	**32**
PIF – Pensions	3,445	3,518	73	3,580	3,624	44
HIF – Disability and rehabilitation benefits	287	283	–3	282	281	0
HIF – Cash benefits	394	402	8	447	440	–7
HIF – Medical and preventive care	1,274	1,318	44	1,429	1,429	0
HIF – Net expenditures of the drug budget	281	285	4	301	297	–4
Other expenditures	132	132	0	138	138	0
NET INTEREST EXPENDITURES	**952**	**945**	**–7**	**1,045**	**990**	**–56**
TOTAL EXPENDITURES	**18,463**	**18,474**	**12**	**19,421**	**19,231**	**–190**

Note: Partly consolidated data.

The 2020 Budget Act foresees the **expenditures of EU programmes** to amount to HUF 1,694 billion, which falls short of the 2019 appropriation by HUF 260 billion. The cash-based deficit reflects the amount of domestic co-financing and the advances paid outside the central subsystem as well as 10 per cent of the funding that is reimbursed by the European Commission only later, and thus it has to be pre-financed from the budget. As this 10 per cent may be accounted for as accrual-based revenue, it does not affect the ESA balance, but adds to the financing requirement and the government debt. Taking into account the expected large utilisation of advances and the revenue appropriation, considerable advance payments should be assumed, but their amount is not detailed in the bill. According to our forecast, EU programme expenditures may fall short of the appropriation, amounting to HUF 1,585 billion in 2020. In the first five months of 2019, payments were around HUF 600 billion and their expansion is not expected to considerably gather pace in 2020 after a slowdown in the past two years. Based on our estimate, about one-third of the total payments may be advances, therefore the estimated two-third share of invoiced payments is basically in line with our 2019 expectations. Effective

Chart 6
Developments in the effective utilisation related to EU funds and in cash payments



Source: MNB, Hungarian State Treasury, Ministry of Finance.

absorption is still forecast to peak in 2019, however, the drop between 2019 and 2020 may be somewhat smaller than previously expected (Chart 6).

Among the **central budget's reserves**, the wage provision was used to reduce reserve appropriations, and such expenditure items were reallocated in our forecast for expenditures appropriations where they will be absorbed during the year. The amount of free reserves is higher than in earlier years, both nominally and in GDP terms (1.0 per cent of GDP).

The appropriations related to the **prenatal baby support** include accrual-based expenditure amounting to HUF 150 billion for 2020. In contrast, our forecast assumes a HUF 39 billion lower accrual-based deficit effect for 2020. Our forecast shows that the 2020 ESA expenditure related to the prenatal baby support may add up to HUF 111 billion in total, representing 0.2 per cent of GDP. The difference between the budget bill and our forecast may be chiefly due to the fact that we estimate new loans and the corresponding accrual-based expenditure incurred due to the waiver of the principal to be lower for 2020.

When quantifying the budgetary effect of the prenatal baby support, not only cash-based expenditure needs to be taken into account but also that **the estimated amount of the waiver of the principal upon the birth of the second and third child should be recognised in the ESA deficit at the time of lending**. According to the rules of European Union statistics, if the future debt write-off is certain, its anticipated amount should be recognised in the accrual-based deficit upon the disbursement of the loan. Although in the case of the prenatal baby support the debt write-off occurs when the child is born, this has to be taken into account in the ESA statistics upon the disbursement of the loan in the form of an estimate. The anticipated waiver of principal is estimated to amount to 30 per cent of the outstanding loans. Accordingly, the budget bill includes a waiver of principal of HUF 126 billion, representing 30 per cent of the new loans estimated to be worth HUF 420 billion, recorded as methodological risk in the ESA corrections. Due to our lower lending estimate, our forecast anticipates a smaller amount of debt write-off for 2020, specifically HUF 93 billion.

The 2020 appropriation for **retirement provision** paid from the Pension Fund amounts to HUF 3,580 billion in total. Our estimate expects pension expenditure to be HUF 44 billion higher than the appropriation (Table 7). The divergence is explained by our higher expenditure projection for the base year and the difference of the macroeconomic paths.

In the case of retirement benefits, the difference in base year expenditure is attributable to the fact that the 2019 Budget Act contains total pension expenditure of HUF 3,445 billion for 2019, whereas our projections estimates HUF 73 billion more. This is caused by the different assessment of the underlying trends in 2019 as well as the dissimilarity of macroeconomic paths. The 2019 Budget Act was prepared with a 2.7-per cent consumer price index and 4.1-per cent real growth, however, the MNB's June Inflation Report includes a 3.2-per cent inflation and 4.3-per cent real GDP growth for 2019. Due to higher real growth, a higher pension premium is anticipated for 2019 than in the budget, and a supplementary pension increase is expected for November due to the consumer price index. The fact that the projected inflation for 2019 is higher than in the budget points towards larger pension expenditure in 2020, too, because we base our 2020 prognosis on higher 2019 retirement provisions.

The 2020 appropriation for the largest pension expenditure item, **old-age pensions over the retirement age**, amounts to HUF 2,888 billion, whereas our forecast includes HUF 68 billion higher expenditure. The divergence is explained by the different base year expenditure on the one hand, and the higher projected inflation for 2020 on the other hand.

- Similar to 2019, in 2020, the difference between the appropriation and our forecast is also influenced by the differing estimate of the inflation, which serves as the basis for the regular pension increase at the beginning of the year.

- In 2020, new old-age pensions will be determined only in the second half of the year, since those born in 1956 retire after reaching the age of 64.5.

Table 7
Comparison of the 2020 statutory appropriation related to old-age pensions disbursed from the Pension Fund and our projection
(HUF billion)

	Appropriation	MNB forecast	Difference
1. Old-age pensions over the retirement age	2 888	2 956	-68
2. Early retirement benefit for women	286	283	3
3. Retirement provision to relatives	**386**	**385**	**1**
4. Lump sum disbursements on an equitable basis	1	1	0
5. Provision for pension premium	20	0	20
5. Total pension expenditures (1.+2.+3.+4.+5.)	**3 580**	**3 624**	**-44**

In the case of the **pensions due to women after the 40-year eligibility period**, the statutory appropriation for 2020 amounts to HUF 286 billion. Our projection estimates slightly lower expenditure (by HUF 3 billion), which is probably principally due to the difference in the estimate of the number of beneficiaries. As regards the early retirement benefit of women, we continue to expect increasing utilisation, considering the fact that women increasingly complete the 40-year eligibility period necessary for retirement as the retirement age gradually rises.

The 2020 budget bill expects **pension premium** payments of HUF 20.4 billion in 2020, based on the GDP growth of 4 per cent included in the macroeconomic path. The MNB's macroeconomic forecast prepared for its June Inflation Report projects GDP growth of 3.5 per cent for 2020, and thus we do not include pension premium payments in our forecast for 2020 (the pension premium is paid if real growth exceeds 3.5 per cent).

In line with our forecast, the expenditure planned for **curative and preventive care** amounts to HUF 1,429 billion next year. The 2020 budget plans to allocate HUF 40 billion for the overhaul of the financing system and HUF 10 billion for enhancing primary care. This measure, which was introduced as part of the overhaul of the healthcare system, provides a way for the more accurate establishment of the actual costs of the treatments, thus hospitals are expected to be less indebted in 2020.

The 2020 budget allocates HUF 393 billion for **gross expenditure on pharmaceutical subsidies**, which is HUF 6 billion higher than our forecast prepared in line with the June Inflation Report. In earlier years, this expenditure item was underbudgeted, but no appropriation increase is expected for next year, assuming an unchanged level of service.

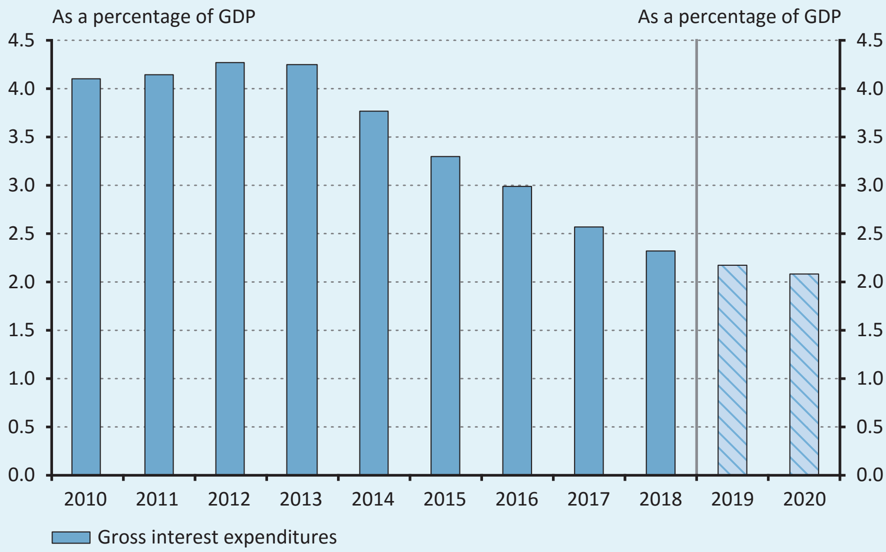
According to next year's appropriation, cash benefit expenditure will amount to HUF 149 billion in the case of sick pay and HUF 216 billion in the case of the childcare benefit. For sick pay, the appropriation is higher than our projection by HUF 3 billion, while for the childcare benefit, it is higher by HUF 5 billion. The difference may be due to the fact that the budget presumably estimates higher utilisation on account of the family protection measures.

5.3 INTEREST BALANCE

The net accrual-based interest expenditure may be consistent with the statutory appropriation according to our forecast, coming in at 2.1 per cent of GDP. The slight decline as compared to 2019 that occurs according to our forecast is caused by the fact that after the repricing of a substantial amount of the debt, only a smaller share of the government debt is being repriced to the current yields, which stagnate around historic lows with minor fluctuations.

The appropriation for the **net cash-based interest expenditure** exceeds our projection by roughly HUF 56 billion. Our forecast is higher than the appropriation both for the gross interest expenditures and interest revenues. The greater expenditure and revenues are attributable to the fact that our forecast takes into account the data from previous years, which also includes debt management operations. However, the appropriation does not include the interest effect of switch auctions, which increase interest revenues to a greater extent and expenditure to a lesser extent.

Chart 7
Interest expenditure
(as a percentage of GDP)



Note: Excluding the imputed interests arising due to the transformation of the pension scheme.
Source: Eurostat, MNB.

6 Legal compliance of the bill

6.1 THE DEBT RULE OF THE FUNDAMENTAL LAW

According to the budget bill and based on the MNB's projection, the gross public debt-to-GDP ratio defined in line with the Stability Act will decrease; accordingly the bill satisfies the debt rule requirement specified in the Fundamental Law. Based on the Fundamental Law, in 2020 the rate should decrease by 0.1 percentage point, which is safely met according to both forecasts (bill: -3.1 percentage points; MNB: -2.6 percentage points). The projected substantial decrease also means that the decrease in the debt prescribed by the Fundamental Law is guaranteed even if the external or internal economic developments turn out slightly less favourably than expected at present.

The MNB's nominal debt projection for the end of 2019 and 2020 is slightly lower than that stated in the bill. The lower initial level at the end of 2019 is offset by the fact that according to the MNB, in 2020 the cash-based balance of the central budget may be HUF 547 billion, i.e. higher than HUF 367 billion, the value indicated in the bill. The bill anticipates a slight growth in the debt of the local government sub-sector and the companies classified into the government sector, which is reflected in our forecast.

The forecasts for the change in the ratio in GDP terms differ mainly due to the different GDP projections. The 2020 bill includes GDP growth of 4 percent, while the MNB projects a rise of 3.3 percent. Both the bill and the MNB assume debt-increasing effects other than the cash-based deficit of the budget in 2020, mainly caused by the utilisation of the EU advances received earlier by local governments and state-owned enterprises and held on their accounts with the State Treasury.

Table 8
Development of public debt
(in HUF billion and as percentage of GDP)

	Bill	MNB	Bill	MNB
	HUF billion		As a percentage of GDP*	
1. Year 2019 initial government debt according to the Stability Act	31,187	30,965	68.6	67.7
2. 2020 cash-based deficit of the central budget	367	547	0.8	1.1
3. Other effects	420	277	0.9	0.6
4. Expected gross public debt according to the Stability Act in 2020 (1+2+3+4)	31,974	31,789	65.5	65.1
5. Change in public debt-to-GDP ratio in 2020 (4-1)			**–3.1**	**–2.6**

*Note: * The MNB and the bill calculate with different nominal GDP. The sum of the items may differ from the aggregate values because of rounding.*

The gross debt-to-GDP ratio of the general government according to the EDP methodology differs minimally from the above due to methodological differences. Calculating, as a rule, an unchanged end-2018 exchange rate of EUR/HUF 321.51, the debt ratio is forecast to decline from 70.8 percent at the end of 2018 to 68.1 percent in 2019, and then decrease further to 65.4 percent by the end of 2020.

6.2 THE 3-PERCENT DEFICIT RULE OF THE STABILITY ACT

The budget balance expected for 2020 satisfies the deficit rule of the Stability Act. Article 3/A (2) b) of Act CXCIV of 2011 on the Economic Stability of Hungary provides that the general government deficit shall not exceed 3 percent. According to the bill, the deficit will be 1 percent of GDP in 2020, which, according to the MNB's forecast, can be achieved through the partial preservation of the reserves, but even without that, the deficit would not be higher than 1.4 percent of GDP, i.e. the balance meets the deficit target set forth in the Stability Act.

6.3 DEBT INCREMENT PERMITTED ON THE BASIS OF THE DEBT FORMULA SPECIFIED IN THE STABILITY ACT

The bill complies with the debt formula specified in the Stability Act. The maximum degree of the nominal increase in the government debt is prescribed by Article 4(2) and (2a) of the Act on the Economic Stability of Hungary. The rule stipulates that if the forecast rates of inflation and real economic growth for the fiscal year both exceed 3 percent, the balance of the budget should be planned in such a manner that the annual growth rate of the nominal government debt must not exceed the rate of the difference between the planned inflation and half of the growth rate. If at least one of the two ratios is not higher than 3 percent, the debt rule prescribes a decrease in the debt ratio of 0.1 percentage point. According to the bill, although the 4-percent real growth in 2020 will be higher than the 3-percent threshold, the 2.8-percent inflation rate will be lower than that, **thus the debt formula prescribes a decrease of 0.1 percentage point, which is satisfied on the basis of the bill and the MNB's projection as well.** Based on the MNB's June forecast, annual inflation will exceed 3 percent in both 2019 and 2020, however, the projection in the Budget Act is the relevant from the perspective of the Stability Act's debt formula.

6.4 REQUIREMENT PERTAINING TO THE STRUCTURAL BALANCE OF THE GENERAL GOVERNMENT

The 1.1-percent structural deficit in the bill does not comply with the medium-term budgetary objective specified in Hungarian law. Article 3/A (2) a) of Act CXCIV of 2011 on the Economic Stability of Hungary provides that the balance of the government sector must be determined in a way that is in line with the achievement of the medium-term budgetary objective (MTO). The Hungarian MTO in 2020 represents a structural balance equalling -1 percent of GDP. The structural balance is the cyclically adjusted government balance net of one-off and other temporary items. The 2020 budget bill projects a structural balance of -1.1 percent to the accrual-based deficit of -1.0 percent of GDP, and thus it does not reach the medium-term budgetary objective, but the fiscal position may converge to it by a considerable degree in 2020.

6.5 RULES OF THE CORRECTIVE ARM OF THE STABILITY AND GROWTH PACT

The budget bill is expected to satisfy the requirements of the corrective arm of the EU fiscal framework. The corrective arm includes the 3-percent deficit target, which is also specified in the Hungarian legislation, and the requirements of the European Union's debt rule.

The criterion related to **the 3-percent deficit** prescribes that the accrual-based deficit of the Member States must not exceed 3 percent of GDP. The deficit target of 1 percent, included in the bill, complies with this rule.

The **EU debt rule** states that the Member States' gross, consolidated government debt ratio calculated at face value must not exceed 60 percent of GDP, and in case it does, the debt ratio must be diminishing at a satisfactory pace. The appropriate decrease in the debt is quantified by the one-twentieth rule, according to which the debt ratio should be reduced by around one-twentieth of the part that exceeds 60 percent on average over three years. Based on the bill, the GDP-proportionate government debt will decrease by 3.1 percentage points in 2020, while according to the latest 2019 spring forecast of the European Commission, the ratio will decline by 1.5 percentage points, which also satisfies the European Union's debt rule.

6.6 RULES OF THE PREVENTIVE ARM OF THE STABILITY AND GROWTH PACT

The 1.1-percent structural deficit in the bill does not fulfil the medium-term budgetary objective yet, however, the rapid moderation of the deficit may satisfy the relevant fiscal rules.

The framework related to the **medium-term objective** (MTO) prescribes that Member States should achieve the structural balance designated jointly with the European Commission, or not to deviate from the recommended adjustment path leading to the MTO. In 2019, Hungary's MTO for the coming years was set at -1.0 percent of GDP. According to the bill, the 2020 structural balance will be -1.1 percent of GDP, which is a substantial shift from the -1.9 percent foreseen for 2019 in this year's Convergence Programme. Although the 1.1-percent structural deficit does not meet the medium-term budgetary objective, as a matter of convention, the European Commission usually uses a 0.25-percentage point tolerance when assessing the MTO ex post, as the structural deficit is an unobservable variable and its estimation is surrounded by considerable uncertainty. Nevertheless, the European Commission cannot be expected to deem the level of the 2020 structural deficit appropriate, because its forecast for that in May was 2.7 percent of GDP, which cannot be expected to fall below 2 percent of GDP even with a lower-than-foreseen ESA deficit. The main reason behind the difference is that the Commission believes that the positive output gap and the corresponding extra revenues are higher than the estimate in the bill.

However, in the context of a 1.0-percent ESA deficit, the pace of the structural deficit moderation may allow Hungary to comply with the MTO criteria. With respect to the structural deficit, the European Union's fiscal rules prescribe an annual structural adjustment of 0.75-percentage point of GDP for 2020 in order to converge to the medium-term objective (in addition to this year's 1.0 percent adjustment), which may be satisfied with the achievement of the set ESA deficit, although considerable calculation uncertainties surround the exact extent of the change in the structural deficit.

Upon deviation from the MTO, the **expenditure benchmark**needs to be applied, the purpose of which is to ensure the convergence on the recommended adjustment path to the medium-term budgetary objective. According to the benchmark, compared to the previous year, the general government's net primary expenditures may increase by no more than the potential GDP growth rate, unless the increasing expenditures are offset by other, discretionary revenue measures. The rule will apply depending whether the level or change of the structural balance expected for 2020 is in line with the requirements for the medium-term budgetary objective. If the required 0.75-percentage point structural improvement is achieved (which corresponds to an annual 4.7 percent growth rate of net expenditures), both the expenditure rule and the MTO criterion may be satisfied.

7 Special topics

7.1 THE GOVERNMENT'S INTEREST SAVINGS IN INTERNATIONAL COMPARISON[2]

The major downward shift of the government yield curve after 2013 and the continued contraction of government debt since 2010 resulted in a major decline in interest expenses. In addition, the growing share of residents among debtors substantially altered the structure of interest expenses. The favourable developments not only reduced interest payments but also resulted in a shift in the distribution of the expenditures between the sectors, as a result of which the ratio of interest expenses paid to residents rose.

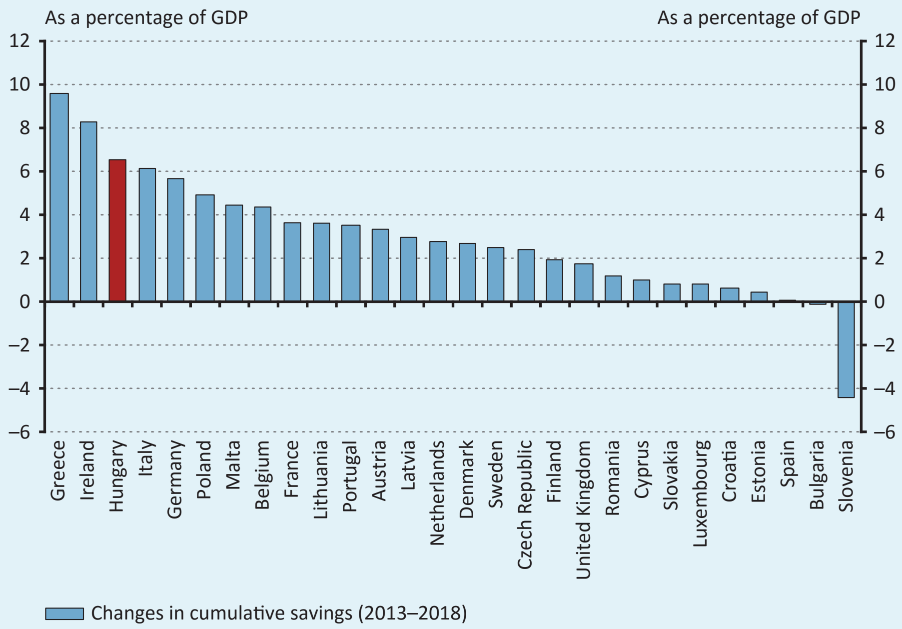
In Hungary, the government's interest expenses dropped from 4.3 per cent of GDP in 2012 to around 2.3 per cent in 2018, which meant annual interest savings of HUF 800 billion in 2018. As a result of the gradual repricing of the government debt to a low yield level, savings may continue to increase slightly in 2019 and 2020. This is because the drop in yields seen in the past years exerts its effect gradually, as the share of the new, low-interest elements grows during the refinancing of the government debt. The repricing will have run its full course when government debt is completely replaced in the low yield environment. Based on the maturity structure of Hungarian debt, one-third of the debt will be repriced within a year, half of it will be repriced in three years and around 90 per cent will be repriced in nine years.

The cumulative interest savings since 2013 amount to 6.5 per cent of GDP or HUF 2,400 billion (when using the GDP data from each year), making it the third highest relative to euro area countries (Chart 8). The reduction of the interest expenses started later than in euro area countries, because in the years following the eruption of the crisis, the Hungarian monetary policy was much tighter than the ECB's, but after that, owing to the monetary policy turnaround, there was a rapid and large expenditure cut. In Germany, the total expenditure reduction amounted to slightly less than in Hungary, 6 per cent, in this period.

Thanks to the swift contraction even by international standards, the Hungarian interest expenses, which exceeded the EU average by 1.3–1.9 percentage points in the mid-2000s, have declined to around the EU average. After 2013, the drop in interest payments was one of the most dynamic in Hungary across the whole EU. This helped reduce Hungarian expenditure to close to the EU average of 1.9 per cent, more specifically 2.3 per cent, in 2018, and it is expected to be around the EU average after the government debt is fully repriced to the current low yield levels.

[2] Based on the special article Gergely Kicsák: *The Interest saving of the Hungarian budget is considerable even according to the Bundesbank's methodology.* https://www.mnb.hu/letoltes/kicsak-gergely-a-bundesbank-modszertana-szerint-is-jelentos-mnb-honlapra.pdf

Chart 8
Cumulative interest savings between 2013 and 2018



Note: Calculated based on the change of the actual interest expenditure relative to GDP since 2012.
Source: Eurostat.

The major decline in the government's interest expenses after 2013 was caused by the large downward shift of Hungarian government securities yields. In line with its primary objective, the MNB introduced several monetary policy measures after 2013 that were also favourable for the budget on account of the reduction of the government's financing costs. In parallel with the cutting of the base rate, first short-term government securities yields then long-term ones contracted following the improvement of Hungary's risk perception. Short-term yields dropped by 660 basis points on average, while a 450–500-basis point decline was seen in the long-term segment of the yield curve. The Self-Financing Programme contributed to the yield reduction through strengthening the demand for government securities, as some of the interbank liquidity that was crowded out flowed to government papers.

The continued decrease in the government debt ratio since 2010 also helped reduce interest payments in GDP terms. The major decline in interest expenses and the drop in government debt are mutually reinforcing positive developments. The reduction in expenditure on account of the falling yields contributes to the diminishment of the debt ratio, which, in turn, has a positive effect on interest payments.

7.2 FISCAL IMPACTS OF THE FAMILY PROTECTION ACTION PLAN

The Family Protection Action Plan, announced in February 2019, provides substantial financial benefit for families: the fiscal impact of the measures may amount to 0.3 percent and 0.5 percent of GDP in 2019 and in 2020, respectively, which may rise to 0.6 percent of GDP in 2021. The most important measure of the Family Protection Action Plan is the introduction of the prenatal baby support, which may be applied for between July 2019 and end of 2022 by young couples planning to have children. In addition to the family support measures, the summer language camp for secondary school students may increase fiscal expenditures by 0.1 percent of GDP both in 2020 and 2021 (Table 9). The fiscal impacts of the announced measures may only be estimated as their exact extent largely depends on the number of participants.

Table 9:
Gross static fiscal impact of the Family Protection Action Plan announced in February
(HUF billion and as a percentage of GDP)

Name of measure	Measure effective	Estimated fiscal impact		
		2019	2020	2021
1. Prenatal baby support	July 2019–December 2022	81	111	125
2. Extension of CSOK loan with interest subsidy to used home purchases	From July 2019	2	4	8
3. Rural CSOK	July 2019–June 2022	35	55	67
4. Mortgage debt write-off upon the birth of the second and third child	From July 2019	12	25	25
5. Personal income tax exemption of mothers with four children	From 2020	0	23	25
6. Car purchase programme for large families	July 2019–December 2022	9	18	18
7. Increasing the capacity of nurseries	From 2019	0	11	40
8. Introduction of grandparents' childcare benefit (gyed)	From 2020	0	0	0
Grand total family protection measures (1.+2.+3.+4.+5.+6.+7.+8.)		**139**	**247**	**307**
Family protection measures (relative to GDP)		**0.3**	**0.5**	**0.6**
9. Summer language camps for secondary school students	From 2020	0	50	61
Grand total of the measures announced in February		**139**	**296**	**368**
Grand total of the measures announced in February (relative to GDP)		**0.3**	**0.6**	**0.7**

Note: The impacts of the village Home Purchase Subsidy Scheme for Families ("CSOK"), announced later than Family Protection Action Plan, are presented together with the seven points measures of the Family Protection Action Plan, announced on 10 February 2019.
Source: MNB estimate.

1. **The prenatal baby support is a general purpose loan of the amount of HUF 10 million, for which the state provides interest subsidy, and upon the birth of the second and third child, it grants child-raising subsidy in the form of pre-payment.** The loan may be applied for by couples, where the wife has not yet reached the age of 41 years and one of the applicants has continuous social insurance legal relationship of at least 3 years. The prenatal baby support may be applied for at credit institutions from 1 July 2019, and the programme can be entered until the end of 2022. The prenatal baby support is subject to loan assessment conducted in accordance with the credit institutions' internal regulations. The maximum duration of the loan may be 20 years, and the monthly repayment may not exceed HUF 50,000. Loan repayment is suspended after the birth of the first and the second child for 3 years each time, already during the pregnancy. Upon the birth of the second child, 30 percent of the outstanding principal will be cancelled, while after the birth of the third child the total principal amount is cancelled. Upon the birth of the second and third child, the state disburses non-refundable **child-raising subsidy** in the form of prepayment. For the purpose of prenatal baby support, children born after 1 July 2019 will be taken into consideration. The state provides warranty for the prenatal baby support.

   According to our estimates, the prenatal baby support may be applied for by 165,000 persons in total until the end of 2022. The annual number of the beneficiaries of the support is estimated to be around 37,000 persons. For the purpose of estimating the number of beneficiaries, the criteria to be taken into consideration include the age of the mother (women aged 18-40 years), the ratio of children born in marriage and the condition related to the existence of continuous social insurance relationship of 3 years. We assume that 37,000 and 44,000 of the 165,000 estimated total number of applicants may apply for the prenatal baby support in 2019 and 2020, respectively.

   Based on these assumptions, the accrual-based fiscal impact of the prenatal baby support may be HUF 81 billion and HUF 111 billion in 2019 and 2020, respectively (Table 9). The cashflow expenditures linked to the prenatal baby support may be lower than that, amounting to HUF 6 billion and HUF 24 billion in 2019 and 2020, respectively. The largest item within the cashflow expenditures is the interest subsidy, which – in parallel with the gradual development of the stock – may be HUF 3 billion in 2019, and increase to HUF 17 billion and HUF 31 billion in 2020 and 2021, respectively. In the coming years, the accrual-based adjustments will significantly increase the fiscal impacts of the prenatal baby support.

Based on the statistical rules of the EU, if the future loan cancellation can be deemed sure, the provisionally estimated amount thereof must be recognised simultaneously with the loan disbursement. This means that based on the accounting rules, the provisionally estimated amount of the principal cancellation to be granted after the birth of the second and third child (child-raising subsidy) must be recognised as fiscal expenditure already when the loan is disbursed. This recognition will not appear in the cash balance, but it will increase the deficit calculated on an accrual basis through the accrual-based adjustments. On the other hand, the cash payments of the prenatal baby support will not have to be taken into consideration in the accrual-based balance in the future at the time of loan disbursement. **According to the statistical approach, roughly 30 percent of the new loans disbursed within the scope of the prenatal baby support will have to be recognised immediately as accrual-based fiscal expenditure simultaneously with the disbursement of the loans,** taking into consideration the estimated ratio of young people who will presumably have two or three children. The advance recognition of the principal cancellation in 2019-2021 may represent an annual fiscal expenditure amounting to roughly 0.2 percent of GDP.

2. **From 1 July 2019, the loan with state interest subsidy, available upon applying for the Home Purchase Subsidy Scheme for Families ("CSOK"), will be also available for the purchase of used homes.** Families with two children can take out a loan of HUF 10 million, while those with three or more children can apply for loans in the amount of HUF 15 million, the interest rate of which may be 3 percent per annum at most. Besides, the HUF 35 million cap on the purchase price of used homes will be cancelled. The fiscal impact of the extension of the loan with state interest subsidy to the purchase of used homes may be HUF 2 billion, HUF 4 billion and HUF 8 billion in 2019, 2020 and 2021, respectively. When calculating the state interest subsidy, we assumed that at the contracts for used homes – the average annual number of which between 2016 and 2018 exceeded 17,000 – the same utilisation rates may arise as those observed at the purchase of new homes.

3. **From 1 July 2019 the Village Home Purchase Subsidy Scheme for Families ("CSOK") is introduced in settlements with inhabitants less than 5,000, where the population decreased compared to the beginning of 2003.** In these small settlements, it will be possible to apply for non-refundable aids applicable to the purchase and building of new housing also for the purchase of used homes. With a view to preventing the rise in real estate prices, not more than half of the highest – i.e. HUF 10 million – aid amount may be used for purchase, while the remaining part may be used for renovation and extension. The Village Home Purchase Subsidy Scheme for Families ("CSOK") will be presumably available in 2,486 small settlements. The provisions of the Home Purchase Subsidy Scheme for Families ("CSOK") applicable to preferred small settlements, make major contribution to the rise in fiscal expenditures through two different measures. Due to the raising of the aid amount and the higher utilisation resulting from the first, the expenditure related to the purchase and extension of used homes will increase. Surplus expenditure in excess of this will be generated by the subsidy available for the renovation of self-owned homes in the respective settlements. The subsidy may be applied for until 30 June 2022.

4. **After 1 July 2019, upon the birth of the second child HUF 1 million, while upon the birth of the third or further children HUF 4 million on one occasion, and upon the birth of additional children HUF 1 million on each occasion will be written off from the family's outstanding residential mortgage.** The loan cancellation may entail an annual fiscal expenditure amounting to less than 0.1 percent of GDP. According to our estimates, the extension of the mortgage loan cancellation may impact roughly 8,000 contracts in 2019, and 16,000 in 2020 and 2021.

5. **Women with four children are exempted from paying personal income tax for their whole life.** This allowance will take effect in 2020, and it can also be claimed for children over 18, who are no longer dependant. The costs of the measure may amount to HUF 23 billion and HUF 25 billion in 2020 and 2021, respectively, while the maximum number of the potential beneficiaries may be around 60,000.

6. **Families with at least three children may apply for a non-refundable subsidy of HUF 2.5 million at most, for purchasing a new, seven-seat car.** The state subsidy may not exceed 50 percent of the gross purchase price of the vehicle, and the applicants must pay the price reduced by the subsidy. According to our estimates, in 2019-2021 a total of 18,000 families may apply for the car purchase aid, the fiscal impact of which may be HUF 9 billion in 2019, and HUF 18 billion in 2020 and 2021.

7. **By 30 June 2022, the number of nursery school places will be increased to 70,000.** The total fiscal impact of the capacity expansion in 2019-2021 may be 0.1 percent of GDP in total, appearing partly in the form of normative subsidies (based on the number of newly enrolled children) and partly in the form of investments.

8. **From 2020, the childcare fee (GYED) can also be claimed by working grandparents.** The transfer of childcare fee to grandparents is not expected to generate significant budget expenditure. Since 2014, under the GYED Extra scheme, mothers receive GYED, if they return to the labour market. Upon utilising the grandparent GYED the benefit will be disbursed to the grandparent instead of the mother.

9. **From 2020, secondary school students in the 9th and 11th grade may participate in a two-week summer language camp abroad during the summer holiday.** The cost of the measure in 2020 and 2021 may be around 0.1 percent of GDP. According to our estimates, the number of participants, together with teachers traveling with the students, may be around 80,000 in 2020 and 99,000 in 2021.

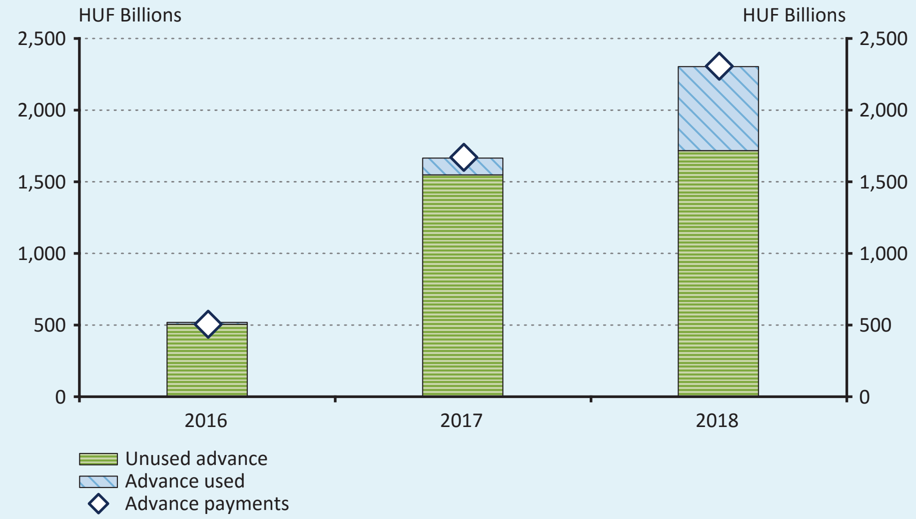
7.3 FINANCING IMPACT OF THE PRE-FINANCING OF EU TRANSFERS

Between 2016 and 2018, more than HUF 4,200 billion was paid from the budget to the beneficiaries as pre-financing of EU transfers, a substantial part of which initially increased the government's financing need and thereby the government debt. After two changes in the regulations, from 2018, the advance is mostly paid to the beneficiaries' sub-accounts held with the State Treasury, and later on the previously paid advances also had to be transferred back to the Treasury sub-accounts. Thus, at present the advance payments within the general government sector – which initially increased the financing need – remain on the Treasury accounts in full, and thus they do not increase the government's financing need.

The pre-financing of EU transfers, paid between 2016 and 2018, significantly increased the financing need. Namely, the advances paid to beneficiaries other than the central budgetary organisations appeared in the budget as expenditures, while the EU transfers are stated only after the utilisation of the advances and the submission of the related invoices to the European Commission. Thus the advances primarily burden the financing until absorption, since thereafter the EU transfer is received in the budget. The purpose of the pre-financing, introduced in 2016, was primarily to improve the liquidity position of the beneficiaries, minimise the frustration of tenders due to shortage of funds and to accelerate the drawdown of funding. In the spirit of this, since 2016, annually roughly HUF 1,400 billion grant and supplier advance was paid to the beneficiaries in 3 years, a large part of which was received by general government actors, i.e. in addition to the central budgetary organisations, primarily by the local government and public corporations.

Until the end of 2017, the value of the advances within the general government sector – which left the Treasury account, but were not utilized – amounted to more than HUF 1,500 billion, which increased the financing need and also appeared in the cash flow deficit. During 2016 and 2017, within the general government sector advances of more than HUF 1,600 billion were paid to local governments and public corporations (primarily to the National Infrastructure Developing Private Company Limited (NIF Zrt) engaged in the drawdown of funds under the Integrated Transport Operational Programme), while utilisation hardly exceeded HUF 100 billion. By 2018, the degree of advance payments substantially declined and the usage of advances accelerated more than twofold; nevertheless, the amount of advances paid at annual level still exceeded utilisation. Accordingly, the balance of unused advances at the local governments and public corporations rose close to HUF 1,700 billion (Chart 9).

Chart 9
Changes in advances related to EU programmes, paid to local governments and public corporations
(cumulated)

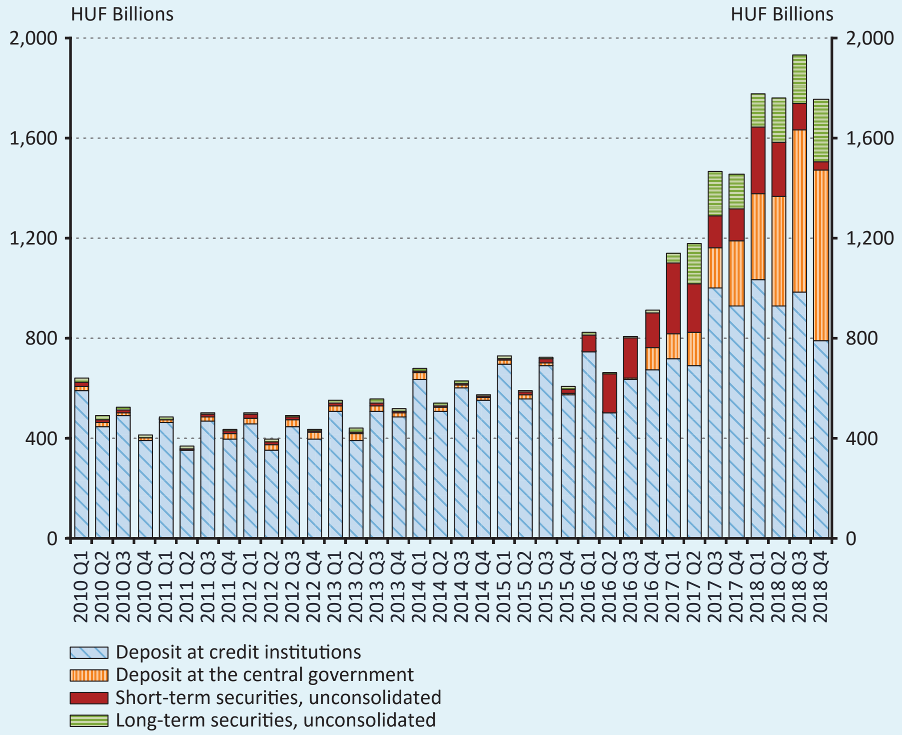


Source: Ministry for Innovation and Technology, MNB estimate.

The government measures of 2017 and 2018 substantially reduced the financing need increasing effect of the pre-financing of EU transfers. The financing need was significantly reduced by the fact that as a result of a Government Decree issued in 2017[3], the advances related to EU transfers are paid to the payment accounts, held with the Hungarian State Treasury, of economic agents belonging to the sub-sectors of the general government. In addition, pursuant to an amendment of the Act in 2018[4], the advances related to EU transfers, disbursed earlier, but not yet used, had to be transferred back to their accounts with Hungarian State Treasury if they exceeded HUF 50 million. As a result of this, the balance of the local governments' and public corporations' accounts held with the Treasury substantially increased, which reduced the financing need in the period under review (Chart 10). **Looking forward, the utilisation of the advances related to EU transfers will generate additional financing need; however, this – provided that the invoices are submitted and settled in a timely manner – will only amount to the value of the national co-financing within the year.**

[3] Government Decree 397/2017 (XII. 13) on the amendment of Government Decree 272 (XI.5) on the Rules pertaining to the absorption of transfers from certain EU funds in the 2014-2020 Programming Period.
[4] Supplementation of Section 111 of Act CXCV of 2011 on Public Finance, in accordance with Section 76 of Act XL of 2018

Chart 10
Changes in the assets of local governments



Source: MNB.

8 Appendix

Table 10
Brief description and static budgetary impact of the 2020 tax measures

	Tax type	Measure	2020 budgetary impact (HUF billion)
Payments by economic organisations	Corporate income tax	Gradual reduction of the HUF 500 million limit of the development tax allowance for SMEs in 2020–2022, to HUF 50 million in the case of small enterprises and to HUF 100 million in the case of medium-sized enterprises	–1
	Advertising tax	Tax rate down to zero per cent	–16
	Simplified entrepreneurial tax	Phase-out of the tax type	*–36 (it causes surplus revenues for other tax types, therefore the net impact is roughly neutral)*
	Small business tax	The tax rate is cut from 13 to 12 per cent, from early 2020	–6
Consumption, turnover taxes	Value added tax	Reduction of the VAT on accommodation services from 18 to 5 per cent	–35
	Tourism development contribution	Extension to the accommodation sector	10
	Excise duties	Raising of the excise duty on tobacco	25
Taxes on labour and contributions	Personal income tax	VAT exemption of mothers with four children	–23
		Interest tax exemption of retail government securities	–6
	Social contribution tax	Effect of the reduction in 2019 Q3	–312
		Effect of the reduction in 2020 Q4 (according to the MNB's forecast, the next cut to the social contribution tax may happen in 2020 Q4)	–76
Total			**–438**

Charles Robert

(1308 – 1342)

King Charles I. was one the most significant rulers of Hungary. He eliminated the anarchy that came about at the end of the Arpadian age, restored the prestige of royal power and its real influence as well as managed to put the economy back on its feet again. King Charles could well be called the new founding father of Hungary, since he could make Hungary a unified and great economic power even in the state of feudal division. A Hungarian king of French ancestry, the descendant of the Capeting dynasty and member of the Anjou family with great influence in Europe, Charles could only take the throne after considerable struggle.

Charles laid royal power onto new foundations and introduced profound reforms. The old and rebellious nobility was replaced by noblemen loyal to him and seized lands were divided up among them, but only as an office fief for the time they held a royal office. The king became even stronger after establishing a new military organisation with the royal banderium, shire banderium and cuman light cavalry.

He pursued a peaceful foreign policy establishing dynastic ties with neighbouring states, which enabled his son to become heir to the Polish crown. At the congress of Visegrád in 1335 (which is also the basis of our current neighbourhood policy) with the Polish and Czech king present, among others decision was made to create a new trade route,

Charles strengthened royal power in terms of finances as well by filling up the treasury. Since Hungary was the primary source of gold and silver in Europe, Charles put mining and trading under close royal control. Charles shared a significant part of royal revenues from mining lease paid for mining precious metals with the owner of the land to facilitate the discovery of new mines. He forbade the export of precious metals; gold and silver had to be given to newly established minting chambers at a price set by the king.

Instead of numerous various currencies, he started minting the silver denarius with a permanent value, then coining golden florins modelled on the golden coins of Florence with the silver farthing becoming its change. Charles abolished the practice of former rulers to inflate money by occasionally reducing the precious metal content of minted coins.

He increased royal revenues by imposing a new tax. Gate tax was levied for each land that had a gate wide enough to let through a cart laden with hay. Customs duty was introduced set at 1/30 of the value of goods exported to or imported from the west or north and 1/20 of southbound goods. Relying on sound economic foundations, in the second part of Charles' reign numerous gothic buildings were constructed, e.g. the royal palace in Visegrád and the Diósgyőr Castle. However, only traces of many of these buildings were left to posterity due to the Turkish devastation.

A Hungarian king with a truly outstanding life, Charles passed away after his 40-year-long reign, and left a strong and rich kingdom to his son. The political ambitions of the Hungarian Anjou dynasty were embodied in Louis the Great, Sigismund and Matthias Corvinus who restored the bygone glory of royal power, but the first stones in this path were laid by Charles I.

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