Opinion of the Fiscal Council

on the draft budget bill of Hungary's 2019 central budget

I.

Antecedents, legal basis and publicity of the Opinion

According to the stipulations of Paragraph 24 of Act CXCIV of 2011 on the economic stability of Hungary (henceforward: Stability Ac) the Fiscal Council (henceforward: the Council, FC) – in harmony with Indent (2) Article 44 of the Fundamental Law – shall formulate its opinion on the draft of the central budget act. In its opinion the Council may make comments and – in case it has fundamental objections as regards the authenticity or feasibility of the draft document – it shall indicate its disagreement.

The Government forwarded the document approved as a draft on Hungary's 2019 central budget (henceforward: the draft), as an attachment to the letter of Minister of Finances, Mihály Varga, file no. PM/1617/2018. addressed to the Chairman of the Council and what was seeking the opinion of the Council as regards the draft.

The Council formulated its evaluation of the submitted document by taking into account the following antecedents related to Hungary's Central Budget Act of 2018.

- In its Opinion 3/2017.04.27. formulated on the 2018 central budget draft the FC established that „the draft is counting with a high, 4, 3 percent economic growth that is exceeding the available forecasts" and "this forecast is based on the expected dynamic growth of the gross average wages as well the planned large scale utilisation of the EU resources". The Council also established that „with some exceptions the revenue and expenditure appropriations are in harmony with the expected fruition of the base year appropriations and the data of the Government's macroeconomic forecast for the year 2018". The FC also established that „the ESA deficit of the whole of the governmental sector, as stipulated by the EU regulations and Point b) Indent (2) § 3/A. of the Stability Act to keep the deficit below 3 % of the GDP, shall be covered by the surplus originating from the organisations listed in the local governmental subsystem and the organisations classified in the group of governmental sector outside the public finance. Apart from the above the Council pointed out that there were some risks concerning the „fulfilment of the EU criteria related to the EU structural deficit".

- „In order to safely implement the fiscal deficit the Council deemed the planned amount reserved for the Country Protection Fund necessary" and agreed with the stipulation that „the Found shall be used in harmony with the criteria set by the draft document". The FC also established that „the planned nominal growth of government debt is in harmony with the planned cash deficit of the central budget. The growth rate however is significantly lagging behind the planned nominal growth rate of the GDP. As a result the GDP proportionate government debts shall decrease to such an extent that the decline of the government debt indicator stipulated by the Stability Act shall meet the requirement on Indent (5) Article 36. of the Fundamental Law and shall – significantly – exceed the measure stipulated by Indent (2a) of § 4. of the Stability Act." The FC expounded that even by a more moderate debt decrease than expected, the EU and domestic regulations shall be met. Additionally, according to the Council „the expected measure of the debt rate decline is in harmony also with the respective stipulation of the European Union concerning government debt."

- In its Opinion 5/2017.06.14. formulated for the final vote concerning the draft on the 2018 central budget of Hungary the Council expounded that „the measure of the government debt indicator planned for 31st December 2018 according to Indent (3) of § 3. of the uniform budget bill T/15381/1237. was well-founded, was established in harmony with the stipulations of the Stability Act and – by the increasing risks due to the increase of certain revenue expenditures – was in harmony with the processes that served as a basis for the bill" thus the stipulation of Indent (5) Article 36. of the Fundamental Law also shall be met.

When formulating its Opinion on the 2019 draft budget the FC was relying primarily on the written analyses and findings prepared by the State Audit Office of Hungary and the Central Bank of Hungary related to the fiscal processes. Apart from these documents the Council reviewed the economic forecasts prepared by domestic research and analysing institutions, international organisations (European Commission, OECD, and IMF) and other, benchmarking market analysers upon the commission of the FC Secretariat. The Council also took into consideration the contents of the Convergence Program of Hungary for the years 2018 – 2022. By reviewing the preliminary data the FC was relying also on the major processes of the implementation of Act XC. of 2016 on the 2017 central budget of Hungary, their respective characteristic features and background, as a basis. The Council was summing up its Opinion on these aspects in a separate document – in harmony with Point c) Indent (1) of § 23. of the Stability Act.

In the context of its authorisation and continuing its practice so far the FC examined the draft of the 2019 central budget of Hungary and its macroeconomic background as an entity and analysed the details, the revenues and expenditures from the aspect of balance and the observation of the government debt rule.

The Council shall inform about its Opinion the Speaker of the National Assembly and the Government. Additionally, it shall publish the Opinion on the National Assembly's website.

II.

The Council's Opinion

According to Paragraph 24. of the Stability Act, on 7th of June 2018 the Council discussed the draft of the 2019 central budget bill of Hungary and formulated the following opinion on the document with a uniform resolution.

1) As regards the authenticity and feasibility of the 2019 draft budget bill of Hungary the Council has no such fundamental objections that would justify the indication of disagreement concerning the draft.

2) The draft is counting with a high, 4, 1 percent growth rate for 2019 that is surpassing consensus of the forecasters'. According to the Council this expectation can be met if the presumed significant growth of wages and employment, as well as the expansion of household consumption based on the former factors became a reality. (This however, shall entail the increase of imports that, on the other hand, shall mitigate the economic growth). Additional measures promoting competitiveness could support the implementation of the targeted growth rate. The risks concerning the economic growth are strengthened by the uncertainties of the international economic environment. If wages and consumption would lag behind the value mentioned by the budget, it would significantly decrease the tax bases and the full implementation of the revenue appropriations. If the wage increases were more moderate it would mitigate the risks of the budget and the decreasing of the social contribution tax – originally planned for mid-2019 – would be postponed for a later date, in harmony with the wage agreement signed at the end of 2016.

3) The revenue and expenditure appropriation of the draft are in harmony with the base expected for the end of year 2018 and the macroeconomic processes forecasted for 2019. The precondition of the implementation of the revenue appropriations is the realisation of the expected macroeconomic course. The draft's calculations regarding the expenditures are realistic, the career programmes, the increase of the investments financed by own and EU resources as well as the undertaking of defence expenditures included. The reserves are offering a cover for managing the macroeconomic risks.

4) The draft does not contain any new, earlier unknown governmental measures that would concern the budget.

5) The Council establishes that the targeted, GDP proportionate 2, 8 percent deficit of the 2019 central budget calculated by EU methodology (ESA 2010) is well founded by the draft and taking into consideration the reserves, is attainable. The targeted deficit is in harmony with the Maastricht criteria and the same stipulation of observing the 3 % limit according to Point b) Indent (2) § 3/A. of the Stability Act. The planned decrease of the budget deficit is in harmony with the cyclical processes of the economy and can accelerate the mitigation of the debt rate as well as increasing of the room for manoeuvre of the future budgets without slowing the economic growth.

6) The EU criteria concerning structural deficit and the stipulation of Point a) Indent (2) § 3/A. of the Stability Act that is the reflection of this criteria, prescribe that the balance of the governmental sector shall be defined so that it would be in harmony with the implementation of the medium term fiscal target that, in case of Hungary, is 1, 5 percent of the GDP. The structural balance according to the draft budget bill departs from the medium term targets in comparison to years 2017 and 2018 (though in 2019 it is approaching again the 1, 5 percent however, remains bigger by 0,2 percent). To reach the undertaken proportion of structural balance steps that would not endanger the economic growth are necessary.

7) As regards the risks, in order to implement the targeted budget deficit, the Council deems it necessary to observe the planned amount of the Country Protection Fund and agrees with the stipulation that it should be used if the criteria listed in the draft are being met.

8) The FC finds that the trend of the 2018 debt indicator calculated on constant exchange rate – (72, 9 percent of the GDP) and that of the 2019 debt indicator (70, 3 percent) is in harmony with the planned and expected macroeconomic processes of 2018 and 2019 and meets the stipulation of Indent (5) Article 36 of the Fundamental Law (government debt rule). The planned level of the debt rate is in harmony also with the stipulations of the EU regulation concerning government debt. The Council deems it favourable that the proportion of debt in foreign currency within the central budget deficit shall further decrease thus, the mitigation of the vulnerability of the country continues.

9)

10) The Council has authorised its Chairman to publish the FC Opinion on the draft budget bill and to expound the Opinion at the plenary session of the National Assembly focusing on the relations of the Opinion and the submitted draft.

III.

Justification

1. The Authenticity of the Draft

According to Indent (2) § 24 of the Stability Act the Council may present observations respectively – in case it has fundamental objections concerning the authenticity or feasibility of the draft document – may indicate the FC's disagreement. The Council evaluated the contents of the draft and found that the provisions, the presented governmental targets and measures as well as the appropriations established the necessary resources for them thus there is no impediment to give the FC's consent regarding the submitted for opinion document.

2. The expected compliance with year 2018

International organisations, like IMF, OECD, and European Commission foresee the acceleration growth rate of the world economy in 2018 – 2019. According to their forecasts the growth rate is well balanced and the expansion shall be supported by the strengthening of consumption and investments. In the FC's opinion the international macroeconomic data received so far tell about a favourable economic recovery however, the soft indicators (business mood indexes, market expectations) are projecting the risk of a slowdown.

The Government based its year 2018 budget on a 4, 3 percent growth rate (that it confirmed also in its Convergence Programme 2018 – 2022). The international organisations, domestic institutional and market analysers continue to expect further strong growth. Their respective forecasts foresee the value around 4 percent. (According to the latest country evaluation prepared by the European Commission the economic growth rate in Hungary in 2018 shall remain around 4 percent as a consequence of the increasing utilisation of the EU resources and the influx of foreign working capital the OECD is counting with an even higher i.e. 4, 4 percentage in 2018, while the IMF indicates a 3, 8 percent growth.)

By the external, generally growth supporting conditions some risks presenting hazards might forcefully materialise (the strengthening of commercial and geopolitical tensions, the prominence of protectionist endeavours, rising oil prices, lack of a final Brexit agreement, managing the immigration related tensions, etc.) and these might affect the economic output of the country in 2018.

The economic development strategy of the Government supports the growth just like its implemented and continuous tax and contribution reduction policy to thus promote the improvement of employment activities as well as the utilisation of EU resources.

Investments shall continue to grow. This means several big volume ongoing developments (their respective realisation shall exert substantial impact on the export performance as well); additionally, educational, healthcare, social and road network development related to EU supports, respectively financed from the central budget shall also increase. In the first quarter of 2018 the dynamic expansion of investments continues and the volume of the development exceeded the data of the same period of the previous year by 17 percent. In most outstanding fields of the national economy investment activity has significantly grown. Compared to the respective data of the same period of the previous year the investment activity of property transactions has growth by 45 %, commerce by 8, 3 %, education by 71 %, human, healthcare and social care by 74 %. The investment activity of vehicle construction was significant as well.

The building and buying activity of households has given a significant forward momentum to the housing market, as a result of what the number of newly built homes keeps increasing further in 2018.
3 394 new homes were built in the first quarter of 2018 that is higher by 65 percent compared to the same period of the previous year.

In case of the EU supports it is a favourable factor that the announcement of all the EU tenders was completed in March 2017 and by April 2018 already 95 % of the available amount was tied up. As the majority of payments up to that point were allocated in the framework of the advancing of EU programmes, the rise of the effective payments – the realised projects – can increase the investment output both in 2018 and 2019. Thus the measure of the investment rate presumably will be close to the high value of last year (21, 5 percent).

Thanks to the continuously expanding employment and the strong economic activity the tight labour market has a favourable effect on the increasing of wages and – as a result – the revenues of the budget. Gross and net average wages - in harmony with the trend of the previous years – have increased equally by 12, 4 percent in the first quarter of 2018 compared to the similar period of the previous year. The growth was heavily influenced by the 8, respective 12 percent raise of the minimum wages and the guaranteed wage minimum, together with wage increases concerning specific fields of the budgetary sector

Thanks to the economic activity and the measures introduced by the Government, employment and activity have further increased. The average number of the employees in the first quarter of 2018 was 4.435 thousand i.e. more by 67 thousand persons than in the same period of the previous year. The number of employees on the primary labour market was higher by 3, 1 percent (125 thousand persons). The number of those employed in the framework of community service was less by 42 thousand persons and those working at international branches were less by 15 thousand persons in the same period. The number of unemployed continued to decline and compared to the first quarter of the previous year it was less by 29 thousand persons and fell to 178 thousand. Unemployment rate changed by 0, 7 percent and was 3, 9 percent. The employment rate of the age group of 15 – 64 rose to 68, 7 percent.

According to the 2018 February-April period data (quarterly rolling average) the number of employees already reached 4.445 thousand persons. The number of those working on the primary labour market grew by 128 thousand and employment rate increased further (to 68, 8 percent). The number and rate of unemployed declined further (to 3, 8 percent).

Beside the measures introduced so far to encourage participation in the labour market, additional steps are necessary to ensure the skilled labour force required by employment and the market as at present 60 thousand jobs are vacant due to lack of adequately skilled workers.

Considering the above in the opinion of the FC a growth rate close to the governmental expectations is attainable in 2018.

Fiscal data from the first quarter of the year and the expected processes are indicating in the direction of a performance close to the original, 2018 appropriation. In the first quarter of 2018 the fiscal deficit turned out to be considerably larger when compared to the same period of the previous year (the cumulative cash deficit was HUF 872 billion that is the highest in the average of the past five years). This considerable deficit primarily is the consequence of the advance of EU payments, the higher expenditures of budgetary organisations and the changes of the due date of VAT referrals (reliable debtors receive the VAT difference in 30 days instead of 45 days). Payments related to EU supports amounted to HUF 650 billion in the first quarter against revenues worth of HUF 64 billion.

However, the balance of the accounts of the governmental sector did show a surplus that amounted to 0, 1 percent of the GDP in the first quarter. This indicator was based on using other statistics but in principal in a similar way to the accrual base ESA deficit. The reason why the high cash deficit is not reflected in the accrual based balance covering the complete governmental sector is that the major proportion of the advance payments on EU supports took place within the public finance, the local governments closed the year with a substantial surplus and, on the other hand, the changes of VAT refunding cannot be taken into consideration in an accrual based accounting. However, compared to the data of the previous two years the own account surplus in the first quarter has significantly decreased and this indicates also that the dynamics of actual expenditures was higher.

Accordingly, and in the Council's viewpoint the 2, 4 percent targeted deficit for the year 2018 calculated by EU methodology, can be maintained. The structural deficit set for 2, 1 percent of the GDP in the Convergence Programme and in harmony with the above is higher – even in case of fulfilment – than the 1, 5 percent medium term budget target set by Point a) Indent (2) § 3/A of the Stability Act.

3. Goals and conditions for year 2019

Expected macroeconomic and public finance indicators

Cutting the government debt and the GDP proportionate fiscal deficit represent a decisive element of the 2019 draft budget bill's target system as well as the ensuring the balanced growth of the economy that is a pre-condition to reaching the above goals.

In line with the trend of the previous years the draft document is built on the 4, 1 percent GDP growth. From the utilisation side this will create the foundation for the 3, 9 percent growth of volume of household consumption, the 9, 5 percent growth of gross fixed capital formation (by what the investment rate could reach close the same level of the previous year). The latter is heavily affected by the dynamic growth of credit boom and the investments of the private sector as well as the developments financed by EU and domestic resources (Modern Cities Programme, road and other infrastructural projects). According to the processes of the previous year the number of employees shall further increase (by 1, 5 percent); (the growth in the private sector is 1, 9 percent while in the public sector they are counting with a 0, 3 percent decline).

As a consequence of the tighter labour market, the implementation of the six year wage agreement and the career models, the gross average wages shall further increase, on a yearly level by 8, 8 percent. Thanks to the endeavours of businesses aiming at the improvement of efficiency the growth rate of productivity is expected to reach approximately the same indicator of the previous year, i.e. 2, 6 percent, the dynamics of the export and import expansion shall be lower than last year (6, 9 percent and 7, 4 percent) however, the difference between the two is decreasing. The expected percentage of consumer prices is 2, 7 % and represents the continuation of moving closer to the 3 percent inflation rate forecasted for the medium term.

The FC examined the elements of the macroeconomic course that represents the foundation of the draft of the 2019 central budget bill. In this course it took into consideration the contents of Hungary's Convergence Programme 2018 – 2022, the evaluations prepared by the

European Commission, the OECD and the IMF, as well as the researches and professional analyses commissioned by the Secretariat of the Council. The various forecasts – with very minor differences – are projecting a 2, 8 percent GDP growth rate and 3, 5 percent for 2019. The tight or limited labour market and the limited building capacities – even by favourable tendencies – represent risks as regards the already undertaken or ongoing investments. Uncertainties of the international economic environment also add to the risks surrounding the economic growth. According to the Council's opinion this is why the GDP would be a reality only when the assumed, significant increase of wages and employment and the subsequent expansion of consumption took place.

Following its practice of the previous years the FC does not wish to pass judgement on the allocation policies this time either. According to the draft the total consolidated[1] public finance expenditures is HUF 19.842, 9 billion that, compared to the GDP means 45, 2 percent. According to the 2018 appropriations this proportion represents 46, 6 percent. (In 2009 this proportion was close to 51 percent.) Thus, according to the draft budget bill the measure of redistribution shall continue decreasing further. Within the aggregated consolidate expenditures the share of Government debt management function (interest expenditures) shall continue to decrease (to 5, 2 percent) due to successful debt management, disciplined fiscal policy and the Central Bank's programmes. (Up to year 2000 its extent well exceeded 10 percent and even in 2009 it was still close to 9 percent.) It's worth mentioning that the economic function's value has been high ever since 2017, i.e. around 20 percent. (In 2009 this was yet 13, 7 percent). According to the Council's judgement it is the strengthening of economic bases that might result in later years the increase of welfare (education, health care, social and cultural) expenditures.

Aspects of the fiscal policy primarily are realised via the public finance central subsystem thus the FC also analysed the trends of the revenue and expenditure appropriations of this subsystem.

Revenues of the central subsystem

The total – not consolidated[2] - revenue appropriation of the central subsystem is HUF 19.474, 2 billion that represents 103, 8 percent of the appropriation total of the previous year.

The budget relies on the established tax structure where – in the interest of encouraging the growth of employment rate and economy – the emphasis shifted from taxes burdening labour to consumption and sales/trade taxes. Beside this it was a significant progress that the efficiency of tax collection improved. This increased the revenues of the budget without

[1] Amount calculated by eliminating the transfers within the public finance (free from accumulation)
[2] Amount calculated without the elimination of the transfers within public finance

raising taxes and thus cleaned market competition. The above steps, together with the decrease of tax burdens for small companies and, from 2017, the tax burdens of big companies have contributed to the continuous improvement of the most important macroeconomic indicators: employment has expanded continuously, the household income keeps growing and this has a favourable repercussion on revenues.

The appropriation of tax and contribution revenues are based on the macroeconomic course described by the draft and are in harmony with it (the gross wage and salaries bill shall increase by 10, 3 percent). However, at the same time they pose the risk that, in case of a more moderate wage and consumption increase, the appropriations might under-perform.

The appropriation of household payments exceeds the 2018 appropriations by 10, 9 percent. Within this the personal income tax appropriation will increase by 11, 9 percent and with respect to the expected expansion of trade, the appropriation of the levies is higher by 2 percent.

Taxes related to consumption altogether exceed the appropriation of last year by 8, 5 percent. The VAT appropriation is higher by 11, 6 percent (HUF 444 billion) than in the previous year. Growth essentially is based on the expansion of consumption however; the base effect of VAT reimbursement is also playing a role in it. Namely, in 2018 the new shortening of the VAT reimbursements' deadline increases the reimbursements thus, it reduces the net cash revenues and this lower basis results in approximately 4 percent as regards next year's growth. Having in mind that the expected growth of consumption surpasses the consensual forecast, risk can be identified as regards the feasibility of the VAT appropriation. In case of excise duty the draft took into consideration that the additional revenues of the households very likely shall not manifest themselves in the consumption of articles serving as the basis of excise levies.

The FC continues to deem the evaluation of tools whitening the economy important, the expansion of the use of these tools that continue to further improve the tax collection efficiency.

Payments of business organisations surpass the 2018 appropriation by 5, 9 percent. Within this, corporate tax is higher by 8, 6 percent, the itemized small business tax appropriation by 20 percent and the small business tax by 72 percent. In case of corporate tax the tax rate reduction together with other investment and growth incentive measures introduced on 1st January 2018 shall prevail. In case of KATA (Itemized Account of Small Businesses) and KIVA (Small Business Tax) the favourable consequences of the tax reduction measures and the simplification of tax payments introduced from 1st January 2017 also had a favourable consequence. As a result of these measures the range of taxpayers shall be transformed: the more favourable taxation environment is attractive for the small and medium size businesses thus the number of businesses belonging to the KIVA category has quadrupled in a couple of years and this effect was calculated with in the planning process. From among the budgetary payment of enterprises the appropriation of energy tax was moved to the excise levies (the latter's appropriation would have resulted in nominal decrease without this change).

The draft does not contain newer tax policy related measures and – in the earlier announced method -- is counting with the further decrease of burdens (for example: the increase of tax reduction for families having two children). In light of the trend of real earnings in the course of year 2019 it is expected that the degree of social contribution tax shall be cut by an additional 2 percent, in harmony with the wage agreement signed at the end of year 2016. In case the increase of real earnings turns out to be more moderate, the tax reduction might be postponed. Altogether, this has a deficit decreasing effect that would moderate the risks concerning the revenues.

Expenditures of the central subsystem

The total – not consolidated – expenditure appropriation of the central subsystem is HUF 20.472, 6 billion, i.e. 101, 8 percent of the previous year's appropriation.

The appropriated amounts of the domestic operational and development projects make it possible to attain quite a few headline targets and, at the same time, serve the long term sustainability of the public finance.

In order to further promote the concept of family-friendly Hungary the budget keeps encouraging having children and supports families raising children. It is not only the expenditure appropriations that are serving the above goals but a number of (family) tax allowances as well. The continuing of the homemaking programme is also assisting the improvement of the quality of lives of the families.

Apart from measures concerning tax policy the budget serves the further improvement of employment by supporting primary labour market employment and the idea that people lived primarily on their labour income.

In order to protect the safety of the country and in harmony with our undertaken obligations concerning our NATO membership, significant resources will be allocated to protecting the borders and to improving the operational conditions of the Hungarian Defence Forces.

The draft also guarantees the security of the elderly by protecting the revalorisation of pensions and by making it possible for them to get their share from the budgetary revenues resulting from the economic growth. The draft also takes into consideration the gradually manifested fiscal effects of measures taken with the purpose of ensuring the long term financing of the pension system. The draft is calculating also with the pension bonus originating from an economic growth above 3, 5 percent. In case the inflation trend exceeds the planned value, on top of the pension bonus additional pension increase falls due.

According to the draft the 2019 budget it continues to enforce the idea that 60 percent of the development resources shall be used to improve competitiveness. On the basis of payments so far the FC is on the opinion that this is feasible when the proportion of the amounts paid for direct economic development in the future reaches more than 60 percent. As regards the utilisation of the EU supports in 2019 the emphasis will shift from advance payments of the utilisation of these funds. The „open from the top" appropriations shall guarantee the financing as well as the fact that the necessary (HUF) cover will be available as a budgetary resource. The realisation of the operative programmes of the period of 2014 - 2020 shall serve primarily the sustainable economic growth the same way as in case of projects financed from domestic resources. On the basis of the appropriations the draft is counting with quite a high proportion of own share. This makes it possible to involve external, non-budgetary resources from a broader range.

Thanks to the own resources and the EU programmes there'll be an opportunity – among others – to continues such projects that aim at directly supporting the economy – employment included – like the Irinyi Project, Suppliers' Development Program, Industry 4.0 Programme and continuing the development of the digital infrastructure. Several welfare programmes – within it health care (where the emphasis has shifted from the countryside to the capital) – educational, religious (faith and public service) and youth and sports development projects - will be financed also from domestic resources.

In meeting the targeted operational and development goals while also observing the stipulations of the government debt rule[3] of the Stability Act - apart from the safe collection of the revenues - the fact that the central budget contains several reserves that can be used in a regulated way to protect the budget against unexpected risks, is a helping factor. Apart from the stability reserves separated in the various chapters that are of the same amount like the appropriations of the previous two years, the Country Protection Fund contains HUF 60 billion while the reserve saved for Extraordinary Governmental Measures set apart HUF 110 billion. It is appropriate to plan the utilisation of these reserves in harmony with the emerging risks related to the revenues and expenditures of the budget bill.

Government interest expenditures might continue to decrease from the 2012 GDP proportionate 4, 3 percent and by 2019 might approach the 2, 1 percent of the GDP. The reason of the mitigation lies in the fact that during the past few years a significant reduction of

[3] We are dealing with this in detail in the government debt section

the yields has taken place and thanks to that the share of low-yielding assets keeps growing gradually within government debt. The international financial turbulence that evolved in May 2018 has increased a little the actual market yields. In case this yield environment is likely to prove to be permanent, the planned appropriation might be exceeded but - according to the estimation of the FC - the risk won't exceed 0, 1 percent of the GDP.

Public finance deficit

The targeted deficit of the public finance, calculated with the EU methodology (ESA2010), i.e. the governmental sector's deficit is smaller by 0, 6 percent than in year 2018 and by 2019 it'll be 1, 8 percent that remains below the 3 % Maastricht criteria and the identical measure stipulated by Point b) Indent (2) § 3/A of the Stability Act. The envisaged degree of the deficit also promotes the implementation of the government debt decreasing criteria stipulated by the Fundamental Law. The reduction of the fiscal deficit is in harmony with the cyclical processes of the economy and is able to speed up the mitigation of the debt rate without slowing down the economic growth and the increasing of the elbow room for future budgets. According to the experience, in case of an economic boom the effect of the deficit reducing fiscal policy is more moderate (i.e. the measure of the fiscal leverage[4] is lower). The unit reduction of the deficit holds back the economy to a lesser degree because the private sector gets access to credits or wholesale funding easier, or can counterbalance the decreasing fiscal demand from earlier savings.

The greatest risk surrounding deficit is related to the macroeconomic course and the feasibility of the tax revenue appropriations. This is mitigated however by the fact that the slower increase of wages would postpone the reduction of the social contribution tax rate as stipulated by the earlier agreement. The effect of this postponement could counterbalance the smaller expansion of the tax base. The utilisation of the EU supports has been surrounded annually by bilateral uncertainties. As regards 2019 the FC sees positive risks as the draft is counting with relatively low revenue from the EU.

The Council deems it favourable to continue the practice, according to what the operational, accumulation and EU budgets are separated in the central subsystem, the balance of the operational part is zero and payment deficit might arise in the other two fields.

According to the governmental calculations the structural deficit[5] will be 1, 7 percent in 2019 that – although it is closer but still higher than the proportion laid down by the Convergence

[4] Fiscal leverage measures the relation of fiscal policy and economic growth. According to the general definition the multiplicator indicates what effect does a unit change in the governmental expenditures exercise on the pace of economic growth.
[5] The balance of the governmental sector cleaned of the cyclical effects of the economy and individual lot (Public Finance Act (Áht.) Point y) Indent (1) § 2.). It is a variant that cannot be measured and observable

Programme 2016 – 2020 and stipulated by the medium range fiscal goal (1, 5 percent). Despite the uncertainties surrounding the calculations of structural deficit we can establish that it'll decrease to the value expected for 2018 and thus its convergence to the medium range goal.

According to the draft the public finance payment deficit will be HUF 1, 197 billion, i.e. 2, 7 percent of the GDP. This is made up from the 2, 3 percent deficit of the central subsystem (HUF 998 billion) and that of the 0, 5 percent deficit of the local governmental subsystem (according to the draft the deviation is the result of the rounding). Thus, in 2019 the payment deficit shall be considerably greater (by 0, 9 percent) than the indicator calculated by the EU methodology. A significant proportion of the difference is the consequence of the fact that as regards the EU programmes the advance payments are still higher than the support received from the EU. This trend might turn in the later years and then the payment deficit might be less than the one calculated by the EU methodology and thus the pace of the GDP proportionate government debt decrease might gain speed.

Achieving the targeted 2019 deficit is supported by the fact that – according to the draft – the planning of the financial bases of social security was based on balance. In the course of the social security funds they also counted with the effects of the macroeconomic parameters.

Government debt

The draft meets the debt rule[6] stipulated by the Fundamental Law and the debt formula prescribed by the Stability Act. Points (2)-(2a) of § 4 of the Stability Act stipulate the maximum of the nominal growth rate of government debt. The rule lays down that in case the inflation forecasted for the given fiscal year and the pace of the growth rate of the real economy equally exceed 3 percent than the balance of the budget should be planned so that the yearly growth rate of the nominal government debt shall not exceed the difference of the half of the degree of the planned inflation and growth. In case at least one of the two indicators does not exceed the 3 percent than the debt rule prescribes 0, 1 percent debt rate

directly thus methodologically it is hotly debated. In case of Hungary the debate concerns the different appraisals of the cyclical effects of the economy (one-off items, in our case, already went out). In the draft budget bill the 1, 7 percent structural deficit is the result of own governmental calculation for year 2019. However, the European Commission calculated with a significantly higher value (3, 3 percent in a forecast prepared at the beginning of May) on the basis that according to their judgement Hungarian economy is performing significantly higher that its potential level. They launched the Significant Departure Procedure (SDP) based on a greater value – even greater than their calculations - also for the previous years. Compared to the EDP procedure however this procedure does not involve any sanctions. The consequence is that they'll call for the correction of the deviation as long as, according to the Commission's view, the non performing country does not reach the medium range fiscal target recommended by the Commission, or the prescribed course to reach that goal (MTO).

[6] Indent (4) and (5) of Article 36 of the Fundamental Law contains the government debt rule as the most important element of rule based fiscal framework. According to this the National Assembly shall not adopt such a central budget act as a result of what government debt would exceed half of the GDP. As long as government debt exceed half of the GDP the National Assembly can adopt only such a central budget act that contains the decreasing of the proportion of government debt compared to the GDP.

decrease. Although, according to the draft the 2018 real growth (4, 1 percent) will be greater than 3 percent, on the other hand the inflation rate shall not exceed it (2, 7 percent), thus the 0, 1 percent reduction rule of the debt formula shall come into force and thus it'll be met. Namely, according to the draft the government debt indicator shall be reduced from 72, 9 percent to 70, 3 percent by the end of 2019 – calculated with a constant exchange rate compared to the rate presumed for the end of 2018 and expected for the end of 2019. The planned 2, 6 percent reduction means that the government debt rule shall be met even if the economic growth might lag behind the planned pace. Thus, apart from the domestic regulations the EU stipulations can safely be met („one-twentieth rule")[7]. The fact that the payment deficit of the central subsystem shall be reduced when compared to the 2018 appropriation is primarily due to the gradual expiration of the advance payments for EU supports.
The regulation concerning the utilisation of the Country Protection Fund is promoting the fulfilment of the debt requirements.

In addition the FC also deems it favourable that within the central budget debt the foreign currency share shall decrease further, by close to 2 percent, to 17, 6 percent. Thanks to the continuous improvement of this share ever since 2011 the exchange rate sensibility of the debt has fallen to less than the half and this and thus contributed significantly to the mitigation of the external vulnerability of the country.

Budapest, June 7, 2018

Domokos László
Member of the Fiscal Council

Matolcsy György
Member of the Fiscal Council

Kovács Árpád
Chairman of the Fiscal Council

[7] According to the correction branch of the European Union Stability and Growth Pact the essence of the so-called one-twentieth rule is that in the average of three years the part of the debt rate above 60 percent should be decreased by its one-twentieth part.