Opinion of the Fiscal Council

for the final voting on the bill of the 2016 central budget of Hungary

I

Antecedents, legal basis and publicity of the Opinion

According to the stipulation of Indent (3) Article 44 of the Basic Law of Hungary the Fiscal Council (henceforward: the Council, or FC) shall formulate its opinion on its prior consent, required for the adoption of the central budget bill. Paragraph 25 of Act CXCIV of 2011 of the economic stability of Hungary (henceforward: Stability Act) serves as the basis for the formulation of the Council's preliminary consent. In the course of this process the Council shall examine if the uniform budget bill is in harmony with the decreasing stipulation of Indent (5), Article 36 of the Basic Law concerning the degree of government debt.

As regards the feasibility of the government debt rule - in its Opinion no. 4/2015.05.08. formulated about the draft budget bill on the 2016 central budget of Hungary - the Council established that on the basis of the Stability Act, the debt indicator expected by the end of year 2015 (74, 3 percent of the GDP – calculated with constant exchange rate) and the same rate calculated for the end of year 2016 (73, 3 percent of the GDP) presented in the draft budget bill, were in harmony with the expected 2015 economic and budgetary processes and those foreseen for year 2016. Apart from this, the Council welcomed the idea that, according to the Convergence Programme, the debt indicator calculated with a rate of exchange supposed for 2016, could decrease by 1 percent (equally to the rate calculated by constant exchange rate).

According to the FC's judgement the planned degree of debt reduction, in harmony with the baseline scenario, shall insure the feasibility of the debt rule, even if there are some negative risks involved. Namely, in the draft bill the Council identified certain risks among what the most significant was that the appropriation of other selling and utilisation revenues has not been supported. Thus, the Council agreed with the provision appearing in the draft bill that investments to be financed from such revenues should start only upon the realisation of the said revenues.

In harmony with the counterbalancing of the implementation risks, the Council considered it right to raise the Country Protection Fund (compared to that reserved for 2015) and the recommendation that – beyond the general chapter reserves employed so far – the central chapters should establish a stability reserve as of 2016.

By taking into consideration the respective FC Opinion, the Government raised the Country Protection Fund appropriation by HUF 30 billion (to HUF 100 billion) in the bill no. T/4730 submitted to the National Assembly. Additionally, it indicated that they shall initiate the amendment of Indent (2) § 4 of the Stability Act (the so-called government debt formula) so that it would regulate the aspects of public finance stability in harmony with the sustainability of growth. At the same time, the Government had not shared the scruples of the FC concerning the risks related to the revenues (apart from revenues from other selling and utilisation, the personal income tax and corporate tax appropriations).

Between the draft that the FC had delivered its opinion on and the draft bill no. T/4730 submitted to the National Assembly – according to the reading of the Government – it was the favourable economic and budgetary processes of the first four months of year 2015 (the industrial, building industry and foreign trade performance, the trends of employment and wages, together with the final cash flow data of the central budget at the end of April, etc.) that made it possible to change certain appropriations. Accordingly, in the submitted draft bill they raised the amount of the following appropriations: personal income tax, social contribution tax, the value added tax and other revenues from selling and utilisation, the expenditures concerning the operation of specific budgetary organisations, the chapter managed appropriations, expenditures related to the supports for local governments, as well as the reserves. Taking into consideration these insignificant changes – the increase represented merely a raise of the revenue totals by 0, 33 percent, while in case of the expenditures, by merely 0, 35 percent – the findings of the Council concerning the draft were also correct for the submitted draft bill as well.

Parallel with the 2016 central budget bill, the National Assembly also discussed the draft bill no. T/4741 on the amendment of certain laws related to taxation (personal income tax, corporate tax, financial transaction tax, etc.) and the bill no. T/4884 on laying the foundations for the 2016 central budget bill of Hungary. The latter also contained the amendment of Indent (2) § 4 of the Stability Act, and establishing the harmony between the act on corporate tax, dividend tax and the respective stipulations of the Stability Ac.

Together with his letter OE-40/707-1/2015 of 16th June 2015 the Speaker of the National Assembly also forwarded to the Chairman of the Council the uniform budget bill T/4730/604 on the 2016 central budget of Hungary that incorporated the amendments endorsed by the National Assembly. In his letter the Speaker asked for the Opinion of the Fiscal Council on the compliance of the bill with the government debt rule, according to § 25 of the Stability Act and the preliminary approval of the Council to submit the budget bill to final voting, according to the stipulations of Indent (3) Article 44 of the Basic Law of Hungary.

II

Resolution of the Fiscal Council

At its meeting held on 19th June 2015 the Fiscal Council reached the following, unanimous resolution regarding the examination of uniform budget bill no. T/4730/604 on the 2016 central budget bill.

1. The Council establishes that the degree of the government debt planned for 31st December 2016 as stated by Point a) Indent (2) § 3 of the uniform budget bill no. T/4730/604 on the 2016 central budget of Hungary is well founded and is in harmony with

the budgetary processes according to the bill. The GDP expected for 2015 and the government debt, as well as the GDP planned for the end of 2016 are based on realistic forecasts. The value of the government debt indicator calculated on the basis of the above data for the end of 2016 (73, 3 %) is lower than the value of the government debt indicator expected for the end of 2015 (74, 3 %). Consequently, the stipulation of Indent (5) Article 36 of the Basic Law of Hungary shall be met.

2. Consequently, in harmony with the stipulation of Indent (3) Article 44 of the Basic Law of Hungary, the Council hereby grants its preliminary consent to submit the uniform budget bill no. T/4730/604 for final voting.

3. The Council hereby authorises its Chairman to inform in writing the Speaker of the National Assembly about its resolution. Additionally, the Chairman shall explain the standpoint of the Council as regards the FC's preliminary consent at the plenary session of the National Assembly.

III

Justification of the Council's Opinion

In relation to the submitted bill no. T/4730 and the changed appropriations endorsed by the National Assembly, both the revenue and expenditure grand totals were affected to the same degree. Hence, the amended cash flow deficit of the central subsystem has not changed. The public finance deficit, calculated by EU methodology, has not changed either. Nevertheless, the amendments have slightly increased the risks surrounding the budget.

The approved amendments have realised the increase of the expenditures partially by leaving the deficit unchanged, as they have reduced the appropriation of the Country Protection Fund by HUF 30 billion (to HUF 70 billion). The appropriation of the chapter stabilising reserve saved for extraordinary expenditures has not changed. Considering that the expected decrease of the debt indicator shall significantly exceed the prescribed measure, in the Council's opinion, there are altogether adequate reserves at disposal to counterbalance the risks. At the same time, the Council maintains its opinion that the target-orientation of the reserves should be improved; namely, in the future it would be practical to define, what risks should the various reserve manage.

They increased the appropriation of other selling and utilisation revenues from HUF 115 billion to HUF 133 billion, thus creating funds for additional investment related expenditures. This would increase the uncertainties concerning the establishment of this resource. At the same time, the related rules link together the launching of investments to the incurring revenues and this shall mitigate the risks of over-spending. Apart from this however, it would be necessary to improve the plans of asset management and to have the appropriated by the law revenues on time.

In several instances the Government decreased expenditure appropriations – often in case of expenditures belonging to the shame chapter – to thus create compensation for the increasing expenditures. Among these there was also an appropriation with open top to cover the redemption of two guarantees. In this case it might happen that the appropriation exceeds its limit mid-year and that shall have to be compensated somewhere else, in order to comply with the targeted deficit. Generally the Council deems it necessary to mitigate the number of appropriations with open top and employing other solutions regarding the possible excess like, for example, by preparing a budget.

The revenues from bank levy have been decreased by HUF 10 billion and thus established the harmony with the amended tax laws.

In the uniform budget bill – similarly to the draft bill that the Council had given its opinion on – and in harmony with the Stability Act, the government debt indicator shall decrease from the 74, 3 percent expected by the end of 2015 to 73, 3 percent. In the Council's opinion the expected reduction of the debt rate is well founded and is in harmony with the foreseen macroeconomic and budgetary processes.

The improvement of the debt rate by 1 percent means that the stipulation of the government debt rule might be met even in case of the emergence of certain negative risks. The danger of the emergence of such negative risks exists even under favourable macroeconomic and public finance processes as the growth of the well-known geopolitical tensions, the uneven performance of the economic output of the EU member-states and the danger of the recurrence of the Euro-zone crisis might weaken the expectations.

Despite the risks surrounding the targeted deficit the Council is of the opinion that the reduction of the debt rate is feasible. Thus the government debt rule, stipulated by Indent (5) Article 36 of the Basic Law probably shall be met in 2016. However, the Council deems it necessary to direct the attention of the Government to the necessity that – in order to securely implement the budget – it should consistently support and strengthen the implementation of the measures improving the efficiency of tax and contribution collection, the execution of measures hindering the accumulation of tax arrears, as well as continue the careful financial management regarding the expenditure and reserve appropriations, displayed in the phase of planning the budget.

The contents of the uniform budget bill no. T/4730/604. did not make it necessary to revise the Council's findings stated in its Opinion no. 4/2015.05.08. about the realisation of the government debt rule.

The Council welcomes that, upon the motion of the Government, the National Assembly amended § 4 of the Stability Act and changed the validity of the so-called debt formula. The new rule, /according to Indent (2a)/ avoids the necessity of resorting to an excessive correction of the budget that would hinder the growth by low inflation rate. Namely, the former debt formula would be valid only in case of having an economic growth and inflation above 3 percent. In every other case the stipulation of the Basic Law to decrease the debt indicator would be valid. The 2016 uniform budget bill meets the stipulations of the new regulation.

As in case of formulating its opinion on the draft bill no. T/4730., apart from relying on the evaluations prepared by the State Audit Office of Hungary and the Central Bank of Hungary, the Council also reviewed the updated economic forecasts prepared by domestic analysing institutions (GKI Gazdaságkutató Zrt.- Economic Research Institute, Századvég Gazdaságkutató Zrt.- Economic Research Institute, MTA Közgazdaság- és Regionális Tudományi Kutatóközpont Közgazdaság-tudományi Intézet – Institute of Economics Centre for Economic and Regional Studies, Hungarian Academy of Sciences), those prepared by international organisations (IMF, OECD, EC) and those, made by other benchmarking market actors and professional fora. Taking into consideration the above too this was how the Council formulated it opinion on the implementation of the government debt rule as stated by the uniform budget bill.

Apart from the above – just like in case of formulating its opinion of the draft budget bill no. T/4730. – the FC also relied on its own evaluation of the state of the execution of the central budget in the second half of 2014 and on the expected trend of the government debt, according to the stipulations of Indent (1) § 23 of the Stability Act. Hence the Council does not plan to formulate a separate opinion on the trend of the budgetary processes in the second half of 2014. In its analysis of the first half of 2015 the Council shall evaluate the relations of the structural changes and public finance.

Budapest, 19th June 2015

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