

**Opinion of the Fiscal Council**  
**on the Execution of the 2018 Central Budget of Hungary and the Trend of**  
**Government Debt**

**I**

**Antecedents, Legal Grounding and Publicity of the Preparation of the Opinion**

According to Point c) Indent (1) § 23 of Act CXCIV of 2011 (hereinafter: Stability Act) the Fiscal Council shall formulate its opinion on the state of the execution of the Central Budget Act and the trend of the government debt every six months.

Accordingly, the Council reviewed the processes of the execution of Act C of 2017 (hereinafter: the 2018 Central Budget Act, Budget Act) throughout the whole year as well as the trend of the government debt.

In its evaluation – following the body’s practice and working method elaborated earlier – the Council was building on the following documents of the FC:

- Opinion on the 2018 budget bill,
  - Opinion on the execution of the 2018 budget act in the first half of the year and
  - Opinion on the 2019 central budget bill.
- In its Opinion 3/2017.04.27. formulated about the draft of the year 2018 central budget bill, the Council found that „the draft was calculating by a high, 4, 3 percent economic growth that exceeded the available forecasts and was built on the expected dynamic growth of the gross average wages and the expected extensive utilisation of EU resources”. The FC also laid down that „with a few exceptions, the expenditure and revenue appropriations were in harmony with the expected realisation of the appropriations of the base year as well as with the data of the macroeconomic forecast of the Government for year 2018”. The Council’s Opinion expressed that the surplus originating from the local governmental subsystem and the organisations classified in the governmental sector outside public finance, were ensuring that the ESA deficit of the total of the governmental sector set by the EU regulations and by Point b) Indent (2) § 3/A of the Stability Act at 3 percent, shall be kept below this limit”. Apart from this the Council called the attention to the risks of „the observation of the EU criteria of structural deficit<sup>1</sup>. „The Council deemed the planned amount set aside for the Country Protection Fund necessary” and agreed with the stipulation that „its utilisation shall be decided only in case of fulfilling the criteria stipulated by the draft bill”.

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<sup>1</sup> The adjusted balance the governmental sector cleaned from the cyclical effects of the economy and individual items (Point y) Indent (1) § 2. of the Public Finance Act).

Beyond the above, in this Opinion, the Council laid down that „the planned nominal growth of the government debt was in harmony with the planned cash deficit of the central budget. The degree of its increase however is significantly lagging behind the planned pace of the nominal GDP growth. As a consequence, the GDP proportionate government debt shall be mitigated to such an extent that the decreasing of the government debt indicator<sup>2</sup> stipulated by the Stability Act shall meet the requirement, laid down by Indent (5) Article 36. of the Fundamental Law concerning the decrease of the government debt indicator<sup>3</sup> and shall – significantly – exceed the measure<sup>4</sup>” stipulated by Indent (2a) § 4. of the Stability Act”. The FC also emphasised that „the expected measure of the decrease of the debt rate<sup>5</sup> was also in harmony with the stipulations of the EU concerning government debt<sup>6</sup>”.

- In the justification section of its Opinion 3/2018.06.07. on the draft of the 2019 central budget bill of Hungary – detailing the expected realisation based on the processes of the first quarter of year 2018 – the Council found that „the international macroeconomic data received up to that point also forecasted a favourable economic activity” for 2018 and 2019 and „the international organisations and domestic institutional and market analysts

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<sup>2</sup> The government debt indicator according to the Stability Act means government debt in the percentage of the Gross National Product (GDP) calculated with the exchange rates fixed by the budget act.

<sup>3</sup> Indents (4) and (5) of Article 36. of the Fundamental Law contains the government debt rule as the most important element of the rule based budgeting. According to this the National Assembly shall not accept a central budget act as a result of what the government debt would exceed half of the GDP. As long as the government debt exceeds half of the GDP, the National Assembly is allowed to accept only such a central budget act that contains the decreasing of the government debt in proportion to the GDP.

<sup>4</sup> Application of the government debt rule according to Indent (2) and (2a) § 4. of the Stability Act:

- in the course of the preparation of the central budget bill the government debt rule shall have to be taken into consideration both for the basis year and the last day of the budget year as the ratio of the expected government debt and the gross national product projected for the given year.

- when calculating the indicator the debt of the central subsystems of the public finance and of other organisations classified in the governmental sector shall have to be calculated by filtering out their obligations toward each other (consolidated) and compared to the GDP.

- transactions denominated in foreign currency shall have to be considered at an exchange rate stipulated by the central budget act.

- any growth of government debt that originate from the timeframe of the ex-post reimbursement of EU resources, the possible lack of liquidity of the European Union’s budget or any other reasons that resulted in not accounting with in the central budget shall not be considered in the calculations.

According to the stipulations of the Stability Act that came into power in 2015 the planned value of the government debt at the end of the year shall be determined in such a way that the pace of the growth rate of government debt compared to that of the previous year shall not exceed the difference of the prognosis rate of inflation stipulated by the budget act and the half of the real GDP growth (*debt formula rule*). This rule can be observed only if the rate of inflation planned by the budget act and the planned value of the real economy growth both exceed 3 percent. Otherwise at least 0, 1 percent decrease of the debt rate shall have to be achieved.

The rule stipulated by Indent (3) Article 37. of the Fundamental Law concerning the execution of the budget is the following: as long as the government debt exceed half of the GDP no borrowing should take place in the course of the execution of the central budget and no such financial obligations shall be undertaken as a result of what the proportion of the government debt to the gross national product would increase when compared to the proportion of the last year.

<sup>5</sup> The degree of government debt projected to the gross national product

<sup>6</sup> The debt rule of the European Union is defined by Treaty on the Functioning of the European Union and the Resolution 1467/97/EK of 7th July 1997. The debt rule of the EU relates to Hungary from 2016.

According to this rule the ratio of the government debt to the gross national product (GDP) shall not exceed 60 percent. In case the ratio is higher than the given reference value the departure shall have to be decreased at a rate of one twentieth annually compared to the benchmark of the previous three years.

expected the continuation of a strong increase also in the future. Additionally, their forecasts foresee a growth rate around 4 percent”. However, the FC directed the attention to the fact that „apart from the external conditions generally supporting the growth rate, circumstances bearing dangers might also appear to a significant extent [...] that might affect the economic output of the country in 2018”.

In the Justification part of this resolution the FC underlined also that „the economic development strategy of the Government was supporting the domestic growth together with the continuing reduction of tax and contributions, and the utilisation of the EU resources aiming the improvement of the employment activities”. The Council deemed it favourable that „the investment activities have been growing significantly in most fields of the national economy”. Additionally, on the basis of the processes of the first quarter the Council „considered the expected economic growth in 2018 very closely achievable compared to the expectations of the Government”, and „according to its opinion „the 2, 4 percent targeted deficit for year 2018, calculated by the EU methodology, was achievable”. At the same time the Council called the attention to the fact that the objective of the structural deficit by the Convergence Programme for 2018 was higher [...] than the 1, 5 percent stipulated by Point a) Indent (2) § 3/A. of the Stability Act as the medium range fiscal goal”.

- In its Opinion 5/2017.06.14. formulated for the final vote on Hungary’s 2018 central budget the FC expounded that „the degree of the government indicator laid down as the target for the 31st December 2018 by Indent (3) § 3. of the uniform budget bill T/15381/1237 on the 2018 central Budget of Hungary was well-founded, established according to the relevant stipulations of the Stability Act and – by the increased risks due to the increase of certain revenue appropriations – was in harmony with the processes serving as the foundations of the bill” thus, the stipulation of Indent (5) Article 36 of the Fundamental Law was fulfilled.
- In its Opinion 6/2018.09.18. formulated on the state of the execution of Hungary’s 2018 central budget act and the expected development of the government debt, by taking into consideration the processes of the first half of the year and the favourable macroeconomic processes, the Council considered that „the economic growth throughout the year might be around 4, 3 percent that was in harmony with the governmental expectations”. Additionally the FC was on the opinion that the annual ESA targeted deficit – calculated by the EU methodology – was achievable as „when calculating it, the advance payment of the EU supports shall not be considered”. The Council also pointed out that in order to attain the targeted deficit it was necessary to have a strong control over the expenditures, especially in case of the central budgetary organisations”. The FC identified significant risks regarding the feasibility of the targeted annual cash deficit. In its Opinion the Fiscal Council stated that „the reason for the worse than expected realisation of the pro rata cash deficit on the revenues’ side was mostly the backlog concerning the revenues of the approved EU programmes [...] while on the side of expenditures and chapter managed appropriations, the implementations were exceeding the pro rata share by 10 percent”.

Finally, the Council pointed out that „the cash accounting principle of the targeted deficit would be achievable only in case the cash accounting arrival of the EU revenues were accelerated and, in case of the expenditures, especially in case of budgetary chapters, the financial control would be stricter”. Beyond the above the FC welcomed the fact that the foreign currency exposure of the central budget via the government debt moderated further, just as the establishment of the Central Residue Accounting Fund, as the latter „might assist the implementation of the balance requirements”. At the same time the FC saw that „primarily due to the significant economic growth the degree of the GDP proportionate government debt might decrease in harmony with the stipulations of the Fundamental Law and the Stability Act and, by the end of the year the degree of the estimated GDP proportionate government debt calculated by EU methodology will very likely meet the so-called one-twentieth rule as well”.

When analysing the execution of the 2018 central budget act of Hungary and of the development of government debt - in line with its practice so far - the FC was considering the written analyses prepared by the State Audit Office of Hungary and the Central Bank of Hungary about the implementation processes of the 2018 central budget, as well as the data collected by the Hungarian Central Statistical Office (KSH) and the various information materials of the Ministry of National Economy. Apart from the above the Council was building on the contents of the Convergence Programmes of Hungary for 2017 – 2021 and 2018 – 2022, as well as the updated forecasts of international organisations (EU, IMF, OECD) and those prepared by market analysts. The additional data requested from and delivered by the Ministry of National Economy also contributed to the evaluation.

However, the Council could not consider the contents of the final account bill that was built on final data as – in harmony with the stipulations of Act CXCV of 2011 on Public Finance – the Government shall submit it to the National Assembly only later.

During the year the National Assembly has not amended the 2018 central budget act as regards the targeted deficit and government debt so those were not changed.

The FC shall inform the Speaker of the National Assembly and the Government about its Opinion and shall publish it on the website of the National Assembly.

## II

### **The Council's Opinion**

At its meeting held on 3rd of June 2019 the Council reviewed the major trends and their respective background regarding the implementation of Act C of 2017 on the 2018 central budget act of Hungary in harmony with the stipulations of Point c) Indent (1) § 23 of the Stability Act. The FC formulated the following Opinion on the above basis.

1) The Council deemed that the Hungarian economic development had a favourable effect on the processes of public finance – as a result of the changing conditions of the world economy and the development of domestic conditions and, as a result of the fiscal and monetary measures taken - and despite the continuing risks, it remained stable and was on a sustainable course. In 2018 the degree of the growth of the real economy was outstanding and the 4, 9 percent expansion well exceeded the measures of the previous years and the expectations of the Government and the analysts.

2) The Council found that the cash deficit of the central subsystem of public finance was HUF 1 445 billion that, as regards the substance, was lower than that amount in 2017 and exceeded only to a minimum degree the amount of the cash deficit defined by the budget act, i.e. HUF 1 361 billion. On the whole the revenues of the central subsystem of public finance were met at a more favourable level, in case of both the statutory appropriations and in comparison to the previous year. Thanks primarily to the dynamic growth of wages and the additional expansion of investments and consumption, the taxes that represent a decisive share (value added tax, excise duty, personal income tax, corporate tax) grew significantly over the evidence of the basis year. The significant increase of value added tax compared to the data of year 2017 was partially the result of the extension of the estimated tax (for example household consumption). Beyond this, the introduction of online invoicing also contributed to the growth of the VAT revenues. On the whole, the expenditures turned out to be higher than the appropriation as well, but were founded by the additional revenues thus making it possible to finance the major priorities – like the six-year-long wage agreement, the homemaking programme, or paying advances on the EU revenues.

3) The ESA deficit of the governmental sector<sup>7</sup> in 2018 was 2, 2 percent of the GDP that was lower than the targeted deficit of the Government set for 2, 4 percent for 2018, and in proportion to the GDP it equals the year 2017 deficit. The EU and domestic stipulations concerning the cash deficit of the public finance were met also in 2018, similarly to the previous years. At the same time the structural deficit in 2018 exceeded the 1, 5 percent share that had been defined as the medium range fiscal goal, stipulated by Point a) Indent (2) of § 3/A of the Stability Act.

4) The Council found that at the end of year 2018 the GDP proportionate government debt was 70, 8 percent according to the EDP report. The debt rate has significantly declined by 2, 6 percent compared to the 73, 4 percent at the end of year 2017. It was the considerable economic growth that primarily contributed to this decline and was also supported by the low level of net financing demand. The degree of the declining government debt was in harmony with the criteria stipulated by both the Fundamental Law and the Stability Act. Apart from this the Council deems it positive that within the central debt the share of foreign currency denominated debt kept declining to 20 percent and the internal financing – within this retail funding - gained strength. Thus the external vulnerability of the country became even smaller.

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<sup>7</sup> Apart from the central and local subsystem of public finance it also contains the data of organisations classified under this title by regulation 479/2009/EK.

5) The Council in particular underlined the measures implemented by the Government in 2018 in order to control public finance. Thus, the surplus financing need originating from the advance payments for the EU supports was mitigated by ordering the actors of the governmental sector to transfer the unused residue of the earlier received EU advances exceeding HUF 50 billion to their respective accounts kept at Hungarian State Treasury while the regulations related to future EU advance payments became more strict as well. The establishment of the Central Residue Accounting Fund<sup>8</sup> in 2018 indirectly could also promote the enforcement of the balance requirements.

### III

#### Justification

##### 1. The Development of Macroeconomic Conditions

In the Council's opinion domestic economy continues to follow a stable growth course that is sustainable in the medium term, thanks to the mostly favourable external conditions that support the growth and despite the threats identified in the FC's Opinions 3/2017.04.27. and 3/2018.06.07. These factors served as a solid foundation for the implementation of the 2018 macroeconomic and public finance indicators, according to the expectations delineated at the time of creating the budget act.

The 2018 budget act was calculating with a growth rate of 4, 3 percent that exceeded the expected rate of the forecasts at the time. In the preparation phase of the budget benchmarking international organisations (EU, IMF, OECD, etc.) as well as market analysts were forecasting a smaller growth then revised their forecasts upward several times during the year.

Domestic economy produced a greater than expected growth rate in 2018, amounting to 4, 9 percent. This was the quickest pace since 2005 and significantly exceeded the EU average (in the Euro zone this rate was 1, 8 percent and in the whole of the European Union it reached 1, 9 percent). According to the consideration of the Council the outstanding expansion of the GDP was supported by the favourable external conditions and, primarily, by the strengthening internal demand and, within it, the development of consumption and investments were playing a decisive role. The lasting and dynamic increase of real wages and the expansion of lending to households also supported the growth of household consumption. By the significant reduction of taxes and contributions, fiscal policy expanded aggregate demand in 2018 and apart from this it also supported the improvement of real economy output together with the more evenly paced utilisation of EU resources. The FC is on the opinion that the

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<sup>8</sup> The regulation of Government Resolution 368/2011. (XII.31.) regarding the budgetary residuals has changed as of 1st January 2018. According to the new regulation the residuals not burdened by obligations shall have to be paid for KMA (quasi reserve). It is the Government that decides upon the utilisation of the KMA upon the submission of the Ministry of National Economy.

foundations of sustainable growth are stable although, in the following years a gradual slowing down of the growth rate is expected.

**From production side**, parallel with the recovery of domestic demand, it was the services that contributed to the **growth** in 2018 (by 2, 4 percent) while the contribution of building industry was 0, 8 percent, of the industry 0, 7 percent and agriculture 0, 2 percent.

Industrial output expanded by 3, 6 percent compared to the previous year. Within this, manufacturing industry by 3, 7 percent, energy industry by 3, 3 percent and mining, that represents a minor share, increased its output by 54 percent. Industrial output was improving in every region. The output of building industry grew by 22, 3 percent, compared to year 2017 and within this, building construction represented 16 percent, building other constructions grew by 31, 4 percent. The output of agriculture was higher by 5, 3 percent compared to the previous year.

Thanks to the favourable recovery, the expansion of retail sale has been steadily growing during the past five years and throughout the whole of year 2018 it grew by 6 percent in comparison to the previous year. Within this, food retail grew by 3, 4 percent, non-food retail by 9, 1 percent and fuel sales by 6, 4 percent. The gross revenues of commercial accommodation services was significantly higher (by 9, 3 percent) than in the preceding year. Apart from this, the utilisation rate of capacities also grew and the number of registered overnight accommodations grew by 3, 8 percent.

The volume of investments significantly grew by 17 percent compared to the previous year and within these building investments by 22 percent, investments related to machinery and equipment by 11 percent. The recovery was partly due to the favourable outlook, partly to the housing and property developments. Investment activity grew at every field of the economy. From among the most significant branches of national economy it reached 33 percent (above average) in the field of transportation and storage thanks to road, railway and motorway constructions. In the energy industry that represents lesser importance, the growth was outstanding (68 percent), while in the field of manufacturing it was below average (6, 3 percent).

The investment recovery was supported by the low interest rates, the growth of the outflow of loans above 10 percent, that was growing in a healthy structure, the high utilisation of capacities, the increasing internal demand and the growing utilisation of the EU supports from the 2014 – 2020 budget cycle. It was also a favourable factor that the developments and capacity enhancing concerned all branches of the national economy.

Thanks to the growth of the available incomes and the various governmental programmes (for example, the Family Housing Support Program – CSOK and the reduction of the VAT tax rate in case of new homes), household investment activities remained dynamic. The numbers of newly built homes kept increasing also in 2018: 17 681 new homes were completed in 2018 that is more by 23 percent compared to the previous year. The building permissions and

the number of newly built homes based on simple reporting was 36 719 that was slightly less than in the previous year (37 997).

**On the utilisation side the GDP growth** was prompted by domestic consumption thanks to the significant raise of wages and the expansion of employment. As regards the whole year the average number of employees was 4 469 thousand, that is more by 48 thousand compared to the data of the previous year. The number of employees on the primary labour market was 99 thousand, while the number of those employed in public works decreased by 46 thousand and those working at permanent establishments in foreign countries decreased by 5 thousand. The employment rate of the age group of 15 to 64 grew by 1, 1 percent and reached the historically outstanding 69, 2 percent. The number of unemployed continued to decline: their number decreased by 20 thousand, compared to the similar data last year and reached the total of 172 thousand while the unemployment rate decreased by 0, 4 percent to 3, 7 percent.

By the favourable employment indicators the tighter job market contributed to the additional growth of the wages. In 2018 both the net and gross average wages grew equally by 11, 3 percent compared to the previous year. Regarding the fact that consumer prices grew by 2, 8 percent in 2018, real wages increased by 8, 3 percent. The average gross wages of those employed full time was HUF 329 900 and the net average wages on national economy level were HUF 219 400. The increasing of minimum wages by 8 percent and the guaranteed wage minimum by 12 percent, together with the wage rising concerning certain fields of the budgetary sector and employees of specific public operators considerably contributed the bigger average wages. Thereby, the income of the households grew and this affected favourably the purchase of consumer goods and, ultimately, the tax and contributions' revenues.

As regards the 2, 8 percent increase of consumer prices, food prices were playing a decisive part (4, 2 percent), together with the increase of alcohol and tobacco prices (5, 6 percent). Apart from these, domestic energy costs increased to a lesser extent (1, 4 percent), articles of clothing (0, 5 percent) and services (1, 6 percent).

The supporting external conditions and the favourable macroeconomic conditions – together with a disciplined fiscal and financial management policy – created a solid foundation for the realisation of the 2018 central budget act thus, for the realisation of the tax and contributions revenues of the budget and the maintaining of the deficit and government debt targets.

### **The Development of Revenues**

As regards **the year 2018 combined, not consolidated revenues of the central subsystem** of public finance (without filtering the transfers – accumulations – within public finance) the performance was HUF 19.873 billion that equals 106 percent of the annual appropriation (exceeding last year's annual revenues by the amount of HUF 1.112 billion and in proportion



by 3, 3 percent). As regards revenues, governmental measures also have had a meaningful emotional impact beside the favourable macroeconomic processes.

Revenues of **the central budget** within the subsystem amounted to HUF 13.594 billion that is 68 percent of the revenue totals of the central subsystem.

- The total of the **payments of entities** amounted to HUF 1.429,8 billion that is higher by 5, 6 percent than the respective appropriation. In this group of revenues the most significant **corporation tax** realisation was 102, 9 percent compared to the statutory appropriation. The revenues exceeded the appropriated amounts in case of the majority of the payment titles as well: thus, in case of the income tax of energy suppliers (114, 9 percent), the energy tax (106, 2 percent), the congestion charges (112, 5 percent), the mining fees (118, 8 percent), gambling tax (113, 1 percent) and the special tax of financial organisations (105, 8 percent). The Itemized Accounting of Small Taxpayers significantly exceed the annual appropriation (by 10, 5 percent) as well as the realisation of small enterprise tax (by 53, 3 percent), because the measures introduced by the Government with the purpose of lessening tax burdens and administration were steering taxpayers from paying simplified business tax and corporate tax, towards taxes meaning less burdens. Essentially it is thanks to this (the decreasing number of taxpayers falling within the scope of Simplified Business Tax) the lagging behind of the simplified business tax turned out to be less (77, 8 percent) than the appropriation. In case of public utility tax (98, 6 percent) and the bit lower advertisement tax (88, 0 percent) the realisation was close to the appropriated amounts.
- From the **other, centralised revenues** the share of the central budget was higher by 9, 3 percent than the appropriation (HUF 507, 5 billion). Within this revenue the revenues from the electronic and time base road tolls represented a decisive portion, approximately 50 percent.
- From the **consumption related taxes** the revenue of the central budget was HUF 5.411,7 billion, i.e. 102, 8 percent of the appropriation. Each payment belonging to this category exceeded the annual appropriation thus: in case of registration tax (103, 9 percent), telecommunication tax (103, 3 percent), insurance tax (112, 8 percent), financial transaction duty (113, 9 percent) and tourism development contribution (166, 6 percent). Even in comparison to the preceding years the **revenues from value added tax** was outstanding (102, 3 percent) and amounted to HUF 90, 1 billion that exceeded the appropriation (and by HUF 403 billion as regards the similar revenues in the previous year). Measures improving tax collection in 2018 had an important role in this favourable result and within it, the launching of online/e-invoicing respectively, the earlier introduction of online cash registers and the Electronic Public Road Trade Control System (EKÁER).
- From **excise duties** the revenue of the central budget was HUF 1.111,9 billion (101, 1 percent). This amounted to a surplus amounting to HUF 89, 8 billion compared to the previous year. The revenue increase was related on one hand to the expansion of the commerce, on the other hand to the changing regulations and the increase of the taxes in case of tobacco good and alcohol.

- **Retail payments** resulted in revenues worth of HUF 2.425,3 billion for the central budget. It's the **personal income tax** that represents the largest revenues both in amount and percentage and reached HUF 2.177,4 billion (103, 9 percent of the appropriation). This was more by HUF 257 billion compared to the personal income tax revenue of the previous year. This significant increase of the revenue is related to the favourable trend of the macroeconomic processes, primarily to the dynamic increase of the gross wage bill.
- The **duty revenues** were realised to 101, 3 percent due to the real estate sales, the level of what remained high. **Motor vehicle tax** was realised at 108, 9 percent of the appropriated amount in 2018 that meant HUF 2 billion more than in 2017. The growth was the result of the surge in selling new cars.
- The revenues of **budgetary organisations and chapter managed appropriations** were HUF 2.390 billion (177, 0 percent). From this amount HUF 2.180 billion appeared (more than the appropriated amount i.e. by more than one and a half time of the planned amount, i.e. 165, 3 percent). In case of the professional chapter managed appropriations the realisation was more than seven times of the appropriation that, mostly was the result of the accumulations within public finance (similarly to the previous years). As regards the EU support for professional chapter managed appropriations, the realisation was HUF 0, 7 billion, that is 23, 2 percent of the appropriation.
- **Revenues from state assets** (mainly from selling, renting properties, movable properties, selling corporate equities, dividends) amounted to HUF 184, 5 billion (192 percent).
- **Interest revenues** exceeded the annual appropriation by HUF 47 billion, i.e. by 64 percent. The excess revenue was mostly realised by issuing Forint denominated bonds
- Revenues of the appropriated **EU programmes** amounted to HUF 1053, 6 billion that equals 55, 1 percent of the annual appropriation. Just like in 2017, the majority of the revenues concentrated for the end of the year and were related to the Széchenyi 2020 Operative Programmes and the Rural Development Programme. The revenues of the EU programmes are defined primarily by the actual use of the resources instead of the volume of the payments, as the individual expenditures can be accounted for to the European Commission only afterwards.
- From the title of **other EU revenues** the ex post returns realised HUF 260, 9 billion (more than four times higher than the appropriation) for the closed programmes of the 2007 – 2013 period.
- The amount of HUF 199, 8 billion arrived in the central budget under the title of levy for the **Quasi Reserve** (KMA). According to the earlier mentioned stipulations, budgetary residues not burdened by obligations, had to be transferred to this fund due to the fact that the rules of procedure concerning the 'withholding' of these residues was changed. Thus the amount that earlier had been transferred from the ministries, shall arrive in the KMA and that is from where the utilisation takes place. This solution improves the transparency of the utilisation of residuals and the aspects of the balance are also taken into consideration.

The total revenues of **the earmarked state funds** were HUF 575, 4 billion, i.e. 111, 3 percent of the appropriation. From among the earmarked state funds the revenues of the National Employment Fund (NFA) that represents the biggest share amounted to 98, 2 percent of the

appropriations. From among these, the backlog was solely related to the return of the expenditures of the pre-financed EU programmes (91, 9 percent). Excess realisation took place in case of vocational training levy (123, 1 percent) and regarding the proportion due to the National Employment Fund of the health insurance and the labour market contribution (101, 8 percent). The total of the revenues of the National Research, Development and Innovation Fund was realised at 96, 4 percent. The innovation levy was foregone compared to the appropriation (95, 9 percent) while the other revenues of the fund were realised at 101, 9 percent. Revenues of the rest of the earmarked state funds were realised above the appropriation: the Central Nuclear Financial Funds by 8, 7 percent, the National Cultural Fund by 11, 6 percent, and the Bethlen Gábor Fund was higher by 247, 4 percent.

The total revenue appropriation of the **social security funds** (HUF 5.680,6 billion) was realised at 100, 4 percent (within it the revenues of the Pension Fund at 99, 8 percent while the revenues of the Health Insurance Fund at 101, 3 percent). A decisive share of the social security fund revenues (in case of the Pension Fund 97, 3 percent and in case of the Health Insurance Fund 58, 9 percent) originated from the social contribution tax and other contributions. Compared to the previous year the revenue from this payment to the Pension Fund was higher by HUF 304, 7 billion. This was the result of the combined effects of several factors: on the one hand, as of 2018 the degree of the social contribution tax decreased from 22 percent to 19, 5 percent, on the other hand, the share of the Fund from this resource grew from 71, 61 percent to 79, 5 percent. Additionally, the significant increase of gross wages increased the tax and contribution funds. The revenues of the Health Insurance Fund from social contribution and other contributions exceeded the amount of the previous year by HUF 86, 4 billion. From among the additional revenue titles of the funds failures occurred as regards arrears charges, fines, budgetary supports and remunerations as well as other revenues, compared to the previous year. In case of the Health Insurance Fund the arrears charges, fines and the healthcare contribution were outstanding compared to the previous year.

## 2. The Implementation of Expenditures

The amount of the total **expenditures of the central subsystem** was HUF 21.318,1 billion – similarly to the year 2018 expenditures without consolidation. This exceeded slightly the previous year's result (by 1, 2 percent), at the same time it amounted to 106, 0 percent of the appropriation.

The share of the **central budget** within the central subsystem was 70, 2 percent (HUF 14.962,8 billion) compared to the previous year's 71 percent. The realised expenditures turned out to be significantly higher (by 7, 9 percent) than the appropriation, while it's practically the same amount as that of the previous year.

- **The chapter managed appropriations of the budgetary organisations** remain the biggest item for what they used HUF 10.387,4 billion, just 101, 3 percent of the appropriation but it was 114, 3 percent of the appropriation. Within this, *the expenditures of the budgetary organisations* (HUF 5.694 billion) exceeded to the greatest extent the

planned amount (by 31, 4 percent) and that of the previous year (by 10, 7 percent). This time it was again the wages and contributions that made up the decisive share (55 percent) that turned out to be higher by 6, 6 percent than in 2017 and within this, individual entitlements stood out by a 9, 3 percent increase. The growth rate of material expenditures exceeded 11 percent compared to the basis year and thus the high expansion of the purchased consumer expenses witnessed in 2017 continued. The measures introduced by the Government mentioned already as a positive step in the chapter dealing with revenues namely, that for the first time in 2018, the budgetary chapters were obliged to pay the appropriation residues not burdened by obligations to the Central Residue Accounting Fund to be used later for expenditure purposes defined by Government resolutions, were playing a role in the significant departure from the planned amount (i.e. it increased the gross expenditures). From the *expenditures of the professional chapter managed appropriations* amounting to HUF 2807, 2 billion (120, 2 percent) the most outstanding supports were used for the following goals: educational and social human services, national agrarian goals, the priority public road projects, the Modern Cities Programme, the Connecting Europe Facility (CEF) projects, the development and maintenance of sports facilities and the handling of mass immigration. At the same time, the *professional chapter managed EU expenditures* were HUF 1.886 billion that represented 78 percent of the annual appropriation and 73, 4 percent of the 2017 factual data. The backlog was justified by the interim tightening of the system of advance payments and the lower than expected realisation of the EU development programmes. The largest payments among the operative cohesion programmes occurred in connection with land, urban and human resources developments.

- For **individual and normative supports** they were using more by HUF 381, 6 billion (16, 9 percent) than in the previous year and more than the appropriation (by 2, 4 percent). Two thirds of the payments were related to passenger transport within public transportation, the remaining part to the operation of the railway network and the Eximbank Zrt. (under the title of interest rate compensation).
- The **amount of home building supports** represented close to HUF 193, 2 percent that was 104, 6 percent compared to the previous year however, it was only 81, 7 percent of the planned amount. Within this the most significant item was the Family Housing Allowance (CSOK) for what approximately HUF 84 billion was spent.
- From the **National Family and Social Policy Fund** they used HUF 641, 3 billion, slightly less than both the appropriation and the expenditure of the previous year. Within the expenditures of the Fund the most significant part was spent on *supporting families* that includes family allowance, childcare allowance and young people's lifetime support. For the above goals they used altogether HUF 400, 4 billion that – due to the demographics – was less by 1, 4 percent than the same expenditures in 2017. The expenditures of *underage supports* also has been shrinking as the entitled people are gradually reaching the age limit set for statutory retirement age thus, they belong to the population of those receiving retirement pension. The amounts used for *income replacement benefits and social income support* (HUF 122 billion) have also decreased and were serving mostly the goals of the social tasks of the districts (care allowance,

benefits for the elderly and the ever decreasing employment benefits, due to the favourable labour market processes).

- The amount of **interest expenditure** payment was HUF 1.048,4 billion that although exceeded by 7, 2 percent the appropriation, but was lagging behind by 4 percent of the similar expenditures of last year. Similarly to the previous years, the decrease was the result of the ongoing change of the value of government debt in a lasting environment of low returns and the continuing mitigation of the debt rate since 2011.
- They were using HUF 283, 5 billion for **expenses related to state assets**, that was two thirds of the previous year and lower by 12 percent than the appropriation. The maximum content was put up by the allocations of resources by state owned companies but spending on the maintenance and investments of state properties also represented a significant share.
- HUF 746, 8 billion was transferred **to support local governments**. Similarly to the previous year, as well as the appropriation, this represented a growth of 6-7 percent. From the increase they were financing the additional tasks related to various wage policy measures, developments and nursery related expenditures.

2, 7 percent of the central subsystem's expenditures were used for the **earmarked state funds**. The realised amount of HUF 567, 9 billion slightly exceeded the appropriation and reached merely 87, 7 percent of the output of the previous year. Within the earmarked state funds the most significant item was the expenditure of the *National Employment Fund* where, compared to the previous year, the setback was considerable again (15, 4 percent) as the number of people employed in public works and finance from the Start Work Programme is continuously decreasing. *The Bethlen Gábor Fund* serving goals beyond the borders of Hungary also grew, compared both to the appropriation and the previous year and by now is close to HUF 90,0 billion. The expenditures of the *National Research, Development and Innovation Fund* – in harmony with the generated revenues – decreased while the utilisations of the *National Nuclear Financial Fund* and the *National Cultural Fund* were realised at the same level as in 2017.

The **combined** expenditures of the two **social security funds** amounted to HUF 5.787,5 billion, 101, 9 percent of the appropriations and, at the same time, considerable higher (by 5, 8 percent) than the realisation in the previous year. This represented more than 27 percent of the central subsystem, compared to the result of the previous year that was 26 percent.

- The **Pension Fund** represented a bigger proportion (with its 58 percent share that was making up the actual expenditure of HUF 3353, 7 billion). Basically this served the purpose of pension benefits the amount of what (HUF 3347, 4 billion) was higher by 5, 5 percent than in the previous year. Within this, the pensions paid for those eligible for old age pension increased by HUF 149,2 billion, pensions paid to women who reached the eligibility by having 40 years of service time, grew by HUF 9, 5 billion compared to year 2017. Just like in November 2017, pension premiums were also paid in November 2018. The amount was HUF 41 billion and the maximum amount per person of the premium was HUF 18 thousand. The circle of beneficiaries was

expanded beyond the circle of old age pensioners to those who have not reached the statutory age limit for old age pension and those, receiving pension-like benefits as well.

The amount of HUF 2433, 8 billion was used from the **Health Insurance Fund** that was 104, 9 percent of the appropriation while this share was 107, 6 percent in the previous year. The largest amount, HUF 1306, 3 billion (more by 8, 5 percent than the planned amount and more by 9, 2 percent than in the previous year) was used for *curative and preventive care*. The growth compared to the base year on the one hand concerned doctors and healthcare professionals while, on the other hand it was spent on larger amount financing of general practitioners and dental care providers. The second largest item (HUF 358 billion) was spent on *medicine reimbursements* that were higher by 6 percent than in 2017. Payments for *invalidity and rehabilitation care* represented also a significant amount however; it has been degressively proportional according to the trend of the number of those eligible for such supports. The Fund used HUF 176, 0 billion for *Child Benefit*, exceeding by 16 percent the evidence of year of 2017. The reason for such dynamic increase on the one hand was that due to the 8, 2 percent increase of the minimum wage at the beginning of 2018 the maximum amount of child benefit also increased while, on the other hand, the number of those provided keeps growing.

#### 4. Achieving the Deficit Target

The accrual based deficit of public finance has been under 3 percent of the GDP for seven consecutive years and since 2015 it was around 2 percent. According to the EDP report<sup>9</sup> published by the Central Statistical Office, the 2018 ESA deficit of the governmental sector was 2, 2 percent of the GDP that was lower than the 2, 4 percent set as the targeted government deficit by the budget act and as regards its GDP portion it is the same as the year 2017 accrual based deficit. Similarly to the previous two years the deficit evolved fundamentally in the last quarter of the year. Through the whole year 0, 3 percent primary balance surplus was realised in proportion to the GDP while the net interest expensed amounted to 2, 5 percent of the GDP.

Halfway the year the cash deficit of the public finance central subsystem was still exceeding the total of the planned share for the whole the year (and was one and a half times more than the result in the first half of 2017) and the FC called the attention to this fact in its Opinion 6/2018.09.18. The advance payments of the EU supports significantly contributed to the high cash deficit. The advance payments decreased in the second half of the year and the cover of the factually utilised EU supports arrived at the end of the year. As a result, as well as thanks to the high level of tax revenues and the controlling of the expenditures, the cash deficit amounted finally to HUF 1.445, 1 billion, only slightly more (by 6, 2 percent) than the planned amount according to the budget.

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<sup>9</sup> In the frame of the Excessive Deficit Procedure=EDP the member states prepare a data report (EDP Report, Notification) about the trend of the two key indicators of the governmental sector: the government deficit and the government debt.

Thanks to receiving advance payment from the central budget for financing EU programmes, the local governments reached a cash flow surplus amounting to HUF 254 billion. At the same time their accrual balance – where the advance payments were not taken into consideration – did show a deficit worth of HUF 42 billion.

The structural deficit exceeded the statutory 1, 5 percent set forth by Point a) Indent (2) § 3/A of the Stability Act as the medium term budget target, also in 2018. The Council pointed out this risk in its Opinion 3/2017.04.27. formulated on the year 2018 draft central budget bill.

## **5. Compliance of the Government Debt Rules**

The decreasing of the GDP proportionate gross government debt that started in 2011 continued also in 2018 thus, the end of the year debt rate calculated by EU methodology subsided by the end of 2018 to 70, 8 percent from the 73, 4 percent at the end of 2017. The decreasing of the debt rate – also considering the peculiarities of individual regulations – is in harmony with the respective stipulations of the Fundamental Law, the Stability Act and the EU regulations concerning government debt.

The more dynamic than expected economic growth, the moderating interest expenditures and the positive primary balance all exerted a significant role in the substantive improvement of the debt rate.

The changing regulations concerning the account management of local governments and public undertakings also contributed to the decreasing of the debt rate. According to Indent (4) § 51. of the Public Finance Act the advance payments concerning EU supports (exceeding the amount of HUF 50 million) for public beneficiaries (local governments, state owned enterprises) also have to be managed by treasury accounts (this „shifting” had to be completed by 30th of September, 2018). Indirectly, but in the same way, the establishing of the Central Residue Accounting Fund also might have contributed to the asserting of the balance requirements. The favourable structural transformation of the debts of the central budget continued also in 2018. By the end of the year the share of foreign currency denominated debt within the central debt decreased to 20, 1 percent (in 2011 it still was 50 percent). The increasing portfolio of government securities held by households also supported the domestic financing in 2018. The increase by more than HUF 750 billion reached the amount of HUF 5.780 billion. Financing sovereign debt from internal, Forint denominated resources is contributing to the mitigation of the external vulnerability of the country.

3rd of June, 2019

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