

Opinion of the Fiscal Council

on the Draft of the Year 2020 Central Budget Bill of Hungary

I

Antecedents, Legal Basis and Publicity of the Opinion

According to § 24. of Act CXCV of 2011 on the Economic Stability of Hungary and, in harmony with the stipulations of Indent (2) Article 44. of the Fundamental Law, the Fiscal Council (henceforth: Council or FC) shall formulate its opinion on the draft central budget bill. In its opinion the Council may make observations and – in case it has fundamental objections concerning the draft document, respectively its authenticity or enforceability – the FC may indicate its disagreement.

The Government submitted the document that had been approved as the 2020 draft central budget bill of Hungary (henceforward: draft) as an appendix of Minister for National Economy Mr. Mihály Varga's letter (File no: PM/5/10/2019.) in which he asked for the opinion of the Council.

The Council formulated its evaluation on the draft by taking into consideration the following antecedents related to Act L on the 2019 Central Budget of Hungary.

- In its Opinion 3/2018.06.07. concerning the draft of the year 2019 central budget bill, the FC found that „the draft budget bill is calculating with a high, 4, 1 percent economic growth that exceeds even the forecasters' consensus for 2019, [...]” Additionally, according to the FC's judgement “this expectation can be realised only if the assumed significant increase of the wages and employment rate, together with the ensuing expansion of household consumption will take place”. The Council added that „additional measures targeted at increasing competitiveness might support this goal” but the FC also pointed out that „the uncertainties of the international economic environment are strengthening the risks surrounding the economic growth.”

Further, the Council noted that „in the draft the revenue and expenditure appropriations are in harmony [...] with the macroeconomic processes planned for 2019. To realise the revenue appropriations it is necessary to implement the macroeconomic scenario. Additionally, the FC was on the opinion that „the draft was calculating realistically with the expenditures [...], the reserves represent a cover for handling the macroeconomic risks”. The Council deemed that „the GDP proportionate 1, 8 percent targeted deficit of the draft document, calculated by EU methodology (ESA 2010)” and considering the reserves viable was referring also to the fact that „it

was in harmony with the Maastricht criteria and the stipulation of Point b) Indent (2) § 3/A of the Stability Act, i.e. the requirement of 3 percent deficit limit". Apart from this, in the Justification section of its Opinion the FC pointed out that „the planned reduction of the fiscal deficit is in harmony with the cyclic processes of the economy and is able to accelerate the reduction of the debt rate¹ without slowing down the economic growth." Following this the Council called the attention to the fact that „according to the draft budget bill the structural balance² deviates from the medium term targets just like in 2017 and 2018 (although in 2019 it'll approach it again however, it is still higher by 0, 2 percent) thus it deemed it necessary to introduce measures that would not endanger the economic growth in order to meet the undertaken structural balance. Beyond the above, in its Opinion the FC also stated that the trend of the 2018-2019 annual government debt indicator³ - in harmony with the stipulations of the Stability Act and calculated at constant exchange rate – is in harmony with both the planned and foreseen 2018-2019 government debt indicator and meets „the (government debt indicator) stipulations⁴ as prescribed by Indent (5) Article 36. of the Fundamental Law". Simultaneously, the FC Opinion also laid down that „the planned degree of the decreasing of the debt rate is in harmony with the stipulations of the European Union concerning government debt⁵". The Council took a positive view on the fact that within the debt of the central budget the share of foreign currency denominated debt continues to decline and this makes the country less vulnerable.

- In its Opinion (file no: 5/2018.07.17.) formulated for the final voting on the 2019 central budget bill laid the Council noted that „the planned rate of the government debt indicator for 31st December 2019 according to the uniform budget bill T/503/854. (Indent (3) § 3.) was well grounded, calculated by having in mind the respective stipulations of the Stability Act, and was in harmony with the macroeconomic and budgetary processes that served as a basis for the elaboration of the bill. As the government debt indicator calculated for the end of year 2019 is lower by 2, 6 percent

¹The level of government debt projected on gross domestic product.

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

³The government debt indicator pursuant to the Stability Act means government debt calculated by fixed exchange rates set by the budget act in proportion to the gross domestic product (GDP). .

⁴Indents (4) and (5) of Article 36. of the Fundamental Law contains the government debt rule as the most important element of rule-based budgeting. According to this the National Assembly shall not accept such a central budget act as a result of what government debt would exceed half of the amount of the GDP. As long as government debt exceeds half of the GDP the National Assembly is authorised to accept only such a central budget bill that contains the decrease of the GDP proportionate government debt. The debt formula laid down by Indent (2)-(2a) of § 4 of the Stability Act is concretising this, as follows. In case the forecasted rate of inflation in the given year, as well as the growth rate of the real economy both exceed 3 percent, the fiscal balance shall be calculated so that the annual growth rate of the government debt shall not be more than half of the planned inflation rate and the growth rate. In case at least one of the two indicators does not exceed the 3 percent limit that 0, 1 percent decrease of debt rate shall have to be realised.

⁵The debt rule of the European Union is defined by the Treaty of the European Union (EUMSZ) and the Regulation of the Council issued on 7th July 1997 (EK rendelet no.1467/97/). The debt rules of the European Union have been valid in Hungary from 2016. According to this rule the share of the government debt ratio to the gross national product (GDP) shall not exceed 60 percent. In case the government debt exceeds this reference ratio then the deviation compared to the reference of the previous three years shall have to be decrease by one-twentieth part at a yearly average („one-twentieth rule”).

than the rate expected for the end of year 2018, the stipulation of Indent (5) Article 36 is also being met”. In the Justification section of the cited Opinion the FC pointed out that „in the interest of the realisation of the targeted deficit and the government debt indicator set as an objective, it is a precondition however, that the Government should follow a disciplined management also in 2019 [...]”.

In the course of preparing its Opinion about the 2020 central budget bill draft the Council primarily choose for baseline the written analyses, findings of the State Audit Office of Hungary and the Central Bank of Hungary concerning the fiscal processes. Apart from these the FC also took into consideration the prognoses of domestic research-analysing institutions – commissioned by the Council’s Secretariat – together with the forecasts of international organisations (European Commission, OECD, IMF, World Bank), as well as other, significant market analysts. Additionally, the Council also took into consideration the contents of the Convergence Programme of Hungary for 2018 – 2022 and 2019 – 2023 and by reviewing the preliminary data, was relying on the major processes of the execution of Act C. of 2017 on the 2018 central budget of Hungary, and the relevant background of those processes as a baseline. The FC formulated its Opinion on this in a separate document, in harmony with Point c) Indent (1) § 23. of the Stability Act.

According to the framework of the power delegated to the FC and following its practice so far the Council examined the draft central budget bill and its macroeconomic background as a unit and analysed the details, revenues, expenditures from the aspect of the realisation of balance requirements and that of the government debt rule.

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

II

The Opinion of the Council

According to the respective stipulations of § 24. of the Stability Act the Council discussed the draft of the 2020 central budget bill of Hungary and – by uniform decision – formulated the following Opinion:

- 1) As regards the authenticity and enforceability of the draft of the 2020 central budget bill of Hungary the Council has no such fundamental objections that would justify the indication of disagreements concerning the draft bill.
- 2) According to the Council’s judgement the draft bill is based on a closed macroeconomic forecast. The draft is counting with a 4, 0 percent economic growth in 2020 that is exceeding the forecasted margins of other, benchmark domestic and international organisations (2, 8 – 3, 5 percent) that can be realised in case the planned expansion of

wages and household consumption takes place. Reaching the growth target could be supported additionally by the introduction of further measures to improve competitiveness.

- 3) In the draft document the revenue and expenditure appropriations are basically in harmony with the preliminary evidence points of year 2018 and the expected data for 2019 as well as with the macroeconomic and public finance processes foreseen for 2020. Beyond the realisation of the macroeconomic scenario that served as the basis of the planning procedure it is also necessary that the Government introduced additional measures aiming at the whitening of the economy to ensure the revenue appropriations. In case the revenues won't reach the appropriated amount, the reserves amounting to 1 percent of the GDP - that is higher than in the previous year - (the Country Protection Fund and the Appropriation of Extraordinary Governmental Measures) can serve as a cover. At the same time, the high level of the above reserves offer adequate security against the threats to the fiscal balance originating from external conditions, risks and unexpected expenditures.
- 4) The Council welcomes those steps that aim increasing revenues and the restraints in spending as long as they are not narrowing economic growth – as a result of what the deficit course might strongly decline. Having in mind the targeted deficits of the countries in the region the Council agrees with the plan of aiming at a lower deficit level for this year in the frame of the Convergence Programme of Hungary for 2019 – 2023. The planned decrease of the fiscal deficit basically applies to the expenditure side and is supported by the rapid growth of the tax bases on the revenue side.
- 5) Considering the contingency reserves as well, the Council is of the opinion that the 1, 0 percent GDP proportionate targeted deficit for year 2020, calculated by the EU methodology (ESA 2010) is well founded and achievable. At the same time, this is also in harmony with the stipulations of the respective Maastricht criteria and Point b) Indent (2) § 3/A of the Stability Act, namely the requirement of the 3 percent limit. The FC finds that the structural deficit in 2020 will not reach the targeted 1, 0 percent however, it is close to this limit thus, it would be appropriate to ponder the harmonising of these goals. Thus the compliance with all targeted budgetary deficits could be ensured.
- 6) The FC finds that the trend of the year 2019 debt indicator (68, 6 percent of the GDP) calculated with constant exchange rate as stipulated by the Stability Law and that of the 2020 debt indicator (65, 5 percent of the GDP) is in harmony with the planned for year 2019 and expected for year 2020 macroeconomic and fiscal scenarios shown in the draft bill and is in compliance with the stipulation of Indent (5) Article 36. of the Fundamental Law, i.e. with the government debt rule. Also, the planned measure of decreasing the debt rate (the so-called „one-twentieth rule”) is in harmony with the regulation of the European Union concerning government debt.

- 7) The Council finds it justified to introduce already in 2019 those measures that aim the strong improvement of productivity and efficiency and by what the economic growth exceeding the average of the European Union will be sustainable not only in 2020 but also over the medium term.
- 8) Concerning the new tax and contributions' related measures announced during the period of formulating its Opinion on the draft bill as well as the excess expenditure, the Council considers them appropriate. However, in the FC's opinion those parts that had not been included in the draft are risky as regards their affordability. The Council deems it necessary that the bill to be submitted to the National Assembly should present the effect of all the measures.
- 9) The FC authorises its Chairman to publish the Council's Opinion regarding the draft bill and present it at the plenary session of the National Assembly with regard to the Opinion's relation to the submitted bill.

III

Justification

1. Authenticity of the Draft Bill

According to Indent (2) § 24. of the Stability Act, the FC may add its comments to the draft bill respectively – in case the Council has fundamental objections as regards the authenticity or enforceability of the draft – the body may indicate its disagreement with the draft. The Council considers that it has no objections to granting its agreement with the draft bill. It notes however, that at the time of formulating their Opinion the appropriations defined on the basis of the resolutions, the presented governmental goals and measures were not fully supported by documents and that this has to be completed.

2. The Expected Macroeconomic and Fiscal Scenarios of Year 2019

The international organisations – the International Monetary Fund (IMF), the World Bank, and OECD – in their (amended) short term forecasts for 2019-2020 - are indicating the slowing down of the world economy's growth, upon having evaluated the tendencies determining the output of year 2018 and the expected trends and processes in 2019. The latest forecast of the IMF and the World Bank expected the following reduction of the growth rates: global economy 0, 2 respectively 0, 1 percent; the performance of the Euro region that is acting as a pulling force for the Hungarian economy 0, 2 respectively 0, 3 percent and within the latter, the output of the German economy by 0, 2 respectively 0, 1 percent, in comparison to their earlier forecasts. At the beginning of May this year the European Commission reduced its former expectation as regards the expansion of the 2019 Euro zone's annual growth rate to

1, 2 percent and for the whole of the European Union to 1, 4 percent. Additionally, the expected growth rate of the German economy was decreased to 0, 5 percent in 2019.

According to the FC, the risk factors that have surrounded the development of the world economy and mentioned in the Council's Opinion 3/2018.06.07. that existed at the time of the preparation of the year 2019 annual budget as well (the danger of the escalation of commercial conflicts, the intensification of geopolitical and regional tension, the failure to agree upon a final Brexit agreement, the effect of immigration, etc.) remain valid. The continuance of the trade war launched by the USA and the protectionist trade policy might target the European Union as well. Thus their continued existence might also affect the 2019 performance of the domestic economy.

Despite the changing and – as regards their tendencies – slightly worsening characteristic features of the external sector, the domestic economy has been expanding in a well-balanced, sustainable and dynamic way for the past several years; its external debt follows a declining path, its pace of convergence to the EU average accelerated and the inflation rate is shaping up in harmony with the goals of the central bank.

In line with the trend of the previous year the Government founded its 2019 budget on a 4, 1 percent GDP growth. The calculations of the international organisations, the domestic institutional and market analysts remain counting with a high – albeit lower than the outstanding performance of the year 2018 – expansion rate of the domestic economy, i.e. 3, 5 – 4, 0 percent. By further increasing their winter forecast, the European Commission is counting with a 3, 7 percent GDP growth, OECD's new forecast is 3, 9 percent, while IMF and the World Bank recently increased their expectations as regards the 2019 growth rate of the Hungarian economy by 0, 3 – 0, 3 percent each to 3, 6, respectively 3, 5 percent.

Based upon the available data so far the performance of the economy in 2019 was well balanced and powerful. Similarly to the practice of the previous years, the economic development strategy of the Government supports this trend.

The basic pulling force behind the expansion is domestic consumption that is the result of household consumption supported by the raising wages and the investment activity based on the large-scale use of domestic and EU resources.

The expansion of the private sector investments continues as it is expected that we will see a gradual starting up of several, significant industrial projects financed by foreign resources (Continental, Rehau, Hankook, etc.) and the related network of suppliers, together with other industries (electronics) and commerce. The environment of low interest rates together with domestic and EU resources, inducing economic development, are also supporting the investment activities of the small and medium size businesses. The developments of educational, healthcare and social infrastructures and those dynamic infrastructure development projects of public road and railway network development continue to represent a

significant volume. The works related to the Modern Cities Programme shall continue and the Hungarian Village Programme will be launched in 2019 as well.

Thanks to the governmental supports and the favourable money market conditions (solid low interest rates) the house building and purchasing activities of the households remain strong. Apart from the raising real wages the Family Housing Support Programme (CSOK) also gives additional impetus for the development. In the first quarter of 2019 altogether 3.661 new homes were built that is more by 7, 8 percent than the result of the similar period in the previous year. The number of issued building permissions and the number of homes built on the basis of simple notification was 9.639, less by 2, 1 percent compared to the first quarter of 2018. The dynamics of the delivered homes/apartments have slowed down because of the scarce home building capacities, while the extension of the preferential VAT regulation (reduced rate) is dragging out the „wearing off” of the home building boom. The interest for the home building and buying supports and opportunities remains high.

The EU development resources of the period 2014 – 2020 are the decisive pillars of the economic development. The amount of the granted subsidies related to the cohesion framework containing the Széchenyi 2020 programmes, together with the national co-financing amounting to HUF 9200 billion by today has reached 100 percent of the total envelope. The share of payments to the beneficiaries (advances included) amounts to close to two thirds of the envelop. At the same the EU reimbursement time has reached only one third of the total envelope primarily due to the slow utilisation of the advances. The full realisation of the concerned projects will be reflected in the growth rate also in the coming years. Considering the „n+3 regulation”⁶ the subsidies of the period ending in 2020 might support the economy up to 2023 and the post return of payments paid in advance from the central budget will appear as revenue that mitigates the cash-flow deficit of the central budget.

Thanks to the six year wage agreement and the labour shortage, wages keep growing. The growth measured in the first two months of 2019 was lagging behind the growth of the same period in 2018 however, the gross wages in the average of these two months (HUF 344.700) were more by 11, 3 percent in comparison to the average wages of the same period of the previous year. The growth of the net wages (HUF 229.200) was the same. Retail sales reflected the higher disposable income the volume of what grew by 6, 5 percent in the first quarter of 2019. Within this, food retail grew by 3, 1 percent; non-food retail by 10, 6 percent; the volume of fuel retail by 11, 8 percent, in comparison to the same period of the previous year.

Also, thanks to the governmental incentives work, employment and activity continued growing. The average number of those employed was 4.497 in the first quarter of 2019 that was more by 62 thousand in comparison to the similar period of the previous year. On the

⁶ Following the expiration of the EU planning cycle (2014 – 2020), contrary to the earlier two years, the supports can be drawn down for three years.

primary labour market there were 87 thousand people more (1, 4 percent) employed while the number of people involved in public works (121 thousand) was less by 37 thousand. The number of unemployed kept decreasing. In comparison to the first quarter data of the previous year this meant less by 12 thousand and their number decreased to 166 thousand. The unemployment rate is less by 0, 3 percent and represents now 3, 6 percent. The employment rate of the age group 15-64 years increased to 69, 9 percent (this exceeds the data of year 2010 by 15 percent).

In the first quarter the labour statistics registered 2 percent less employment seekers (279 thousand) compared to the data of the same period last year. In the meantime the share of the vacant posts compared to the total number of posts has decreased only to a minimal degree. Labour shortage combined with the great number of those who can't find employment at the primary labour market, might indicate the structural problems related to the workforce whose skills are not answering the demands of the market. Thus, additional steps are necessary to support acquiring skills that are required by the market.

Based on the above characteristics the Council deems the expansion of the economy in 2019 - expected by the Government - attainable. The data of the pro rata temporis performance are supporting this expectation.

In the first quarter the GDP growth reached a historic height, 5, 3 percent compared to the similar period of the previous year. The driving force behind this output remains the household consumption and the investments. Industrial and building production expanded dynamically in the first three months of the year in volume, i.e. by 6, 2 respectively 48, 2 percent. The growing demand for the latter might unavoidably appear in the surge in the building industry prices (in the first quarter these prices were higher by 10, 3 percent in comparison to the prices of the same period of the previous year). The outstanding growth is expected to slow down due to capacity limits, the slowing down demand and the high base prices.

According to the first quarter data and breaking the trend of the previous two years, the cash deficit of public finance – without local governments – was altogether HUF 141, 9 billion that is significantly lower than the deficit in the same periods of the previous years. Within this, the central budget closed with a deficit of HUF 139, 6 billion, the social security funds by HUF 3, 7 billion, while the earmarked state funds reached a surplus of HUF 1, 4 billion.

The cumulated cash deficit in the first quarter represents 14, 2 percent of the annual appropriation. The additional budgetary revenues realised parallel with the tax cuts and the reduction of expenditures are playing an important role in this favourable result. Revenues more by HUF 640, 8 billion (14, 8 percent) in comparison to the similar period of the previous year were collected in the first quarter. Revenues from value added tax, personal income tax and excise duty together with those originating from the pension insurance, health insurance and labour market contributions paid by the insured persons, can be highlighted. The ex post revenues from the EU programmes represented a significantly higher amount, together with

the post returns and payments related to state assets. Expenditures were less by HUF 89, 2 billion (1, 7 percent) in comparison to the same period of the previous year. Mostly this is related to the moderation of the EU expenditures. On the other hand, expenditures of budgetary organisations and retirement benefits were higher. In connection with the EU development projects the revenues of the budget reached HUF 283, 7 billion while such expenditures amounted to HUF 344, 3 billion.

The accrual principle balance of the complete public finance showed a surplus of HUF 182 billion in the first quarter – according to the financial accounts of the Central Bank of Hungary – that is approximately 1, 8 percent of the estimated quarterly GDP. A similar (respectively higher) surplus appeared at the beginning of years 2016 – 2017. In 2018 there was a low deficit.

The employment and tax policies of the Government are very likely ensuring the continuation of the fiscal balance together with the economic development built on this and exceeding the EU average. Thus, according to the FC, the 1, 8 percent targeted deficit calculated by the EU methodology, this objective can be met and it affects the decreasing of the government debt indicator as well.

3. Goals and Conditions in 2020

3.1. Expected Macroeconomic Indicators

The draft of the 2020 budget bill is targeting the decrease of the government debt and the budget deficit calculated by the EU methodology (ESA 2010). In the line of the priorities of the Government this is the goal together with the demographic measures and the strengthening of the competitiveness.

The draft is building again on a dynamic, 4, 0 percent GDP growth. This is supported by the growth resources: the 4, 8 percent growth of the volume of household consumption, that of the gross fixed capital formation that is significantly lower in comparison to the previous year at 3, 8 percent. (Similarly to year 2019 the latter is able to keep the investment rate well above 25 percent as a result of the high gross fixed capital formation so far, and the developments financed both from domestic and EU resources). According to the draft bill 2, 8 percent inflation rate will accompany the additional pickup of consumption.

Thanks to the vigorous labour demand and the governmental measures promoting employment, the number of employees keeps growing by 1, 3 percent (by 1, 6 percent in the private sector while the number of those employed in the public sector remains the same). The number of unemployed shall decrease. According to the macroeconomic path of the budget the dynamic wage increases will continue, the gross and net wages will increase further,

equally, by 8, 3 percent (in the private sector by 8, 9 percent). This is in harmony with the demands of the tight labour market, the expected raise of the minimum wages, the guaranteed wage minimum expected for 2020 and specific, legal determinations.

The draft estimates the growth of labour productivity 2, 7 percent. Despite the unfavourable signs of foreign market processes, foreign trade might expand thanks to the fact that the export development targeted investments will „begin to bear fruit”. The gap between the export and import is getting closer (by 1, 2 percent) as the former will expand by 5, 2 percent while the latter by 5, 4 percent in comparison to the previous year.

In harmony with its established practice, the Council examined the elements of the macroeconomic path that served as a the basis of the 2020 draft budget bill. When formulating the body’s opinion they also considered the contents of Hungary’s Convergence Programme 2019 – 2023, the evaluations prepared by the European Commission, the OECD and the IMF, as well as the analyses maintained by the experts commissioned by the FC Secretariat. The forecasts are predicting a GDP growth between 2, 8 and 3, 5 percent in 2020.

According to the consideration of the FC a GDP growth exceeding by approximately 2 percent the forecast of the European Union, can be realised only if the planned growth of wages and employment takes place, together with the expansion of the household consumption and investments foreseen by the draft.

The foundations⁷ of Hungarian economy are solid. Signs indicating a slowdown of the world economy compared to the period so far (due to the escalation of commercial conflicts, the Brexit and the globally unresolved problem of migration, etc.) are already visible. The chances that as regards foreign trade relations, this might significantly narrow the elbow room and possibilities of the Hungarian economy are high. Fending off this and mitigating the negative consequences, additional measures improving competitiveness (productivity, efficiency) are necessary.

Aspects of the fiscal policy are primarily realised via the central subsystem of public finance thus the Council was also analysing the appropriations of the revenues and expenditures of this subsystem.

3.2. Revenues of the Central Subsystem

The total – not consolidated⁸ - revenue appropriations of the central subsystem is HUF 21.311,6 billion that is bigger by 8, 8 percent than last year’s appropriation, by 7, 2 percent compared to the preliminary actual data and, by 5, 2 percent in comparison to the expected factual realisation in 2019.

⁷ When formulating its Opinion the FC was relying on the following evaluations: growth of the economy, industrial, building industry performance, domestic trade, export-import, employment, wages, consumption, investment, inflation, public finance deficit, government debt.

⁸ Calculated without filtering the financial flow within public finance.

According to the consideration of the Council the tax revenues are determined by three basic processes. These are, the tax reform introduced after 2010 on the one hand, that had transferred the focus of the tax system to the taxes levied on consumption (VAT, excise duty, etc.) in order to give incentives to economic growth and employment. On the other hand, the multiannual cycle of growing incomes and consumption resulted in significantly more revenues. Finally, the whitening of the economy, i.e. the proportion of the actually collected taxes were significantly raised, parallel with decreasing the tax rates and introduction of targeted measures (linking cash machines, vending machines to the tax office, using the EKÁER system controlling road transport and the introduction of online invoicing) and reducing administrative burdens. Based on the above, the draft budget for 2020 is also counting with the dynamic growth of tax revenues.

The appropriation of the payments of entities is exceeding the appropriation of the previous year by 17, 3 percent (HUF 230 billion) while the expected realisation is more by 8, 0 percent, i.e. HUF 125 billion. Corporation tax, the appropriation of what in comparison to year 2019 is expected to be higher by 19, 1 percent (HUF 76 billion), represents a decisive amount in this revenue group and compared to the expected realisation it might grow by HUF 39 billion. This might be realised in case business profits produce significant improvement. It is justified to transfer the effects of the tax measures announced following the forwarding of the draft budget bill to the FC (the changing of the regulation of „uploading” corporate tax, decreasing of the small company tax, etc.) within the bill.

By formulating the conditions of the legal operation of its economic and tax policies (simplifying administration, cutting back rates of taxation, fending off obstacles from the way of establishing a company, creating the conditions for a supportive operation of the authorities, information, etc.) the Government established circumstances thanks to what the number of taxpayers paying their taxes according to the small business tax and the itemized tax of small taxpayers, has increased significantly. Having in mind this as well, the appropriation of small business tax for next year might grow by 75, 9 percent (HUF 88 billion) and the itemized tax of small taxpayers for 2020 might grow by 38, 2 percent (HUF 188 billion). This might have a reducing effect on the revenues from other taxes (personal income tax, social contribution tax, corporate tax). Contrary to the previous year the planned revenue from advertisement tax is HUF 0, 5 billion vs. the former HUF 15, 1 billion as a result of reducing this tax to zero.

Taxes related to consumption – together – are exceeding the appropriation of the previous year by 12, 3 percent (the expected revenue from this tax in 2019 by 7, 1 percent). The appropriation of the value added tax is exceeding that of the previous year by 13, 7 percent (HUF 589 billion) and the expected revenue in 2019 by 8, 2 percent, i.e. HUF 368 billion. Also, building on the results so far, in order to promote the affordability of the revenue appropriations, the FC deems it necessary to continue introducing measures to whiten the economy.

The excise duty appropriation is more by 7, 5 percent (HUF 86 billion) in comparison to the previous year's appropriation and by 5, 1 percent compared to the expected revenues. Increasing taxes might increase illegal demand. Thus, as regards this field, it'll be necessary to reinforce control and inspections. The share of the financial transaction tax (HUF 226 billion) in essence remains the same (1, 1 percent of the central subsystem's revenues).

The appropriation of retail payments is higher by 10, 8 percent (HUF 283 billion) than it was in 2019. Within this revenue group the personal income tax revenue is decisive and in comparison to the previous year it is more by 10, 2 percent (HUF 240 billion) while compared to the expected realisation, by 9, 6 percent (HUF 228 billion). Similarly to other taxes, this is also depending on the realisation of the macroeconomic path and, within it, the realisation of the expected rise of wages are a pre-requisite of the implementation of the planned revenues. Levy revenues might exceed the previous year's appropriation by 19, 3 percent, in harmony with the trend of movable tangible properties and immovable properties.

During the past years, targeting individual groups of taxpayers – the introduced tax policy measures, apart from decreasing the burdens - have strengthened the predictability of the tax system and the practice of voluntary following the norm. The draft contains the effects of exempting women, rearing four children, from paying taxes, the VAT tax exempt of interest gains from retail securities and those effects of the „six-year wage agreement” according to what the degree of social contribution tax shall decrease by an additional 2 percent in 2020. From this revenue the two social security funds shall have an additional growth by 4, 3 percent, i.e. HUF 220 billion, altogether reaching a total of HUF 5344, 1 billion.

Altogether the tax and contribution revenues are in harmony with the macroeconomic parameters however, the planned trend of the latter is exceeding the forecasts of other organisations and analysers thus, the accessibility of the revenues are surrounded by risks. In case of the priority taxes, the aspects of planning the appropriations and the factors considered were not explained. However, the increased reserve appropriations shall cover these risks thus, the targeted 1 percent GDP proportionate deficit, calculated by the EU methodology, is viable even by slightly less revenues than expected.

3.3. Expenditures of the Central Subsystem

The total – not consolidated – expenditure appropriations of the central subsystem is HUF 21.678,6 billion that is more by 5, 3 percent in comparison to the 2019 appropriation while compared to the preliminary fact by merely 1, 7 percent and the expected 2019 realisation by 1, 1 percent.

The annually more and more moderate increase of the factual and expected realisation of the previous two years is in harmony with the goals of Hungary's Convergence Programme 2019

– 2023 according to what the role of the governmental sector⁹ is gradually narrowing and its expenditures (the degree of redistribution) by 2020 shall be merely 44, 8 percent (less by 1, 7 respectively 1, 6 percent than the realisation of year 2018 and the year 2019 appropriation) in comparison to the years prior 2016 when this exceeded even 50 percent. This means that the decreasing of the fiscal deficit is taking place fundamentally on the expenditure side.

Continuing the division into three main groups, from the expenditures of the central subsystem in 2020, they shall use nearly 83 percent for current (operational) goals, 9, 3 percent for the accumulation tasks financed domestically, while for the developments financed by the EU 7, 8 percent.

In the period of 2018 – 2019 *governmental investments* grew to the 6 percent of the GDP that is high, in comparison to the historic average. The reduction of the GDP proportionate expenditures in the coming years represents a turning back to the long-term average that might support lifting the capacity limitations of the building industry. As regards the domestic accumulation budget amounting to HUF 2, 015, 3 billion, the budget marked the following priorities: the implementation of the Modern Cities Programme the goal of what is building up the modernisation and the competitiveness of the rural regions, together with setting the foundation for the improvement of the living standard of people living in the countryside; building motorways up to the borders of the country, linking regional centres to the expressway networks; moreover, improving the accessibility of small rural settlements with a population less than 5000 in the frame of the Hungarian Village Programme and renewing public roads and transportation related facilities of these settlements. The railway infrastructure investments may continue, beyond the EU resources also from domestic budgetary resources. The scheduling of the investments is influenced by the finitude of the machinery and – mainly – manpower capacity shortage of the building industry together with the rising prices. The expansion of irrigated cultivation might be a tool to improve the competitiveness and productivity of the agriculture.

From the amount of HUF 17.969 billion appropriated for *operational budget*, the following goals may be realised:

Personal allocations within public finance shall increase by 7, 1 percent, i.e. significantly exceeding the inflation rate and this contains also the career programmes. The draft is guaranteeing the conditions for the employees of the public sector the continuation of raising wages, in harmony with the programme launched in 2012 that also takes into consideration the sectoral characteristics. The number of staff employed in public finance shall not change.

According to the budget the *Family Protection Action Plan* that was launched in 2019 will be expanded by additional measures in 2020 and is a budgetary priority. The programme covers the support of young people as they start their adult life and homemaking, the recognition of

⁹ Apart from the central and local subsystem of the public finance it contains also the data of the entities classified here according to the Resolution of the Council 479/2009/EK (25th of May, 2009).

big families, intends to support creating a healthy balance between family life and employment as well as reinforcing Hungarian villages. It's a positive aspect that the realisation of the demographic revolution shall promote the long term sustainability of the economy and, ultimately, the long term sustainability of public finance. The lending of new loans amounting to HUF 420 billion in 2020 is realistic however, as regards the number of those concerned and the average amount of the loan, there are several uncertainties. The FC identified a bigger expenditure related to the interest rate support of the „*baby expecting*” programme that, in case of the realisation of the planned lending scheme as described by the bill, might exceed the appropriation. The development programme of institutions taking care of small children during the day (day care centres, mini-day-care centres, family and workplace day care centres) may continue. The continuing increase of day care occupancy might support mothers returning to the labour market following childbearing, as well as the harmonisation of the family life and work.

In harmony with the legal requirements, the draft contains the increase of *pensions* with the inflation rate i.e. maintaining the real value of the pensions. The bill is counting with a 4 percent increase that is, paying a premium on pensions is also part of the appropriation (it comes into being in case the growth rate exceeds 3, 5 percent).

Expenditures to be used for *defence purposes* will increase by 28, 4 percent while law enforcement expenditures by 5, 5 percent. Thus, the amount used for defence purposes continues coming closer to the level undertaken as regards our NATO obligations. Maintaining the day-to-day sense of security remains a priority together with preventing and averting terrorist threats.

According to the draft there are additional resources for *measures protecting the economy and increasing competitiveness*. In the opinion of the FC these are strictly necessary to ensure that – alongside the risks presented by international money markets and risks of the real economy – the continuous economic growth, exceeding in effect exceeding the average of the European Union, was sustainable in our country. The measures planned for 2020 shall have their impact mostly in the field of vocational training, employment and tax administration. Beyond the above however, the FC deems it necessary to consider additional measures concerning competitiveness to ensure the sustainable catching up path.

The budget is ensuring *reserves* larger than in previous year, amounting to 1 percent of the GDP, concerning the appropriations of „Country Protection Fund” and „Extraordinary Governmental Measures Fund”. This shall serve the purpose of strengthening fiscal security and maintenance, averting external risks and financing extraordinary expenses. The amount allocated to the Country Protection Fund is HUF 378 billion while the amount of the Extraordinary Governmental Reserves is HUF 110 billion in year 2020. Their aggregate amount thus grows to HUF 488 billion that is approximately more by HUF 260 billion in comparison to the number of these reserves in 2019 that amounted to HUF 225 billion.

The appropriation of the *EU development budget* amounts to HUF 1.694. 3 billion, less by 13, 4 percent than that of the previous year, as the major part of the EU resources shall have landed by the end of 2019 at the beneficiaries as an advance. The advances paid to local governments and companies increased the cash deficit of the central budget in the previous years. In case the reimbursement of the advance payments is being met, it will improve the cash balance (given that the related expenditures have been realised).

According to the draft the EU supports that will be considerable also in 2020, can serve the general, respectively energy and info-communication developments of businesses, the research and development schemes, the priority touristic developments and employment increase. Infrastructural goals – public road, railway, city transport, utilities and flood protection – can be realised via the outstanding amount of supports. Developments assisting the adjustment to the consequences of climate change, improving water supply, waste water treatment and waste management in settlements, respectively projects targeting the better utilisation of renewable energy sources can be continued. The EU resources earmarked for the development of healthcare and social services together with those intended for social adaptation, can significantly promote the inclusion of the poor and disadvantaged groups.

3.4. Public Finance Deficit

From the aspect of planning the year 2020 central budget, it was a favourable precedence that, as a result of the endeavours aiming fiscal and financial balance, the public finance (governmental sector) deficit, calculated by the EU methodology (ESA2010) has been realised stably under the 3 percent of the GDP. Even in 2018, it was more favourable than the planned 2, 4 percent and was 2, 2 percent of the GDP, just like in 2017. The targeted deficit for year 2019 is 1, 8 percent of the GDP that – in the opinion of the FC based on the processes of the first quarter of the year and the forecasts – are attainable.

While the balance of our public finance is showing a lower than ever deficit, we cannot forget that several member states of the EU and especially in the Central European region, produced even lower deficit levels.

Based on the above, according to the FC, it is a significant result that the targeted GDP proportioned fiscal deficit of 1, 0 percent in the 2020 budget, calculated by the EU methodology, is smaller than the earlier defined 1, 5 percent in the Convergence Programme. Thus the 2020 deficit may be lower by 1, 2 percent than the factual data of year 2018, while lower by 0, 8 percent than the 2019 plans, remaining significantly below the 3 percent Maastricht criteria and the similar degree stipulated by Point b) Indent (2) § 3/A. of the Stability Act. This low level is supporting the additional decrease of the debt rate.

As regards the attainability of the targeted deficit the Council identified some risks concerning the achievability of the revenue appropriations. These partially stem from the fact that until the moment of publishing the Council's Opinion, calculations serving as a foundation for the

appropriations have not been presented yet. However, the increased reserves are able to serve as a cover for these risks, being higher than those of the previous year.

According to the Council the decreasing deficit is in harmony with the idea that in times of economic recovery putting a brake on public finance expenditures is justified as it is not necessary to „heat up” the economy by fiscal tools. The powerful approaching of break-even fiscal path is also in harmony with the conception of the Council presented in its former opinions. Apart from this it is also a favourable sign that the primary balance in 2020 shall be positive for the ninth year and the only reason the total balance becomes negative is the burdens of interest rate related expenses.

In the Council’s opinion the continuation of the practice according to what, within the central subsystem divided into three parts, the balance of the operational part has been zero for the third time and cash deficit can arise only in the accumulation and EU budget, is also a forward-looking sign.

The planned share of structural deficit is 1, 1 percent, i.e. it is higher for the period of 2020 – 2022 than the targeted medium term 1, 0 percent fiscal deficit (MTO) stipulated by the European Commission. When formulating an opinion on this, the Council calls the attention to three factors. The medium term fiscal goal up to 2019 was 1, 5 percent of the GDP and it declined only in year 2019 Convergence Programme to 1, 0 percent beginning with 2020. On the other hand, the structural deficit has significantly decreased with the declining ESA balance. Thirdly, considerable uncertainty is surrounding the changing estimation of this indicator that cannot be observed directly, due to the fact that it is hard to estimate the amount of additional revenues originating from the economic cycle. Overall, the targeted structural balance is expected to be unattainable in 2020 despite that it shall significantly decrease and the fiscal processes are pointing in the direction of realising the medium term structural deficit goal. In case of the structural deficit reaching a result lower by 0, 1 percent would not call for significant measures, having in mind the elbow room of the budget. This way, in 2020, we could meet all the relevant fiscal regulations.

According to the draft budget bill the cash deficit of public finance amounts to HUF 427, 5 billion (0, 9 percent of the GDP), against the 2019 appropriation of HUF 1.197 billion (2. 7 percent of the GDP). The planned 2020 rate originates from the 0, 8 percent (HUF 367, 1 billion) and the 0, 1 percent (HUF 60, 4 billion) deficit of the municipality subsystem. As long as the cash deficit appropriated for 2019 is significantly higher (by 0, 9 percent) than the share calculated by EU methodology for 2020, the tendency existing since 2017 shall change and the cash deficit might be smaller. This is mostly the consequence of the fact that advance payments in case of EU programmes remain below the incoming EU supports. The powerfully decreasing cash deficit is speeding up, approaching the government debt rate stipulated by the Fundamental Law that prescribes this to be 50 percent of the GDP.

3.5. Government Debt

According to the draft bill – calculating with the foreign currency exchange rates fixed in the bill –the government debt indicator predicted to be 68, 6 percent for the end of 2019 shall decrease to 65, 5 percent by the end of 2020. The continuation of the economic activity, together with having a considerably smaller cash deficit of the central subsystem than the deficit appropriated for 2019 – see above – are supporting the accelerating decline of the debt indicator.

The draft bill is in harmony with the debt rule and the debt formula stipulated by Indents (2)-(2a) § 4. of the Stability Act (see footnote 4). According to the draft bill the degree of the 2020 real growth rate (4, 0 percent) is greater than the 3 percent however, the 2, 8 percent inflation rate does not exceed that rate thus, the regulation of decreasing the debt formula by 0, 1 percent is valid and this largely prevails. The decrease of government debt has a favourable effect on the interest expenditures of the budget as well.

The government debt rate calculated by the EU methodology has dynamically decreased in recent years, similarly to the debt rate calculated by the stipulations of the Stability Act. The GDP proportionate debt rate mitigated by the end of year 2018 by 2, 6 percent to 70, 8 percent was falling further in the first quarter of 2019 to 70, 1 percent. Looking forward, the dynamic reduction of the debt rate shall continue thus, the EU regulations (the „one twentieth rule” – see footnote 5) shall be met safely.

Beyond the above the FC deems it favourable that within the debt of the central budget the share of foreign currency denominated debt that is expected to be 17, 2 percent in 2019, continues to decline in 2020 to 14, 4 percent. Thanks to the continuous improvement of this proportion, the vulnerability of the debt as regards external processes has declined significantly and this shall contribute to the further moderation of the country’s external vulnerability to a great extent.

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