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of the Fiscal Council KVT/45-1/2019

Opinion

of the Fiscal Council

on the situation of the execution of Hungary's 2019 central budget and the expected dynamics of government debt (based on the processes of the first half of the year)

Antecedents, legal basis and publicity of the preparation of the Opinion

According to Point c) § (1) of Act CXCIV of 2011 on the economic stability of Hungary (henceforward: Stability Act) every six months the Fiscal Council shall formulate its opinion on the situation of the execution of the Central Budget Act and the expected dynamics of the government debt.

According to this stipulation, the FC reviewed the situation of the execution of Act L. of 2018 (henceforward: Central Budget Act of 2019, budget act) and the expected dynamics of the government debt in the first half of 2019.

Following its practice and methodology employed so far, in its Opinion the Council was building on the antecedents related to the preparation of the year 2019 budget bill and those, related to Act LXXI of 2019 on the 2020 central budget.

- In its Opinion 3/2018.06.07. concerning the draft of the 2019 central budget bill the Council stated that „the draft budget bill is counting with high economic growth, i.e. 4, 1 percent for 2019, that exceeds the consensus of the forecasters, […]. Additionally, according to the FC, this expectation can be realised if the significant growth of wages and employment and the ensuing expansion of household consumption come true". The FC added that „additional measures targeting the improvement of competitiveness might promote the realisation of the targeted growth level" however the Council was also pinpointing that „the uncertainties of the environment of international economics are strengthening the risks surrounding the economic growth". The Council also stated that „the revenue and expenditure appropriations of the draft document are in harmony with the macroeconomic processes planned for year 2019". In this regard the FC also fixed that „the draft bill is counting realistically with the expenditures […], and the reserves offer a cover for managing the macroeconomic risks". The FC thinks that „the 1, 8 percent GDP-proportionate targeted deficit for 2019 mentioned by the draft bill and calculated by the EU methodology (ESA 2010)" is reasonable, taking into consideration the reserves, and mentioned also that „it was in harmony with the Maastricht criteria and the 3 percent stipulation of Point b) Indent (2) § 3/A of the Stability Act". Apart from the above, in the Justification section of its Opinion, the Council pointed out that „the planned decrease of the budget deficit is in harmony with the cyclical processes of the economy and is able to accelerate the decrease of the debt rate[1] and the future expansion of the fiscal elbow room without slowing the economic growth". Thereafter, the FC drew the attention to the fact that „according to the draft budget bill – similarly to years 2017 and 2018 – the structural balance deviates from the medium term target (although in 2019 it is approaching this level however, still exceeds it by 0, 2 percent)" thus the FC deemed it necessary to introduce measures that won't endanger the economic growth, and reaching the undertaken structural balance[2]. Beyond the above the Fiscal Council stated that the dynamics of the government debt indicator[3] for 2018 and 2019 depicted by the draft budget bill was in harmony with the macroeconomic and fiscal processes envisaged for 2018 and 2019 and „meets the stipulation of Indent (5), Article 36. of the Fundamental Law (government debt rule)" [4]. The Council also laid it down that „the planned measure of the debt rate decrease is in harmony with the stipulation of the European Union related to government debt[5] as well". According to the opinion of the FC it was a favourable development that the share of foreign currency denominated debt keeps decreasing and this will result in the moderation of the vulnerability of the nation's economy.

- In its Opinion 5/2018.07.17. formulated for the final voting of the 2019 Central Budget Bill of Hungary, the Council found that „the degree of the government debt indicator foreseen for the 31st of December 2019 and stipulated by Indent (3) § 3. of the uniform budget bill concerning the 2019 Central Budget Act of Hungary was well founded, was formulated in harmony with the stipulations of the Stability Act and the macroeconomic and fiscal processes that served as the foundation of the bill. As the value of the government debt indicator calculated for the end of year 2019 was lower by 2, 6 percent than the indicator expected by the end of year 2018, the stipulation of Indent (5) Article 36. of the Fundamental Law of Hungary shall be met as well". In the Justification section of this Opinion of the Council pointed out that „in the interest of

[1] Degree of government debt per gross domestic product

[2] The balance of the governmental sector cyclically adjusted and cleaned of individual items (Áht. – Public Finance Act – Point y) Indent (1) § 2).

[3] The government debt indicator stipulated by the Stability Act means the percentage in the proportion of the Gross National Product (GDP) calculated by the exchange rate fixed in the budget act.

[4] As the most important element of the rule-based budgeting, Indent (4) and (5) Article 36. of the Fundamental Law of Hungary contains the government debt rule. According to this the National Assembly shall not endorse such 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 shall adopt solely such central budget act that contains the decreasing of the government debt to the GDP ratio. The debt formula is concretised by Indent (2)-(2a) § 4. of the Stability Act. According to this, in case the forecasted inflation and the pace of real economy growth in the subject year both exceed 3 percent, the fiscal balance shall be planned so that the annual growth rate of the total of the government debt should not be bigger that the difference of the planned inflation rate and half of the growth rate. In case, from among the two indicators at least one does not exceed 3 percent that 0, 1 percent debt rate decrease shall have to be reached.

[5] The Treaty on the Functioning of the European Union (EUMSz) and the resolution 1467/97/EK of 7th of July 1997 of the European Council defines the debt rule of the EU. This has been valid for Hungary for the first time since 2016. According to this rule the share of the government debt to the gross national product (GDP) shall not exceed 60 percent. In case the government debt exceeds this reference value the diversion shall have to be decreased by one twentieth part in annual average compared to the baseline of the previous three years („the one-twentieth rule").

realising the stipulated targeted deficit and government debt indicator, it is a pre-condition for the Government to carry out a disciplined financial management throughout 2019 […]".

- In the Justification part of its Opinion 4/2019.06.03. concerning the draft bill on Hungary's 2020 central budget, the Council touched on the subject of the realisation of the year 2019 budget expected on the basis of the processes of the first quarter of the year. It found that „the risk factors […] having surrounded the trend of the world economy and referred to in the FC Opinion 3/2018.06.07. prepared for the elaboration of the 2019 annual budget, continue to exist […] and their continuation might affect the output of domestic economy as well". Despite the changing and slightly worsening environmental characteristics of the external economy „the performance of the economy in 2019 remains well balanced and strong – based on the available data so far" and this tendency is supported by the economy development strategy of the Government – continuing the practice of the previous years. In the Justification section of the above Opinion of the FC the body considered that „ in harmony with the expectations of the Government for year 2019, the expansion of the economy was attainable" as these expectations „were supported by the *pro rata temporis* performance data. The GDP growth in the first quarter was 5, 3 percent compared to the same data of the previous year and thus reached a historic height". At the same time the Council emphasized that „the outstanding growth rate is expected to decline thanks to the capacity limits and the external, more moderate demand, as well as to the high base". For all that the FC deemed it favourable that the employment and tax policies of the Government – and the economic growth built on this and exceeding the EU average – is expected to continue, thus ensuring the fiscal balance. In the Justification part of its Opinion the Council also noted that „the 1, 8 percent targeted deficit in 2019, calculated by EU methodology, may be maintained and this shall favourably affect the decreasing of the government debt indicator as well".

According to the established practice as regards the half-year evaluation, the Council choose primarily the written findings of the State Audit Office of Hungary and the Central Bank of Hungary concerning the fiscal processes of the first half of year 2019. Apart from these documents it also reviewed the economic analyses of domestic research and analysing institutions, international organisations (European Commission, OECD, IMF, World Bank) and other benchmarking market analysers commissioned by the FC Secretariat. The Fiscal Council also took into consideration the contents of the Convergence Programme of Hungary for the years 2019 – 2023.

Fulfilling its obligation depicted in Point c) Indent (1) § 23. of the Stability Act, the Council so far has analysed annually the processes and the characteristic features of the implementation of the budget act in the first half of the year, as well as the expected development of the government debt, formulated its opinion on these aspects and published the opinion.

The FC shall inform of its Opinion the Speaker of the National Assembly and the Government and shall publish its evaluation at the National Assembly's website.

II

The Opinion of the Council

Based on the stipulations of Point c), Indent (1) § 23. of the Stability Act, at its meeting held on 10th of September 2019, the Council reviewed the major processes of the implementation of Act L. of 2018 in the first half of the year as well as the respective background of the said processes, together with the expected trend of the government debt. According to this the FC formulated the Opinion below.

1) Following the evaluation of the macroeconomic processes in the first six months of year 2019 the FC is on the opinion that, in harmony with the latest governmental and analysers' evaluation, the economic growth might be greater than the planned 4, 1 percent as regards the whole year, and thus – similarly to the first half of the year – this growth might offer strong support to reaching the fiscal goals. However, beside the still favourable external and internal conditions, the well-known and potentially dangerous circumstances that represent risks for the growth of domestic economy might intensify.

2) Concerning the trend of the public finance deficit in the first half of the year the Council states:

   a) The accrual based public finance data showed a surplus. According to the data of KSH (Hungarian Central Statistical Office) indicated a surplus worth of HUF 10 billion in the first quarter while, according to the MNB (Central Bank of Hungary) the financial account showed a surplus worth of HUF 120 billion in the first half of the year, as regards the accrual based fiscal data of the whole of the public finance.

   b) The cash deficit of the central subsystem amounted to HUF 390 billion that is merely 39, 1 percent of the planned appropriation. Compared to the factual data of the same period in the previous year, the balance shows a deficit less by HUF 1.030,5 billion. This change was supported by the fact that, thanks to the faster economic growth and the improving efficiency of tax collection, the revenues have grown faster than the fundamentally strictly controlled expenditures. The revenues from taxes (personal income tax, VAT and excise duty) and contributions – altogether – grew by nearly HUF 180 billion, compared to the first half of the previous year. The gap between the EU expenditures and revenues that the budget had to complete, amounted merely to HUF 364 billion, that is one third of the same expenditures last year and it has also contributed to this result.

3) As regards the fiscal balance expected for the whole year the FC finds the followings:

   a) The FC considers the annual, accrual based 1, 8 percent targeted deficit of the GDP achievable. Opposite the accrual based surplus of the first half of the year the balance - very likely - might approach significantly the targeted deficit in the second half of the year. This trend primarily would be the result of the decrease of the social contribution tax valid from July and the gradual launching of the programmes of the Family Protection Action Plan. Hence, the seasonality of the accrual based fiscal deficit might be similar to the previous three years, i.e. the decisive part of the deficit might grow in the last quarter.

   b) In the FC's opinion the targeted accrual based deficit is fundamentally achievable while in case of specific appropriations, a two-way movement is expected. The accelerated utilisation of the advances as regards the EU programmes this year might deviate in both directions from the plans. Based on the experiences gained during the previous years, the tax revenues related to consumption might be over-realised; at the same time, certain expenditures might exceed the appropriations as well. As regards the provisions, transfers to the concerned expenditures might be bigger and, in case of the Social Security Fund expenditures related to curative and preventive care, might require payments beyond the plans. The Council deems these acceptable only in case these expenditures shall not endanger the realisation of the ESA targeted deficit.

4) As to the development of the government debt the Council found the followings:

   a) The degree of the gross government debt in the share of the gross national product decreased from 70, 8 percent at the end of 2018 to 68, 7 percent in mere six months and thus followed the trend of the past seven years. Compared to the degree measured in the same period last year – 74, 0 percent - this represents a significant, 5, 3 percent decline. Thus, contrary to the characteristics of the processes of the past years as regards the performance of the first six months of the given year, the debt rate has declined significantly throughout the year, thanks to the low cash deficit and the rapid GDP growth.

   b) The FC takes a positive view on the fact that the structure of the government debt stock keeps improving annually and continuously. Within the decisive debt of the central budget that represents 95 percent, the share of the Forint denominated debt kept increasing, compared to the end of the previous year, and reached nearly 81 percent while the share of the foreign currency denominated debt strongly declined to 18, 4 percent. This further moderates the vulnerability of the central budget.

c) The Council considers that thanks to the stable and vigorous economic growth and the disciplined fiscal policy, the GDP proportionate government debt might decline further in 2019, in harmony with the stipulations of the Fundamental Law and the Stability Act and might meet the targets of the 2019 – 2023 Convergence Plan. Thus the measure of the GDP proportionate government debt, calculated by the EU methodology, might further decline and meet the so-called 'one-twentieth' rule by the end of the year.

d) On the basis of the public finance processes and with regard to the favourable economic circumstances, the Council supports the decrease of the government debt rate beyond the domestic and EU requirements.

III

Justification

1. Evolution of the Macroeconomic Conditions

Following the trend of the previous year as regards the 2019 central budget, the Government was building on a 4, 1 percent GDP **growth.**

Benchmarking international organisations (OECD, IMF, World Bank) as well as domestic institutional and market analysts continue to maintain their earlier growth rate forecasts, i.e. ranging between 3, 2 and 4, 0 percent. Apart from this they are pessimistic as regards the expected performance of the global economy (within that of the Euro zone and the Economy of the European Union).

The summer evaluation of the European Commission identified the global economic risks. The narrowing of world trade and the downturn of processing industry performance might concern other branches and regions as a result of the prolonged economic and commercial confrontation between the USA and China, as well as the uncertainties surrounding the trade policies of the USA. Additionally, Brexit is causing serious uncertainties within the European Union while growth prospects are being moderated also, thanks to the falling business trust. Apart from the above the European Commission also laid it down that internal consumption (especially household consumption) and the strong labour market demand continue to drive economic growth in the EU.

Domestic and international analysers consider that Hungary can achieve a greater than planned growth rate. By amending its calculations prepared last May, the European Commission adjusted its forecast to 4, 4 percent as regards our expected economic growth in 2019.

According to the data received so far, the economic performance is „balanced and powerful" (as the Fiscal Council expounded in the Justification section of its Opinion 4/2019.06.03. on the draft of the 2020 budget bill, when it was dealing with the evaluation of the fiscal processes of year 2019) and – following the practice of the previous years – this trend is supported by the economic development policy of the Government.

Following the outstanding growth rate of 4, 9 percent in 2018, the significant expansion of gross domestic product continued also in the first half of this year. Compared to the same period last year, the expansion of the economic output continued; in the first quarter of 2019 it reached the outstanding 5, 3 percent and in the second quarter it was 4, 9 percent. On the production side the 2019 growth was primarily the result of the pickup of internal demand and the closely connected market services however, the performance of the building and industrial sectors were also playing a decisive role.

Industrial and building industry performance kept growing dynamically in the first half of the year by 5, 8 percent, respectively by 35, 1 percent in volume. Due to the possible decline of external demand – thanks to the existing commercial tensions – the former might be more moderate throughout the year while the latter could be affected by the scarcity of capacities.

The major driving force in Hungary behind the growth remains household consumption (thanks to the high wage increases and the expanding employment rate), the output of investments (the works related to projects intended to increase the various domestic and foreign processing industry capacities, the railroad, public road, educational and healthcare developments, the tasks of the Modern Cities project and the Hungarian Villages Programme that all represent decisive pillars for the investment boom that shall serve as a foundation of our sustainable development).

Both the business and the residential sectors are contributing to the increasing of the national economy investment rate to 27 – 28 percent this year. Alongside the various government programmes (CSOK – Family Housing Support Programme, baby waiting support, reduced VAT, etc.) the home building and shopping activities remain unchanged. The number of newly built homes in the first half of the year (6.472) was only slightly lower that the same number in the previous year. The number of issued building permissions and homes built on simple announcement remain high (18.227); this is higher by 0, 9 percent than the data of the same period of 2018. Home building is characterised by different territorial processes. The number of completed homes in Budapest and the small towns was less than in the same period of last year however, in the county towns and municipalities more homes were put into service. In time the reduction of home building processes might be postponed also because of the tight capacities.

As a result of the six year wage agreement and the strong labour demand **employment** has expanded further and the activity rate grew.

According to the April – June 2019 data (three-month' moving average) the average number of employed people is 4.511 thousand that is more by 36 thousand than the data of the same period in the previous year. The employment rate of the 15 – 64 age group has grown to 70 percent. There are 85 thousand people more on the primary labour market while the number of people involved in public works was less by 58 thousand. The drop in the number of the unemployed continued as well: the average number of unemployed in the April – June 2019 period was 155 thousand thus, compared to the data of the same period of the previous year, was less by 0, 3 percent and reached 3, 3 percent. According to the records of the National Employment Agency the number of those seeking jobs was 248 thousand at the end of the first half of the year and this is more by 3, 1 percent than the data of the same period in 2018. This can be regarded as a reserve that could ensure resources to moderate the tensions of the labour market. The measures introduced by the Government offer assistance to obtain qualifications for jobs in demand.

Thanks to the high level of labour force demand and the governmental measures aiming employment **earnings** continued growing. In the first six months of the year both the gross and net average earnings grew by 10, 6 percent (to HUF 359.550 respectively to HUF), following the trend until now and compared to the same period of the previous year. It was not only the pre-recorded raise of the minimum wages that affected the growth but also the governmental measures concerning the settling of wages in the fiscal institutional sector.

The continuing raise of gross average wages appeared in the development of retail sales (increasing the tax bases as well). In the first half of the year the volume of retail sales expanded further by 5, 7 percent compared to the same period of 2018. Within this, as regards the respective volumes, food retail sector grew by 2, 9 percent; non-food retails by 8, 5 percent; and fuel retail by 7, 8 percent. Analysing the expenditure groups of consumption the dynamics of durable goods was the highest in the first half of 2019. The gross revenues of commercial accommodations grew by 8, 9 percent, proportionately with the number of registered guest nights and utilisation of guest nights.

Inflation calculated in annual comparison was 3, 4 percent in June 2019. Factors determining the inflation rate indicated a variety as regards the previous period; throughout the past year the price of unprocessed foodstuff, spirituous beverages and tobacco products grew in a significant degree while the indicators describing base inflation processes remained below 4 percent. While vigorous internal demand is increasing the prices, the worsening external boom keeps curbing the pace of the price increases.

In case the external conditions won't become less favourable and the favourable tendencies will sustain, the economic growth rate might exceed the original expectations of the Government through the year, relying on the strong internal demand that is particularly supported by the growing investments. Via consumption and wages the growth contributes to the increase of tax revenues.

2. The Development of Revenues

As regards the combined revenues of the public finance **central subsystem** the realisation in the first half of 2019 was HUF 10.109 billion, that represents 51, 6 percent of the annual appropriation (as regards its share this is higher by 6 percent and in amount by HUF 1. 044 billion compared to the similar period of last year).

Within the subsystem 52, 5 percent, i.e. HUF 6.863 billion was realised in the **central budget.**

What concerns the **payments of entities** the amount of the realisation in the first half of the year amounted to HUF 651 billion that is 45, 1 percent of the annual appropriation. Compared to the annual plan, a significant backlog arose as regards corporate tax (realisation 32, 6 percent), the income tax of energy suppliers (realisation 17, 7 percent) and the simplified business tax (realisation 26, 7 percent). As of the beginning of last year the simplified business tax is not optional anymore (this tax will be terminated from 2020) and thus the number of taxpayers further decreased (transfers to small business tax and itemised small business tax). As a result the revenues from this tax were below the expectations. Gambling tax revenues, *pro rata temporis*, were close to the annual appropriations (47, 5 percent), in case of environmental charges it was 46, 4 percent and public utilities' tax revenues amounted to 49, 2 percent. Revenues exceeding the *pro rata temporis* share were realised in case of the following taxes: company cars (50, 3 percent), special taxes of financial institutions (52, 9 percent), itemised small business taxes (64, 7 percent), small business tax (64, 7 percent) and mining tax (64, 8 percent). The explanation for the significant surplus in case of small business tax and itemised small business tax was that the number of taxpayers has expanded more vigorously than presumed (against the number of taxpayers falling under the category of simplified business tax), while the increase of the mining tax revenues was related to the greater than expected growth of the energy prices. In case of the other centralised revenues the realisation was 52 percent. The slightly higher than the *pro rata temporis* realisation was partly the result of the base effect (in 2018 the realisation was higher than the planned) and partly the result of raising the increased prices. In case of this heading, within the total revenues (HUF 267 billion), the electronic toll fee and the time-based toll revenues (HUF 103 billion, respectively HUF 42 billion) represented the greatest impact.

From the **consumption related taxes** the budget received HUF 2. 928 billion that represents 50, 3 percent of the annual appropriation (in amount this is exceeding the realisation of the same period of the previous year by HUF 475 billion). These proportions were exceeded by the financial transaction fee (53, 5 percent), the insurance tax (60, 4 percent) and the tourism development contribution (74, 9 percent) however, in comparison to the *pro rata temporis* share the realisation of the registration fee was lagging behind (46, 3 percent). The revenue from the financial transaction fee was outstanding and exceeded the data of the same period of the previous year by 6, 5 percent, despite the fact that beginning with this year the population does not have to pay such a tax after transfers below the amount of HUF 20 thousand,. Revenues from the taxes burdening consumption, **value added tax** revenues represent a decisive share, the realisation of what was 50, 6 percent (HUF 2.170 billion and was higher by HUF 397 billion compared to the data of the same period in last year). Tax measures promoting the whitening of the economy affected the revenues favourably (for example, the introduction of online invoicing and its expansion in 2019) and as a result the gross VAT revenues increased by 12, 9 percent. From **excise duties** HUF 544 billion arrived in the central budget (47, 7 percent of the realisation), that was higher by HUF 45 billion compared to the similar data in the same period of 2018. The increase originated from the increasing alcoholic beverage and fuel sales, as well as from the changing of the respective laws (increasing the taxes on tobacco goods).

Payments from the public resulted revenues for the budget amounting to HUF 1.297 billion (49, 7 percent of the realisation). **Personal income tax** represents the greatest share (HUF 1.155 billion) i.e. 48, 9 percent realisation. This is closely related to the continuous expansion of employment and the high gross wage outflow continuing this year, as well as counterbalancing the effect of transforming the cafeteria system, the increase of the tax allowances of families rearing two children and the effect of the exemption from taxes as regards the retail securities issued beginning with June, this year. **Payments of the levy** were realised at 56, 5 percent of the appropriation. The further strengthening of tourism and the growing house prices – first of all in big cities – were playing a decisive role in this result as the latter factor keeps increasing the tax base. The realisation of **motor vehicle taxes** was 57, 3 percent thanks to the favourable effect of the continuous expansion of motor vehicle traffic/selling.

The revenues of the **fiscal organisations and chapter managed appropriations** amounted to HUF 1.034 billion that represents 74, 7 percent of the annual appropriation. From this amount HUF 928 billion was produced by the fiscal organisations, that is 69 percent of the appropriation. In case of the professional chapter managed appropriations the realisation was four times higher compared to the result of the same period last year. In harmony with the previous years this was due to the accumulations within public finance. As regards the revenue from the EU chapter managed appropriations the realisation was HUF 726 billion that amounted merely to 6, 4 percent of the annual appropriation.

The **revenues related to state assets** amounted to HUF 121 billion (related to real estates, movable property, dividends, and other revenues) and represent 94, 8 percent of the realisation. As to the over-execution in January, this was the result of selling frequency user rights and the fact that the major part of the dividends were paid to the central budget following the adoption of the annual reports, in June.

Interest revenues related to debt service (interest) realisation turned out to be three times higher than the appropriation, i.e. HUF 114 billion. The outstanding revenue originated from the interest rate profits realised at auctions and swap auctions (selling securities at a price higher than their nominal value).

From the titles of **EU revenues** the realisation altogether was HUF 346 billion. Within this the revenues of the endorsed EU programmes amounted to HUF 266 billion that represents 20 percent of the annual appropriation. Under the title of ex-post reimbursement of EU supports we received HUF 80 billion that is 66, 2 percent of the annual appropriation. The reimbursement of the costs of collecting duties represented budget revenues amounting to HUF 81 billion (54, 5 percent).

Budget balances not burdened by commitments have to be paid to the **Central Balance Accounting Fund.** Under this title the revenues amounted to HUF 262 billion. The Government decides on the utilisation of this amount based on the proposal submitted by the finance minister.

The combined revenue appropriation of the **separated state funds** was realised at 50, 7 percent (HUF 308 billion). **The National Employment Fund (NFA)** that represents a decisive role among the separated state funds produced 50, 8 percent (HUF 454 billion) of the annual appropriation. Within this, the return of the pre-financed EU programmes reached 51, 6 percent, in case of the vocational training contribution it was 52, 7 percent, while the share due to the NFA from health insurance and labour market contribution was 50 percent. The realisation of the share due to NFA from the social contribution tax was close to the appropriation (48, 7 percent). The realised revenues in case of the **Central Nuclear Financial Fund** reached 57, 6 percent while in case of the **National Cultural Fund** it was 76, 8 percent.

The revenue appropriation of the **Social Security Funds** (HUF 5.893 billion) was realised to 49, 8 percent in the first half of the year (within it he revenues of the Social Insurance Pension Fund was 49, 4 percent, and of the Health Insurance Fund 50, 5 percent). The decisive share of the revenues of the social security funds (98, 2 percent as regards the Social Insurance Pension Fund and 69, 3 percent in case of the Health Insurance Fund) originate from the social contribution tax and contributions. The revenue of **the Pension Insurance Fund** from this source is exceeding the result of the same period of the previous year by HUF 49 billion. Beginning with the second half of 2019 the measure of this tax shall continue to decrease further – in harmony with the six year wage agreement – as well as the share of the Fund from this resource to 70, 22 percent (however, the strong gross wage outflow shall balance this out). The revenues of the **Health Insurance Fund** originating from the social contribution tax and contributions was more by HUF 167, 3 billion compared to the data of the first half of year 2018. The reason of this growth was partly due to the effect of the tax and contribution revenue growth following the wage increases. On the other hand, the explanation lies in the fact that the share of the Health Insurance Fund from social contribution grew to 27, 3 percent this year. 2, 5 percent of the social contribution revenue is due to the National Employment Fund.

Thus, the realisation of the social contribution tax and contributions combined and compared to the first six months of the past year represents 100, 8 percent. It is a good sign that this was realised against a background of the decrease of the tax rate scheduled for several years.

3. The Development of Expenditures

In the first half of 2019 the **public finance central subsystem** flatly realised HUF 10. 500 billion expenditures, using 51 percent of the annual appropriation. It is a positive sign that the realisation here was less by 0, 6 percent than in case of the revenues that is just the opposite of the same realisation in the first six months of the previous year when the proportion was higher by nearly 4 percent than the revenues. (The significantly differing effect will be felt when we are going to discuss the cash balance.) Thus, this year, the expenditures have been exceeding the result of the first half of 2018 merely by HUF 14 billion, that is 0, 1 percent.

As regards the **central budget** the payments amounted to HUF 7.330 thousand that is 52, 1 percent of the appropriated amount. This is representing slightly less than 70 percent of the central subsystem's expenditures.

The utilisation in case of **individual and normative supports** as well as **the subsidies for fares** amounted to HUF 315 billion, i.e. 61, 8 percent of the annual appropriation. Higher than *the pro rata* temporis realisation emerged in relation to the passenger transport reimbursements that represent a decisive share.

In case of **homebuilding supports** the realisation was merely HUF 86 billion that is somewhat greater than the expenditures of the same period in 2018 however, it represents only 35, 6 percent of the appropriated amount. Beginning with the second half of the year the submission of claims might speed up and a dynamic growth is expected due to the newly introduced programmes (Family Housing Support Programme for village dwellers, taking over mortgage credits at a higher degree when the family is planning to have children).

From the appropriation of the **National Family and Social Policy Fund** the utilisation was HUF 329 billion (51, 4 percent). In case of the family supports – and within this category, in case of the larger item, i.e. the family allowance – the payment was slightly less than the *pro rata temporis* amount and the realisation in the same period of the previous year. The number of those entering the support system remains lower than the number of those exiting the system. However, the income replacement and support and the supplementary premium was greater than the *pro rata temporis* appropriation, as well as the data of the similar period in 2018, primarily due to the significant raise of the care allowance.

Expenditures of the central budgetary organisations and chapter managed appropriations amounted to nearly 70 percent of the utilisations of the central budget. In the first half of the year the realisation was HUF 5.087 billion that represents 55, 2 percent of the appropriated amount. They were using significantly more than the *pro rata temporis* share (16, 4 percent), i.e. HUF 2.994 billion for institutions and mostly personal allowances and contributions compared to the previous year. The amount of HUF1.644 billion paid for the latter was greater by HUF 80 billion than in the same period of the previous year. Additional expenditures occurred concerning various defence procurements, building facilities for the law enforcement agencies and the renovation of the Opera House. In harmony with the regulation introduced last year, the institutions transferred the appropriation balances not burdened by obligations (HUF 262 billion) to the Central Balance Accounting Fund and this increased the gross expenditures. (Throughout year 2018 such payments were realised in the amount of HUF 200 billion.)

Expenditures related to EU programmes represented HUF 711 billion, lagging behind the *pro rata temporis* realisation by 14 percent and significantly below the result of the previous year. The under-performance was mostly present in case of the cohesion operative programmes related to the 2014 – 2020 period. The Integrated Transport Development Programme, the Economic Development and Innovation Programme and the Regional and Urban Development Programme, in descending order, received the most significant share of the payments. Within the expenditures the share of advance payments remains significant. At the same time it is a positive sign that the utilisation of the advances was around HUF 380 billion in the first half of the year that represents a 50 percent increase compared to the same period of 2018.

The performance of the expenditures of **Other professional chapter managed appropriations** was HUF 1.383 billion that nearly equals the *pro rata temporis* amount and only minimally lags behind the result of the same period in 2018. The normative financings (human services of public educational purpose, non-public higher educational institutions, faith and moral education, school books, public educational contracts, supporting social purpose human services), developments realised within the framework of Modern Cities Programme, the availability fees of motorways, maintenance and operation of public roads, but the utilisation for the expenditures related to „Investment incentive targeted appropriation", national agrarian support and rail development were also significant. The expenditures here were also „accumulated" by the payment of free balances to the Central Balance Accounting Fund.

The amount of HUF 370 billion transferred under the title of **local governments** was slightly higher than the *pro rata temporis* share. The amount was higher by HUF 16 billion than the utilisation of the same period of the previous year and was used mostly for specific important developments as well as child welfare tasks.

In harmony with the planned schedule the utilisation under the title of **Contribution to the EU budget** was HUF 217 billion.

Expenditures related to state assets were significantly higher compared to the previous year by HUF 139 billion however, as regards the *pro rata temporis* share this represented nearly 10 percent less. Capital increases in companies – related to the economic processes – represented a decisive share.

They were using HUF 478 billion – nearly 2 percent less – for **gross interest expenses** compared to the same period of the previous year. Due to the repricing, contrary to the previous years and compared to the same period in 2018, the interest expenses moderately decreased.

From the **central reserves** the most important element from the aspect of the public finance balance is the **Country Protection Fund** the role of what is to manage unforeseen risks. Its original appropriation was HUF 60 billion. The rule remains the same in 2019 i.e. the Fund can be used in two stages (in the present case HUF 30 billion following the submission of the EDP report until 31st of March 2019 and the remaining part, following the presentation of the EDP report until 30th of September 2019), in case the ESA deficit does not exceed the targeted deficit of the given year, taking into consideration the amount of the reserve to be used (in this case 1, 8 percent of the GDP). In the first half of 2019 the transfer of HUF 30 billion took place according to the above stipulation.

The reserve titled **Extraordinary governmental measures,** serving the purpose of replacing fiscal revenue shortfalls originating from finances allocated to cover the expenses of tasks stipulated by government decisions, due to unavoidable reasons, could not be realised. From the 2019 appropriation amounting to HUF 165 billion, HUF 65 billion was used in the first half of this year. Essentially this corresponds with the 40 percent that, according to the Public Finance Act (Áht), can be used in the first six months of the year without the authorisation of the National Assembly.

The appropriation of **Provisions** amounting to HUF 136 billion and is set aside mostly for financing chapter careers and wage measures, as well as developing specific public services was exceeded already in the first half of the year by HUF 9 billion. As a result we can count on additional expenditures in the remaining months as this appropriation is open at the top.

Based on Government decisions and spent on various educational, cultural, transportation, water related and sports tasks, etc., more than 90 percent of the **Investment preparation fund,** amounting to HUF 20 billion was already used No excess expenditures are expected in this regard as this appropriation cannot be exceeded.

According to the FC it is a favourable sign that the **Central Balance Accounting Fund** shall contribute to the implementation of fiscal goals by transferring the resources to those purposes that the planning, capacity and other conditions are available. The role of this fund keeps gaining importance as – according to the intentions of the Government and contrary to the last year – in 2019 they are going to transfer HUF 300 billion instead of last year's HUF 200 billion. From the increased amount they already used HUF 256 billion.

Beginning with 2019 the **Chapter Stability Reserves** were terminated. The loss was replaced partly by the Government measure according to what and compared to year 2018 they significantly increased the amount of additional reserves and this amount is going to be increased further in 2020. On the other hand, in the former arrangement it was not clear if this reserve could be utilised primarily for the purposes of the given agency or for general governmental purposes.

2, 4 percent of the central subsystem that amounts to HUF 248 billion was used to cover the expensed of the **Separated State Financial Funds.** This means a lagging behind by nearly 10 percent of the *pro rata temporis* utilisation however; it slightly exceeded the expenditures in the same period of the previous year. The biggest item – with an expenditure amounting to HUF 195 billion - remains the National Employment Agency. Within this the utilisation of the Start Labour Programme, similarly to the trend of the previous years, is decreasing due to the strong demand in the labour market and the low level of unemployment. As regards the realisation of other expenditures the implementation amounting to HUF 48 billion was nearly three times higher than the same data of the first half of 2018. This is the result of the incoming payments to the budget prescribed for 2019 (no such obligation existed in the previous year).

Expenditures of the **social security funds** amounted to HUF 2.920 billion that equals 27, 8 percent of the total expenditures of the central subsystem. The utilisation in case of both funds was near to the half of the annual appropriation.

As regards its range, the expenditures of the **Pension Insurance Fund** stands out - within the financial funds of social security – amounting to HUF 1.706 billion that, with the exception of other expenditures worth of HUF 3 billion, is serving the **retirement provisions.** Apart from the beginning-of-the-year raise of pensions, these payments contain the increasing number of those provided and the effect of the composition (i.e. the increasing number of those receiving higher pensions due to the increasing net wages are replacing part of those entitled to pension). In comparison to the same period of 2018 the realisation grew by HUF 46 billion, i.e. by 2, 8 percent.

Within the **Health Insurance Fund,** utilising altogether HUF 1. 215 billion, the amount used for **curing-preventive entitlements** amounting to HUF 628 billion was more by HUF 32 billion compared to the base period. The growth compared to the same period of the previous year was the result of a decisive extension of the consolidated specialised care (within it, for example in case of financing high-value medications and in-patient specialised care) and, to a lesser extent, the result of the additional financing of general practitioner and dental care, dialysis and transport of patients.

In the first six month of the current year the debts of hospitals amounted to HUF 43 billion. In other words this means that – compared to the situation in last December – the increase of the debt has generally grown each month by HUF3, 4 billion. Last year this increase was HUF 3, 5 billion per month in average. Due to the recurring debt, partial debt consolidations took place during the past years; usually, at the end of the year, in the form of a one-time support respectively, by the distribution of the end-of-the-year balance of the cure and prevention entitlement appropriation that originally serves the financing of the public health institutions. This is expected also this year.

Health insurance spent HUF 188, 2 billion in the first half of this year on **reimbursement of medicines.** This amount was higher by HUF 14, 3 billion compared to the amount spent for such purposes in the first six months of 2018.

Nearly one third of the Health Insurance Fund – amounting to HUF 338 billion – was used for **cash benefits** (less than in the same period last year for invalidity rehabilitation benefits but much more for child benefits and sickness benefit).

4. Affordability of the Targeted Deficit

The year 2019 Central Budget Act defined the amount of the **cash deficit of the public finance central subsystem** in HUF 998, 4 billion. The deficit in the first six months of the year amounted to HUF 390 billion that was the result of the central budget's deficit of HUF 467, 3 billion respectively, the surplus of separated state funds (HUF 61 billion) and the surplus of the social security funds (HUF 16, 3 billion). It is a positive sign that the deficit of the subsystem was less by HUF 1.030,5 billion, compared to the data of the first half of the previous year. (When evaluating the performance of the budget in the first six months in 2008 the Council criticised that the central subsystem reached practically the deficit planned for the whole year already in the first six months.)

As described in Points 2 and 3, the fact that compared to the *pro rata temporis* appropriation, the expenditures of the subsystem expanded by 1 percent while, in case of the revenues, we saw an expansion of 1, 6 percent, has contributed to the favourable development of the cash deficit.

In comparison to the previous year, the difference as regards the pace of the realisation of the revenues and expenditures related to EU supports was playing a less negative role in the development of the cash deficit. The total of EU expenditures was HUF 711 billion while the revenues reached HUF 347 billion. Thus the difference undertaken by the budget this year was slightly more than one third of the same indicator in the same period of the previous year.

As regards the second half of the year there are several factors that would increase the expected cash deficit compared to the first half of the year. The fact that as of June 2019 the tax rate of social contribution was decreased will result the decrease of the revenues while the expenditures will grow, thanks to the gradual launching of the programmes of the Family Protection Action Plan. As part of the Economy Protection Action Plan, the obligation to fill up in December the corporate tax will be terminated. Very likely this will not affect the accrual based balance however, will increase the cash deficit.

In the second half of the year, in case of certain expenditure titles mentioned by Point 3 - the realisation of the utilisation of EU advances, the transfers from the provisions, health care expenditures – might be higher than the appropriation. This can be appropriate if it won't endanger the ESA targeted deficit.

The estimated **accrual based balance of the total of public finance –** on the basis of the ESA deficit published by the KSH (Hungarian Central Statistical Office) and the net financing ability of public finance according to the MNB forecast for the second quarter of the year – indicated a surplus of HUF 130 billion in the first half of the year. The GDP proportionate deficit planned to be 1, 8 percent for the whole year might become a reality if, in the second half of 2019, the expenditures will exceed the revenues. The decrease of the social contribution tax and the gradual upswing of the Family Protection Action Plan are heading in this direction. The seasonality of the accrual based fiscal balance within the year thus might be similar to the previous three years when the major part of the deficit occurred in the last quarter of the given year.

The explanation for the difference between the cash balance and the accrual based balance – similarly to the previous years but to a significantly lesser degree – is the result of paying the advance on the EU supports. This does not have to be taken into consideration in case of the accrual based accounting.

As in case of the year 2019 draft central budget bill the Council called the attention again to the fact that the degree of the targeted **structural deficit** amounting to 1, 7 percent is higher than the 1, 5 percent stipulated by Point a) Indent (2) § 3/A of the Stability Act as the medium term fiscal goal. According to the forecast of the Convergence Programme the degree of the structural deficit in 2019 could be higher – 1, 9 percent – due to the different assessment of the cyclical components. At the same time, according to the approved 2020 central budget, the structural deficit shall decrease significantly in 2020 and shall be 1, 1 percent that, although does not reach the targeted medium term fiscal deficit that was to be 1, 0 percent as of 2020 however, in effect, it'll approach the targeted share.

5. The Effectiveness of the Government Debt Rules

At the end of the first half of 2018 the **gross government debt** amounted to 70, 8 percent of the GDP while at the end of the first six month of 2019 this share was 68, 7 percent. This means a decline of 5, 3 percent compared to the previous share. Thus, the debt rate has significantly decreased throughout the year, contrary to the characteristic processes experienced in the first halves of the previous years, thanks to the low level of cash deficit and the dynamic growth of the GDP.

According to the 2019-2023 Convergence Programme by the end of year 2019 the target is 69, 2 percent. Even beside the expected growth of the cash deficit in the second half of the year, meeting this share seems to be viable and thus, the government debt rate can continue to decrease in harmony with the stipulations of both the domestic and the EU prescriptions.

The **debt of the central budget** is nearly 95 percent that is playing a decisive role as regards the development of the government debt. The slight growth of this debt in the first half of the year (amounting to HUF 166 billion) is lagging behind the development of the cash deficit of the central budget. It is favourable that at the end of June this year the **structure of the debt stock** amounting to HUF 28.854 billion **improved**, as the tendency experienced in the previous year, i.e. the growth of the share of Forint denominated debt, continued to grow. By the end of June the value of the Forint denominated debt stock of the central budget was HUF 23.349 billion (compared to the HUF 22.796 billion at the end of 2018) as a result of what the respective share continued to increase from 79, 5 percent of 80, 9 percent, within six months. The foreign currency denominated debt by the end of June decreased by HUF 420 billion to HUF 5.305 billion thus its share declined from 20 percent to 18, 4 percent. The FC welcomes that the high demand for retail securities is ensuring the further decline of the foreign currency share within government debt and the share of government debt financed by domestic resources increased.

The stipulation of the Stability Act (debt formula) is being met. This lays down that in case the forecasted inflation for the given fiscal year and the growth rate of the real economy equally exceed the 3 percent share, the budget's balance shall have to planned so that the annual growth rate of the nominal government debt shall not exceed the pace of the half of the difference of the planned inflation and growth rate. However, in case from among the two indicators at least one does not exceed 3 percent, the debt rule stipulates a minimum 0, 1 percent decrease of the debt rate. The latter is valid for 2019 as the budget act calculated with an inflation rate below 3 percent. Hence, a significantly bigger moderation of the debt rate than 0, 1 percent can be realised.

The FC considers the so-called **one-twentieth rule** also achievable that belongs to the correction part of the EU Stability and Growth Pact. According to the Maastricht debt regulation the GDP proportionate debt of the governmental sector (government debt rate) shall not be higher than 60 percent. In case it is higher, the debt rate shall have to be decreased and has to reach the 60 percent rate by an appropriate pace. According to the general rule the decrease of the debt of a member state can be regarded of appropriate pace if the measure of the gap between the 60 percent limit and the real debt is annually decreased on average by one-twentieth part as regards the subject year and the two previous years.[6]

At the end of 2018 the Maastricht debt rate amounted to 70, 8 percent. In harmony with the regulation the debt rate has to be decreased annually by approximately 0, 5 percent (by one-twentieth part of the current 10, 8 percent of the debt exceeding 60 percent). The budget act however is projecting a debt rate decrease exceeding 2 percent that – based on the favourable data of the first half of the year – according to the Council is achievable.

[6] When analysing the compliance to the stipulations of the one-twentieth rule the Commission is calculating with three methods. From among these it is enough to have compliance with only one method. From among the three methods in case of two they are defining one-one benchmark that the debt shall have to reach. In the first case they are checking if as regards to the subject year and the two previous years the average decrease of the debt reached the one-twentieth share. In case the answer is negative, the second examination takes place i.e. the analysing of the foresight: in this case they examine if the decrease of the debt rate shall decline at an appropriate pace following the subject year. In the course of the analyses the Commission shall take into consideration its own estimation and forecast, apart from the factual data and independently from the forecasts of the country in question. In case of the third method they are calculating with a debt rate cleared of the effects of the economic cycle for the past three years and this rate shall have to meet the first type (retrospective) benchmark. In case a member-state does not meet the stipulations of the one-twentieth rule according to neither of the above methods, the Commission may initiate an EDP procedure.

In view of the above the Council welcomes that the targeted and expected debt rate decrease is greater than the stipulation as, on the one hand, this is ensuring the compliance of the regulations even in case certain circumstances become less favourable while, on the other hand this shall increase the future fiscal elbow room.

6. Sustainability

Based on its mandate, the Fiscal Council shall analyse the public finance processes and their respective macroeconomic relations from the aspect of the balance criteria. Even considering this aspect, the FC considers that having in mind that the sustainability of the macroeconomic and public finance processes represent a significant pillar of balance, it shall address the latter as well in the body's bi-annual evaluation.

To obtain sustainability of the economy – apart from the still available extensive resources, primarily the inclusion of labour force reserves – the improvement of efficiency and competitiveness is also necessary. The Economy Protection Action Plan of the Government and the Programme for More Competitive Hungary are playing a special role in this however, these can be considered merely as a first step. The decreasing of tax burdens – taking into account the fiscal elbow room – according to the FC's opinion is the right direction. Beside this however, the development of human resources shall have to play a significant role as this is also the precondition of sustainable economic growth, having in mind the decreasing workforce supply, due to demographic reasons. To this end, among others, the increasing of the level of health care and education provisions, their system-level development and the increasing of the efficiency of these services are important. The competitiveness programme elaborated by the Central Bank of Hungary is also offering and overall support for ensuring Hungary's sustainable growth.

The utilisation of the remaining part of EU supports in the next few years (part of what is already at the disposal of the beneficiaries in the form of an advance) might support the company level economic development, the improvement of public efficiency and the modernisation of the infrastructure.

The pre-condition of sustainable growth is fiscal stability however; on the other hand, dynamic economic growth considerably supports the decrease of the fiscal deficit and of the debt rate as we could see in the bygone years and also at present. As regards the external balance processes, it would be especially favourable if the activity of Hungarian companies abroad would pick up, not solely in the field of exports but also via direct investments.

The additional moderation of the public finance deficit would contribute to the expansion of the fiscal elbow room that, on the other hand, creates an opportunity – if necessary – for additional impulse on behalf of the budget, in case the external economic recovery would significantly deteriorate. With regard to the external risks the flexible planning and execution of the budget is very important. In several countries of the EU and, within it, in a number of countries of the East-Central European region, public finance deficit is lower even today, than in our country, or they even have a surplus in their respective budgets. This is why the FC supports that the excess revenues due to the economic growth should assist the decrease of the fiscal deficit and this is the direction the 2020 budget act is following. Thus the anticyclical fiscal reserve is growing and, in case of favourable conditions, we can reach the below 60 percent GDP proportionate government debt in the course of the present governmental cycle.

As the briefly outlined macroeconomic and public finance goals are achievable only in case of favourable internal and external conditions, we should be prepared also for the negative effects of the external environment, both in the economy and in the public finance.

Budapest, 10th of September 2019

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