Opinion of the Fiscal Council

on the draft bill of Hungary's year 2023 central budget

I

Antecedents, legal basis and publicity of the Opinion

Pursuant to § 24 of Act CXCIV of 2011 on the Economic Stability of Hungary (henceforth: Stability Act) and pursuant to Indent (2) Article 44 of the Fundamental Law, the Fiscal Council (henceforward: Council, FC) shall formulate an opinion about the draft of the central budget bill. In its opinion the Council may make observations and, in case the Council has fundamental objections as regards the authenticity or feasibility of draft, may indicate its disagreement.

Minister of Finance, Mr. Mihály Varga forwarded the draft bill of Hungary's year 2023 central budget, discussed and approved by the Government, to the chairman of the Fiscal Council as an appendix of his letter PM/9/1/2021. on 26th of May, 2022.

The FC formulated its following opinion by taking into consideration the antecedents of Hungary's year 2022 central budget related to Act XC of 2021 as well.

> In its Opinion 5/2021.04.27. on the draft of the year 2022 central budget bill the Council established that „the draft of the budget bill is counting with a high – 5, 2 percent – growth that is near to the upper band of the well-known domestic and international forecasts, due to the essential expansion of earnings and employment, household consumption and fixed capital formation."
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> In the Justification section of its Opinion, the FC indicated that „in their opinion the expected economic expansion might be realised in case the epidemic shall die off as expected and no sudden frictions arise in world economy." Additionally, the Council supported that the public finance deficit-to-GDP-ratio should be reduced from the 7, 5 percent in 2021 however, they considered the 5, 9 percent target too high. „Namely, in the Council's opinion the expected rapid recovery could serve as a basis for a more substantial deficit decrease in 2022 that would be the guarantee of restoring balance and

sustainable convergence." According to the FC „following the temporary increase in 2020, the decreasing trajectory of the government debt indicator remains lasting, in compliance with the respective stipulations of the Fundamental Law and, according to the draft budget bill, its degree shall decrease from the 79, 9 percent in 2021 to 79, 3 percent by the end of 2022."

The Council also established that „the draft of the year 2022 budget is in compliance with the government debt rule prescribed by the Fundamental Law" and „meets the stipulation of Indent (2a) § 4 of the Stability Act". Despite this – in compliance with the note indicated in the targeted deficit – the FC did not find the 0, 6 percent mitigation of the year 2022 government debt indicator adequate and noted that „the economic recovery that started already in 2021 makes a greater decrease of the debt indicator possible and this would be also necessary to ensure that, in case of the possible occurrence of risks, the mitigation remained secure." Furthermore, the Council pointed out that „the degree of reserves ensuring the security of fiscal management was merely 0, 4 percent that is below even the low level planned for 2021 (0, 5 percent of the GDP)."

At the end of 2021 the Government decreased the originally planned 5, 9 percent targeted deficit-to-GDP-ratio for 2022 and wishes to stick to it despite the negative processes affecting the budget due to the Russian-Ukrainian war. The decrease is planned to be realised mostly by postponing specific public investments.

- By giving its consent to submit the year 2022 central budget bill for final voting – in its Resolution 6/2021.06.10. - the Council established that „the FC found the degree of the government debt indicator planned for 31st of December, 2022 feasible, as described in Indent (1) § 3 of the uniform budget bill of Hungary's year 2022 central budget, and that this was established in compliance with the respective stipulations of the Stability Act as well as, with the macroeconomic and public finance processes that served as the basis of the bill. As the degree of the government debt calculated for the end of 2022 is less – 0, 6 percent - than the debt indicator expected for the end of 2021 thus, the stipulation of Indent (5) Article 36 of the Fundamental Law is also being observed." At the same time, in the Justification section of the above Resolution the Council also noted that „the GDP growth that exceeded the expectations of the first quarter and the ensuing favourable shift of growth expectations, the growth of the nominal GDP level has significantly exceeded the bases calculated both in 2021 and 2022, that leads to the increase of both the tax bases and the fiscal revenues. This improves the targeted deficit marked in the bill as well as the feasibility of the government debt indicator i.e. mitigates the risks of non-compliance and, at the same time, confirms the justification of the Council's recommendation for 2022 to target a lower deficit and government debt indicator."

- In its Opinion 1/2022.04.21. evaluating the state of the execution of Hungary's year 2021 central budget act and the evolution of the government debt, by analysing the processes of the whole year, the Council established that „in 2021, compared to the situation in 2020, the coronavirus epidemic affected the Hungarian economy and public finance to a lesser degree. Thanks to the strong resilience of the economy, the governmental and Central Bank initiated measures, our country was successful in protecting the nation from the economic consequences of the epidemic." The FC focused the attention to the fact that „it deems the stability results of 2021 a decisive factor, especially in the light that the Russian aggression against the Ukraine from February 2022 and the economic consequences of the sanctions in response are also redrawing the trajectory of the Hungarian economy in 2022." Additionally, the Council emphasised that „the results of the year 2021 recovery are also valuable because they offer a solid foundation for handling the new challenges." At the same time, the FC called the attention to the fact that „although, at the time of the preparation of the evaluation we are not familiar yet with the more exact effects of the war, certain decisive elements of the considered macroeconomic trajectory of the year 2021 budget – the GDP and the inflation rate - are going to be different compared to the forecast."

In the course of formulating its Opinion on the draft of the year 2023 central budget of Hungary and, in compliance with its standard procedure, the Council based its Opinion the written analyses and findings prepared by the State Audit Office of Hungary and the Central Bank of Hungary. Beyond these papers it reviewed the economic forecasts of domestic research and analysing institutes commissioned by the FC Secretariat as well as, the forecasts prepared by international organisations (European Commission, OECD, IMF, World Bank) and those prepared by benchmarking market analysts. Beyond the above, the FC also took into consideration the contents of Hungary's Convergence Programme for the period of 2022 – 2026. Furthermore, when formulating its opinion, the Council was also relying on the known processes, the major characteristic features and their respective background about the execution of Act XC of 2021 on the year 2022 central budget, and considered these as a basis.

Within the framework of its mandate, following its standard procedure, the FC examined the draft of the year 2023 central budget bill of Hungary and the budget's macroeconomic background in a single unit and analysed the details, the revenues and expenditures from the aspect of the balance and compliance with the government debt rule. In doing so, the FC was mindful of the fact that because of the unprecedented rise of energy prices and the continuous problems of the supply chains, the increased uncertainties as regards the economic outlook and the downward risk indicators, the European Commission recommended the Council of Europe to maintain the EU level escape clause concerning the EU fiscal regulations also in 2023.

As before, and in compliance with its mandate stipulated by the Fundamental Law and the Stability Law, the Council did not take a stand regarding the policy of distribution and supply.

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

II

The Opinion of the Council

At its meeting held of 3rd of June 2022, in compliance with § 24 of the Stability Act the Council discussed the draft of Hungary's year 2023 central budget bill and – with unanimous decision – formulated the following opinion.

1) As regards the authenticity and feasibility of Hungary's year 2023 central budget bill the Council has no such fundamental objections that would justify the indication of disagreement concerning the draft document.

2) The Council notes that the draft budget bill is counting with a 4, 1 percent economic growth through the further increase of the record high employment, the rapid growth of earnings, household consumption, and substantive expansion of the accumulation of fixed assets and by improving productivity. This fits in the band of the forecasts of known domestic and international forecasters. In the Council's judgement the expected economic growth can be realised in case the epidemic does not return, the effects of the war remain within the band mapped out at the time of the planning and the further deterioration of the foreign trade balance will be avoidable. The above factors might represent downward indicating risks as regards the growth.

3) The Council supports the endeavours to improve the balance and to mitigate the public debt to-GDP-ratio and the deficit. It assesses positively the idea that as regards the revenues they are trying to adjust the taxes to the ability to pay and shall not increase the taxes of the public respectively, those paid after labour. The Council finds that measures concerning the revenue side represent a significant share – especially via the windfall profit taxes while, the steps taken on the expenditure side might contribute to the improving balance in a more lasting and efficient way. The execution of the measures concerning the expenditure side – without decreasing the income of families - is imperative for realising the authentic and well established stabilisation. The improving of our external and internal macroeconomic balance positions can happen only by clarifying the expenditure-side details and their respective realisation as soon as possible.

4) The Council deems it a step in the right direction that the accrual-based deficit (ESA) of the governmental sector in 2023 shall decrease to 3, 5 percent that is close to the Maastricht criteria while, the public finance cash deficit decreases to 3, 3 percent. The fiscal deficit as a goal can be achieved if the planned macroeconomic trajectory is realised respectively, if the detailed elaboration of the planned tax changes and expenditure decreasing step takes place and shall be realised. The Council acknowledges that both the respective EU and domestic regulations allow the public finance deficit to exceed 3 percent also in 2023. The Council is encouraging the achieving of the 3 percent deficit, as soon as possible, if and when, the economic circumstances allow this.

5) The Council recommends to the Government the option to decrease the beyond the year amount of pre-financing by staging the pre-financing of the 2021 – 2027 cohesion and rural developments, by attaching stricter conditions as regards the level of preparedness of such programmes, by ranking the programmes respectively, instead of advances, encourage borrowing and thus mitigate the planned deficit of the EU development budget. It is advisable that they would use the thus released amount for increasing reserves, in order to manage the number of risk factors endangering the realisation of the budgetary objectives.

6) The Council finds that the planned degree of the structural deficit-to-GDP-ratio is exceeding the ESA deficit, and is 4, 5 percent. Similarly to the previous years this share is higher than the 1, 0 percent stipulated by the medium-term budgetary objective (MTO) as regards the structural deficit. The Council takes into account that the EU and domestic regulations regarding a structural deficit exceeding the medium-term budgetary objective

allow this also in 2023. At the same time, the draft bill does not contain the detailed derivation of the balance. The Council proposes to replace this by the time of submitting the bill.

7) According to the Council's opinion the revenue and expenditures appropriations in the draft are in compliance with the planned macroeconomic and public finance processes both in case of the expectations regarding 2022 and the plans for 2023, especially in respect of the mentioned balance requirements.

   a) The precondition of the realisation of the revenues, the realisation of the macroeconomic trajectory is necessary as that is the base on what the plans were made. The effects of the measures aiming the increase of tax revenues and announced on 26th of May 2022 have already appeared in the planned revenues however, the detailed evidence providing support for these are not presented in the draft document. The Council considers that, in compliance with the planned amendment of the tax laws, this has to be replaced at the time of submitting the bill.

   b) In order to enforce two major priorities, the budget is establishing independent funds: the Utility Fund and the Defence Fund. According to the draft document the resources of these two funds shall be covered by the payments of companies in those sectors that – beyond the budgetary support of the defence – earned significant additional profits beyond the planned amount - as a result of the market processes.

   c) The expenditures reflect that protecting the reduction of the utility costs remains in the focus of the year 2023 budget together with supporting families and protecting the elderly. Beyond this, defence, law enforcement and helping refugees are an important component. Decreasing the expenditures acquires great significance in mitigating the budget deficit however, this issue is not discussed either by the draft bill. The Council is asking for an explanation of this at the time of the submission of the bill as well.

   d) The order of chapters in the draft is not yet in compliance with the new government's structure. This must be rectified as well, until the bill is submitted.

   e) In 2023 the draft is calculating with an amount of HUF 2.057 billion from EU resources. By contrast, the expenditure appropriation of the EU development budget is HUF 3.408 billion with the advances paid mostly from the budget. Access to the 2021 – 2027 period budget cycle exceeding EUR 40 billion is pending on the agreement between the Government and the European Commission.

8) The Council notes that, in compliance with the respective stipulation of the Fundamental Law, the decreasing trend of the government debt rule[1] remains lasting and, according to the draft budget bill, its degree shall decrease from the end of 2022 share of 76, 1 percent to 73, 8 percent by the end of 2013. In the Council's opinion, achieving this target seems to be feasible on the basis of the macroeconomic and fiscal trajectory.

    a) The draft of the year 2023 budget bill is in compliance with the government debt rule stipulated by the Fundamental Law and with the regulation of Indent (2a) § 4 of the Stability Act.

    b) The Council welcomes that the government debt management intends to save the favourable structure established during the past years, also in 2023, keeping the share of the foreign currency denominated debt on a low level – even by a slight increase - as well as the expansion of the circle of domestic investors and thus increase the participation of the population in financing public debt and increase the maturity time of the debt.

    c) The bill is counting with the significant increase of the nominal government debt (exceeding it by HUF 1.600 billion) however; the draft bill does not include any justification. The Council calls for this to be remedied at the time of submitting the bill.

9) The FC empowers its chairman to publish the body's Opinion regarding the draft document and present it at the plenary session of the National Assembly considering its connection with the submitted bill.

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[1] Government debt indicator: According to Indents (4)-(5) Article 36 and the stipulations of Indents (2)-(3) of Article 37 of the Fundamental Law, in the course of the execution of the aforementioned stipulations such a quotient expressed as a percentage and rounded to one decimal place is to be taken in consideration […] that

- in its numerator of the government debt and,
- in its denominator should contain the value of the gross domestic product in harmony with this law and calculated according to the prescription of the Community regarding the European system of national and regional accounts (Stability Act § 2).

III

Justification

1. Authenticity of the draft bill

According to Indent (2) § 24 of the Stability Act the Council may make comments on the draft of the budget bill respectively, in case it has fundamental objections regarding authenticity or feasibility of the draft bill, the FC may indicate its disagreement. The FC considers that there is no impediment to grant its agreement at the same time, the Council requires the clarifications mentioned in its Opinion.

2. Macroeconomic and fiscal processes in 2022

Despite the continuation of the geopolitical, regional and economic strategy tensions known until then (American-Chinese, Middle East), following the coronavirus shock, year 2021 brought along a „rebound-like" growth of world economy, thanks to the intensive and multi-level supportive economic policies. Global economy expanded by 6, 1 percent, in the Eurozone by 5, 3 percent, the Chinese economy by 8, 1 percent and the US economy by 5, 7 percent, compared to the performance of the previous year. The economic and targeted fiscal measures introduced by the government supporting the recovery/restarting of the economy were playing a decisive role in this and, additionally, it was also an important factor that the restraining effect of the coronavirus epidemic on economy decreased significantly, thanks to the effectiveness of the vaccines, the high level vaccination and the reasonable restrictions.

Aside from the faltering global production and supply chains the consequences of the Russian-Ukrainian war also appeared, together with jumping inflation, the difficulties of importing raw materials, materials, the increase in demand for imported energy, the restrictions concerning transportation etc. put complete production lines in difficult situation. The war and the ensuing sanctions are having a drastic effect on the money and commodity markets.

In their respective forecasts for 2022, benchmarking international financial organisations were unanimously projecting a lower growth rate compared to 2021 and predict the slowdown of global economy. In their forecast (April, 2022) for the whole of the world economy for 2022 the International Monetary Fund was counting with a 3, 6 percent expansion. In its analysis published in January this year the World Bank forestalled 4, 1 percent GDP growth. On the basis of the spring 2022 analysis of the European Commission the economy of the EU as a whole and the Euro-zone countries might reach 2, 7 percent growth in 2022. They also added that the war is testing the economic resilience of the Union thus, compared to the earlier expectations, the growth outlook of the EU economy is clearly pointing downwards. According to the IMF and the World Bank China's economic performance will also be more moderate this year (the former projects 4, 4 percent economic growth for 2022, the latter predicts 5, 1 percent growth rate). From the aspect of the effectiveness of domestic economy it is not negligible that according to the latest IMF outlook they restrained the degree of the previously forecasted 3, 8 percent growth of the German economy in 2022 to 2, 1 percent.

Following the blow-over of the coronavirus epidemic the restarting of the economy continues to be a challenge for the economy. Beyond this it also has to be considered what consequences the already introduced (and the planned in future) sanctions (especially the gas and oil embargos), the increasing refugee wave imply, what additional burden these factors put on the budget, as these all affect the 2022 – 2023 performance of the domestic economy.

Benchmarking international financial organisations are forecasting a 4 percent expansion of the Hungarian economy in 2022: the IMF forecast mentions 3, 7 percent, the World Bank 4, 3 percent while the European Commission 3, 6 percent.

When planning the year 2023 annual budget the Government based its expected 4, 7 percent growth rate in 2022 on the expectation that compared to the previous year, household consumption volume shall grow by 4, 9 percent and the gross fixed capital formation by 2, 7 percent. The number of employees is increasing to the same extent as last year, i.e. by 0, 7 percent; within this, in the private sector, by 1, 4 percent. At the same time a downsizing of 3, 3 percent is expected in the public sector. Gross average earnings might grow by 16, 7 percent (by 15, 3 percent in the private sector and by 21, 1 percent in the fiscal sector). The expansion of foreign trade turnover might be moderate thus, exports might grow by 3, 8 percent while imports by 3, 4 percent.

The draft bill is counting with an 8, 9 percent consumer price increase in 2022 that is significantly exceeding the 5, 1 percent in 2021.

Several factors are supporting the expectations of the government. Investment rate is high: in 2021 it was 27, 1 percent, the second highest in the European Union. The increase of the investments remains dynamic. Influx of foreign capital continues (in 2021 approximately HUF

2 thousand billion FDI /foreign direct investment/ arrived), thus creating several thousand new jobs.

Economic growth generates strong labour demand. The number of unemployed decreased by 34 thousand in the first quarter of 2022 compared to the same period last year, the unemployment rate decreased by 3, 7 percent. According to the National Employment Service the number of registered job seekers is 251 thousand (less by 16, 8 percent compared to the data of the previous year). The nearly 20 percent increase of the minimum wage might support the situation of the employees as well as the exemption of those under the age of 25 from the obligation to pay personal income tax.

The volume of retail sales grew by 10, 3 percent in the first quarter of the year; within this, by 1, 1 percent in food and non-food, non-specialised retail sales, by 16, 9 percent in non-food retail sales and by 27, 4 percent in fuel retail sales. The sales in commercial accommodation also grew in the first quarter (as a result of the lifting of restrictions, etc.).

According to the (first) estimates of the Hungarian Central Statistical Office (KSH) the performance of the economy in the first quarter of the year turned out to be larger by 8, 2 percent – by 8, 0 percent on the basis of the seasonally and calendar adjusted and balanced data – when compared to the same period of last year. Each branch of the national economy contributed to the growth; mostly industry and market services. The expansion exceeded the same data of last year by 2, 1 percent. The acceleration of consumption can be attributed to the big wage dynamics, the great volume of transfers and the base effect.

According to the data of the first four months of 2022, the revenues of the public finance central subsystem were realised at HUF 9.824, 6 billion (this is more by 24, 8 percent compared to the revenues of the same period of the previous year). The expenditure of the subsystem was HUF 12.460 billion that exceeded the expenditures in the first four months of last year by 39, 7 percent. From among tax revenues the VAT was HUF 2.244, 5 billion (more by HUF 475 billion i.e. by 26, 8 percent) than the realisation of this type of revenues last year; the realisation of excise duties (HUF 377, 8 billion) also exceeded the data of last year's first four months by 0, 3 percent. Revenues from personal income tax amounted to HUF 440, 6 billion. Compared to the performance of the base period the incoming amount was more by HUF 200 billion (by 21 percent) (HUF 1.161, 1 billion), thanks to the increasing wages. At the same time, mainly because of the one-time tax reimbursement to families rearing children, compared to the base of HUF 66 billion – the allocated amount was HUF 720, 5 billion. Thanks to the combined effect of the above factor this type of revenues was less by HUF 452, 6 billion, compared to the same period of the previous year. Revenues from EU programmes amounted to HUF 286, 2 billion that is 12, 3 percent of the mandatory appropriation (HUF 2.363, 3 billion) however, exceeds the HUF 153, 5 billion of last year.

The central subsystem's cash deficit in the first four months of 2022 altogether amounted to HUF 2.635, 6 billion that is 83, 6 percent of the annual appropriation. Within this, the deficit of the central budget was HUF 2.669, 7 billion, of the social security funds HUF 18, 7 billion while the separated public funds reached a surplus of HUF 57, 7 billion. During this period the highest expenditure was paid for pensions (HUF 1.679, 6 billion) and for curative-preventive treatments (HUF 709, 1 billion). The allocation of personal income tax for families was also a significant item (HUF 620, 9 billion).

The negative effect of external conditions concerning the public finance management has been strong. In the first four months of the year the revenues have considerably exceeded the appropriated amount however, uncertainty has been „testing" the resilience of the economy and public finance.

3. Budgetary objectives and conditions of year 2023

3.1. Macroeconomic indicators serving as the basis of the planning

The draft is based on a 4, 1 percent GDP growth for next year's budget. On the utilisation side this is supported by the 4, 3 percent increase of household consumption and the 4, 2 percent growth of gross fixed capital formation. In 2021 the latter was 5, 9 percent and the year 2022 forecast is 2, 7 percent. The private sector investments and the developments realised from domestic and EU resources (public road and other, infrastructural investments) might increase the investment rate-to-GDP-ratio even above 27 percent and this might contribute significantly to the expansion of the domestic economy.

Despite the labour market environment remaining historically stretched the number of employees might continue to increase by an additional 0, 3 percent. In this the supporting measures introduced by the Government and the EU following the decrease of the pandemic might also be contributing factors. Within this, an expansion of 0, 4 percent is expected in the private sector while, in the public sector they are not counting with any changes. Due to the exhaustion of labour reserves it is important that productivity may improve further by 3, 8 percent.

Following the robust wage increase in 2022 the growth of average income might increase by a further 10, 2 percent in 2023 (11, 6 percent in the private sector and 5, 5 percent in the fiscal sector) that is the consequence of the stretched labour market and the wage increase concerning specific groups of public sector employees.

Due to the changes in foreign trade and work economy, the risk elements hindering or endangering the production process, the energy crisis and, because of the consequences of the sanctions, the expansion of exports and imports might be merely 5, 9 percent respectively 5, 5 percent.

Thanks to the governmental measures and those introduced by the central bank, together with the base effects, the pace of consumer price increase is expected to slow down and its annual average in 2023 will be 5, 3 percent compared to the 8, 9 percent in 2022.

According to the Council the economic expansion described by the draft bill can be realised if the Russian-Ukrainian war is over, the restoration of the production-supply chains takes place in time, the containment of energy prices will be successful and thus, these and other effects of the negative processes concerning the economy's operation can be moderated.

3.2 Revenues of the central subsystem

The revenue appropriation of the total - not consolidated – revenues of the central subsystem is HUF 30.913 billion that is more by 23, 7 percent than the year 2021 preliminary realisation and, more by 21, 7 percent than the year 2022 annual appropriation and more by 10, 8 percent than the expected value in year 2022[2].

The appropriation of **payments by business entities** is HUF 2.990, 9 billion exceeding the expected realisation, more by 38, 9 percent calculated for 2022 prior to the introduction of the new tax measures and in amount by HUF 838, 1 billion. Within this revenue group the revenue ***from corporate tax*** traditionally represents an outstanding magnitude the appropriation of what (HUF 792 billion) might increase by 10, 3 percent compared to the expected realisation in 2022

[2] By the year 2022 expected value we mean the notification forecast prepared for the EDP report in April 2022. However, since the EDP report several tax measures were introduced that concern the year 2022 revenues thus, the effect of these measures was not mentioned in the forecasts at the time.

(in amount by HUF 85 billion). The year 2023 appropriation of *small business tax* (HUF 165, 9 billion) shall grow by 17, 6 percent, i.e. HUF 25 billion compared to the expected realisation, the appropriation of the *itemized tax of small taxpayers* (HUF 226, 8 billion) shall increase by merely 5 percent compared to the expected revenue from this source in the previous year.

In case of several tax types to be discussed below, the Government announced temporary revenue increasing measures for 2022 and 2023; the effects of what are not included yet in the expected realisation of year 2022 that is addressed below as base year. The appropriation of *mining fees* (HUF 240 billion) shall be more than triple as a consequence of the sets of measures compared to the expected realisation of year 2022. The appropriation of *energy providers' income tax* is expected to grow by more than four times of the expected result of year 2022 while, an amount of HUF 337, 9 billion might be paid to the Treasury under the title of *special tax of financial organisations* that is close to five times more than the expected realisation of year 2022. The appropriation of *retail tax* (HUF 172, 7 billion) is higher by 84, 5 percent compared to the expected realisation in 2022, thanks to the increasing of the upper two tax rates. Pursuant the amendment of the law in 2019 the rate of *advertising tax* shall increase from 0 percent to 7, 5 percent after the part of the tax base above HUF 100 billion, as of 1st of January, 2023. The budget is counting with revenue of HUF 15 billion following the entry into force of this measure.

Taxpayers may realise a payment of HUF 38, 8 billion under the title of *gaming tax* (more by 17, 7 percent than the expected revenue of the previous year). The appropriation of *utility tax* (HUF 53, 4 billion) shall not change compared to the expected revenue of the previous year. Beyond the above, the appropriation of *other centralised revenues* (electronic and time-based tolls, rehabilitation contribution, etc.) is HUF 682, 3 billion, higher by 1, 5 percent than the expected realisation.

The appropriation of **taxes related to consumption** is HUF 9.210, 2 billion that exceeds the expected realisation of the previous year by 17, 3 percent. The fiscal consolidation steps in 2023 concern several taxes related to consumption however, the expected 2022 data do not contain these yet so we see a considerable revenue increase as regards the concerned taxes. The fact that the amounts originating from taxes related to consumption cover close to 30 percent of the central subsystem's revenues indicate the weight of such taxes. The appropriation of ***value added tax*** (HUF 7.061, 4 billion) exceeds the expected realisation in 2022 by 15, 2 percent (in total by HUF 929 billion). The continuing expansion of employment rate, demand and consumption render reality to the appropriation.

The appropriation of *excise tax* is HUF 1.458, 9 billion that might exceed the expected realisation of the previous year by HUF 208 billion, i.e. by 16, 6 percent. In the background of this significant increase we find the tax harmonisation obligation (tax increase) of the EU. The appropriation of the *registration tax* (HUF 18, 7 billion) is more by 9, 4 percent than the expected realisation. The appropriation of the *transaction duty* (HUF 323, 5 billion) is exceeding the expected realisation of the previous year by 33, 4 percent. The year 2023 appropriation of *telecommunication tax* is HUF 96, 4 billion, more by 71, 8 percent than the expected realisation of the previous year. The appropriation of *insurance tax* (HUF 179, 7 billion) is more by 54, 9 percent compared to the expected revenues of the previous year. The appropriation of *tourism development contribution* (HUF 41, 6 billion) exceeds the expected realisation of the previous year by 19, 5 percent. The *airline tax* is a new obligation (related to the establishment of the two new funds) and they expect revenues amounting to HUF 30 billion from these sources for the year 2023 budget.

The appropriation of **payments of the public** is HUF 4.168, 2 billion that exceeds the expected realisation of the previous year by 42, 5 percent, (in total, by 1.243,3 billion). In this circle of revenues ***personal income tax*** represent the biggest weight, the appropriation of what (HUF 3.733, 7 billion) exceeds the expected realisation by 44, 1 percent, in total by HUF 1.143 billion. The continuous expansion of employment, the high outflow of earnings and the fact that the family tax refund has mitigated considerably the cash basis of the current year are playing a decisive role in this. At the same time, payments from personal income tax increased by 14 percent, compared to the expected realisation this year even following the correction effect of the tax refund and, these revenues are significantly exceeding the dynamics forecasted by the macroeconomic indicators of the draft bill.

The appropriation of *levy revenues* is HUF 261, 3 billion that is more by 8, 9 percent (in amount by HUF 21 billion) compared to the expected realisation in the previous year. In the background of this growth we find the continuing expansion of real estate turnover (especially of high value real estates) and the ensuing jump of the levy bases. Under the title of *motor vehicle tax* the annual appropriation is HUF173, 2 billion that exceeds the expected realisation of the previous year by 84, 8 percent. The reason for the huge change is that company car tax and motor vehicle taxes will increase and merge.

A significant share of the central subsystem’s revenues originates from the **social contribution tax and contributions.** From this the total amount of HUF 6.636 billion is due to the Pension

Insurance and Health Insurance Funds and the National Employment Fund. This is more by 10, 7 percent, in amount by HUF 644 billion, compared to the expected realisation of year 2022.

At the National Land Fund the draft is calculating with revenues amounting to HUF 300 billion from selling properties, the details of what are not known.

3.3 Expenditures of the central subsystem

According to the draft document the **total** – not consolidated – **expenditure** appropriation is HUF 33.265,2 billion, more by 16, 5 percent than the year 2022 appropriation and by 7, 1 percent compared to the expected realisation in 2022.

The **structure of the budget** is characterised by a clear structure so the appendix of the bill contains public expenditures and revenues in a transparent, clear detail. However, the draft reviewed by the FC does not follow yet the new structure of the Government (for example, the Ministry of Human Resources is still listed among the chapters while new portfolios are still missing). This has to be rectified before submitting the budget to the National Assembly.

From the total **expenditures** regarding **the three big groups** within the central subsystem in 2023 they plan to use 80, 7 percent for current (operational) goals, 9, 0 percent for accumulation goals from domestic resources and for operational and 10, 2 percent development expenditures financed by the EU. The share of these groups was 78, 1 percent, 10, 5 percent and 11, 4 percent in the year 2022 budget so the decline of investments expenditures is obvious. During the past five years the investment expenditures-to-GDP-ratio of the governmental sector at average was 5, 7 percent and this meant that Hungary took the first place in the European Union.

Among the expenditures of the 2023 budget the protection of the utilities' costs decrease, supporting families and protecting the elderly also remain the **priorities.** Border protection and helping refugees play a significant role as well. Compared to the previous years, the epidemic protection or the restarting of the economy are not priorities anymore. At the same time – even if to a lessening degree – the budget ensures resources for these purposes as well.

Under the conditions of the present increasing tendencies of the world market (and the domestic market) prices the fact that the so-called ***Utilities Fund*** is a new, separate chapter is contributing to the protection of the price level of utilities.

Furthermore the creation of the ***Defence Fund*** is also part of the budget as a new chapter. Its purpose is to appropriately manage the challenges before security policy presented by the war conflict in the region, the maintenance of an efficient defines force, the modernisation of military equipment, providing equipment for the military manpower, improvement of accommodation facilities, increasing the number of the staff and, altogether, continue the arms development programme. In order to meet our military obligations prescribed by our treaty of alliance and the respective international agreements, by 2023 we may fulfil our commitment to spend 2 percent of the GDP on defence.

Beyond the budgetary support for defence so far, the resources for the two new funds can be created by enforcing the payment of a share of the significant, unplanned extra/windfall/ profits that is the result of the market developments.

On the basis of the budget ***supporting families and improving their quality of life*** may continue. The housing scheme continues to play a key role in the frame of what public support to create their own home remains significant for families with children respectively, for couples who are committed to rear children. Sustaining the family tax system that is promoting the importance of work and childcare and offers one of the lowest, single rate personal income tax (15 percent) and supports child rearing with family tax respectively, contribution reductions, is also supporting families.

Furthermore, women having at least four children are exempt from paying personal income tax while, the participation of young people in the labour market, their starting independent life and a family is supported by exemption from paying personal income tax beyond the age of 25 and up to the level of average earning. Although the latter do not count as expenditures however, due to the loss of revenue represent, the same burden for the budget.

The 2023 budget also keeps in the focus the ***protection of pensioners.*** The goals aiming at keeping the revalorisation of the pensions are feasible, just like keeping women in high esteem. In 2022 the pension for the 13th month in full was restored and the pensioners received a compensation altogether amounting to 8, 9 percent that was made up from the 5 percent raise in January and from July, from the statutory 3, 9 percent midyear increase.

The budget calculates with a 5, 2 percent increase of the pensions in 2023 that also applies to the pension of the 13th month, above the regular monthly allowance. Besides the above the institution of pension bonus will be maintained also in 2023 to thus ensure that those on pension would also have their share from the results of the economic growth. In recognising the role of women within the family the option to apply for pensions prior the statutory age limit – from 2022 this age limit is 65 – in case the person in question has at least forty years of service.

From the year 2023 budget ***law enforcement*** can also receive several, additional resources. Appropriations related to mass immigration and anti-terrorism measures remain eligible for increasing thus, the necessary resources remain available. The budget is also paying special attention to cyber-security and IT developments thus adapting to the challenges of our times.

Besides the major priorities in 2023 it becomes possible to continue ***the ethical and material esteem of public servants,*** the execution of the already launched career programmes and continue the already introduced wage increases at the National Tax and Customs Administration, in the cultural and social sectors, the judiciary, law enforcement and defence. The execution of the multi annual, comprehensive wage development programme of medical doctors that was launched in 2021 is being realised from a significant resource just like the wage increase of paramedics that had been launched earlier as well. The provisions make further wage-related measures possible. Despite this the pace of wage increases in the public sector remains significantly slower than in case of the private sector (the base data are also reflected in this) and this might be a source of tension. Therefore, it is appropriate to give more freedom to the heads of fiscal organisations by introducing wage bill management to enable them to be more highly valued, retaining their key employees without endangering public service standards.

In case of **domestically financed developments,** the appropriation of what (HUF 3.258 billion) is less by HUF 258 billion compared to the previous year, there are two fields that might witness greater progress; namely the healthcare institutions owned by public and religious institutions and in the field of higher education, in order to further strengthen the provision system. In case of the latter, in compliance with the framework of the changing model – apart from operational support – the institutions may receive funding for their specific investments in the field of infrastructure, innovations and ecosystems. Beyond the above, according to the draft bill, significant investments promoting economic growth may be realised. The Investment Fund, established in 2021 continues its work to this end. From this Fund they are planning to realise primarily those investments that are by now in implementation stage. The FC deems it justified to implement this endeavour in the widest possible circle.

The draft bill is calculating with an amount of HUF 2.057, 1 billion from **EU resources** in 2023. By contrast, the appropriation of the **expenditures of the EU development budget** amount to

HUF 3.407, 9 billion. The difference is the total of the co-financing by member-states (own contribution) and the advances paid by the budget. Expenditures related to the cohesion, rural development and other schemes of the 2014 – 2020 period are still significant, amounting to more than HUF 1.000 billion.

Expenditures related to the 2021 – 2027 programmes might reach HUF 1.600 billion and an additional amount of more than HUF 600 billion may be the payment to be made in the frame of the Recovery and Resilience Facility. Access to the EU resource frame of the 2021 – 2027 period amounting to more than EUR 40 billion is pending on the agreement between the Government and the European Commission. For the advances paid on the EU supports of cohesion and rural development programmes of the 2021 – 2027 period, the budget has an appropriation amounting to more than HUF 2.000 billion. The full utilisation of the EU frameworks does not call for advance payments to such extent so, the advance payment beyond a year could be mitigated significantly by staging such payments and by attaching stricter conditions regarding the degree of the preparedness or, by the possible ranking of these payments, without endangering the economic growth. In case the rapid implementation of the development is justified and the beneficiary is a company or private person, it could be an option to encourage these actors by guarantees and/or interest subsidies to raise loans in order to realise the scheme as soon as possible. Via the thus released appropriations it would be possible to mitigate by one third the deficit of the EU development budget and create from these reserves a stock for handling the number of risks endangering the implementation of the budgetary objectives.

Contribution to the EU budget might reach HUF 597, 3 billion that is more by 32, 4 billion, i.e. by 5, 7 percent compared to the previous year.

3.4. Public finance deficit

As regards the public finance, the war conflict, the competition for energy and raw materials and the ensuing inflation that is partially the consequence of the above factors, have replaced the crisis of the previous years caused the coronavirus epidemic. The FC welcomes that the draft bill – in compliance with the governmental endeavours to strengthen financial stability and maintain fiscal discipline –is counting with a 3, 5 percent accrual-based (ESA) deficit in 2023 as opposed to the 6, 8 percent in 2021 and the expected 4, 8 percent in 2022. This, almost entirely, would appear in the public finance central subsystem while the balance of local governmental subsystem is zero.

Interest expenditures – in conjunction with the growing yields of government securities and the accelerating inflation rate – are growing strongly and by 2023 they might reach 3 percent of the GDP. The primary deficit calculated without this factor is 1, 5 percent of the GDP.

According to the FC the targeted fiscal deficit is accessible in case the planned macroeconomic trajectory is realised, they elaborate in detail and implement the planned tax changes and the decrease of expenditures and the extra revenues from the economic growth won't be tied up by the budget. The EU regulations allow the slightly more than 3 percent public finance deficit also in 2023. As regards the domestic regulations, the Stability Act offers a similar room to manoeuvre only in case of decreasing the GDP thus, in order to establish compliance with the EU regulations, this law was amended.

The planned degree of the structural deficit-to-GDP-ratio is higher than the ESA deficit; it is 4, 5 percent. Similarly to the previous years, this is higher than the 1, 0 percent stipulated by the medium-term budgetary objectives (MTO). At the same time, the draft bill does not contain the detailed derivation of the structural balance. The FC asks that this be included when submitting the bill. The European Council suspended the requirement regarding the medium-term budgetary objectives due to the COVID-19 epidemic and the exemption remains valid also in 2023.

The cash deficit of the public finance central subsystem planned for 2023 will decrease dramatically as well: it will be less by HUF 800 billion compared to the previous year's appropriation, i.e. HUF 2.352, 1 billion (to GDP-ratio this amounts to 3, 4 percent so the decrease is 1, 8 percent). Within the central subsystem divided into three parts, the balance of the operational part has been zero for the sixth consecutive year and cash deficit may occur only in the accumulation and EU budgets.

3.5. Government debt

Following a transitory increase in 2020, the government debt indicator moved to a downward path in 2021 and, according to the draft bill, by the end of 2022 it will decline to 76, 1 percent and by the end of 2023 to 73, 8 percent. The more vigorous economic growth is a contributing factor beside the mitigation of the public finance deficit. The planned decrease of the government debt indicator by 2, 3 percent shall create an implicit reserve from the aspect of compliance with the government debt rule, as this means that in case of the planned degree of the GDP growth this stipulation of the respective prescription of the Stability Act would be realised even if the debt level is higher by HUF 1.500 billion respectively, even in case of a 2, 4 percent economic growth.

At the same time the nominal government debt in the draft bill is increasing at a pace that exceeds significantly the deficit (by HUF 1.600 billion) and the draft bill does not contain any justification in this respect. It would be appropriate to replace this as well before submitting the bill to the National Assembly.

Based on the outlook of the Convergence Programme for the period of 2022 – 2026, by the end of this period the government debt indicator- to-GDP-ratio may decrease to 63 percent.

The year 2023 annual budget bill is in compliance with the government debt rule[3] stipulated by the Fundamental Law and that of Indent (2a) § 4 of the Stability Act. According to the latter, the end-of-year degree of the government debt indicator shall have to be decide in such a way that the annual decrease of the indicator reached at least 0, 1 percent, apart from the compliance with the respective EU regulations. The prescribed decrease of the government debt indicator can be reached on the bases of the macroeconomic and fiscal trajectories.

Based on the recommendation of the European Commission, by continuously maintaining the activation of the general exemption clause, the suspension of the sanctions of the EU debt regulations[4] is expected to remain valid although, the Commission continues to investigate the compliance with the rule also in 2023.

[3] Indents (4) and (5) Article 36 of the Fundamental Law contains the government debt regulation, as the most important element of the accrual-based budget. According to this regulation the National Assembly shall not adopt such a central budget act as a result of what the government debt would exceed half of the GDP. As long as government debt exceeds half of the gross national product, the National Assembly is authorised to adopt only such a central budget act that contains the mitigation of the government debt in the share of the gross national product.

[4] The debt regulation of the European Union is determined by the Treaty on the Functioning of the European Union and the 1467/97/EK Resolution of the Council of 7th of June 1997. The debt regulation of the European Union has been valid in Hungary from 2016. According to this regulation the government debt-in-GDP-ratio shall not exceed 60 percent. In case government debt exceeds the stipulated 60 percent the debt regulation of the European Union prescribes that the deviation from the reference value compared to the previous three years as a baseline shall have to decrease by one-twentieth at an annual average, based on those changes of the previous three years that have appropriate background data („retrospective rule"). The stipulation according to the debt criteria is considered to have been realised even in case the fiscal forecasts of the Commission indicate that the deviation

The share of foreign currency denominated debt within the debt of the central budget shall increase to 23, 4 percent by the end of 2023. The share of foreign currency debt nevertheless remains low and remains within the tolerance band prescribed for the Government Debt Management Agency.

Government debt management wishes to maintain the favourable financing situation of the previous years also in 2023, and the stability of the participation of domestic actors and, within this, that of the public, in financing government debt. Additionally, it is a favourable element that the realisation of the object set in 2020 – i.e. increasing the average remaining maturity date of government debt – can be continued.

Budapest, 2022. június 3.

Domokos László

Költségvetési Tanács tagja

Matolcsy György

Költségvetési Tanács tagja

Kovács Árpád

Költségvetési Tanács elnöke

shall decrease to the prescribed extent in the three year period that includes two years following the last such year the respective data are available for („forward looking rule”). When using the reference value of adjusting the debt share, the effect of the cycle on the pace of debt mitigation shall be considered (cyclically adjusted rule”).