Opinion of the Budget Council

on the implementation of the Act on the 2022 Central Budget of Hungary and the

and the evolution of public debt

I

Background, legal basis and publicity of the Opinion

The Fiscal Council (hereinafter referred to as the Council, FC) shall issue an opinion on the state of implementation of the Central Budget Act and the development of public debt every six months pursuant to Section 23 (1) (c) of Act CXCIV of 2011 on the Economic Stability of Hungary (hereinafter referred to as the Stability Act).

On this basis, the Council has reviewed the full-year implementation of Act XC of 2021 on the 2022 Central Budget of Hungary (hereinafter referred to as the 2022 Budget Act) and the development of public debt.

In its Opinion on this subject, the FC built on the history of the preparation of the 2022 Budget Law, following its practice and working method.

- In its Opinion No 5/2021.04.27. on the draft bill on the 2022 central budget of Hungary, the Council stated that "the draft budget bill projects high economic growth of 5.2 percent, close to the upper end of the range of known domestic and international forecasts, through a substantial increase in earnings and employment, household consumption and fixed capital formation."

  In the explanatory memorandum to its Opinion, FC said that it "considers that the expected economic expansion could materialise if the epidemic subsides in line with expectations and there are no unexpected frictions in the global economy." The Council supported a reduction in the general government deficit as a share of GDP compared to the 7.5 percent plan for 2021, but considered the 5.9 percent figure to be high. "In the Council's view, the expected rapid economic recovery also provides an appropriate basis for a more marked reduction in the deficit in 2022, which should ensure a rebalancing and a sustainable catching-up." In the FCs view, "in line with the provisions of the Fundamental Law, the downward trend in the government debt ratio, after a temporary increase in 2020, will be sustained and, according to the draft budget bill, will decline from 79.9 percent in 2021 to 79.3 percent by the end of 2022."

  The Council also concluded that "The draft Budget Bill 2022 complies with the public debt rule provided for in the Fundamental Law" and complies with the provisions of Article 4(2a) of the Stability Act. Nevertheless, in line with the deficit target, it considered the reduction of the debt ratio by 0.6 per cent in 2022 insufficient, indicating that "the economic recovery, which will already start in 2021, will allow for a higher reduction of the debt ratio, which is also necessary to ensure its reduction in case risks materialise." He also pointed out that "the level of reserves for the safety of budgetary management is only 0.4 percent of the GDP, which is also below the low level (0.5 percent of GDP) planned for 2021."

- In its Resolution No 6/2021.06.10., giving its preliminary consent to the final vote on the 2022 central budget bill, the FC stated that the "government debt ratio planned for 31 December 2022 should be adjusted to the level of the 2022 budget of Hungary. The level of government deficit by 31 December 2022 as envisaged in paragraph 3 (1) of the [...] Consolidated Finance Bill on the Central Budget of the Republic of 2022 is justified, has been established in accordance with the provisions of the Stability Act and is consistent with the macroeconomic and public finance developments underlying the Bill. As the debt indicator calculated for the end of the year 2022 is 0.6 percentage points lower than the indicator expected for the end of the year 2021, the requirement of Article 36(5) of the Fundamental Law is also fulfilled." However, in the explanatory memorandum to this decision, the Council considered that "the better-than-expected GDP growth in the first quarter and the resulting favourable shift in the growth outlook will result in nominal GDP levels in both 2021 and 2022 significantly above the budget planning assumptions, leading to an increase in tax bases and budgetary revenues. This improves the achievability of the deficit target and the debt indicator under the proposed law, i.e. reduces the risk of non-compliance, while confirming the justification for the lower deficit and debt indicator targets recommended by the Council for consideration in 2022."

- Closely related to the assessment of the implementation of the 2022 Budget Law is the fact that the originally planned deficit target of 5.9 percent of GDP was lowered by the Government to 4.9 percent at the end of 2021, and then raised to 6.1 percent in September 2022 due to the accrual-increasing effect of the special natural gas stockpiling.

- At the end of 2021, the public debt ratio was significantly lower at 76.8 percent compared to the 79.9 percent set in the Budget Law. Also in view of this, the Government set the projected value of the government debt ratio for the end of 2022 at 76.1 percent in the April 2022 Convergence Programme, maintaining the objective of its effective reduction.

- In its Opinion No 1/2022.04.21 on the state of implementation of the Law on Hungary's central budget for 2021 and the evolution of the public debt, the Council pointed out that "the economic consequences of the Russian aggression against Ukraine starting in February 2022 and the sanctions in response to it will also redefine the economic path of Hungary in 2022." It further stressed that "the outcome of the recovery in 2021 is also valuable because it provides a solid basis for addressing new challenges." However, he also pointed out that "although the precise impact of the war is not known at the time of writing, some of the key elements of the macroeconomic path considered in the 2022 budget - GDP and inflation - will evolve differently from projected."

- In its Opinion No 4/2022.09.27 on the interim status and prospective development of the implementation of the Act on the Central Budget of Hungary for 2022, the Council noted that "the situation of Hungarian public finances in the years 2020-2022 will be strongly influenced by global economic developments" and that "the fragmentation of global value chains persisted even after the epidemic, with a significant increase in raw material prices and, from the summer of 2021, in energy prices. These processes have slowed economic growth and raised inflation worldwide." The FC added, that "after 24 February 2022, the Russia-Ukraine war widened and deepened the existing problems, posing challenges to the global economy not seen for decades". The Council noted that "the Hungarian economy has recovered rapidly following the outbreak of the coronavirus." In this context, the FC Opinion noted that "the short-term outlook is less favourable. A more moderate growth rate is expected in the second half of the year due to the slowdown in the global economy, EU sanctions, high inflation, soaring energy prices and the exceptional drought".

- The Council also stated in its assessment that "the year-end cash deficit will be significantly higher than planned, based on past and expected developments". A significant contribution to this was made by "measures taken in the first quarter to raise the incomes of certain groups of the population (personal income tax refunds to family members, payment of the full one-month 13th month pension, and the arms allowance for law enforcement personnel), some of which increased budget revenues through tax revenues". The FC stressed that the "increase in the public debt ratio in the first half of the year, from 76.8 percent at end-2021 to 77.5 percent, was mainly due to the high cash deficit, as well as to the increase in liquidity and the revaluation of foreign currency debt". The Council noted that the Government "has taken a number of measures during 2022 to address the effects of the exceptional global economic developments". In addition, it assessed that "comprehensive consolidation measures have been taken as from May 2022 to achieve fiscal stabilisation, with a focus on the application of the extra profit tax [...] and a substantial restraint in fiscal expenditure, notably investments.

The Council reviewed the information on the state of the economy and public finances provided by the Hungarian Central Statistical Office (HCSO) and the Ministry of Finance, as well as the economic assessments and forecasts of domestic research and analytical institutes requested by the FC Secretariat, certain international organisations (European Commission, IMF, OECD, World Bank) and other market analysts. The Council also took into account the information contained in Hungary's convergence programme for 2022-2026.

II

The Opinion of the Council

At its meeting on 30 March 2023, the Council reviewed the main processes and background of the implementation of Act XC of 2021 on the Central Budget of Hungary for 2022, based on Article 23(1 (c) of the Stability Act. It issued the following Opinion on these.

1) After the 7.1 percent "bounce" in 2021, the Hungarian economy continued to grow dynamically in the first quarter of 2022, but this was curbed by Russia's aggression against Ukraine and its many consequences. The collapse in energy security and the explosion in energy prices have hit the Hungarian economy hard, fuelling inflation and widening the external deficit. The budget has had to face an extraordinary additional budgetary burden to maintain, at least in part, the reduction in household utility bills despite the sharp increase in gas and electricity prices, and to provide broad support to several other economic actors, in addition to public institutions, to compensate for the increase in energy prices. Thanks to the strong resilience of the economy and the measures taken by the government, the economy grew by 4.6 percent for the year as a whole.

2) On the development of the budget deficit, the Council notes:

a) The Budget Law set the cash deficit of the central subsystem of general government at HUF 3 152.7 billion. The actual cash deficit was HUF 4753.4 billion, up by 50.8 per cent (HUF 1 600.7 billion) (HUF 20.5 billion lower than in the previous year), and was particularly large in the first quarter, due to measures to increase the incomes of some groups of the population, and in the fourth quarter, mainly because of the need for broad compensation for energy price increases. Government measures taken in the course of the year to improve the balance (introduction of extra-profit taxes, expenditure restraint) significantly curbed the deficit growth.

b) The cash balance was positively affected by an 18.4% year-on-year increase in tax revenues, reflecting real growth in the economy, wages and consumption moving in line with rising inflation, on the one hand, and the introduction of extra-profit taxes, on the other.

c) EU revenues planned in the budget appropriations to finance the operational programmes continued to slip significantly in 2022, leading to a further increase in the domestic fiscal burden, which contributed to the increase in the cash deficit and nominal public debt. In the absence of an agreement, Hungary did not benefit from the resources allocated to it under the Recovery and Resilience Facility (RRF) in 2022, so the programmes launched under the Recovery Plan were also financed by the central budget.

3) The Council welcomed the fact that, despite the high cash deficit, the general government sector deficit as a percentage of GDP has been reduced from 7.1% in 2021 to 6.1% in 2021,

according to preliminary data. However, the Council continues to stress the importance of bringing the balance below the 3 percent Maastricht criterion as soon as possible, as the reduction in the deficit will also help to rebalance other parts of the economy.

4) The government debt ratio declined from 76.8 percent at the end of 2021 to 73.6[1] percent at the end of 2022 (preliminary data), better than expected. Thus, after a temporary increase in 2020, the debt ratio continued to decline again in 2021. This is in line with both the debt rule of the Constitution and the Stability Act. At the same time, the Council points out that the improvement is only marginally attributable to the decline in the budget deficit, as it is overwhelmingly the result of rapid nominal GDP growth, which also reflects the impact of high inflation. The debt manager has partly financed the increased public debt through foreign currency bond issuance, which has led to an increase in the foreign currency ratio of central government debt to 25.0% in 2022 from 20.6% a year earlier.

5) The Council authorises the Chairman of the Council to publish and represent the opinion.

III

Justification

1. Evolution of the macroeconomic conditions

The Government has based the 2022 budget on GDP growth of 4.3%, but at the beginning of 2022, economic growth was expected to be even more dynamic. The latest forecasts for 2021 put the growth rate of the Hungarian economy in the 4-6 percent range in the analyses of the most important international organisations. The OECD put Hungary's economic growth at 6.0 percent (up from 4.0 percent), the IMF at 5.7 percent (up from 3.7 percent), the World Bank at 4.7 percent (up from 4.6 percent) and the European Commission at 5.5 percent (up from 5.2 percent).

However, the Russian war against Ukraine launched on 24 February 2022 and the international sanctions in response to it have boosted inflation in energy and other commodities. The combined effect of these has put a lot of pressure on individual economies. The energy crisis and economic stabilisation measures slowed economic growth worldwide, but growth was sustained throughout the year.

The major international financial institutions (IMF, World Bank, OECD, and European Commission) continued to revise their forecasts - typically downwards - throughout the year. The economic consequences of the Russian aggression are severe, with the general slowdown in the world economy, inflation, falling demand, sharp increases in energy and other commodity prices and the large (Russian) gas exposure of the Hungarian economy also

[1] The value is the ratio of nominal debt as reported by the MNB in the preliminary financial accounts data to nominal GDP as reported by the HCSO.

putting/reporting a heavy burden on the budget, while the significant slowdown in the performance of the major economies (US, Germany) also creates uncertainty in the outlook.

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Even under these conditions, in 2022 the Hungarian economy's output (**gross domestic product**) would be 4.6 percent higher than in the previous year, according to raw, seasonally and calendar adjusted and balanced data. According to the statistics, economic growth slowed down from quarter to quarter, so that in the last quarter of 2022 economic growth was 0.8 percent compared to the same period of the previous year, while it was 0.4 percent lower than in the previous quarter. Growth was supported by government measures to support the functioning of the economy, productivity improvements and capacity expansions, on the one hand, and strong wage growth and employment expansion, on the other.

On the output side, services contributed the largest share (4.1 percentage points) to the 4.6 percent increase in GDP volume, while industry contributed 1.0 percentage point and construction 0.2 percentage point, a significantly smaller share than in previous years. Agriculture, which was hit by an exceptional drought, moderated volume growth by 1.0 percentage point. The remaining 0.3 percentage point was due to the balance of taxes and subsidies moving in line with value added. On the consumption side, final consumption contributed 3.5 percentage points to annual GDP growth, gross capital formation 0.4 percentage points and the external trade balance 0.7 percentage points.

Industrial production will increase by 5.8 percent in 2022 (following 9.5 percent growth in the previous year). Within this, manufacturing output grew by 5.8 percent, energy by 1.2 percent and mining by 9.0 percent. In manufacturing, output volumes exceeded the previous year's level in every month of the year. Output declined in four of the subsectors, while output in the manufacture of transport equipment and machinery and equipment increased by 14.6-14.6 percent, computer & electronic products by 9.0 percent, food, beverages & tobacco by 6.6 percent, and electrical equipment by 35.5 percent year-on-year. Industrial exports were 8.0 percent higher than a year earlier, with 59 percent of total industrial sales and 7.1 percent of manufacturing sales coming from sales to foreign markets. Domestic industrial sales increased by 3.6 percent.

Construction output increased by 3.0 per cent year-on-year, with construction of buildings up 6.3 per cent but other construction down 1.4 per cent. The impact of the significant rise in material prices and the government's restraint on investment was also felt, reflected in the number of contracts for other construction, which fell by 17.3 per cent compared with a year earlier.

Agricultural production was hit by an extreme drought in 2022. The drought affected around 80 percent of agricultural lands, of which 1.5 million hectares were declared drought-stricken. The situation was most severe in the Great Plain. It affected crop production as a whole, but particularly severely maize production, which fell by 62 percent compared with the average for the previous 10 years. Similar declines were recorded in the lower-weight oats and around 30 percent in rye, sunflower and rape. Livestock production was down by around 6 percent. Taken together, compared to 2021, the volume of agricultural output fell by 18 percent and value added by 32.3 percent. At the same time, the cost of agricultural production rose sharply by 44.7 percent due to a surge in energy and raw material prices. The higher costs and lower production volume resulted in a 49.7 percent increase in farm producer prices. High food prices also played a major role in overall inflation in 2022.

The **volume of investment** in the national economy expanded by only 1.0 percent in 2022 compared to the previous year. Nevertheless, the investment rate increased from 27.2 percent in 2021 to 28.5 percent in 2021, driven by a rapid increase in investment prices. However, the decline in the real investment rate since 2019 has continued. Investment in construction rose by 1.7 percent and investment in machinery and equipment by 0.2 percent. Among the most heavily weighted sectors, manufacturing saw the largest increase (21 percent) and real estate 4.4 percent. In contrast, transport and storage decreased by 7.9 percent, trade by 8.7 percent and public administration by 9.8 percent. In agriculture, investment activity rose by 6.6 percent, and construction also showed a relatively slight increase (1.3 percent).

In 2022, the number of **newly handed over dwellings** increased by 3.2 percent compared to the previous year (20,540 new dwellings were taken into use). In Budapest, the number of newly handed over dwellings was 6.1 percent lower, in the cities with county rights 11 percent higher, in other cities 3.9 percent lower, and in municipalities 24 percent higher. The Government has continued to support home creation through the incentives it has been using so far.

Employment has risen to record levels. The average number of people in employment - for the year as a whole - was 4 million 696 thousand, 61 thousand more than the previous year. On a positive note, the number of people in the domestic primary labour market increased by 60 thousand compared to the previous year. The numbers of people working abroad also increased by 13 thousand, while the number of people claiming to be in public employment fell by 12 thousand. The employment rate for people aged 15-64 was 74.4%, 1.3 percentage points higher than the previous year. (All the main age groups recorded an increase in employment rates over the year as a whole. The most significant increase was in the 55-64 age group, where the employment rate rose by 2.8 percentage points to 65.6 percent.) The **average number of unemployed persons** in 2022 was 176,000 (19,000 fewer than in the previous year), and the **unemployment rate** fell from 4.2 per cent in January to 3.6 per cent at the end of the year.

Average gross and net average earnings excluding discounts both increased by 17.5% (year-on-year) for the year as a whole. The main contributors to the strong average earnings growth were the tight labour market, the frontloaded and additional wage increases in some promotion schemes, the payment of a service allowance equivalent to six months' salary for law enforcement personnel (the so-called "gun money"), and the increase in the minimum wage and the guaranteed minimum wage implemented in 2022. The combined effect of these is also reflected in the annual outturn of the budget's tax and contribution receipts.

The **volume of retail sales** rose by 5.3% year-on-year on a calendar-adjusted basis. Within this, mixed food and grocery retail trade declined by 1.5% (down from 2.2% in the first half of the year), but the steady rise in energy and raw material prices and the 'surge' in agricultural commodity prices have held back sales significantly since June. Non-food retail sales volumes fell by 5.8%. At the same time, fuel retail trade grew by 24.2%, reflecting the surge in sales in April-July and the price freeze that stimulated them for most of the year.

Commercial accommodation turnover figures for 2022 are characterised by a "recovery". Commercial accommodation establishments (hotels, guesthouses, holiday parks, collective accommodation) recorded 26.2 million overnight stays for the year as a whole, up 44.5 percent on the previous year. Within this, domestic guests increased by 17.7% (14.9 million) and foreign guests by 106.1% (11.3 million). Accordingly, the gross revenue of commercial accommodation increased by 68.9 per cent compared to the previous year, generating HUF 464 billion in sector revenue.

Consumer prices rose by 14.5 percent on average, with the highest increases for household energy and food (21.7 percent and 26.0 percent respectively), durable consumer goods by 12.2 percent, other goods by 12.0 percent, spirits and tobacco by 9.9 percent, services by 7.1 percent and clothing by 5.5 percent. Consumer prices for pensioner households rose by 15.2 percent.

2. Budgetary processes

2.1. Evolution of central subsystem revenue

The total revenue of the **central government sub-system** amounted to HUF 29,786.1 billion, which is 117.3 percent of the annual estimate (exceeding the previous year's revenue by HUF 4,684.2 billion). Within revenue, tax and contribution receipts (due to the revenue from general sales tax and extra profit taxes) were 18.4 percent higher than a year earlier, for the year as a whole.

Within the central sub-system, **central budget** revenues amounted to HUF 20,850.6 billion, representing 70 percent of the central sub-system's total revenue.

Payments from economic agents amounted to HUF 2,894.4 billion, which is 47.7 percent higher than the annual estimate (HUF 1,959.9 billion) and HUF 1,002.5 billion higher than the previous year's revenue. Corporate tax is a key element of this revenue group. Revenue from this item amounted to HUF 746.6 billion (26.8% more than the annual estimate and HUF 188.6 billion more than the previous year). The significant increase in revenue compared to the base year is partly due to the favourable macroeconomic developments in 2021, as reflected in the May corporate tax return data. Revenue from the **special tax on financial institutions** amounted to HUF 327.0 billion, nearly five and a half times the forecast (HUF 60.9 billion), due to the higher advance tax liability imposed by the tax return data and the temporary application of the "extra profit tax" for 2022 and 2023, which generated HUF 247.3 billion in additional revenue in 2022.

Retail sales tax revenue amounted to HUF 176.7 billion (231.6 percent of the forecast), which is HUF 98.2 billion higher than the previous year. This is due to higher settlement payments, and consequently higher advance payments, than in the previous year, and the cash flow outturn of the additional tax introduced in 2022, amounting to some HUF 70 billion. Revenue from the **small business tax** amounted to HUF 145.5 billion (120% of the forecast), which is HUF 34.3 billion higher than the year before. The natural increase in the number of taxpayers and the re-declarations related to the change in the rules for the small taxpayers' itemised tax played a decisive role in this. The revenue from the **itemised tax on small taxpayers** was HUF 186.1 billion (78.6% of the total) and HUF 9.7 billion lower than a year earlier. This is mainly due to the mid-year (September) changes in the tax rules (subject, scope of activities, thresholds, etc.). In view of this, 68% of the taxpayers subject to this tax are now subject to flat-rate taxation, small business tax or have ceased to be self-employed. **Utility tax revenues** were 100.2 percent of the annual target (HUF 53.5 billion). The payment of the **eco-tax** is below the target (HUF 5.1 billion), with a 93% execution rate.

The revenue from **mining royalties** amounted to HUF 241.3 billion (more than six times the annual allocation, 635.1 percent). This outturn, which is well above the estimate, is based on two pillars: on the one hand, world energy prices have been much higher than expected at the time the estimate was made, and on the other hand, the rate of royalties on hydrocarbons (oil and gas) has tripled in the course of the year. The implementation of the **income tax on energy suppliers** is almost four times higher than the forecast (HUF 54.8 billion) (HUF 203.8 billion). The implementation is much higher than the forecast due to the extension of the tax to bioethanol and biofuel producers, sunflower oil and starch producers and the Ural-Brent exchange rate differential. The revenue from the **rehabilitation levy** amounted to HUF 135.6 billion (116.6 percent of the budgeted amount), which is HUF 22.3 billion higher than the previous year. The higher revenue was due to an increase in the tax rate, linked to the increase in the minimum wage. The **gaming tax** received 46.4 billion forints (137% of the forecast), which is 17.9 billion forints more than the previous year. **Retail sales tax** receipts are 231.6%

of the forecast (HUF 176.7 billion) and HUF 98 billion higher than the previous year. This is due to the change in regulation and the tax rate. The implementation of the **company car tax** is 126.8% of the forecast (HUF 49.8 billion) and exceeds the previous year's revenue by HUF 10.5 billion. This is also due to regulation and changes in the tax rate.

Other centralised revenue amounted to HUF 551.8 billion, which is 106.2 percent of the statutory appropriation and HUF 63.6 billion more than the previous year. This revenue group is dominated by electronic tolls (proportional to the distance travelled) (HUF 277.1 billion) and time-based tolls (HUF 84.5 billion), as well as environmental product charges (HUF 90.0 billion). The above-forecast performance in toll revenues is the result of a dynamic increase in traffic as the coronavirus epidemic subsided (a significant increase in the number of vignettes purchased by both domestic and foreigners) and a 16% increase in tolls. Compared to the previous year, the increase in the environmental product charge and the landfill fee revenue was 4.9 and 4.6 percent respectively. For the former, the increase is linked to an increase in the volume of products subject to the product charge, and for the latter to an increase in the volume of recycling. The revenue from the main fines (building, infringement and other fines, fines from the Economic Competition Office, etc.) exceeded the annual estimate (HUF 54 billion) by HUF 7.1 billion.

From consumption-related taxes received HUF 8 7,718.3 billion in the budget, 120.4% of the annual estimate (HUF 1,475.5 billion more than the annual estimate and HUF 1,664.3 billion more than the previous year's revenue). The two main consumption-related taxes in the Hungarian tax structure remain unchanged: general sales tax and excise duties. The **general sales tax** implementation is 125%, amounting to HUF 6860.3 billion, which is HUF 1373.2 billion higher than the forecast and HUF 1463.1 billion higher than the previous year. The strong tax revenue growth was fuelled by revenue-increasing government measures (13. The rise in inflation has been accompanied by a decline in consumption volumes only to a lesser extent and with a lag, as households tried to maintain their consumption levels at the expense of their savings In 2022, the number of VAT taxable persons increased by 5.8% and the number of VAT-exempt taxable persons decreased by 2.8% compared to 2021, contributing to the increase in VAT receipts. Revenue from **excise duties** came in at HUF 1,229.5 billion (94.9 percent of the estimate), HUF 66.7 billion below the estimate and HUF 13.9 billion lower than a year earlier. Within excise goods, revenue from fuels amounted to HUF 626.3 billion, HUF 89.1 billion lower than a year earlier, reflecting the lower tax rate temporarily introduced in March. The increase in tobacco revenue was helped by the July 2022 tax rate increase, while the increase in spirits and edible products revenue is linked to nominally higher turnover.

HUF 293.6 billion (126.3% of the budget) was received in the form of the **financial transaction tax** (FTT), which is HUF 61 billion more than the annual estimate. The increase in revenue was driven by the growth in financial transactions, the increase in the number of transfers, the spread of the use of applications to facilitate them, the increase in the tax threshold for bank transfers and the extension of the tax (0.3 percent) to securities transactions, with the exception of the Treasury and the Post Office. The **registration tax** implementation is HUF 15.7 billion (63.4 percent of the estimate), 7.2 percent below the previous year's implementation. **Telecommunication tax** implementation is 181.2 percent

(HUF 96.6 billion) and HUF 37.9 billion higher than the previous year, due to the payment of the additional tax (HUF 39.5 billion). The **insurance tax** revenue of HUF 169.2 billion (146.6 percent of the estimate) was budgeted, also due to the introduction of the additional tax, which resulted in an increase of HUF 56.7 billion in revenue. The implementation of the **tourism development levy** on catering and commercial accommodation service providers is 113.7% of the forecast (HUF 38 billion).

Retail payments provided HUF 3,144.0 billion in revenue to the budget (99.6 percent of the annual estimate). **Personal income tax** is the dominant revenue item in this segment, amounting to HUF 2,785.9 billion (97.2 percent of the total), HUF 102.6 billion less than a year earlier. The strong increase in wages had an overall positive impact on revenues from this heading, while the impact of the one-off tax refund to parents raising children (HUF 660 billion) was not included in the legislative appropriation. The shortfall was partly offset by a dynamic increase in the earnings bill. **Levy payments** reached 131.8% of the annual target (HUF 261.8 billion), which is HUF 37.8 billion higher than the previous year. The growth of the economy, buoyant housing market transactions and the spectacular increase in the market value of real estate (the tax base), especially in large settlements and resort areas, supported the development of levy revenues. **Motor vehicle tax** revenue came in at HUF 95.9 billion (106% of the annual appropriation), up HUF 0.9 billion on the previous year.

The balance sheet line Payments from general government systems recorded a cash inflow of HUF 1 113.6 billion (almost six and a half times the appropriations). Within this, payments from Central Budgetary Bodies amounted to HUF 54.2 billion (double the appropriations), payments to the Residuals Settlement Fund - against appropriations of budgetary bodies - amounted to HUF 121 billion, and payments to the Savings Fund - against uncommitted balances of general government appropriations - amounted to HUF 746.4 billion.

The combined revenue appropriations for the **Earmarked Public Funds** were 114.1 percent (HUF 802.7 billion) of the total. The largest volume of revenue from these funds is the **Economic Reactivation Employment Fund** (ERAEF), which reached 108.7% of the annual target (HUF 510.1 billion). Among the resources of the ERAEF, the share of social security contributions to the Economic Re-Launch Employment Fund (ERLEF) reached 113 percent (HUF 302.2 billion), the reimbursement of expenditure on pre-financed EU programmes reached 166 percent (HUF 132.8 billion), the budget support to the ERAEF reached 102 percent of the estimate (HUF 50.8 billion), while the other revenue reached 33.8 percent (HUF 24.3 billion). The **National Research, Development and Innovation Fund**'s revenue was 115.8 percent of the target (HUF 152 billion). The main part of this is the revenue from the innovation levy, which was 121.3% of the target (HUF 111.1 billion). The **Central Nuclear Financial Fund**'s revenues were 125.2 percent of the target (HUF 68.6 billion), while the **National Cultural Fund**'s revenues were close to 97 percent of the target (HUF 13.5 billion), while the **Bethlen Gábor Fund**'s revenues were almost double the target (172.8 percent) at HUF 58.4 billion.

The revenue of the **social security funds** (HUF 7 6 623.7 billion) was 106.7 percent of the total, amounting to HUF 8 132.8 billion (of which the revenue of the **Pension Insurance**

Fund was 108 percent and that of the **Health Insurance Fund** 105.1 percent). The bulk of the revenue of the social security funds comes from social security contributions and social contribution tax. In 2022, the state tax authority again allocated 54 percent of the social security contributions collected to the Pension Insurance Fund, 37.9 percent to the Health Insurance Fund and 8.1 percent to the Economic Re-employment Fund.

The share of **social contribution tax** payable to the Pension Insurance Fund (HUF 1 697.9 billion) exceeded the previous year's revenue by 0.3 percent (HUF 5.8 billion). The continued 2.5 percentage point cut in the social contribution tax rate from 2022 onwards reduced revenues, but this was partly offset by further employment growth and an increase in average earnings (minimum wage, wage floor increase, February payment of law enforcement personnel benefits, other sectoral benefits). The combined **social security contribution** payable to the Pension Insurance Fund and **pension contributions** amounted to HUF 2,060.9 billion (112.8 percent of the target). The favourable higher revenue is the result of higher employment and higher earnings. The central budget provided HUF 696.4 billion for the Pension Insurance Fund's benefit expenditure, the rebuilding of the 13th month benefit and the pension premium (HUF 25.5 billion more than a year earlier).

The share of the **social contribution tax** payable to the Health Insurance Fund (HUF 672.3 billion) is 0.3% (HUF 2.2 billion) higher than the previous year, but HUF 23.9 billion below the annual target. The shortfall is due to a reduction in the rate of social contribution tax, but was mitigated by an increase in taxable income. The **social security contribution** payable to the **Health Insurance Fund** and the health insurance contribution (combined) amounted to HUF 1406.3 billion, 12.1% (HUF 151.7 billion) above the target, mainly due to the increase in contributory income. The annual budgetary contribution of the Health Insurance Fund amounted to HUF 1 236.3 billion, which is HUF 492.5 billion higher than the amount transferred in the previous year.

Both the Pension Insurance Fund and the Health Insurance Fund continued to strengthen their enforcement practices for late payment penalties and fines (by 63.7% and 70.5% respectively compared to the previous year, improving contribution discipline).

2.2. Evolution of central subsystem expenditure

In 2022, the **central sub-system of general government**, as in the case of revenue, net of consolidation, has a **combined expenditure** of HUF 34,539.5 billion, which is 15.6% higher than in the previous year and 21.0% higher than the target. [2]

Within the central sub-system, **central budget expenditure** continued to account for the bulk of the total in 2022, with HUF 25,462.1 billion, 73.7 percent more than in the previous year. The execution exceeded the target by 26.1 percent and the previous year's level by 16.8 percent.

[2] Here again, the budget is the revised appropriation as amended by law. We indicate where the benchmark is different.

Expenditure of budgetary bodies amounted to HUF 7135.8 billion, 102.2 percent of the previous year and 132.5 percent of the appropriations. The large deviation from the planned level was mainly due to the fact that for the fifth year in a row, in 2022, budget bodies had to pay unobligated appropriations balances into the Central Residuals Clearing Fund, and then used most of them for expenditure purposes set out in individual government decisions.

57.3 percent of the expenditure of the budget bodies (10 percentage points more than in the previous year) was spent on wages and salaries, amounting to HUF 4095.6 billion. The share of expenditure on goods and capital expenditure continued to fall.

Expenditure on chapter-managed professional appropriations amounted to HUF 5 067.2 billion, 52.5 percent more than the appropriations and 15.9 percent more than the previous year. The latter reflects a significant increase in spending, mainly on economic development, normative funding for public education, social services, child protection, etc., infrastructure, defence and law enforcement, innovation and ecosystem development. The large deviation from the target here was also due to large payments to the Savings Fund and their reuse.

Payments for EU programmes amounted to HUF 2991.7 billion, the highest in the last five years, almost 100 percent of the appropriations and 133.4 percent of the previous year's. As in previous years, most of the spending was for the Economic Development and Innovation Operational Programme and the Integrated Transport Operational Programme. Significant amounts have already been frontloaded to the Operational Programme for Territorial and Urban Development Plus, the Operational Programme for Economic Development and Innovation Plus and the Operational Programme for Implementation Plus for the programming period 2021-2027.

The HUF 1,599.9 billion used for **various normative and specific subsidies, public service broadcasting and social policy fare support** was 225.3 percent of the allocation and 193.7 percent of the previous year's allocation. The increased burden was largely due to new spending on public utility protection of HUF 375 billion, compensation for district heating companies of HUF 290 billion more than the previous year and public transport reimbursements of HUF 48 billion.

Compared to HUF 251.5 billion in 2020 and HUF 376.5 billion in 2021, **housing subsidies** amounted to HUF 635.3 billion in 2022 (significantly exceeding the target by 66.4 percent). This was mainly due to the home renovation subsidy introduced from 1 January 2021 and the related loan to be taken out from February 2022. Contributing to the increase in spending were the further widening of the scope for claiming the family home creation allowance, the tax refund subsidy and the housing mortgage loan assistance for families with several children, as well as the expansion of the scope of the preferred small villages covered by the rural subsidies and the increase in the number of beneficiaries of the various schemes.

The **National Fund for Family and Social Policy** was used 4.4% more than the budgeted amount and 6.0% more than the previous year, amounting to HUF 715.4 billion. *Family allowances* accounted for HUF 400.2 billion of the Fund's expenditure, representing 56% of total expenditure, 3 percentage points less than in the previous year. Of this, family allowances were slightly lower than in the previous year at HUF 309.3 billion, in line with the trend in the number of beneficiaries. *Benefits under the age limit* amounted to HUF 114.8 billion, well above both the budget (18.2%) and the previous year (15.7%). The increase was due to the fact that these benefits also received the 13th month and, like pensions, pension-like benefits were increased several times. *Income support and income supplementing social allowances* amounted to HUF 176.6 billion, compared to HUF 162.3 billion budgeted and HUF 152.3 billion paid out in the previous year. Two thirds of the expenditure was for district social functions, which increased due to the 5 percent increase in the nursing care allowance and the increase in the child care allowance from 88 percent to 100 percent of the minimum wage. Other supplementary allowances (disability allowance, personal allowance for the blind, etc.) also included increases in pension-like benefits, as well as the 13th month allowance.

Support to local governments amounted to HUF 1080.1 billion, up 6.6% compared to the previous year and 23.8% more than the budget. The latter is the result of additional subsidies for central wage measures in 2022, certain (industrial park) developments, the provision for refugees from Ukraine, and to compensate for the temporary reduction in business tax for SMEs.

In 2022, **cash interest expenditure** increased substantially to HUF 2,100.6 billion from HUF 1,408.1 billion in the previous year and HUF 1,369.6 billion in the target. The rise in interest expenditure is explained by the increase in nominal government debt on the one hand and the higher interest rate environment on the other. In the rising yield environment, the market price of government securities at issuance is lower than the nominal value of the securities, which led to a substantial cash interest expenditure of the government in 2022.

A slightly lower amount than in the previous year, HUF 586.3 billion, was transferred from the budget as a **contribution to the EU budget**.

Expenditure on state property amounted to HUF 1,155.7 billion in 2022, compared to HUF 1,474.1 billion in 2021. Most of the expenditure was related to companies, while a smaller part was related to real estate and movable property.

Total **expenditure on earmarked state funds** amounted to HUF 538.8.7 billion, which is considerably less than the previous year's outturn of HUF 709.8 billion and even below the target of HUF 577.9 billion. Among these, the expenditure of the **Economic Re-activation Employment Fund** decreased from HUF 449.4 billion in 2021 to HUF 323.4 billion. The job-retention programme of HUF 100 billion has been discontinued, while expenditure on the start-up jobs programme has been reduced by HUF 29 billion (in line with the target of HUF 120 billion). Within the Fund's expenditure, pre-financing of EU programmes has been HUF 45 billion lower than planned, as the new programming period has not yet fully started (the outturn is HUF 40.1 billion). At the same time, passive expenditure (mainly job-search subsidies) of HUF 114.3 billion exceeded both the previous year (by HUF 20 billion) and the appropriations by HUF 9 billion. The **National Research, Development and Innovation Fund** also made a significant contribution of HUF 123.3 billion, while the Bethlen Gábor Fund spent HUF 47.9 billion, the **Central Nuclear Fund** HUF 22.6 billion and the **National Cultural Fund** HUF 21.5 billion.

The **social security funds** spent a total of HUF 8,538.6 billion, 109.9 percent of the appropriation and 115.8 percent of the 2021 appropriation.

Within this, HUF 4,799.1 billion was paid out of the **Pension Insurance Fund** in 2022, which is significantly higher than both the previous year's expenditure (by 16.4 percent) and the amount of the appropriation (by 15.1 percent). Apart from HUF 7.6 billion in other (administrative) expenditure, the amount was used for pension benefits. This increase was largely due to the full (four-week) benefit for 13th month beneficiaries, compared to the two-week benefit originally planned. Other factors included the carry-over effect of the 1.8% additional pension increase in 2021 to 2022, the 5.0% pension increase in January 2022, the additional 3.9% pension increase in two tranches (July and November) due to higher inflation than forecast in the budgeting period, and the 4.5% pension increase retroactive to January, which also covers the 13th month benefit. In line with the increase in GDP, a pension premium was also paid in November to those entitled to old-age benefits (age-tested and Women40). However, spending was reduced by the fact that the number of people eligible for early retirement benefits in December 2022 was almost 17,500 fewer than at the end of the previous year, mainly due to the age limit increase.

Of the social security funds, expenditure on the **Health Insurance Fund** amounted to HUF 3 739.5 billion, up 15.1 percent on the previous year and 3.9 percent on the budget. Of this, the amount spent on curative-preventive benefits continued to increase, reaching HUF 2,203.2 billion in 2022, compared with HUF 1,340.7 billion in 2019, HUF 1,612.2 billion in 2020 and HUF 1,880.0 billion in 2021. The higher expenditure compared to the previous year was mainly due to the wage increase for doctors working in inpatient and outpatient care in state and municipal hospitals, the increased wage subsidies for general practitioners and dentists, and the wage increase for health care professionals in January 2022, which was introduced in January 2021 and continued in 2022. In 2022, as in previous years, HUF 30 billion was used to settle the debt of the health care system (HUF 19.0 billion from additional subsidies and HUF 11 billion from internal savings). HUF 960.9 billion was used for expenditure on cash benefits financed by the Health Insurance Fund, an increase of 15.1% compared to the previous year. Expenditure increased most for childcare allowances (16.4 percent), with significant increases for disability and rehabilitation benefits (10.7 percent) and sickness benefits (12.2 percent). The combined amount of pharmaceutical and medical aid allowances was HUF 522.6 billion, compared to HUF 488.9 billion in 2021.

3. Meeting the deficit target

The actual cash deficit was HUF 4753.4 billion (HUF 20.5 billion lower than in the previous year), 50.8% higher than the HUF 3 152.7 billion cash deficit of **the central government subsystem set in the Budget Act,** at HUF 4 753.4 billion (HUF 1 600.7 billion). The former was due to measures to raise the incomes of certain groups of the population, while the latter was mainly due to extensive compensation for energy price increases.

The evolution of the current account balance benefited from a significant increase in tax revenues, driven by real growth in the economy on the one hand, and by wages and consumption moving in line with rising inflation on the other.

In 2022, the deficit was also reduced by the impact of the balance improvement measures announced in parallel with the preparation of the 2023 budget law. The vast majority of the revenue measures are related to the special taxes on extra profits of around HUF 700 billion, mainly affecting the energy, financial, insurance, retail trade and telecommunications sectors. In addition, other tax revenue measures were taken, mainly increasing excise duties, company car tax, and public health product tax, and significantly reducing the number of small taxable enterprises eligible for the special tax on small businesses.

The measures on the expenditure side were aimed at saving and increasing efficiency in ministries, budget bodies and government programmes. From 1 August 2022, in order to maintain the reduction in overheads, the previous official price will be available for consumption below the average consumption level, while a higher official price has been set for consumption above that level, thus reducing the burden on the budget due to the increase in world prices in 2022.

At the same time, the non-realisation of a significant part of the EU revenues planned in the budget appropriations to finance the operational programmes also contributed to the increase in the cash deficit and nominal public debt in 2022. They were again anticipated by the central budget. The same was done for the programmes launched under the Recovery Plan, as Hungary did not benefit from the resources foreseen for it under the Recovery and Resilience Facility (RRF) in 2022 in the absence of an agreement.

The budget law set **the government sector's 2022 ESA (accrual-based) deficit** at 5.9% of GDP. In line with the recovery of the economy, the Government reduced this deficit target to 4.9 percent in December 2021. In July 2022, in addition to the replenishment of emergency natural gas stocks, it was decided to build up additional emergency natural gas stocks of about 740 million cubic meters, raising the accrual-based deficit target to 6.1 percent.

Based on preliminary data, the ESA deficit is now 6.1 percent of GDP (the final figure will be available in the EDP report[3] to be published by the Central Statistical Office in early April). However, the deficit is still significantly higher than the 2 percent of GDP in 2019 and the seven years before that when the balance remained below the 3 percent Maastricht criterion.

Preliminary data show a primary deficit of 3.4 percent of GDP for the year as a whole, while interest expenditure amounted to 2.7 percent[4] of GDP.

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[3] Under the European Union's Excessive Deficit Procedure (EDP), Member States report twice a year (EDP Report, Notification) on the evolution of two key indicators of the general government sector: the deficit and the debt of the general government sector.

[4] Following the restructuring of the pension system in 2011, the statistics record an interest expense on the liabilities equal to the assets taken over by the state, known as imputed interest expense. This imputed interest expenditure amounted to 0.2 percent of GDP in 2021, i.e. the actual interest expenditure paid on government debt was that much lower.

Exceeding the Maastricht deficit criterion was allowed in 2022 by the escape clauses in both the EU and domestic fiscal frameworks. The EU fiscal rules were suspended under the general escape clause and, in line with this, the relevant paragraph of the Stability Act was amended in 2021, according to which the rule setting the maximum budget deficit and the medium-term budgetary objective shall not apply between 2021 and 2023.

In 2022, the structural deficit[5] also exceeded the medium-term budgetary objective (MTO) (1 percent) under Article 3/A (2) (a) of the Stability Act, but in 2022 this requirement was not in force.

4. Evolution of public debt

Gross public debt as a share of GDP declined to 73.6 percent at the end of 2022, from 79.3 percent at the end of 2020 and 76.8 percent at the end of 2021, according to preliminary data (the amounts of public debt were HUF 38,400 billion, HUF 42,350 billion and HUF 48,840 billion, respectively, in the same years). The reduction in the public debt ratio is due to a significant increase in nominal GDP. Thus, after a temporary increase in 2020, the government debt indicator resumed its downward trend from 2021 onwards, similar to the 2011-2019 period.

The decline in the government debt ratio is in line with the debt rule of the Fundamental Law[6], and is significantly higher than the reduction commitment under the Stability Act.

The foreign currency share of central government debt increased to 25.0% by the end of 2022 from 20.6% a year earlier. The increase in the foreign currency ratio was also driven by the revaluation of foreign currency debt, in addition to significant foreign currency bond issuance last year. Even after last year's increase, the foreign currency share of central debt remains well below the 2011 level of around 50 percent.

Budapest, 30 March 2023

Windisch László	Kovács Árpád
Member of the Fiscal Council	Chairman of the Fiscal Council

[5] The exact value of the 2022 balance of the general government sector adjusted for the effects of the economic cycle and individual items (Stability Act § 1 (e)).1.§ e) will be known in May.

[6] Article 36(4) and (5) of the Fundamental Law contains the public debt rule as the most important element of the rule-based budget. It stipulates that Parliament cannot pass a law on the central budget that would result in a public debt exceeding half of GDP. As long as the public debt exceeds half of the total GDP, Parliament can only adopt a central budget law that includes a reduction in the ratio of public debt to total GDP.