Opinion of the Budget Council

on the draft bill on the 2024 central budget of Hungary

I

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

The Fiscal Council (hereinafter referred to as the Council, Fiscal Council, FC), in accordance with Article 24 of Act CXCIV of 2011 on the Economic Stability of Hungary (hereinafter referred to as the Stability Act), and in line with Article 44(2) of the Fundamental Law, hereby issues an opinion on the draft Act on the Central Budget. In its opinion, the Council may comment on the draft and, if it has fundamental objections to the draft as to its credibility or enforceability, may express its disagreement with the draft.

On 19 May 2023, Minister of Finance Mihály Varga sent the draft bill on the 2024 central budget of Hungary (hereinafter referred to as the "draft"), which was discussed and approved by the Government, to the Chairman of the Fiscal Council as an annex to his opinion request letter PM/8/9/2023.

The KT's assessment of the draft was also based on the following background in the context of Act XXV of 2022 on the 2023 Central Budget of Hungary.

- In its Opinion No. 2/2023.03.30. assessing the implementation of the Act on the Central Budget of Hungary for 2022 and the development of public debt on the basis of the developments throughout the year, the Council concluded that the actual cash deficit of the central subsystem of the general government in 2022 was HUF 4753.4 billion, 50.8 percent (HUF 1,600.7 billion) higher than the original estimate of HUF 3,152.7 billion. In its Opinion, the Council "welcomed the fact that, despite the high cash deficit, the government sector's accrual deficit as a percentage of GDP decreased from 7.1 percent in 2021 to 6.1 percent in 2021, according to preliminary data." However, the Council continued to stress the importance of bringing the balance below the 3 percent Maastricht criterion as soon as possible. The Council also assessed that "the government debt indicator declined from 76.8 percent at the end of 2021 to 73.6 percent[1] at the end of 2022 (according to preliminary data), better than expected. Thus, after a temporary increase in 2020, the government debt indicator

[1] The value is the ratio of nominal public debt to nominal GDP as reported by the HCSO.

continued to decline again in 2021" and "this is in line with both the debt rule of the Fundamental Law and the Stability Law". At the same time, the Council points out that "the improvement is only marginally attributable to the decline in the budget deficit, which is overwhelmingly the result of rapid nominal GDP growth, reflecting the impact of high inflation."

- In its Opinion No 2/2022.06.03. on the draft bill on the 2023 central budget of Hungary, the Council stated that "the draft budget bill is not in line with the [known then, i.e. in April and May 2022] 4.1 per cent, in line with the range of domestic and international forecasts, on the back of a further increase in record high employment, rapid growth in earnings, household consumption, a substantial expansion in fixed capital formation and an improvement in productivity". In its opinion, the FC considered that "revenue measures, in particular through extra-profit taxes, have a significant weight in rebalancing, while expenditure measures can contribute to improving balances in a more durable and effective way". At the same time, he indicated that "implementing expenditure measures without reducing family incomes is essential for a credible and sound implementation of stabilisation". The Council considered as an important ambition that "in 2023, the general government sector deficit on an accrual basis (ESA) will be close to the Maastricht criterion of 3.5 percent, while the general government cash deficit will be reduced to 3.3 percent", while noting that "EU and domestic rules allow for a general government deficit above 3 percent by 2023", but urged "the early achievement of the 3 percent deficit, if economic conditions allow". In its Opinion, the Council pointed out that the "draft budget bill for 2023 complies with the public debt rule provided for in the Fundamental Law and with the provision of Article 4(2a) of the Stability Act. It stated that "in line with the requirement of the Fundamental Law, the downward trend in the government debt ratio will be sustained and its level will be reduced from 76.1 per cent at the end of 2022 to 73.8 per cent at the end of 2023, according to the draft budget bill."

- In its Opinion No 2/2022.06.03. on the draft bill on the central budget of Hungary for 2023, the Council stated that "the draft budget bill was not adopted in the [then, i.e. April and May, 2022] known 4.1 per cent, in line with the range of domestic and international forecasts, on the back of a further increase in record high employment, rapid growth in earnings, household consumption, a substantial expansion in fixed capital formation and an improvement in productivity". In its opinion, the Fiscal Council considered that "revenue measures, in particular through extra-profit taxes, have a significant weight in rebalancing, while expenditure measures can contribute to improving balances in a more durable and effective

way". At the same time, they indicated that "implementing expenditure measures without reducing family incomes is essential for a credible and sound implementation of stabilisation". The Council considered as an important ambition that "in 2023, the general government sector deficit on an accrual basis (ESA) will be close to the Maastricht criterion of 3.5 percent, while the general government cash deficit will be reduced to 3.3 percent", while noting that "EU and domestic rules allow for a general government deficit above 3 percent by 2023", but urged "the early achievement of the 3 percent deficit, if economic conditions allow". In its Opinion, the Council pointed out that the "draft budget bill for 2023 complies with the public debt rule provided for in the Fundamental Law and with the provision of Article 4(2a) of the Stability Act. It stated that "in line with the requirement of the Fundamental Law, the downward trend in the government debt ratio will be sustained and its level will be reduced from 76.1 per cent at the end of 2022 to 73.8 per cent at the end of 2023, according to the draft budget bill." This was considered achievable by the FC on the basis of the macroeconomic and fiscal path [underlying the draft budget bill of April and May 2022]."

- The Council examined the compliance of the proposed unified budget law No. T/152/471 on the central budget of Hungary for 2023 with the public debt rule and gave its consent to the final vote by its Resolution No. 3/2022.07.14., stating that it "takes note of the planned public debt ratio for 31 December 2023 as provided for in paragraph 3(1) of Article 3 of the proposed unified budget law No. T/152/471 on the central budget of Hungary for 2023 It has been established in accordance with the provisions of the Stability Law, in line with the macroeconomic and public finance developments underlying the bill at the time of its preparation. As the debt indicator calculated for the end of 2023 in the Bill is 2.3 percentage points lower than the indicator expected for the end of 2022, the requirement of Article 36(5) of the Fundamental Law is also fulfilled. In its Resolution, the Council considered it appropriate to draw attention to the "increased macroeconomic risks since the start of the 2023 budget planning, in particular the higher than expected inflation, the slowdown in world economic growth, the consequences of the war between Russia and Ukraine (energy crisis, etc.) and the delay in the agreement with the EU". In the FC’s opinion, these "together increase the risk of higher-than-planned deficits and public debt". The Council continued to urge "the early achievement of the 3% deficit, if economic conditions allow".

- During his contribution to the National Assembly's vote on the final vote on the 2023 central budget bill, the Chairman of the Council also stressed that "negative risks could further

increase in the second half of 2022 and during 2023, and it is therefore appropriate to prepare for them by alternative scenarios." Developments since then have confirmed that the Council's warnings in its Opinion of 3 June on the draft 2023 Finance Bill and in its Resolution of 14 July on its assent to the final vote and its presentation to National Assembly have been justified.

- The Council examined the compliance of the draft law T/2667 on the amendment of Act XXV of 2022 on the 2023 central budget and gave its preliminary consent to the final vote with its Resolution 3/2023.03.30., stating that "the public debt indicator will be reduced from 73.5 percent at the end of 2022 to 69.7 percent at the end of 2023 according to the unified proposal. The Council is of the opinion that the targeted reduction in the debt ratio is consistent with the macroeconomic path used as a condition for the bill and the fiscal paths envisaged." On this basis, the Council considered that "the level of government debt-to-GDP ratio expected by the end of 2023, when implementing Act XXV of 2022 on the 2023 Central Budget of Hungary, taking into account amendments, is in line with the requirement of Article 36(5) of the Fundamental Law."

In the explanatory memorandum to this Resolution, the Council considered it important to point out that "the amended budget is also subject to risks. Therefore, in implementing it, it is necessary for the budgetary authorities to take realistic, sustainable savings measures which do not jeopardise the delivery of public services. Otherwise, the smooth delivery of public services would require significant additional expenditure, which would risk jeopardising the achievement of the debt target." It also indicated that "despite the partial compensation of the increase in energy prices, the real value of appropriations to finance public services has declined significantly in several areas, so that the resulting tensions require further attention in the budget implementation." The Council also stressed the importance of reducing the budget deficit, "as this will help to rebalance other areas of the economy (e.g. by contributing to improving external financing capacity)."

In formulating its Opinion on the draft bill on Hungary's 2024 central budget, the Fiscal Council - continuing its previous practice - based its Opinion on the written analyses and findings of the State Audit Office of Hungary and the National Bank of Hungary on the budget processes. In addition, it reviewed the economic forecasts of international organisations (European Commission, IMF, World Bank, OECD), domestic research and analysis institutes commissioned by the Council Secretariat and other authoritative market analysts. In addition, the FC took into account the Convergence Programme of Hungary 2023-

2027. Furthermore, in formulating its opinion, it has built on the known trends and main features of the implementation of Law XXV of 2022 on the 2023 central budget and its background as a baseline.

In addition, the FC requested and received additional information and calculation material from the Ministry of Finance to support its opinion on the draft budget for next year, and to estimate revenue and expenditure estimates. These also helped to shape the Council's position on the draft.

In the framework of its mandate, the FC examined the draft bill on the 2024 Hungarian central budget and its macroeconomic background as a whole, i.e. it analysed the details of the draft, its revenues and expenditures from the point of view of the balance of payments and compliance with the public debt rule.

As in the past, the Council did not take a position on distributional and supply policy issues, in line with its mandate under the Fundamental Law and the Stability Law.

The Council informs the Speaker of the National Assembly and the Government of its Opinion and publishes it on the website of the National Assembly.

II

Opinion of the Council

On 23 May 2023, the Council discussed the draft bill on the 2024 central budget of Hungary, in accordance with Article 24 of the Stability Act and on this basis - by unanimous resolution - formulated the following opinion.

1) The Council has no fundamental objections to the authenticity and enforceability of the draft bill on the 2024 central budget of Hungary that would justify a declaration of disagreement with the draft. However, the Council feels obliged to draw the Government's attention to a number of risks to the achievement of the planned objectives.

2) The Council notes that the draft budget bill foresees 4.0 per cent economic growth in 2024, higher than the average of known domestic and international projections, supported by an expansion in household consumption, a renewed dynamic increase in gross fixed capital formation and a growth rate of exports exceeding imports. The Council considers that the economic growth projected by the government could materialise if external and domestic conditions are favourable, but is subject to a number of risks. On the one hand, Russia's aggression against Ukraine and its response (sanctions) will continue to negatively affect the Hungarian economy in 2024, Europe's energy security problems, although alleviated, have not disappeared, and negotiations on the disbursement of funds from the European Union to Hungary are protracted. On the other hand, the realisation of the government's forecast would require private sector investment to be able to compensate for the (significant) fall in public investment spending in real terms, and the resulting competitive export capacity to enable Hungarian exports to grow at a pace significantly above the rate of expansion of export markets.

3) The Council has previously considered it necessary to bring the government sector deficit below 3% of GDP in order to balance the Hungarian economy and budget. The draft budget bill is in line with this: in 2024, the general government sector deficit on an accrual basis (ESA) will fall below the Maastricht criterion by 1.0 percentage point to 2.9 percent, compared to 2023, while the cash deficit of the central government subsystem will be reduced by 1.5 percentage points to 2.9 percent. However, there are risks to the achievement of these

targets. One is that the expected economic growth may not materialise, which would reduce budget revenues. As regards the outturn of revenues in 2024, there is a risk of an expected underperformance of some revenues in 2023, mainly related to consumption, which would worsen the base of these appropriations. The Council sees a serious risk that the appropriations for the budget bodies in kind, including energy compensation, will be significantly below the level of price increases realised in 2022 and expected in 2023 and 2024. The other operating appropriations of several budget headings of institutions not under the control of the Government will decrease by up to 10 percent compared to the 2023 appropriations, leading to a very significant decrease in real terms for these institutions. Without targeted austerity and task rationalisation measures, there is a risk that maintaining the viability of the budget bodies will require large unplanned expenditures in 2024. The Council considers that this also entails operational and service quality risks, which should be mitigated in the budget. The deficit target of 2.9% implies that a small surplus in expenditure and some shortfall in revenues would raise the deficit above 3% of GDP. An increase in the cash deficit would also result if the revenue of HUF 2 479.8 billion planned from EU funds in 2024 is not fully disbursed, while the expenditure allocation of HUF 3 605.5 billion from EU programmes would be largely used.

4) The Council notes that the planned structural deficit-to-GDP ratio is below the ESA deficit of 2.6%. It also urges that the structural deficit target be achieved by the end of the period, in line with the Convergence Programme 2023-2027.

5) The Council welcomes that, as required by the Fundamental Law, the downward trend in the government debt ratio continues and is projected to decline from 69.7 percent at the end of 2023 to 66.7 percent at the end of 2024, according to the draft budget bill. The Council considers the reduction in the debt ratio to be achievable in view of the planned 3 percentage point reduction, despite the macroeconomic and budgetary risks outlined. On this basis, the Council concludes that the draft budget bill for 2024 complies with the debt rule of the Fundamental Law and with the provision of Article 4(2a) of the Stab.

6) The Council notes that the draft bill does not include the expected necessary loss compensation of the MNB and is therefore not in line with Article 166 (3) of Act CXXXIX of 2013 on the Central Bank of Hungary, which provides that "if the amount of equity capital falls below the subscribed capital at the end of the year under review, the difference shall be reimbursed by the central budget in equal annual instalments (...) within 5 years directly to the profit and loss reserve." The central bank's results have been largely negatively affected by

the overall stimulus measures taken to deal with the koruna crisis and the subsequent interest rate increases necessary to bring down inflation, which are expected to reduce the own funds to below subscribed capital by the end of 2023. The Council considers it necessary that the draft law also takes into account this expected legal obligation so that the deficit target and the debt rule continue to be met.

7) In examining the draft, the Council has identified that the achievement of several revenue and expenditure estimates requires further action. According to the information received from the Ministry of Finance and the documents provided to the FC at its request, these measures are being developed. It would be useful if the National Assembly were informed of the government measures underpinning the appropriations when the bill is tabled. The Council considers it important that the size and structure of the measures should be such as to allow inflation to be brought down as quickly as possible and to help restore balance in the long term.

8) The Council, while acknowledging the advantages of the spring-summer budgeting (preparation opportunities, positive effects on stability, social programmes), considers it necessary to draw attention to the current limitations of the macroeconomic conditions for fiscal planning, which imply that the predictability of external developments surrounding the Hungarian economy in 2024 is subject to high uncertainties. The risks associated with this may require a re-planning, limiting the role of the budget as an economic compass.

9) The Council authorises its Chairman to make public the body's Opinion on the draft and to present it to the plenary session of the National Assembly, taking into account its relation to the submitted bill.

III

Justification

1) Credibility and enforceability of the draft

Pursuant to Section 24 (2) of the Stability Act, the Council may comment on the draft budget bill or, if it has fundamental objections to the draft, its authenticity or enforceability, it may express its disagreement with the draft. The FC does not make use of this possibility, but considers it necessary to draw attention to a number of risks to the achievement of the planned objectives.

2) Macroeconomic and budgetary developments in 2023

According to the major international financial institutions, the world economy is in a fragile phase, with the prospect of subdued growth in the short term. The war between Russia and Ukraine will continue to affect global economic activity this year. In their latest short-term analysis, the International Monetary Fund (IMF) and the World Bank forecast global growth to slow to 2.8 percent in 2023, down from 2.9 percent previously. The OECD's latest outlook shows the global economy slowing further, with growth forecast at 2.6 percent for this year. Compared to these growth rates, India and especially China are expected to outperform, as their economies pick up momentum and grow more dynamically following the full lifting of restrictions on the coronavirus epidemic. The IMF and the World Bank have jointly estimated that their GDP is likely to expand by 5.9 and 5.2 percent respectively in 2023. Developing countries are projected to grow by 3.9 percent this year, according to the IMF. On the downside for Hungary's expected economic performance, the IMF's forecast cited above has lowered the German economy's expected performance this year by 0.2 percentage points to -0.1 percent. According to the OECD's assessment, the German economy's output is expected to grow by only 0.3 percent in 2023 compared with last year's outcome.

In its spring (May) 2023 forecast, the European Commission expects the Hungarian economy to expand by 1.0 and 1.1 percent, slightly more than its previous estimate, as the EU and euro area economies are expected to grow by 1.0 and 1.1 percent respectively, after a better-than-

expected start to 2023. The faster growth is conditional on the European economy gradually adjusting to energy prices, which should allow the economic community to avoid recession despite the difficulties. Both the IMF and the OECD have forecast growth of 0.8% for the euro area this year.

The major international financial institutions estimate that Hungary's economic output growth in 2023 could be modest. The IMF (in April 2023) expects growth of 0.5 percent this year, while the OECD in its November 2023 forecast expects 1.5 percent. The European Commission's analysis this spring puts our annual expansion at 0.5 per cent. Domestic market analysts have been cautious in their expectations, expecting economic growth of between -0.5 and 0.6 percent. Our situation is heavily influenced by the consequences of Russian aggression, the slowdown in the global economy, the impact of inflation, the fall in demand, energy price developments, the economy's high exposure to Russian gas and, as a result, significant market uncertainty.

The Government has based the 2023 Budget on economic growth of 4.1 per cent. Macroeconomic and fiscal developments in 2022 have changed the implementation assumptions significantly from those assumed when the law was adopted, making it inevitable to amend the adopted Budget Law for 2023 - building on a new macroeconomic path. Russia's war in Ukraine and the sanctions imposed in response to it, have amplified inflationary trends, the energy crisis that has erupted and the measures taken to stabilise the economy, not to mention external market developments, have slowed economic growth.

The Government, assessing these underlying processes, has initiated the amendment of the 2023 Budget Law, which in its proposal foresees an increase of 1.5 percent in 2023. This was based on the assumption that household consumption would increase by only 0.9 percent compared to the previous year, while gross fixed capital formation would fall by 1.0 percent and employment by 0.2 percent (including 1.0 percent in the public sector). A very modest increase in external trade is expected, with exports up by 2.8% and imports by 1.4%. The revised macroeconomic trajectory projected a 15 percent increase in consumer prices in 2023, broadly in line with the actual rate of 14.5 percent in the previous year, while market forecasts suggest that inflation of 18-19 percent in 2023 is not unthinkable.

On the basis of the information available so far, economic expansion is expected to be moderate and slightly positive on an annual average basis, with acceleration in the second half of the year. Our performance in 2023 will certainly be affected by the protraction of the

Russian-Ukrainian war, the escalation of existing geopolitical tensions, war sanctions and the limited conditional access to EU funds for Hungary. All these create an unfavourable environment for our economy. Nonetheless, both consumer demand and private investment should pick up in the second half of the year as inflation slows and base effects build.

Several factors support expectations of accelerating economic growth. The significant investment announced in recent years has helped and continues to help growth. In the previous half-decade, the Hungarian economy led the EU in investment rates). However, in recent years, the rise in investment rates has been driven by rising prices due to capacity constraints, while the constant price investment rate has been declining since 2019. Although investment volumes will be 4.8 percent lower in 2023 compared to the previous year (largely due to a reduction in public investment), the industry has been and will continue to expand with new capacity, reflecting the high investment rates of recent years. If last year's drought is not repeated, agriculture could also make a significant contribution to annual output. Among the factors supporting growth, developments in services with significant export potential (logistics, transport, accommodation services) and large investments brought in by foreign working capital play an important role. Moreover, in addition to the instruments already in place, the Government is helping domestic SMEs and large companies to recover from the crisis and expand exports through low-interest, state-subsidised investment, working capital and green investment loans under the Baross Gábor Reindustrialisation Loan Programme. The Baross Gábor Capital Programme aims to increase investment activity and improve energy efficiency.

According to the data for the first quarter of 2023, the revenue of the central sub-system of general government was HUF 8398.0 billion, 23.1% of the estimate, HUF 691.6 billion less than the forecast. Expenditure of the central government subsystem amounted to HUF 10 487.7 billion, which is 26.4% of the target, exceeding the annual target by HUF 548.0 billion. Payments by business organisations in the first quarter amounted to HUF 679.0 billion, 17.2% of the annual target, and HUF 305.7 billion below the annual forecast. Within this, HUF 172.1 billion was received in corporate tax, HUF 79.1 billion less than the annual forecast (17.1% of the forecast). Mining royalty revenue amounted to HUF 73.8 billion, 22.1% of the forecast, HUF 9.7 billion below the annual forecast (this is due to the increased royalty rate, the extraction volume requirement, the Brent oil price, the Dutch TTF gas price and the exchange rate variation). Energy sector payments in Q1 amounted to HUF 107.7 billion, 15.0 percent of the annual target (HUF 71.3 billion below the annual target), which is related to changes in

the tax rates imposed under this heading and the evolution of extra profit taxes. Tax revenues linked to consumption were 20.1% of the annual target, at HUF 2051.5 billion at the end of Q1. The bulk of this, 78.1 percent, was accounted for by VAT receipts of HUF 1602.8 billion, which were HUF 393.7 billion below the target at 20.1 percent. In this period, VAT receipts are affected by the fact that VAT payments related to the last quarter of the previous year fall in the first quarter, while on the other hand, the first quarter of the year reflects the lower economic activity. Excise duty receipts amounted to HUF 301.9 billion, 4.4% below the forecast. Personal income tax receipts amounted to HUF 940.7 billion, 23.2 percent below the target and HUF 74.5 billion below the target by the end of March 2023. This is due to the increase in the annual wage bill and the low base, as a result of the family tax rebate at that time (February). Revenue from EU programmes amounted to HUF 536.5 billion, covering 23.9% of the annual allocation.

The cash deficit of the central subsystem in the first quarter of 2023 was HUF 2,089.7 billion, which is 61.5 percent of the annual target. The deficit of the central budget amounted to HUF 2019.0 billion, that of social security funds to HUF 89.5 billion, while the surplus of the separate state funds was HUF 18.9 billion.

According to the preliminary financial accounts data released by the MNB, the accrual deficit in the first quarter of 2023 was similar to the cash deficit at HUF 2020 billion, accounting for around 12% of estimated quarterly GDP.

Overall, the significant underperformance of several tax items poses a risk to the annual outturn. This, in turn, will adjust downwards the base of the 2024 appropriations, thus also posing a risk to the 2024 outturn.

3) Budget targets and conditions for 2024

3.1 Macroeconomic indicators underlying the planning

The draft central budget for 2024 is based on GDP growth of 4.0%. The sources of this growth are: on the consumption side, a 2.8 percent increase in household consumption and a 3.7 percent increase in gross fixed capital formation, as well as an export surplus. The projected pick-up in consumption should be supported by a 6.0 percent increase in consumer prices, which is much lower than in previous years.

With a labour market that has been tight for years, employment is expected to expand by 0.4 per cent, with the competitive sector benefiting and the public sector remaining unchanged in the draft bill. The number of unemployed will fall. The modest increase in employment indicates that the economy's labour reserve is being depleted, and thus the draft basically relies on a 3.6 percent improvement in labour productivity

After strong wage growth in 2022 and 2023, the draft foresees average gross and net wage growth of 10.7 percent in the competitive sector and 8.9 percent in the public sector in 2024.

Despite the adverse external developments (escalation of known geopolitical tensions, the continuing Russian-Ukrainian war, the energy and raw materials crisis, the impact of EU sanctions policy, etc.), exports and imports could expand by 5.9 and 4.3 percent respectively, which would exceed the growth of these indicators in 2023, thanks to the implementation of investments for export promotion.

In the Council's view, one of the critical factors for the realisation of the forecast is the projected 3.7 percent expansion in gross fixed capital formation, as government investment spending will continue to decline in real terms in 2024, and a rapid pick-up in housing construction is not expected. Thus, private sector investment should deliver the projected growth. The other critical factor is whether the dynamics of export growth can outpace the 4.3 percent growth in imports by 1.6 percentage points, in line with the projected expansion in domestic consumption. While the known improvements in export capacity on the supply side provide the basis for a growth rate of exports above 5 percent, the projected expansion of export markets is significantly below international forecasts.

3.2. Revenues of the central subsystem

The total **non-consolidated revenue estimates** of the central subsystem amount to HUF 38,912.3 billion, which is 30.6% higher than the preliminary estimate for 2022 and 7.0% (HUF 2,536.4 billion) higher than the estimate for 2023 (hereafter: the expected estimate), as revised in January.

Taxes and contributions account for the largest share of revenue sources.

The **estimate for payments by business entities** is HUF 3 772.9 billion, 4.2 percent (HUF 166 billion) less than the previous year's revised estimate. Within this revenue group, **corporate tax** is the main contributor, with an increase of 14.8 percent (HUF 14.843 billion) compared to the expected outturn in 2023 (HUF 14.8 billion). Based on the implementation of

corporate tax for the months I to IV of 2023 (23.4 percent of the annual appropriation), a risk can be identified for 2023. Major factors influencing the planning of the appropriation (nominal GDP, growth in gross fixed capital formation, growth in exports) do not justify an increase of this magnitude, and the expected shortfall in 2023 increases the risk of this. (The draft budget bill does not provide information on the revenue impact of the global minimum tax.)

Small business tax (HUF 227.6 billion) is expected to increase by HUF 44 billion (24.0 percent) compared to the 2023 forecast, due to the re-reporting (increase in the number of taxpayers) following the restructuring of the small taxpayer specific tax. However, the small taxpayer specific tax (HUF 77.8 billion) is 4.2 percent lower (HUF 3.4 billion) than the previous year's forecast. The decrease is linked to the restructuring of the tax system (downsizing) in September 2022.

For the **energy sectors**, the target for **payments** is HUF 513.6 billion, which is 28.3% lower (HUF 202.5 billion less) than the previous year. The mining levy is budgeted at HUF 192 billion, 42.5% (HUF 142 billion) less than in the previous year.

Tolls are budgeted at HUF 549 billion, which could be 33.7 percent (HUF 138.4 billion) higher than expected in the previous year.

Payments by financial institutions are estimated at HUF 253.4 billion, 29.2% (HUF 104.6 billion) lower than expected in the previous year. Of the revenue estimate, the replacement tax revenue is reduced by 50 percent by 2024 (HUF 132 billion) compared to the baseline. This means that the phasing out of the additional tax will only be partial, but the legal basis for this is not yet in place. The revenue from the special tax without the additional tax will increase by 29.1 percent compared to the base, the feasibility of which is at risk.

The **retail sales tax** target is HUF 249.7 billion, 21.7% (HUF 44.5 billion) higher than expected in the previous year. The pharmaceuticals tax is HUF 32 billion, HUF 90.5 billion less than in the previous year.

The **company car tax** (HUF 80.8 billion) is 2.5% higher than expected, while the gaming tax (HUF 52.7 billion) is 12.4% higher than expected. The utility tax (HUF 41.4 billion) is HUF 12 billion lower than in 2023, while the eco-tax (HUF 5.3 billion) remains unchanged compared to the previous year.

The estimate for **other centralised revenues** (fines, environmental product charges, etc.) could be HUF 145.5 billion, 6.4% (HUF 9.9 billion) lower than the previous year's estimate.

Rehabilitation contribution appropriations are HUF 173.8 billion, 10.1 percent (HUF 15.9 billion) higher than the expected outturn of the previous year.

Revenues from **consumption-related taxes** provide 28.4 percent of the resources of the central subsystem. This group of revenues is estimated at HUF 11 041.3 billion, 8.4 percent higher than the expected outturn of the previous year. This is mainly due to the return of the economy to a strong growth path, stable employment, average earnings, household consumption growth and inflation developments.

The **general sales tax** target is HUF 8,574 billion, which is 7.4 percent (HUF 588.0 billion) higher than the revised 2023 target. In the first four months of 2023, tax revenue was only 29.7 percent of the annual target. If the 2023 base is much lower, this will have a negative impact on 2024 revenues.

The **excise tax** target is HUF 1,677.7 billion, which is HUF 212.8 billion (14.5 percent) more than the previous year's revenue, which is significantly higher than the forecast increase in purchased consumption (9.3 percent). In addition, there is a risk in the 2023 execution due to the decline in consumption (in the first 4 months, the execution was below the forecast at 33 percent, with 29 percent of the total execution achieved.)

The **registration tax** is budgeted at HUF 17.7 billion, 5.9 percent (HUF 1 billion) higher than the expected execution in the previous year.

The **Financial Transaction Tax** (FTT) is foreseen (HUF 348.3 billion), which is 4.8 percent (HUF 15.9 billion) above the previous year's forecast. Insurance tax is HUF 234.2 billion, 6.7% (HUF 14.8 billion) more than expected in the previous year.

The **tourism development contribution** is HUF 54, 5 billion, 48, 9 % (HUF 17, 9 billion) more than expected for the previous year. The airline contribution is HUF 39.3 billion, 11.6% more than expected in the previous year. The 2024 estimate for the telecoms tax is HUF 95.6 billion, HUF 0.8 billion below the previous year's expectation.

The total amount of retail payments is HUF 4,857.2 billion, 9.5 percent (HUF 422.5 billion) higher than the expected 2023 total. In this revenue group, personal income tax is the dominant revenue item, with HUF 4,475.8 billion of the revenue budgeted, up 10.2 percent, or HUF 415.3 billion more than the expected outturn. This is due to favourable employment data

(low unemployment, government measures to support employment, etc.) and high wage outflows (10.3% increases in average earnings). The target for levy revenue is HUF 280.1 billion, only 2.3% (HUF 6.4 billion) higher than expected in the previous year. Real estate activity, as in previous years, has come to an end, with demand gradually declining due to high supply prices, as reflected in the 2023-24 figures. For motor vehicle tax, the annual forecast is HUF 101.2 billion, just above the previous year's forecast by HUF 0.8 billion.

The central sub-system's target for **social contribution tax and contributions** revenue is HUF 7,968.9 billion, which is 10.1% (HUF 731.8 billion) higher than the expected outturn of the previous year. Of this, the share for the Pension Insurance Fund is HUF 5 424.3 billion, the share for the Health Insurance Fund is HUF 2 152.5 billion and the share for the National Employment Fund is HUF 392.1 billion.

The amount of the **municipal solidarity contribution** (chapter IX), planned as partial revenue from local government grants, is 29.7 percent higher than the expected value for 2023 and almost double (195.9 percent) the actual value for 2022. The contribution base is primarily affected by the evolution of net sales of local business taxpayers. The projected revenue outturn is based on a change in regulation in 2023.

3.3. Expenditure of the central subsystem

According to the draft, total non-consolidated expenditure appropriations for the central sub-system of general government amount to HUF 41 427.1 billion, 19.8% higher than the 2022 provisional outturn and 4.2% higher than the 2023 appropriations, as revised in January.

The structure of the budget is clearly structured, so that the annex to the bill provides a transparent breakdown of public expenditure and revenue in sufficient detail.

Of the total expenditure, 84.0 per cent is planned to be used in 2024 for current (operational) purposes, up 3.3 percentage points on the previous year's initial appropriation, 84.0 per cent for the three broad categories within the central sub-system, 7.3 per cent for domestically financed capital expenditure, down 1.7 percentage points, and 8.7 per cent for EU-funded operational and development expenditure, down 1.6 per cent. The share of the same groups in the 2022 budget appropriations is still 78.7, 10.6 and 10.7 percent respectively. Thus, there is a clear planning bias towards current (operating) expenditure, mainly due to increases in pension-like benefits, debt service (interest) and various wage increases. As in recent years, the budget for the operation of the State will remain break-even next year, so that expenditure

on public services will continue to be financed by operating revenues. Only domestic accumulation and EU budgets are expected to run deficits.

Spending priorities for the 2024 budget include preserving the cuts in overheads, strengthening defence, supporting families, protecting the elderly and increasing the value of public service workers.

To help protect the level of public finances, the draft also includes a specific heading for the Residual Fund in 2024. The budget is HUF 1 361.2 billion, which is some HUF 1 218.8 billion less than the revised 2023 allocation. The significant difference is due to the moderation of energy prices after the peak in 2022. In addition to the maintenance of the reduction in household energy bills, the Fund will also be available to central budgetary bodies, municipalities, church and civil institutions and state-owned companies.

Given the smaller scale of **central budgetary support** - and the wage increases discussed later - there are strong **risks** to the sustainability of the operations of budgetary institutions at 2023 levels and their ability to continue to provide services. The planned expenditure of budgetary bodies and headed appropriations for 2024 is HUF 9 718.3 billion, 2.3 percent lower than the 2023 legal appropriation. Although the source of the increase in personnel expenditure is included in the provision, there is a risk that the appropriation no longer covers higher expenditure due to the 6 percent increase in consumer prices and the increase in capital expenditure as set out in the government's targets following the previous restraint.

The **Defence Fund**, which enables the proper management of the security policy challenges posed by the war conflict in the region, the maintenance of an effective defence force, the modernisation of military equipment, the equipment and improvement of personnel accommodation conditions, and the continuation of the force development programme aimed at increasing the number of personnel, is also included in the 2024 budget as a separate chapter. In 2024, the total expenditure on defence may (also) reach 2 per cent of GDP in order to meet military obligations under federal and international treaties.

The budget could continue to **support families and improve their quality of life**. The draft budget bill ensures, in addition to tax cuts, the continued financing of the multifaceted childcare support scheme, with an increase in income-linked benefits in line with the government's projections.

In 2024, **protecting pensioners** remains a priority, by ensuring the sustainability of pensions and the long-term sustainability of the pension system, and by recognising the highly valued role of women. In 2024, pensioners will also receive a pension premium in November, if economic growth is expected to exceed 3.5% and the public finances balance target is met. In addition, beneficiaries who receive benefits that are to be increased in the same way as pensions may receive a lump sum calculated in the same way as the pension premium, subject to a separate Resolution by the Government. The source of these is included in a provision in line with the projected economic growth of 4.0 percent. There is also provision for women with 40 years of pension entitlement to receive an early retirement pension in recognition of their role in the family.

In addition to the top priorities, in 2024, the **financial reward of civil servants** will remain a priority. Resources are provided for the career development programmes and pay measures launched earlier, as well as for new ones. The 2024 budget includes funding for the two phases of the pay development programme for health professionals, which started in 2023 and for the pay increases for doctors and nurses in primary, specialised and epidemiological care under the previous pay development programme. The so-called 'base building' of the previous salary increases has been done for teachers, vocational training staff, and professional staff in the police and defence. The provision will allow for further wage measures, such as further salary increases for teachers and vocational training staff, salary increases for government agencies, etc.

The analysis also identifies several appropriations for **subsidies to local governments** as being at risk (Chapter IX). Expenditure on additional operating subsidies to local governments was already secured in 2022 only through transfers, but its amount was planned unchanged in 2023 and 2024. **General operating aid and expenditure on childcare** are also only slightly above the amount foreseen for 2023 and are therefore unlikely to be sufficient to finance the mission. The 2024 appropriation for childcare is only 4.2 percent above the 2023 statutory appropriation. Expenditures in 2022 were planned at the same level as in 2021, but the appropriation had to be increased by 16.1 percent during the year. The 2023 appropriation, taking into account the transfer, was planned 16.4% higher than the previous year, i.e. almost at the same level, which is not sufficient given the average inflation forecast for 2023, especially for municipalities with low business tax revenues (the first quarter of 2023 is higher than the forecast).

Within the expenditure of the E. Fund, the planned **expenditure estimate for general practitioners and on-call care for general practitioners** for 2024 is HUF 258.8 billion, which is 0.4 per cent (HUF 1.1 billion) higher than the revised estimate for 2023. The low increase may be due to an organisational change, as on-call care under municipal responsibility will be transferred to ambulance services in 2023, but no information on this is provided in the explanatory memorandum.

One of the largest expenditure appropriations in the **curative and preventive care sub-heading** of Fund E is the appropriation for consolidated specialised care, which finances outpatient and inpatient specialised care. An appropriation of HUF 903.6 billion is planned for this heading in 2024, which is HUF 24.5 billion (2.6 per cent) less than the base appropriation. Part of the Pharmaceutical Preventive Care sub-heading of Fund E is an appropriation for **High Value Drug Financing** - not open from above. The amount of this appropriation for 2024 ($129.7 billion) was the same as the amended 2023 legislative appropriation. The expenditure appropriation for 2021-2022 was HUF 119.7 billion, which was exceeded by 26.1 percent in 2021 and 48.1 percent in 2022. The April 2023 outturn reached 35.3 percent of the target. On this basis, the sufficiency of the 2024 appropriation is not assured, as it has been consistently exceeded since 2021 (on a pro-rata basis in 2023).

The draft expects **EU funding** of HUF 2479.8 billion in 2024 - with its own risks. **The EU development budget,** on the other hand, **has a spending target** of HUF 3605.8 billion. The difference is the sum of co-financing (own contribution) from Member States and advances paid by the budget. The largest share of total expenditure - nearly 51 percent - is already related to the operational programmes for 2021-2027. The share of expenditure linked to the previous seven-year cycle is still high at 18.5 percent. Expenditure on the Recovery and Resilience Instrument represents 21.3 percent of the draft. The remainder is for other purposes.

The **contribution to the EU budget** in 2024 could amount to HUF 692.4 billion, an increase of HUF 30.2 billion, or 4.6 percent, compared to the previous year.

The draft budget does not include the expected need to **compensate** the **Central Bank of Hungary for losses**. The costs of the central bank's activities - a series of measures to stimulate the economy in the context of the crisis and then to bring inflation down - are reflected in the central bank's results. The stable and cheap resources of more than HUF 11 000 billion provided by the central bank have played a key role in the post-epidemic recovery

of the economy and have also directly contributed significantly to public financing through the payment of HUF 500 billion in dividends by the MNB. Subsequently, the MNB embarked on a cycle of interest rate hikes to fight inflation, and these two factors combined to increase the MNB's interest expenditure. As a result of the higher interest expenditure, the MNB's own funds will turn negative by the end of 2023, and the budget will have a reimbursement obligation from 2024 onwards under Article 166(3) of Act CXXXIX of 2013 on the Central Bank of Hungary (MNB), the expected evolution of which the MNB will report regularly to the Ministry of Finance.

3.4. General government deficit

In line with the government's efforts to strengthen financial stability and maintain fiscal discipline, the draft projected deficit is 2.9% of GDP in 2024, compared to 3.9% in 2023, consisting of a deficit of 2.8% of GDP for the central subsystem, a deficit of 0.2% for the local government subsystem and a surplus of 0.1% for other government sector entities.

The cash deficit of the central government sub-system is also projected to narrow sharply in 2024, by HUF 885.4 billion less than expected for 2023, to HUF 2,514.8 billion (2.9 percent of GDP, a decrease of 1.5 percentage points). In addition, the local government sub-system is expected to have a cash deficit of 0.2 percent.

Interest expenditure on an accrual basis will increase after repricing, in the context of rising government bond yields and high inflation, and could reach 3.8 percent of GDP by 2024, but lower than the 4.1 percent of GDP in Hungary's Convergence Programme published in April 2023. The bulk of the increase in expenditure over the years is likely to come from inflation-tracking retail premium Hungarian government bonds (PMÁP), for which the doubling of holdings in the last year also has a growth bias. The draft primary balance excluding interest expenditure thus shows a surplus of 0.8 percent of GDP.

The Council also endorses the draft's idea that the minister responsible for public finances will prepare a forecast of the expected annual real growth of gross domestic product in 2024 by 30 April and 31 October. If this is higher than 4.0 percent, he will forecast the annual surplus in accrued tax and para-fiscal revenues due to higher-than-planned real growth and, at the same time, reduce the ESA deficit target for 2024 by an amount equal to this surplus, net of the excess of the planned pension premium over the planned amount.

The structural deficit-to-GDP ratio is further improved from 4.9 percent in 2022 and 3.6 percent in 2023 to 2.6 percent in the draft. This is below the ESA deficit and close to the medium-term objective (MTO) for the structural balance of 1.0 percent.

Overall, meeting the deficit target is considered risky. The main reason for this is that the macro-pathway is subject to many risks. For 2024, the government's forecast for GDP growth, community and household consumption, gross fixed capital formation and exports is more optimistic than authoritative macroeconomic analysts. This is compounded by uncertainties about the disbursement of EU funds due to the country. Against this, there is little fiscal space separating the deficit target from the deficit required by domestic and EU fiscal rules. Only HUF 51.2 billion is the excess of the government sector deficit over the deficit rule, assuming unchanged GDP growth.

3.5. Public debt

After a temporary increase in 2020, the government debt ratio started to decline again in 2021, falling to 76.6% in 2021 and 73.3% by the end of 2022. According to the preliminary financial accounts of the MNB, the debt ratio remained unchanged at 73.3 percent of GDP at the end of the first quarter of 2023. According to the draft law, the ratio will decline to 69.7 percent by the end of 2023 and to 66.7 percent by the end of 2024.

The planned 3 percentage point reduction in the debt ratio provides considerable room for manoeuvre to reduce the debt ratio even if nominal GDP growth is more moderate or the cash deficit is higher than planned. This provides a sufficient safety margin to minimise the risk of non-compliance with the debt rule.

Based on the outlook of the Convergence Programme for 2023-2027, the government debt-to-GDP ratio could fall below 60 percent already by 2026.

The draft budget bill for 2024 complies with the public debt rule[2] provided for in the Fundamental Law and with Article 4(2a) of the Stab. According to the latter, the end-of-year

[2] Article 36(4) and (5) of the Fundamental Law contains the public debt rule as the most important element of the rule-based budget. Accordingly, the National Assembly 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, The

value of the public debt indicator shall be set in such a way that the annual reduction of the public debt indicator, while enforcing the EU rules on debt reduction, reaches at least 0.1 percentage points. The required reduction in the debt ratio is achievable on the basis of the macroeconomic and budgetary path. This would also bring the debt reduction in line with the so-called one-twentieth debt rule[3] still in force in the EU.

The foreign exchange ratio of central government debt will rise to almost 27% by the end of 2024. Thus, the foreign currency debt ratio will remain below the 30 percent limit set for the Public Debt Management Centre.

Budapest, 23 May 2023

Windisch László

Member of the Fiscal Council

Matolcsy György

Member of the Fiscal Council

Kovács Árpád

Chairman of the Fiscal Council

National Assembly can only adopt a central budget law that includes a reduction in the ratio of public debt to total GDP.

[3] Reform of the EU's budgetary framework and economic governance is underway, with the European Commission publishing its legislative proposals in April. The Commission's intention is to have the new rules in place from the 2024 budget year. Under the new fiscal framework, which focuses on medium-term debt sustainability, the one-hundred-year debt rule would be abolished, among other requirements and procedures.