Resolution of the Fiscal Council

on its Consent to the Final Vote on the Year 2024 Central Budget Bill of Hungary

I

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

The Fiscal Council (hereinafter referred to as the Council, FC) shall formulate its position on the basis of Section 25 of Act CXCIV of 2011 on the Economic Stability of Hungary (hereinafter referred to as the Stability Act) on the preliminary consent required for the adoption of the draft bill on the central budget, pursuant to Article 44 (3) of the Fundamental Law. In doing so, it shall examine whether the bill complies with the requirement of a reduction in the level of the public debt ratio as provided for in Article 36(5) of the Fundamental Law.

In its Opinion No 4/2023.05.23. on the draft bill on the 2024 central budget of Hungary, the Council stated that "the draft budget bill foresees economic growth of 4.0 percent in 2024, higher than the average of known domestic and international forecasts, supported by household consumption growth, a renewed dynamic increase in gross fixed capital formation and a growth rate of exports exceeding imports." In its view, "the economic growth projected by the government could materialise if external and domestic conditions are favourable, but there are a number of risks." Among these, the FC highlighted that "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 dragging on." The Council also noted that "the government's forecast would require private sector investment to compensate for the (significant) fall in public investment spending in real terms, and the resulting competitive export capacity to allow Hungarian exports to grow at a pace significantly faster than the expansion of export markets."

In previous years, the Council had already called for "the government sector deficit to be brought below 3 percent of GDP in order to balance the Hungarian economy and budget." It has now concluded that "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 compared to 2023 to 2.9 percent, 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." Among other things, "the expected economic growth is not achieved, which would reduce budget revenues." There is a risk of "an expected underperformance of consumption-related revenues in 2023, which would worsen the base of these appropriations". The Council also saw a serious risk that "the appropriations for the general government in kind, including energy compensation, would fall significantly short of the rate of price increases realised in 2022 and expected in 2023 and 2024". All these, the Council considers, "also entail operational and service quality risks, the mitigation of which must be prepared for in the budget. A 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 projected cash deficit would also result if "the revenue of HUF 2 479.8 billion projected 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 up".

In its Opinion, the Council welcomed that "in line with the provisions of the Fundamental Law, the downward trend in the government debt ratio continues and is projected to decline from 69.7% at the end of 2023 to 66.7% at the end of 2024, according to the draft budget bill", and thus "considers the reduction of the government debt ratio to be achievable, in view of the planned 3 percentage point decline, despite the macroeconomic and budgetary risks outlined". According to the explanatory memorandum, 'the planned 3 percentage point reduction in the debt ratio provides considerable room for manoeuvre in case the debt ratio is reduced 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."

On this basis, the Council concluded that "the draft budget bill for 2024 complies with the public debt rule of the Fundamental Law and with the provisions of Article 4(2a) of the Stability Act.

The FC's response to the government's comments on the draft bill on the 2024 central budget of Hungary is contained in the general explanatory memorandum to the bill submitted under T/4181, No 4/2024.05.23. This was referred to by the Chairman of the Fiscal Council during his oral presentation of the Opinion at the beginning of the general debate on the draft bill, as mandated by the Council.

Compared to the draft bill submitted to the Parliament, the Council's conclusions on the draft bill were also correct for the submitted bill, taking into account the changes in the main revenue and expenditure of the bill submitted to the Parliament, which reduced both the revenue and expenditure totals by HUF 651.5 billion, thus not affecting the cash deficit and the public debt ratio.

On 3 July 2023, the Speaker of the National Assembly sent to the Council by letter No.OE-42/452-1/2023 the Consolidated Budget Bill No.T/4181/471 containing the amendments adopted by the National Assembly on the 2024 Central Budget of Hungary, requesting the Council's opinion on the compliance of the bill with the public debt rule pursuant to Article 25 of the Stability Act and the granting of its prior consent to the final vote on the bill pursuant to Article 44(3) of the Fundamental Law.

In reaching this Decision, the FC has relied on the assessment of the State Audit Office of Hungary and the Central Bank of Hungary.

The Resolution of the Fiscal Council

On 6 July 2023, the Council adopted the following decision on the basis of the examination of the Unified Central Budget Bill No. T/4181/471 on the Central Budget of Hungary for 2024 pursuant to Article 25 of the Stability Act:

> 1) The Council concludes that the amendments proposed for adoption in the single budget bill do not change the planned cash deficit. Consequently, the planned amount of government debt remains unchanged. The adopted amendments only slightly increase the risk of expenditure overruns. The Council takes note that the bills to increase the tax and fine revenues necessary to meet budget revenue requirements have been voted by Parliament.
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> The Council notes that the planned level of the government debt indicator as of 31 December 2024, as envisaged in paragraph 3(1) of the Unified Budget Bill T/4181/471 on the Central Budget of Hungary for 2024, has been determined in accordance with the provisions of the Stability Act, in line with the macroeconomic and public finance developments underlying the Bill. As the value of the debt indicator projected for the end of 2024 in the Bill is 3 percentage points lower than the value of the indicator

expected for the end of 2023, the requirement of Article 36(5) of the Fundamental Law is also fulfilled.

2) The Council maintains the majority of its comments on the draft budget law, given that neither economic conditions nor the budget law have changed to such an extent that the risks indicated have been eliminated.

a. The protracted war between Russia and Ukraine, the sanctions in response to it and the sharp fluctuations in world energy prices, which affect both the expenditure and revenue sides of the budget, are creating greater than usual macroeconomic risks.

b. Some elements of the economic developments in 2023 point to downside risks around the macroeconomic path underpinning the budget (lower-than-expected household consumption and higher-than-projected inflation), while other factors have been favourable in recent months (energy prices and balance of payments developments). In several cases, these changes have a direct budgetary impact in 2024.

c. The Council maintains its observation that without targeted austerity and task rationalisation measures, there is a risk that the need to maintain the viability of the budgetary bodies may require large unplanned expenditures in the course of 2024.

d. The Council notes that the bill in its present form does not include any obligation to compensate for budget losses under the current legislation, due to the expected negative capital of the Central Bank of Hungary. The Council takes note of this on the basis of the letter of the Minister of Finance dated 3 July 2023. In this letter, the Minister of Finance informed that the Government will initiate an amendment to the Law on the Central Bank of Hungary this year, according to which "the negative capital of the Central Bank should be compensated primarily by the positive results expected in later years". If the amendment, which would also require the agreement of the European Central Bank, is adopted, the budget would no longer be obliged to reimburse the Bank when the 2024 Budget Law enters into force.

e. The budget takes into account the cohesion and recovery funds for the EU budget cycle 2021-2027, so the implementation of the budget is conditional on their receipt on time and in the amounts foreseen.

4) The planned reduction of the debt ratio by 3 percentage points provides a significant margin to ensure that the risks indicated do not fundamentally jeopardise the reduction of the debt ratio, and the Council therefore gives its prior consent, in accordance with Article 44(3) of the Fundamental Law, to the final vote on the single budget bill T/4181/471.

5) The FC authorises its Chairman to immediately inform the Speaker of the National Assembly of the Decision and to present it to the Plenary of the National Assembly prior to the final vote.

III

Grounds for the Council's decision

Meeting the revenue estimates in the bill required amendments to several tax and other laws. These amendments were adopted by Parliament.

Inflation started to fall in February 2023 and disinflation is becoming more pronounced compared to the peak in January. However, the 15 percent annual average inflation expected by the budget for this year is below consensus expectations, which increases the likelihood of a supplementary pension increase in November 2023, which would also increase the base for pension expenditure in 2024. In addition, a larger-than-expected fall in domestic consumption could be associated with a smaller-than-planned increase in VAT receipts in 2023, which would worsen the 2024 appropriation base.

Compared to the bill submitted under T/4181/471, the changes in appropriations adopted by Parliament reduce the revenue and expenditure of the central subsystem budget for 2024 by the same amount (HUF 20.5 billion). Within this, operating expenditure and revenue are reduced by HUF 12.3 billion, and general government expenditure and revenue by HUF 8.2 billion.

The amendments do not change the cash deficit of the central subsystem and thus the amount of government debt. The general government deficit calculated according to the EU methodology remains the same.

The reduction in revenue appropriations is mainly due to the Pharmaceuticals Manufacturers' Tax, as a change in legislation will allow more of the tax to be written off - for development expenditure. Under the amendment to the bill on the contribution of airlines and amending certain tax laws, tax relief from corporate tax (tao) may be granted for the operation of strategic investments registered until 31 December 2025. Another new element is that the proposed amendment reduces the VAT on daily newspapers to 0%, which has no significant budgetary impact.

The reduction in expenditure appropriations is made in the Overhead Protection Fund for the compensation of budgetary bodies. The amount of operating expenditure foreseen in the appropriations for the compensation of central government bodies under heading L.2 decreases by HUF 20.5 billion from HUF 207.8 billion to HUF 187.3 billion.

As a result of internal transfers, the funds for the reconstruction of the Palace of Justice and the Ministry of Agriculture buildings on Kossuth Lajos Square (HUF 47.4 billion) are transferred from the Investment Fund to the Parliament chapter, which will carry out the implementation. A significant additional amount - HUF 10.0 billion - is allocated to the operation and development of the National Public Service University. Smaller amounts will be used to provide additional support for artistic activities, church programmes and nationality tasks.

In sum, the amendments contained in the single budget bill T/4181/471 did not require a revision of the finding of the Council in its Opinion 4/2023.05.23 on the validity of the public debt rule. In the light of the above, the FC has adopted a Resolution on the compliance with the public debt rule of the draft unified budget bill, in accordance with Article 25 of the Stability Law, and gives its consent to the final vote on the draft unified budget bill T/4181/471.

At the same time, the Council Decision deemed it necessary to draw attention to a number of risks to the achievement of the 2024 budget, in particular the deficit target. These are explained in detail in its Opinion No 4/2023.05.23 on the draft bill on the 2024 Hungarian central budget.

The Fiscal Council can accept that the MNB's loss compensation will not be paid from the budget because the Government - in consultation with the MNB - has decided to initiate an amendment to the Act on the Central Bank of Hungary. The intention of the amendment is that the negative equity of the central bank should be compensated primarily by the positive results expected in later years. If the equity capital were to remain negative for an extended period, the central budget would have to ensure recapitalisation to the level of the subscribed capital in the medium term, with more flexibility than at present.

The amendment is based on the fact that the amount of own funds does not affect the performance of the statutory tasks of the central bank, and that the domestic central bank loss compensation rule is currently less flexible and stricter than in many European countries. The amendment would result in no actual loss compensation in the coming years. The bill would be submitted to Parliament after consultation with the European Central Bank.

Budapest, 6 July 2023

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