Opinion of the Fiscal Council

on the Mid-year State and the Expected Development of its Implementation in the First Half of the Year of the Hungary 2023 Central Budget Act

I.

History, legal basis and publicity of the Opinion

Pursuant Point (c) Section (1) of § 23 of the year 2011 Act of CXCIV on the Economic Stability of Hungary, the Fiscal Council (henceforward: Council, FC) “shall formulate its opinion on the state of the execution of the central budget act and the expected evolution of the government debt every six months”.

On this basis, the Council reviewed the situation of implementation of Act XXV of 2022 on the Hungary's 2023 central budget, as amended by Act VI of 2023 (hereinafter: Budget Act), as well as the development of public debt in the first half of year, the budgetary processes and the expected performance of the main (balance) indicators of public finance.

In its Opinion on this matter, following its practice and working method so far, it built on the precedents related to the preparation of the 2023 budget law.

- In its Opinion 2/2022.06.03 formulated on the draft bill on Hungary's 2023 central budget the Council stated that “the draft budget bill envisages an economic growth of 4.1 per cent, in line with the range of known domestic and international forecasts [then, April/May of 2022], driven by a further increase in record-high employment, rapid wage growth, household consumption, substantial growth in fixed capital formation and improved productivity". In its opinion the Council considered that "revenue-side measures, in particular through extra-profit taxes, play a significant role in striking a balance, while expenditure side measures can contribute more permanently and effectively to improving fiscal balances". At the same time, the FC also indicated that "the implementation of expenditure measures, without reducing family incomes, is absolutely necessary for a credible and sound implementation of stabilization". The Council considered it an important ambition that "in 2023 the accruals-based (ESA) deficit of the general government sector will decrease to 3.5 percent, close to the Maastricht criterion, while the general government cash flow deficit will decrease to 3.3 percent", while noting that "EU and domestic rules allow for a general government deficit exceeding 3 percent in 2023", but urged "the 3 percent deficit to be reached as soon as possible, where economic circumstances permit'. In its opinion, the Council pointed out that "the draft budget bill for

2023 complies with the sovereign debt rule provided for in the Fundamental Law and in Section (2a) § 4 of the Stab. Act". It stated that "in accordance with the provisions of the Fundamental Law, the downward trend of the government debt ratio will remain persistent and its rate will decrease from 76.1 percent at the end of 2022 to 73.8 percent by the end of 2023, according to the draft budget bill." The Council considered it feasible to achieve this on the basis of the macroeconomic and fiscal path [that was prepared in April and May 2022, which formed the basis of the draft budget bill.

- The Council examined the compliance of the uniform Budget Bill T/152/471 on the 2023 central budget with the sovereign debt rule and **Decision No 3/2022.07.14** gave its consent to the final vote by acknowledging that "the debt indicator planned for 31st of December 2023 pursuant to Indent (1) § 3 of the uniform budget bill T/152/471 on the year 2023 central budget. This degree has been established in harmony with the stipulations of the Stability Act as well as, with the macroeconomic and public finance processes existing at the time of the preparation of the bill that served as a basis for the bill. As the value of the government debt indicator calculated for the end of 2023 is lower by 2, 3 percent than the indicator expected for the end of 2022, according to the bill, the requirement of Indent (3) Article 36 of the Fundamental Law is also fulfilled". In its resolution, the Council considered it appropriate to draw attention to the "heightened macroeconomic risks since the start of budget planning for 2023, among which budget implementation is particularly affected by higher-than-expected levels of inflation, a slowdown in global economic growth, the consequences of the Russia-Ukraine war (energy crisis, etc.) and a protracted agreement with the EU". In its view, these "increase the overall risk of higher than planned deficits and debt". The FC continued to call for "a 3 percent deficit to be reached as soon as possible, if economic conditions allow."

- During his speech in the General Assembly of the Parliament on granting its consent to the final vote on the 2023 central budget bill, the Chairman of the Council also stressed that "negative risks may further increase in the second half of 2022 and during 2023 and therefore [...] It is appropriate to prepare alternative scenarios to address them." The changes since then have justified the Council's calls for attention as it was expressed in its Opinion of 3rd of June to the draft budget bill for 2023, and it its decision of 14th of July on its consent to the final vote and its presentation to Parliament.

- In its **Opinion 1/2023.01.12.** based on the draft bill proposing to amend Act XXV of 2022 on the Hungary's 2023 Central Budget the Council stressed that "Russia's war against

Ukraine, the sanctions imposed in response, the explosive rise in energy prices and the associated uncertainty in the external economic environment pose risks to the achievement of the fiscal targets set out in the draft budget bill." The Council also noted that the draft bill "envisages economic growth of 1.5 percent by 2023, compared to 4.1 percent originally assumed, due to the lingering effects of the war and energy crisis, the slowdown in global growth and the dampening effect of inflation on real incomes." In its opinion, the Council also drew attention to the need to "pursue a conservative policy in the use of fiscal reserves" and continued to call for "the achievement of a deficit of 3 percent if economic conditions allow, since a reduction in the deficit will also help to restore balances in other areas of the economy." In addition, it stated that "thanks to the high nominal GDP growth rate of 16.6 percent, the government debt ratio will continue to decline in 2023. It is projected to decline from 73.5 per cent expected at the end of 2022 to 69.7 per cent by the end of 2023."

- The Fiscal Council examined the compliance of Bill T/2667 amending Act XXV of 2022 on the 2023 Central Budget with the sovereign debt rule and with **Decision 3/2023.03.30** gave its preliminary consent to the final vote, stating that the "government debt ratio will decrease from 73.5 percent at the end of 2022 to 69.7 percent by the end of 2023, according to the unified proposal. In the Council's view, the target reduction in the debt ratio is in line with the macroeconomic path used as a condition of the bill and with the budgetary developments set." On this basis, the Council considered that "during the implementation of Act XXV of 2022 on the Hungary's 2023 Central Budget, taking into account amendments, the debt-to-GDP ratio expected by the end of 2023 meets the requirement of Section (5) Article 36 of the Fundamental Law."

  In the explanatory memorandum of said Decision, the Fiscal Council considered it important to draw attention to the fact that "the amended budget is also surrounded by risks. Therefore, in implementing it, it is necessary for budgetary authorities to take realistic, sustainable austerity measures without jeopardizing the performance of public tasks. Otherwise, the smooth delivery of public services will require significant additional expenditures, which risks achieving the public debt target." In addition, the Council also indicated that "despite partial compensation for the increase in energy prices, the real value of appropriations financing the performance of public tasks has decreased significantly in several areas, so the management of the resulting tensions deserves further attention during budget implementation." The Council reiterated the importance of reducing the budget deficit "as this will also contribute to rebalancing in other areas of the economy (e.g. by contributing to improving external financing capacity)."

In accordance with its established practice, the Council conducted its half-yearly evaluation of the 2023 budget while keeping in mind the analyzes of the State Audit Office and the National Bank of Hungary. In addition, the FC reviewed the information of the HCSO and the Ministry of Finance on the situation of the economy in the first half of the year and on the central subsystem of public finance at the end of June, as well as the economic assessments and forecasts of certain international organizations (European Commission, IMF, World Bank, OECD), domestic research and analysis institutes, and other market-leading analysts invited by the Secretariat of the Council. The Council also took into account the 2023 National Reform and Convergence Programmes of Hungary.

II.
The Opinion of the Council

At its meeting held on the 3rd of October 2023, the Council reviewed the main processes and background of the implementation of Act XXV of 2022 on the 2023 Central Budget, as amended by Act VI of 2023, on the basis of Point (c) Section (1) § 23 of the Stability Act. It has formed the following Opinion on the above mentioned.

1) The Council notes that the economic situation at home and in Europe in 2023 will be primarily influenced by the aftermath of the energy crisis and the protracted Russia-Ukraine war. These negative factors have affected the Hungarian economy particularly strongly due to its geographical proximity and exposure to energy markets following the rapid recovery from the coronavirus pandemic.

2) In the first half of the year, the volume of domestic GDP decreased by 1.7 percent compared to a year earlier. In the Council's view, our economy will return to growth in the second half of the year, but annual GDP growth will fall short of the level projected at the time of the adoption of the amendment to the budget law. The main reason for the stalling in economic growth is the decline in domestic demand, stemming from the impact of inflation on real earnings and uncertainty about the economic outlook. A sustainable resumption of economic growth therefore presupposes a sustained reduction in inflation. At the same time, the Council notes that the labor market is strong: employment remains at record levels and unemployment rates are among the lowest in the European Union. From the point of view of economic growth and investment, it is of

paramount importance that Hungary has access to the allocated EU cohesion and recovery funds as soon as possible.

3) In the Council's assessment, the cash-flow deficit at the end of the year – based on current and expected developments, excluding government measures – will be higher than budgeted. The cash flow deficit of the central subsystem of general government was set at HUF 3400.2 billion by the amended Budget Act of 2023. The deficit in the first half of the year – reaching 85.2 percent of this – amounted to HUF 2896.0 billion, then reached HUF 3299 billion by the end of August, which is 97 percent of the appropriation. On the revenue side of the budget, the lower-than-planned performance of VAT revenues contributed to the higher than pro rata temporis deficit as a result of the decline in consumption. Restricting access to EU funds allocated to Hungary also increases the cash flow deficit and, despite budgetary advances to support planned programmes, increases uncertainty about economic growth. On the expenditure side, several items were paid in the first half of the year (13th month pension, postponement of the accounting of home renovation subsidies to 2023, utility subsidies after high energy consumption in winter) that will no longer appear in the second half of 2023, while a smaller expenditure is expected to be required for utility subsidies. However, interest expenditure and, in view of the need for an additional pension increase, pension expenditure and other benefits affected by the increase will be met in an amount higher than foreseen.

4) The Council notes that the government debt-to-GDP ratio increased from 73.9 percent at the end of 2022 to 75.0 percent at the end of the first half of the year due to the high cash flow deficit. The share of foreign currency debt in central government debt, which represents a dominant proportion of government debt, increased from 25.0 percent at the end of 2022 to 25.2 percent at the end of June 2023.

5) The cash flow deficit concentrating in the first half of the year also significantly increased the accrual deficit. In the first half of 2023, according to HCSO data, the ESA deficit amounted to 6.3 percent of half-year GDP. In the second half of the year, deficit growth is expected to be significantly lower than in the first half of the year, but budgetary developments still point towards a higher deficit than original.

6) The Fiscal Council notes that on 3rd of October 2023, according to a statement from the Ministry of Finance, the Government raised its 2023 ESA deficit target to 5.2 percent of

GDP. The increase in target is justified by both cash flow and accrual data. The increased deficit target reflects economic and fiscal developments. Even with the new deficit target, the Council sees a need for close control of expenditures. According to FC's assessment, despite lower than projected GDP volume growth and the increased deficit target, the government debt ratio may decline by the end of the year due to significant nominal GDP growth, in line with the debt rule.

7) To sum up, the Council considers that the macroeconomic risks it indicated in its opinion on the 2023 budgetary planning have become reality. As a result, developments in the intervening period of the year show a performance below time-proportional targets on the revenue side and a significant overachievement on the expenditure side. In the Council's view, a lasting improvement in the balance of the budget will require measures in the future. However, when designing these new measures, ample care should be taken to not cause consumer prices to rise, because bringing down inflation is an important condition for long-term budgetary balance.

III.

Justification

1. The evolution of macroeconomic conditions

The continuation of the Russia-Ukraine war, the related sanctions and their consequences (energy crisis, decrease in demand, inflationary processes, etc.) leave a strong mark on the performance of the global economy. According to the assessment of leading international financial institutions (IMF, World Bank, OECD, European Commission), the global economy is in an uncertain phase and consequently moderate growth is expected in 2023. In their forecasts for this year, they revised their current projections partly downwards at the beginning of the year and mostly slightly upwards during the year.

As a result of the extraordinary rise in energy prices, inflation in Europe reached a multi-decade high in 2022, which, together with global energy and food prices, is past its peak, but core inflation, which captures underlying developments, is moderating only slowly. As a result of the impact of inflation on real incomes, demand in the European Union as a whole is subdued and growth in the USA and China, which dominate the global economy, is slowing down.

In **its latest assessment, the IMF raised its projections for global economic growth** to 3.0 percent (from 2.8 percent), the World Bank to 2.1 percent (from 1.7 percent previously) and the OECD to 2.7 percent (from 2.6 percent previously). According to the European Commission's assessment in September, economic activity in both the European Union and the euro area is projected to grow by 0.8% (previous projections were 1.0% and 1.1% respectively). At the same time, it is unfavorable for the growth of the Hungarian economy that the IMF expects a 0.3 percent contraction and the Commission a 0.4 percent contraction in Germany.

In Hungary, macroeconomic developments were fundamentally determined by the extraordinary surge in European energy prices experienced in 2022, which significantly increased the current account and budget deficits and resulted in the highest inflation in the European Union. The impact of all this will ease in 2023, so inflation has moderated since the beginning of the year, the budget deficit is expected to decrease compared to last year and the trade balance may be in surplus. At the same time, economic growth slowed down significantly, mainly due to the demand-dampening effect of inflation. The economy's export performance is favorable despite stalled external demand. The scale of the economic downturn is being reduced by the recovery of agricultural production after last year's extreme drought.

The Government based the original budget – for 2023 – on economic expansion of 4.1 percent. However, macroeconomic and budgetary developments in 2022 have changed the conditionality of implementation to such an extent that amendments to the already adopted 2023 budget are inevitable. Thus, the new macroeconomic trajectory of Act XXV of 2022, as amended by Act VI of 2023, envisages growth of 1.5 percent in 2023. According to the assessment of authoritative international financial institutions, the growth of the Hungarian economy's performance in 2023 may be modest. The European Commission's analysis of May and the IMF's analysis in April expect growth of 0.5 percent, while the OECD indicates stagnation (compared to 1.5 percent growth forecasted in the previous November). Strong market uncertainty, domestic demand and a decline in export orders also led to modest expectations among domestic market analysts, forecasting a growth rate between -0.5 and 0.6 percent.

The **volume of** gross domestic product decreased by 0.9 percent in the first quarter of 2023 and by 2.4 percent in the second quarter - compared to the same period last year. According to seasonally and calendar-adjusted and balanced data, economic performance contracted by 0.4 percent quarter-on-quarter in Q1 and by 1.1 percent year-on-year, compared to 0.3 percent and 2.3 percent respectively in the second quarter. For **the half year as a whole**, economic performance declined by 1.7 percent compared to the same period last year. The largest decreases were in industry and market services (including transport, warehousing and trade). The decline was mitigated by agricultural performance. The decrease in the added value of services was partly offset by the growth of the human health and social work sectors. On the expenditure side, economic performance was decreased by 1.4 percentage points through final consumption, by 3.2 percentage points through gross capital formation, while the balance of external trade improved performance by a significant amount.

Industrial **production** fell by 4.8 percent year-on-year in the first six months of the year. Most of the manufacturing sub-branches (9 out of 13 subsectors) contributed to the decline in performance, with the largest decrease (by 24.1 percent) in the production of chemicals, while in the areas of petroleum processing, rubber-, plastic and non-metallic mineral production, as well as in metal production, wood and paper industries severe downturns were experienced. In the other manufacturing subdivisions, the volume of production increased by between 3.5 and 20.9 percent, with the largest increase of 20.9 percent in the manufacture of electrical equipment and with an increase of 14.5 percent in the heaviest subdivision (vehicle manufacturing). The volume of foreign sales, accounting for 60 percent of sales, decreased by 0.2 percent and that of domestic sales by 17.3 percent compared to the previous year.

Construction **production decreased by 7 percent** in the first six months of 2023 compared to the same period last year, within which the construction of buildings decreased by 6.1 percent, that of other structures decreased by 7.6 percent and that of specialized construction decreased by 5.3 percent. At the end of the period, the contract portfolio of construction companies was 23.7 percent lower than a year earlier, within which contracts for the construction of buildings were 3.0 percent lower and those for the construction of other structures were 36.5 percent lower. Domestic demand declined (driven by high material prices and contractor fees), but government cuts in investment also had a strong impact on performance.

Volume of **investments in the national economy, in the first half of 2023** as a whole decreased by 9.6 percent compared to the same period last year. Most sectors contributed to the decline. Investment activity was mainly driven by the manufacturing sector. The developments of this subsector, which represents one third of the investments in the national economy and represent the largest weight, increased by 11.6 percent compared to the same period of the previous year. In contrast, different degrees of reduction were observed in all other subsectors. The investment performance of previously strong real estate transactions decreased by 15.2 percent compared to the same period of the previous year, driven by the completion of office building projects and the decline in housing constructions and renovations in the current period. The investment volume of transport and warehousing decreased by 17.1 percent in the first half year as a whole, due to the moderation of state infrastructure developments. Investment performance in agriculture decreased by 4.6 percent, driven by farmers' reductions in construction and import-related development expenditures related to machinery and vehicles.

Housing **activity** was adversely affected by the slowdown in economic activity and the weakening of domestic demand (due to high inflation). In the first half of the year, 7353 new homes were built, 19 percent less than in the same period last year. In the capital, county seats, other cities – in order: 36; 28; 6.9 percent fewer apartments were built, while 9.2 percent more apartments were newly occupied in villages, with the majority (66 percent) of which were built in the agglomeration areas of large settlements. The number of homes to be built on the basis of building permits issued and simple notifications was 10,880, which is 39 percent lower than a year earlier. The desire to build decreased in all settlement categories compared to the same period last year: 17 percent fewer apartments are planned to be built in the capital, 38 percent in county seats, 47 percent less in other cities and 53 percent less in villages compared to the previous year. With regard to housing support that also encourages housing construction, the amount of CSOK available in preferred small settlements will increase significantly from 1 January 2024, but in larger settlements the CSOK will cease to exist, but the Government plans to introduce new forms of housing support for those living here, the details of which are still being worked out.

Based on July 2023 data**, the number of employed** persons was 4,728,000, which is 29,000 more than in the previous year. The employment rate for people aged 15-64 was 74.8 per cent (0.4 percentage points more than in the previous year). The number of unemployed was 194,000 and the unemployment rate was 3.9 percent in July. According to the administrative data of the National Employment Service, the number of registered jobseekers decreased by 2 percent to 227 thousand.

Both average gross and net **earnings** increased by 13.6 percent in the first six months of the year (HUF 556,700 and HUF 383,800, respectively). The change in average earnings (rate of increase) was influenced by the service allowance paid in February 2022 to defense and law enforcement officials, equivalent to six months' salary. Excluding this effect, the increase in average gross earnings and net average earnings, taking into account discounts, would both be 2.7 percentage points higher.

The **volume of retail sales** in January-July – based on calendar-adjusted data – decreased by 9.9 percent compared to the same period last year. Within this, sales volumes fell by 7.0 percent in food and food mixed retail, 7.6 percent in non-food retail and 21.7 percent in fuel retail.

The **turnover of commercial** accommodation increased in January-July compared to the same period last year: tourist accommodation registered a total of 22.4 million overnight stays by 0.6 percent. Domestic guests spent 8.1 percent less (totaling 12.0 million) nights in tourist accommodation, while foreigners spent 13 percent more nights (totaling 10.4 million). Total gross revenues are HUF 75 billion, which is 15 percent higher than a year earlier at current prices.

The **pace of price increases in consumer prices** moderated further in August 2023 compared to the same period last year. On an annual basis (up from 17.6 percent in July), the average price increase was 16.4 percent. Over 12 months, food prices rose by 19.5 percent, household energy by 34.7 percent, spirits and tobacco by 12.7 percent, services by 13.2 percent and durable goods by 2.3 percent. Among retired households, consumer prices increased by 17.2 percent compared to the same period last year. The disinflationary process is expected to intensify further in the remaining months of the year. In August, fuel price growth pushed the overall price increase from the previous month to 0.7 percent, but core inflation was only 0.2 percentage points between the two months.

2. Development of revenues of the central subsystem

In the first half of 2023, revenues of HUF 17,790.8 billion were generated **in the central subsystem** of general government, which is 48.9 percent of the annual appropriation. This is HUF 3366.2 billion – 23.3 percent – more compared to the **same period of the previous** year (hereinafter: previous year or base period). The increase was primarily related to a significant increase in tax and contribution revenues of HUF 2249 billion, to which the contributions of business organizations and tax revenues related to labor contributed to the greatest extent. In addition to underlying macroeconomic developments, last year's low base due to the personal income tax refund disbursed in the first half of 2022 and the impact of the extra profit taxes introduced in the second half of 2022 this year – in the first half of 2022 – played a role in growth dynamics.

Within the central subsystem**, the revenue of the central budget** is HUF 12,518.9 billion, which is 48.1 percent of the **amended statutory appropriation (hereinafter: annual appropriation).**

The **amount of payment by business entities** is HUF 1866.4 billion, which is 47.4 percent of the annual appropriation.

In this main revenue group, **corporate tax** plays a decisive role, with revenues amounting to HUF 638.1 billion (63.5 percent of the annual appropriation), which exceeded the previous year's figure by HUF 177 billion. Compared to performance in the base period, this significant increase in revenue (difference) is primarily due to the increase in profits realized in previous years: in the case of advances, the tax surplus resulting from the achievement of profits in 2020 and 2021 was reflected in the increase (approximately HUF 120 billion), while in the case of May tax returns, the increase can be derived from profits in 2021 and 2022 (approximately HUF 50 billion). In addition, individual payments (taxpayer self-audits, court rulings, liabilities established during tax audits, etc.) also contributed to the revenue result.

As regards **payments by financial institutions**, HUF 144.3 billion was received in revenue (40.3 percent of the annual appropriation), which exceeded the revenue of the previous year by HUF 104.1 billion. This is due to the higher advance payment obligation imposed on the basis of return data. In the first half of 2023, HUF 36.3 billion was generated **from the itemized tax of small taxpayers**, which is 44.7 percent of the annual allocation (at the same time, HUF 70.5 billion less than the previous year's revenue). As a result of the restructuring of the substantive and procedural rules of this tax type in 2022, the number of taxpayers fell to less than a third (from 460 thousand to 130 thousand), so half-year revenues decreased in the first half of the year. The revenue **from the small business tax** was HUF 87.2 billion (47.5 percent of the annual appropriation), but its performance is HUF 17.5 billion higher than in the previous year – due to the increase in the number of small companies and the wages paid by them. **Utility tax** revenue was 46.9 percent. The implementation of the **eco-tax** was significantly lower than the pro-rata allocation (45.6 percent). The performance of **gaming tax** revenue is 56.8 percent (HUF 26.6 billion in amount), which is HUF 3.3 billion higher than in the previous year. The performance **of company car tax** revenue (HUF 39.8 billion) corresponds to the annual allocation (50.5 percent).

The budget received HUF 141.6 billion in revenue from the **mining royalty** (42.4 percent of the annual appropriation), but its amount is HUF 73.2 billion higher than in the previous year. The development of revenue was influenced by the imposition of the production obligation, changes in the price of Brent crude oil, the price of gas on the Dutch stock exchange (TTF) and the exchange rate, as well as changes in the method of calculating mining royalties. As **regards payments from the energy sector,** revenues amounted to HUF 280.5 billion (only 39.2 percent of the annual appropriation), which exceeded the performance in the base period by HUF 225.5 billion. Compared to the base year, the significant increase in revenue was due to the change in the rules of the taxes payable under this heading and the fulfilment of extra-profit taxes: on the one hand, the scope of income tax of energy suppliers expanded, and on the other hand, extra-profit taxes affecting the energy sector were recorded on this balance sheet item, such as the extra-profit tax paid on the basis of the Urals-Brent exchange rate difference, balancing power plants and renewable energy producers exiting the subsidized off-take system. As a **pharmaceutical manufacturer tax**, HUF 39.5 billion of revenue was received in the 2023 budget (with an annual appropriation of HUF 122.5 billion). **Retail tax** revenues amounted to HUF 36.5 billion (17.8 percent of the annual appropriation), which is HUF 21.2 billion higher than in the base period. This is due to the fulfilment of additional payments resulting from the previous year's accounts. (In the first half of the year, the cash flow related to settlements was fulfilled from this tax, and the first advance payment obligation due for this year falls in the month of July for most taxpayers.) The income from the **rehabilitation contribution** was HUF 78.1 billion (49.5 percent of the performance), HUF 14.5 billion higher than the performance in the base period. This is due to the increase in the minimum wage, which determines the tax rate, and the increase in the number of employees.

From **other centralized revenues,** HUF 275.7 billion was realized, which is 48.7 percent of the statutory appropriation, but 5.1 percent higher than in the same period of the previous year. In this revenue group, **electronic (**proportional to the distance travelled) **and time-based tolls** continue to dominate (HUF 140.4 billion and HUF 59.3 billion respectively), with performance accounting for 45.2% and 59.2% of the annual appropriations. Revenues of HUF 27.3 billion and HUF 7.2 billion were received from **the environmental product fee** and **the landfill fee** respectively (the fulfilment of the former is 45.5 percent of the statutory appropriation; the latter is 44.7 percent). As a result of the **water resource contribution**, HUF 6.5 billion (50.5 percent of the annual statutory appropriation) was received in the budget. The revenues of the fine generated 59.0 percent of the appropriation, HUF 32 billion.

In the first half of the year, revenues amounted to HUF 4353.1 billion from **consumption-related taxes**, which is 42.7 percent of the annual appropriation, which is HUF 276.7 billion more than in the previous year. The two key elements of taxes on consumption are value added tax and excise duty.

Value added tax generated revenues of HUF 3328.0 billion in the first half of the year, with performance representing 41.7 percent of the annual appropriation, only HUF 73 billion, 2 percent higher than in the base period. The low level of net VAT revenues is driven by high allocations on the one hand and a significant decline in gross revenue growth dynamics on the other. The decline in VAT revenues is mainly explained by the decline in domestic demand and the consequent slowdown in retail sales.

Revenue from **excise duty** amounted to HUF 648.2 billion (44.3 percent of the appropriation), which is HUF 67.5 billion (12 percent) more than in the previous year. Since July 2022, all excise duty rates have increased. Excise revenues paid on fuel barely increased despite the fact that this year the earlier, higher tax rate is again in place compared to the previous year (when a temporarily lower tax rate was in effect from March 2022 to December 6, 2022), as fuel turnover fell significantly in the first six months of the year. The increase in tobacco revenues was driven by tax rate increases in July 2022 and January 2023 and related market reactions. For *spirits and other* products, the July 2022 tax changes can be used to justify revenue growth.

As **a financial transaction levy**, HUF 166.5 billion was received in the budget (50.1 percent of completion), HUF 33.7 billion more in amount than in the previous year, the significant increase is the result of the tax rate increase in July 2022, but there is also a significant increase in financial transactions, the number of transfers and the widespread use of applications supporting it. The implementation **of registration tax** amounts to HUF 7.7 billion (45.9 percent of the appropriation), HUF 0.6 billion less than in the previous year. **Telecommunications tax** compliance is 63.4 percent (HUF 61.1 billion in amount) and twice as much as in the base period. HUF 118.0 billion (53.8 percent of the appropriation) was received in the budget from **insurance tax**, which is HUF 57.8 billion more than in the previous year. The **contribution of airlines** amounted to HUF 15.4 billion in revenue (43.8 percent of the appropriation). As a **tourism development contribution** to be borne by catering and commercial accommodation service providers**,** HUF 8 billion (22 percent of the appropriation) was received in the budget.

The **execution of retail payments** in the first half of the year amounted to HUF 2102.6 billion, which is 47.4 percent of the annual appropriation.

Personal income tax represents the dominant weight in this revenue group**,** which amounts to HUF 1915.5 billion (47.2 percent of the annual appropriation), HUF 885.1 billion more than the previous year's revenue. In addition to the dynamic growth of the gross wage and salary bill of the national economy this year, the significant increase can be explained by the low base formed in 2022 due to tax refunds for families. Gross revenues through June 2023 were 15.6 percent higher than a year earlier. In addition, this year the partial tax exemption for young people has been extended, so from 2023 mothers under the age of 30 will also be exempt from paying tax up to the average wage of last July if they give birth to or adopt a child, while being between the ages of 25 and 30.

The dynamics of **levy payments** slowed down, with 45.0 percent of the annual appropriation received in the budget (HUF 123.3 billion in amount). The moderate performance was due, on the one hand, to the change in the macroeconomic situation, the slowdown in growth, on the other hand, the decrease in the number of transactions in the housing market, the tightening and limitation of credit conditions, etc**.** As to the **vehicle tax**, HUF 63.7 billion (63.4 percent of the annual appropriation) was generated, which is HUF 3.6 billion more than in the base period. The additional revenue over and above the appropriation is mainly due to the base effect, as last year's revenue was also 6 percentage points higher than the 2022 statutory appropriation.

The **revenues of budgetary bodies and appropriations managed by chapters** amounted to HUF 1412.0 billion, which is 76.8% of the annual appropriation. In the case of budgetary bodies, HUF 1041.4 billion of this amount was realized, 64.7 percent of the appropriation was fulfilled, and in the case of appropriations managed by professional chapters, approximately 162.5 percent of the annual appropriation (HUF 370.6 billion in amount).

Payments **from the subsystems of general government** amounted to HUF 1426.0 billion on the balance sheet line (70.4 percent of the annual appropriation). Within this, *payments from central budgetary bodies* amounted to HUF 229.9 billion (performance is 67.2 percent of the annual appropriation), the *Central Residual Settlement Fund* received HUF 98.6 billion from the appropriations of budgetary bodies in the first half of the year, and *the Savings Fund* received HUF 224.2 billion in payments. The payment of *Separated State Funds* was completed to 50 percent (HUF 7.0 billion in amount), while the payment of Local Governments *was realized in 54.7 percent* of the appropriation (HUF 129.8 billion in amount). The revenue of the *Public Utility Defense Fund* from the central budget and the income of the *Defense Fund* from central budget were met in 50-50 percent of the annual appropriation (the former HUF 584.1 billion, the latter HUF 132.3 billion).

Revenues **related to state assets (**revenues related to real estate, chattel, dividends, other incomes) amounted to HUF 337.7 billion, which is 49.9 percent of the annual appropriation (30 percent higher than in the base period, but the course of payments is not uniform, revenues related to the National Land Fund amounted to only HUF 5 billion in the first half of the year). Three items represent a decisive proportion in the implementation of the appropriation: HUF 79.5 billion came from **carbon dioxide quota sales**, HUF 1334 billion came from **revenues related to companies** (including HUF 108 billion from MVM Zrt.), and a further HUF 72.6 billion revenue was recorded in the chapter **on state investments**.

Debt service (interest) revenues amounted to HUF 186.2 billion, which is 43.9 percent of the annual appropriation. Higher interest income than in previous years can be linked to the recognition of interest paid on KESZ stock and debt management operations.

In the first half of the year, **revenues of EU programmes** amounted to one third of the annual appropriation (HUF 2244.5 billion), i.e. HUF 754.7 billion. The low performance is mainly due to the fact that the revenues of the 2021-2027 Cohesion Operational Programmes are significantly below the planned amount, and the drawing of recovery funds has not yet started. Other **EU revenues received** on the balance sheet line as reimbursement of customs collection costs amounted to HUF 17.2 billion (41.8 percent of the annual appropriation), which is below the pro rata temporis but HUF 1.1 billion higher than the revenue for the base period.

The **combined revenue allocation of the allocated state funds** was met in 51.5 percent (HUF 389.2 billion).

> The largest weight in the revenues of these funds **is represented by the National Employment Fund (NFA),** whose performance and annual allocation (HUF 424.5 billion) reached 43.6 percent (HUF 185.0 billion in amount). Among its resources, the share of social security contributions due to the National Employment Fund was achieved to 47.7 percent (HUF 172.4 billion in amount), the reimbursement of expenditure of pre-financed EU programmes to 7.3 percent (HUF 4.4 billion in amount), and that of other revenues to almost two and a half times (HUF 8.1 billion in amount).
>
> The revenues of the **National Research, Development and Innovation Fund** were met to 63.9 percent of the appropriation (in amount of HUF 91.3 billion), decisive in this is the

innovation contribution (the fulfilment of which is 59.1 percent). Revenues amounted to 55.1 percent (HUF 61.6 billion) at the **Central Nuclear Financial Fund,** 49.3 percent (HUF 7.2 billion) at the **National Cultural Fund,** and 71.2 percent (HUF 44.2 billion) at the **Bethlen Gábor Fund**.

The **revenue target of social security funds** (HUF 9587.9 billion) was met in 50.9 percent in the first half of the year (within which the revenues of the Pension Insurance Fund increased to 52.1 percent and the revenues of the Health Insurance Fund to 49.3 percent). A significant proportion of the income of social security funds comes from social contribution tax and social security contributions. (The state tax authority transfers 54 percent of the social security contributions paid to the Pension Insurance Fund, 37.9 percent to the Health Insurance Fund, and 8.1 percent to the National Employment Fund.)

The **part of social contribution tax** due to the Pension Insurance Fund (HUF 942.3 billion) exceeds the base period revenue by 9.8 percent (HUF 84.3 billion in amount). Compared to the annual appropriation, the completion is 47.9 percent. The **part of social security contributions** due to the Pension Insurance Fund and pension **contributions** amounted to HUF 1174.5 billion, which exceeded the revenue received in the base period by HUF 165.0 billion (16.3 percent). The 2023 budget of the Pension Insurance Fund will receive HUF 1,071.6 billion in central budget support to support care expenditures. The budget contribution for the first six months (HUF 744.8 billion) is HUF 260.4 billion higher than in the base period.

The **part of the social contribution tax** due to the Health Insurance Fund (HUF 373.2 billion) exceeds the revenue of the base period by 9.9 percent (HUF 33.5 billion in amount). The part of the **social security contribution** due to the Health Insurance Fund and the **health insurance contribution** – together – amounted to HUF 801.6 billion, which exceeded the revenue received in the same period of the previous year by HUF 112.7 billion (16.4 percent). Among the revenues of the Health Insurance Fund, its contribution to the central budget amounted to HUF 636.2 billion in the first half of the year, which is HUF 18 billion more than in the previous year.

3. Development of expenditure on the central subsystem

In the first half of 2023, expenditure of HUF 20,686.8 billion was made in **the central subsystem of general government**, using 52.1 percent of the appropriation, nearly 20 percent more than in the same period of the previous year. While measures aimed at restarting the economy and increasing household income (wage increases, faster than planned reconstruction of the full amount of the 13th month pension, bringing forward the law enforcement service allowance) increased the level of expenditures in this period of 2022, in the first half of 2023 the amounts paid for utility protection and housing support were the main areas where the pro rata temporis were exceeded.

As a result of the 20.1 percent increase**, payments in the central budget** reached HUF 15,427.2 billion, within which the main expenditures were as follows.

The **combined allocation of individual, normative and public media subsidies as well as social policy fare subsidies in** 2023 (HUF 2912.3 billion) is almost double that of the whole year of 2022, because, on the one hand, motorway availability charges were transferred from the expenditure appropriations of the professional chapter to this balance sheet item, and on the other hand, from among the reserves for energy price compensation placed in the Public Utility Protection Fund, household utility protection and payments related to subsidies to state-owned enterprises are also recorded here. 56.4 percent of the target amount was paid in the first half of 2023, a significant part of which was HUF 969.2 billion related to the support of district heating suppliers, the universal service for residential electricity and natural gas, and the compensation of stockpiling. A large amount – HUF 318.5 billion, 34.7 percent more than in the base period – was also paid for the reimbursement of long-distance and suburban public transport services, in connection with increased energy and fuel costs.

Compared to the previous year's actual figure, the amount planned for 2023 decreased significantly – by 40 percent – to HUF 382.9 billion for **housing subsidies**, which, however, can be exceeded. (More than 100,000 applications were submitted in the last month prior to the completion of the home improvement program on December 31, 2022, and the processing and thus payment of which was delayed to the first months of 2023. In addition to this one-off expenditure, grants for other housing schemes are less than pro rata temporis. As a result of these two effects, payments will be made in 2023. In the first half of the year, they exceeded 86 percent of the appropriation.

From **the allocation of the National Family and Social Policy Fund**, expenditure of HUF 385.9 billion was made 6.1 percent more than in the base half-year and 1.1 percentage points more than in the pro rata period.

A large percentage (54.4) of this amount **was paid out for family allowances**, HUF 210.1 billion. Of this, a slightly smaller amount than in the base period, HUF 154.8

billion was allocated *to family allowance*. The additional amount was used to support *various goals related to raising children and starting life*.

HUF 96.0 billion (6.1 percent more than in the same period of the previous year) was used **for income substitute and income supplementing social support**. The increase in expenditure was mainly due to the fact that the amount of some benefits increased in line with the higher minimum wage from January 2023, while for other benefits there was a 15 percent increase equal to the pension indexation in January. Of this, HUF 55.3 billion was paid for various *district social tasks*, such as *the home care fee for children and the nursing fee*. HUF 67.4 billion was paid for *benefits under the age limit*, while HUF 40.6 billion was disbursed for *additional support, including disability support and personal allowance for blind people*.

Within the central budget's expenditures, nearly 40 percent was accounted for by **central budgetary bodies and appropriations managed by chapters** – amounting to HUF 6113.0 billion.

The greater part – slightly less than in the previous year, but 59.4 percent of the appropriation, HUF 3434.8 billion – was used **for the expenditure of budgetary bodies**. Of this expenditure, the amount paid for personal allowances and employers' contributions amounted to HUF 2,065.0 billion, while material expenses amounted to HUF 810.4 billion. HUF 173.8 billion was allocated for investments and HUF 31.8 billion for renovations. According to the rule introduced six years ago, the institutions paid HUF 98.6 billion into the Central Residual Settlement Fund as the residual appropriation not burdened with liabilities. The higher than pro rata expenditure is explained by the fact that in order to meet the deficit target, the central budget chapters and allocated state funds under the control of the Government had to meet 94.0% of their annual payment obligation of HUF 250 bn, or HUF 235 bn, until 16 March 2023. The **expenditure of appropriations managed by professional chapters** amounted to HUF 2678.2 billion, which is 54.0 percent of the annual appropriation. Most of the payments went to normative financing of various state and non-state human services, regional development tasks, transport developments, tourism programs, investment incentives, investments preserving cultural values and church activities. Similarly, to last year, non-committed appropriations – HUF 244.2 billion – had to be transferred to the Savings Fund. From this and from the Residual Settlement Fund, the managing bodies of the chapter applied for and received an additional grant of HUF 247.8 billion, which, when spent, increases the net expenditure of the chapters.

In addition to the continued slow arrival of revenues from EU programmes, the **implementation of EU programmes** continued, albeit moderately, with advances from domestic budgetary resources**.** In the first half of the year, HUF 1461.4 billion was paid, which is 11.5 percentage points less than in the pro rata period and 20.9 percent less than in the base period. The amount of advance payment was HUF 572.6 billion, and the remaining amount was used for invoice-based use. The largest payments from the 2014-2020 programming period were made for the Economic Development and Innovation Operational Programme, the Integrated Transport Development Operational Programme and the Environment and Energy Efficiency Operational Programme. Among the Széchenyi Plan Plus programmes for the period 2021-2027, major payments were made for the Regional and Settlement Development Operational Programme Plus, the Economic Development and Innovation Operational Programme Plus and the Implementation Operational Programme Plus projects.

In the first half of the year, HUF 577.7 billion was **disbursed to local governments**, 51.9 percent of the appropriation, 2.0 percent more than a year earlier. The majority of the funding – 80.4 percent – was a normative contribution to general operation and sectoral tasks (certain public educational, social, child welfare, child catering and cultural) tasks. The additional support represented 12.8 percent, HUF 73.8 billion, doubling that of the base period. The large increase occurred in the case of compensation for energy price increases for municipalities with more than 10,000 inhabitants, wage increases for cultural institutions (including increases in the minimum wage and guaranteed wage minimum), and support for local public transport tasks. 6.8 percent of the expenditure, HUF 39.7 billion, was related to additional tasks during the year, the majority of which, HUF 35.7 billion, financed wage measures for 2023, in addition to which local governments received contributions for expenses spent on the care of refugees arriving in Hungary due to the Russia-Ukraine war, as well as for operational and development tasks.

The **contribution to the EU budget** was slightly less than half of the appropriation, HUF 321.8 billion.

The **amount of expenditures related to state assets** was HUF 813.8 billion, which is more than double that of the base period. Almost two-thirds of this amount was spent on the recapitalization of state-majority owned companies. One-tenth was used for immovable property and movable property, while one-fifth was used for priority public investments. Recapitalizations usually involve large individual payments, which can lead to significant overruns of pro-rata temporis appropriations and payments in the first half of 2023. Thus**,** regarding **the corporate portfolio**, Corvinus Zrt. received a capital injection of HUF 360.2 billion, which alone accounts for 44 percent of the expenses of the first half of the year. This capital injection financed the acquisition of shares in Vodafone Zrt., Posta Insurance Zrt. and Posta Life Insurance Zrt. Other major corporate expenses included the HUF 30 billion capital increase of Eximbank Zrt. and HUF 29.4 billion of the National Defense Industrial Innovation Zrt., as well as the combined HUF 52.5 billion funding allocation of regional water utility companies, which will be used for operational purposes in accordance with the relevant government decision. The majority of the expenses related to the **real estate portfolio** (HUF 61.9 billion) are incurred by the Hungarian National Property Management Zrt. Of this, HUF 42.8 billion is the advance paid on real estate purchases in 2024 and 2026, which is now reflected in cash flow, but does not burden the accrual-based budget deficit. The amount of **state investment expenditures** was HUF 159.5 billion, which served transport (road and railway development) purposes on the one hand, and building construction investments on the other.

Gross **interest expenses** amounted to HUF 1360.1 billion, which is 4.4 percentage points higher than the pro rata temporis settlement. The increase in interest expenditure is mainly driven by high inflation and the environment in government securities markets. It is positive that the majority (87.1 percent) of this expenditure is a HUF payment.

The total statutory appropriation of **central reserves** is HUF 977.2 billion. Of this, HUF 586.6 billion has been used so far, the most, HUF 393.3 billion (76.4% of the appropriation) from **the Provisions** item. As the latter is an open appropriation from above, there is a risk of exceeding the margin, jeopardizing the achievement of the deficit target. **Extraordinary government measures** transferred HUF 101.6 billion to various tasks, complying with the legal requirement that 40 percent of the amount can be spent in the first half of the year. Of the HUF 7.7 billion of the **Central Reserve for Epidemic Control**, only HUF 0.3 billion was used. From the **Investment Fund** item, HUF 91.4 billion (45.7 percent) of expenditure was realized.

HUF 298.8 billion was used for the expenditure of **the separated state funds**, barely exceeding the pro-rata period, but 8.4 percent, HUF 23 billion more than in the previous year.

The greater part of this increase – HUF 13 billion – was reported to the **National Employment Fund**, which was worth HUF 173.2 billion. Within this, passive expenses and jobseeker allowances are used at HUF 61.4 billion, HUF 13 billion more than in the base half-year, due to a significant increase in the minimum wage and a smaller than planned decrease in the number of beneficiaries. In the case of other expenses, the increase is also significant, HUF 12 billion, which arose in connection with the Dunaferr group of companies as a wage guarantee payment. At the same time, expenses related to the Start work programme amounted to HUF 58 billion, HUF 11 billion lower than in the base period. The decrease in expenditure is mainly due to the fact that a larger advance payment was made to municipalities in the first half of last year. In addition, it had an impact that, compared to the base period, the average number of public employees fell from 80,000 to below 67,000, while the average salary of public employees increased by 16 percent.

Other significant expenditures were incurred by the **National Research, Development and Innovation** Fund (HUF 70.4 billion, 55.8 percent of the annual appropriation) and the **Bethlen Gábor Fund** (HUF 39.5 billion, significantly better than pro rata temporis, with 63.7 percent performance).

Social **security fund** expenditures amounted to HUF 4960.8 billion, which is significantly higher than in the previous year by 18.3 percent.

Within the financial bases of social security, the **Pension Insurance Fund** stands out in terms of magnitude, with a performance of HUF 3,002.5 billion, exceeding that of the base period by 27.0 percent. Of this, only HUF 3.8 billion is other expenditure, so the decisive part is **financed by pension benefits**. The large increase in payments for this purpose was caused by the impact of the additional pension increases of 3.9 percent and 4.5 percent implemented in two instalments in July and November in 2022, carried over to 2023, and the 15.0 percent inflation-tracking pension increase implemented from January of the current year, due to the higher-than-expected inflationary effect. The valorization procedure for determining initial pensions also played a role, as the impact of the significant increase in average net earnings in previous years was reflected in the valorization multipliers announced in March. In February, pensioners received a full monthly amount for the second time after 2022 under the title of 13th monthly pension. The increase in the retirement age ended by 2022, as a result of which the decrease in the number of people receiving benefits gradually ceased, so in June 2023 13.5 thousand

(0.7 percent) more people received early retirement benefits compared to the same period of the previous year. In contrast, the number of people receiving pensions with the benefit of women's 40-year entitlement period started to decrease due to more and more reaching old age, so in June 2023 it was 7.2 thousand (4.6 percent) lower than in the same period of 2022.

HUF 1958.3 billion was used from the **Health Insurance Fund**, 48.6 percent of the annual appropriation, 7.1 percent more than in the previous year. The pro-rata performance was the same **for the expenditure of curative and preventive care**, which accounted for the largest part, at HUF 1119.4 billion, which was 4.2 percent higher than in the base period. This increase was mainly due to the salary increase of inpatient and outpatient doctors introduced from January 2021 and continued in the second and third phases from January 2022 and 2023, as well as wage subsidies for general practitioners, dentists and their specialists, the salary increase for healthcare professionals on 1 January 2022, and other additional funding. The reason for the less than pro rata performance is mainly the wage increase of professionals employed in health service and health care workers (technical, economic) on 1 July, as this payment is spread over the last 5 months of the year. The situation is similar with the income supplement for health workers, the payment of which will be in the autumn period. In addition, there will be savings in the first half of the year in the use of appropriations for outpatient and chronic inpatient care. This is because, in the transition from average to performance finance, the capacity of providers had not yet reached pre-Covid levels until June. However, the increase is noticeable, with higher performance expected in the last months of the year.

According to the data provided by the National Health Insurance Fund Management, ***the debt stock of healthcare providers*** at the end of June 2023 is HUF 90.0 billion. (This includes data on university clinics, municipal and church-run and private providers.) The debt stock of state-run healthcare institutions – basically under the control of the National General Directorate of Hospitals (OKFŐ) – amounted to HUF 67.3 billion at the end of June. Compared to the debt stock in June, as a result of an itemized survey, public health institutions received HUF 39.4 billion in July, while clinical centers of universities maintained by trust foundations received HUF 22.4 billion, and church-maintained health institutions HUF 2.6 billion for overhead expenses expected this year – as part of the overhead compensation of central budgetary bodies.

HUF 243.1 billion was spent on **pharmaceutical subsidies**, 13.2 percent more than in the base period. A little more than 27 percent of the Health Insurance Fund, HUF 531.3 billion, 11.8 percent more than a year earlier, was used **for cash benefits**. Within this, the HUF 199.6 billion payment for the largest item, *disability and rehabilitation benefits*, was 16.9 percent higher than in the first half of the previous year. Among other cash benefits, expenses increased for *childcare allowance* (by 13.0 percent) and decreased for *sick pay* (by 4.9 percent) compared to the same period last year.

4. Achievability of the deficit target

Compared to HUF 3400.2 billion in **the 2023 cash flow deficit allocation of the central subsystem of** general government, the deficit in the first half of this amount reached HUF 2896.0 billion. The balance arose from a deficit of HUF 2908.3 billion in the central budget and HUF 78.1 billion in social security funds, as well as a surplus of HUF 90.4 billion in separated state funds. A month later, at the end of July, the cash flow deficit was even larger than at the end of the half-year, at HUF 2940.3 billion. In August, it reached HUF 3299 billion, or 97 percent of the statutory appropriation.

The **accrual-based deficit** of total general government is projected to decline further in 2023, also on the basis of the revised deficit target of 5.2 percent, after 7.5 percent in 2020, 7.1 percent in 2021 and 6.2 percent in 2022. According to the data of the Central Statistical Office, the ESA deficit amounted to 6.3 percent of half-yearly GDP during the first half of the year.

On the revenue side of the budget, the lower than pro rata temporis fulfilment of VAT revenues due to the decline in consumption due to high inflation contributed to the high cash flow and accrual deficit, and on the expenditure side, mainly in connection with utility price protection, the large compensation for universal service and stockpiling, as well as the increase in interest expenditures. Restricting access to EU funds allocated to Hungary – despite the modest advance payment of funding for planned programmes in Hungary – seriously impairs the balance of the budget. On the expenditure side, several items were paid in the first half of the year (13th month pension, postponement of the accounting of home renovation subsidies to 2023, utility subsidy after high energy consumption in winter) that will no longer appear in the second half of 2023, and utility subsidies are expected to require lower expenses. The amount of the latter is favorably influenced by the substantial decrease in natural gas prices compared to last autumn's prices. However, interest expenditure and, in view of the need for an additional pension increase, pension expenditure and other benefits affected by the increase will be met in an amount higher than foreseen.

Thus, deficit growth in the second half of the year is expected to be significantly lower than in the first half of the year, but budgetary developments still point towards a higher deficit than the original.

The **Maastricht deficit criterion**, which is included in both domestic and EU fiscal frameworks, stipulates that the [1] **accrual-based deficit** of the general government sector must not exceed 3 percent of GDP. The deficit over the past 3 years and even the revised deficit target of 5.2 percent planned for 2023 exceeds this requirement. However, this is possible due to the suspension of the Maastricht deficit target criterion in both the EU and domestic fiscal frameworks. The general escape clause in the EU allows for a temporary deviation from the reference value for the budgetary position and from the medium-term budgetary objective and the adjustment path towards it, provided that this does not jeopardize the medium-term sustainability of public finances. Under the escape clause, the EU institutions take the discretion not to open an excessive deficit procedure (EDP) under rules in the corrective arm of the Stability and Growth Pact (e.g. the deficit criterion), but to make country-specific economic policy recommendations. In the Hungarian legal order, the Stability Act has been amended, so that the rule concerning the general government deficit and the medium-term budgetary target will not apply in the 2021-2023 budgetary years based on the transitional provision of the law[2].

According to domestic and EU rules, the general government sector's debt-to-GDP ratio should be consistent with the achievement of the medium-term budgetary objective. The **structural balance** is used to measure the trajectory towards the goal. The structural balance is the balance of the general government sector net of cyclical effects of the economy and of one-off and temporary items. The medium-term budgetary objective is a structural deficit of 1 percent of GDP from 2023 to 2025. By contrast, according to the Convergence Programme for 2023-2027, the structural budget deficit would have been 3.6 percent of GDP in 2023 even with the original deficit target. However, by 2027 this rate could fall below 1 percent. The structural balance target requirements have been suspended for 2023 in both domestic and EU rules.

[1] In addition to the central and local subsystem of general government, it also includes data on entities classified under Regulation (EC) No 479/2009.

[2] Government Decree No. 196/2021 (IV. 28), § 1

5. Enforcement of sovereign debt rules

Government debt stood at 75.0 percent of GDP at the end of the first half of 2023, compared to 73.9 percent at the end of 2022, based on preliminary financial account data from the MNB. The debt ratio thus increased by 1.1 percentage points compared to year-end 2022. In addition to the high cash flow deficit, the increase in government debt was caused by significant net output, with which the majority of the annual plan was already fulfilled in the first half of this year.

When adopting the amendment to the 2023 budget law, the Fiscal Council noted that the value of the public debt ratio at the end of the year is expected to decline. In line with the debt rule of the Fundamental Law, the gross government debt-to-GDP ratio may decrease by the end of 2023 even with the increased deficit target and the lower than projected increase in GDP volume, in line with the debt rule of the Fundamental Law, due to dynamic nominal GDP expansion, expected more moderate debt issuance in the second half of the year, and the use of part of government deposits to finance debt maturities and deficits.

Another domestic fiscal rule for government debt is the **debt rule of the Stability Act**. The requirement states that the public debt ratio must decrease by at least 0.1 percentage points per year while EU rules are enforced.[3] This rule is fulfilled on the basis of the expected decline in the government debt ratio.

The **European Union's "one-twentieth" debt rule** is expected to be met if the debt ratio declines sufficiently in 2023. Based on its own forecast, the European Commission uses three methodologies (forward-looking, backward-looking and cyclically-adjusted) to calculate the rate of change in the debt ratio. If at least one of them achieves the required reduction of one-twentieth, the rule shall be deemed to be complied with. Based on the recommendation of the European Commission, the suspension of sanctions under EU debt rules will remain in place until the end of 2023, subject to continued activation of the general escape clause, although compliance with this rule will continue to be assessed.

The **share of foreign currency debt** in the central budget debt, which is dominant within government debt (HUF 47,927.5 billion at half-year), increased slightly: from 25.0 percent at the end of 2022 to 25.2 percent at the end of June 2023. Until the end of the year, the ratio of central foreign currency debt will remain below the maximum level of 30 percent set out in the

[3] Section 4(2)(a) of Act CXCIV of 2011 on Hungary Economic Stability

debt manager's strategic target, even with the September foreign currency bond issuances, driven by the purchase of government securities by domestic players and especially by the public.

Budapest. 3rd of October 2023

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