PUBLIC FINANCE

REPORT

2016
JUNE

"Intending to ensure the benefit of the general public ... and the good condition of the country by useful remedies..."

(from a charter of King Charles Robert - February 1318)

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REPORT

Analysis of the 2017. budget bill

2016
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To support the fulfilment of its fundamental duties set forth in Act CXXXIX of 2013 on the Magyar Nemzeti Bank, in particular the tasks related to the definition and implementation of monetary policy, the Magyar Nemzeti Bank analyses developments in the budget deficit and debt, monitors the financing of the general government, analyses the impact of financing on monetary developments, capital markets and liquidity, and researches fiscal policy issues.

Pursuant to Act CXCIV of 2011 on the Economic Stability of Hungary, the Governor of the MNB is a member of the Fiscal Council (FC), and thus the professional expertise and accumulated information available in the MNB can indirectly support the work of the FC. The MNB prepares background analyses for the tasks of the FC stipulated in the Stability Act and makes such available to the FC. The general public can learn about the most important results of these expert analyses in the publication entitled 'Public Finance Report'.

This report was prepared by the staff of the Directorate for Fiscal and Competitiveness Analysis with the contribution of the staff of the Directorate Economic Forecast and Analysis. The publication was approved by Dániel Palotai, Executive Director.

The analysis is based on information available for the period ending on 6 May 2016.

Contents

1. Summary

The subject of this analysis is the 2017 budget bill submitted to the Parliament on 26 April and assessed in the light of the MNB's fiscal forecast. Based on the information available, as part of this analysis, the MNB prepared its own projection for the 2017 budget balance, and this projection is compared to the appropriations in the bill.

According to the budget bill, the ESA budget deficit in 2017 is projected at 2.4 per cent of GDP. Accordingly, compared to the declining deficit path expected in both last year's Convergence Programme and the March Inflation Report, the Government is planning significant easing, which will be implemented in three areas: an increase in government investment (e.g. public road development and Modern Cities Programme), pay increases in addition to those previously known (in public administration and the tax office), and a targeted VAT cut. After reviewing the details of the bill, we believe that certain revenue items may fall short of the estimate, and **thus the specified deficit target can only be achieved with partial cancellation of the Country Protection Fund**.

One change compared to previous years is that the operating budget and the accumulation (investment) budgets are shown separately as well, considering that the aim of the Government is to reach a zero per cent 'operating deficit' in 2017. The operating budget contains almost all revenues and expenditures other than investment; consequently, its balance would be positive. Formally, however, its balance will be exactly zero, because the VAT revenue above what is necessary to reach a zero 'operating deficit' will be shown in the accumulation budget. The deficit of the latter is equal to the total deficit. At the same time, the zero 'operating deficit' does not represent an effective limit for fiscal policy as the operating balance of the state has been positive since 2012.

Our forecast suggests that the gross general government debt-to-GDP ratio according to the EDP methodology may decline by 0.8 percentage point in 2017. Using the end-2015 EUR/HUF exchange rate of 313, the debt-to-GDP ratio would amount to 74.5 per cent at end-2016 and 73.7 per cent and end-2017 (the gross government debt-to-GDP ratio was 75.3 per cent at end-2015). Excluding the increase in debt due to pre-financing EU funds from the budget in line with the debt rule in the Fundamental Law and the Stability Act, the debt-to-GDP ratio may decline to an even greater extent: by 1.5 percentage points according to the bill and by 1.7 percentage points according to the MNB's forecast. Accordingly, the debt rule of the Fundamental Law, which will be the focus of a later decision of the Fiscal Council, is expected to be complied with. At the same time, the actual level of the debt ratio depends strongly on the exchange rate of the forint.

The macroeconomic path underlying the bill is solid and is similar to the MNB's projection in the March Inflation Report, but there is a major difference with regard to inflation. The bill estimates 3.1 per cent GDP growth and 0.9 per cent inflation for 2017. The MNB's projection in the March Inflation Report is 3 per cent for economic growth and 2.4 per cent for inflation. The lower inflation projection in the budget bill may partially be attributable to the fact that the macro path of the bill also takes account of new tax measures (reduction of VAT on the Internet and on basic food products) which were not yet known when the MNB's March inflation projection was prepared.

Based on our forecast, EU fund disbursements may be some HUF 550 billion lower than the appropriation in 2017. According to our projection, disbursements related to EU programmes may amount to HUF 1,678 billion in 2017, whereas the bill projects disbursements amounting to HUF 2,239 billion. The underlying reason for the lower disbursement in our forecast is that, in our opinion, the drawdown of funds relating to the 2014–2020 cycle may be lower than what is indicated in the bill. This is justified by the fact that up until April 2016 a mere HUF 34 billion was paid from the new cycle. The savings on own contributions related to the lower use of EU

funds are estimated to amount to 0.2 per cent of GDP. The higher drawdown of EU funds indicated in the bill may justify, inter alia, that the macro path in the bill is based on a higher increase in investment and the wage bill compared to the forecast in the MNB's March Inflation Report and that in the case of certain tax revenues (VAT, personal income tax) it also contains higher revenues.

Of **the key measures** and items **of the budget bill** the following items should be highlighted: the targeted reduction of the value added tax rate (in the case of certain basic food products, restaurant services and Internet usage fees), the termination of credit institutions' contribution, the expansion of the family tax allowance of families with two children, further reduction of the bank levy, an increase in public investment (public road investment, Modern Cities Programme), the continuation and expansion of career path programmes (teachers, public health employees, law enforcement employees, civil servants and employees of the National Tax and Customs Administration). In addition, the budget bill mentions several measures (expanding the use of online cash registers, increasing the number of POS terminals, introducing the system of online invoicing, developing the Electronic Trade and Transport Control System) that serve to combat the hidden economy, but measures in relation to which the details are not yet known have not been taken into account in our projection.

The budget bill complies with the debt rule outlined in the Fundamental Law, the debt rule set forth in the Stability Act and the 3 per cent deficit requirement. It also complies with the rules belonging to the corrective arm of the Stability and Growth Pact of the European Union, i.e. the rule determining the rate of decline in debt, and the 3 per cent deficit.

The 2.1 per cent structural deficit indicated in the budget bill does not comply with the medium-term fiscal deficit target determined for 2017 in Hungary's Convergence Programme. Pursuant to the Stability Act, the balance of the public sector must be determined in a way that it can be in line with the achievement of the medium-term fiscal target. In the 2016–2020 Convergence Programme, as of 2017 the Government set a structural deficit of 1.5 per cent of GDP as the new target. According to the bill, a fiscal deficit of 2.4 per cent according to the EU methodology may correspond to a 2.1 per cent structural deficit in 2017, meaning that the medium-term fiscal deficit target set forth in the Convergence Programme will not be achieved. At the same time, the bill emphasises that in the coming years the Government intends to gradually and significantly reduce the structural deficit of the Hungarian budget to the expected level or below, reaching 1.7 per cent in 2018, 1.5 per cent in 2019 and 1.2 per cent in 2020.

2. General government balance

The bill sets the ESA deficit of the general government at 2.4 per cent of GDP in 2017, representing a 0.4 per cent increase compared to the deficit expected for 2016. According to our forecast, the cash balance of the central budget may correspond to the target, while the balance of local governments may be slightly more favourable. According to the MNB's estimate, the ESA bridge containing statistical corrections could be more unfavourable than that in the Budget Act, but this is mostly related to the accrual-based accounting of EU funds and net interest expenditures, and as such it may be regarded basically as a technical item.

Table 1
ESA balance of the government sector
*(as a percentage of GDP)*

	2016			2017		
	Statutory appropriation	MNB forecast	Difference	Statutory appropriation	MNB forecast	Difference
1. Balance of the central subsystem	−2.2	−1.8	0.4	−3.1	−3.1	0.0
2. Balance of local governments	−0.1	−0.1	0.0	−0.1	0.0	0.0
3. Cash-based (GFS) balance of the general government (1+2)	**−2.2**	**−1.8**	**0.4**	**−3.2**	**−3.2**	**0.0**
4. GFS–ESA difference	0.2	−0.3	−0.5	0.8	0.7	−0.1
5. ESA balance of the government sector (3+4)	**−2.0**	**−2.1**	**−0.1**	**−2.4**	**−2.5**	**−0.1**
6. ESA balance with (partial) cancellation of central free reserves	**−2.0**	**−2.0**	**0.0**	**−2.4**	**−2.4**	**0.0**

Our forecast suggests that the primary surplus of the government sector may decline by 0.6 percentage point in 2017, but the sector will continue to have a surplus. The decline in the primary surplus will be partly offset by a further decrease in net accrual-based interest expenditures of the general government over the entire forecast horizon, and compared to the end-2015 value these expenditures may decline by some 0.6 percentage point to 2.7 per cent of GDP by end-2017 (Chart 1). The considerable fall in interest expenditures is attributable to the low domestic yield environment, with both the cuts in the central bank base rate and the self-financing programme contributing significantly in this regard.

According to our forecast, the ESA deficit of the general government may equal the budget target, although it requires the partial cancellation of the Country Protection Fund. Our forecast suggests that the primary revenues may fall short of the targets indicated in the bill by 0.2 per cent of GDP. The difference is mainly explained by the lower revenue expected from the value added tax. The difference between the target and our projection is primarily attributable to the fact that, upon preparing the budget bill, the Government presumably took into account a stronger effect from combating the hidden economy and assumed the utilisation of more EU funding (of which there is a VAT payment obligation concerning funding used by the Government, but a VAT refund may be applied for regarding funding used by the private sector). In addition, our forecast for revenues from taxes on labour also falls short of the estimates in the bill, because the budget expects a slightly higher increase in the whole-economy wage bill (nearly 7 per cent as opposed to the MNB's estimate of 6 per cent).

According to our forecast, in the case of housing subsidies the expenditures may exceed the appropriation by 0.2 per cent of GDP, basically because the MNB estimates the amount of the family home creation allowance requested for new homes to be higher; at present, relevant estimates can only be very uncertain.

Chart 1
Decomposition of the ESA balance
as a percentage of GDP
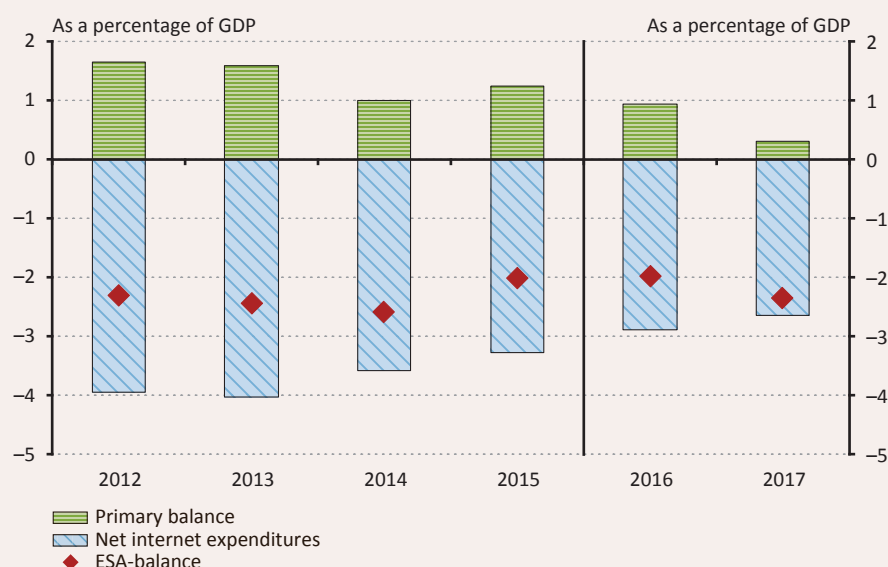
Note: The interest expenditures do not contain the imputed interest expenditures occurring as a result of the restructuring of the pension system.

However, the slightly lower-than-estimated revenues and the higher expenditures are offset by our forecast suggesting that budgetary institutions will be able to use EU funds to a lesser extent in 2017 than planned in the budget, and thus the savings on own contributions related to EU funding may reach 0.2 per cent of GDP. In addition, we assume partial cancellation of the Country Protection Fund, which improves the balance by 0.1 per cent of GDP in itself (Table 2).

Table 2
Difference between the MNB forecast and the budget bill
(on ESA basis, as a percentage of GDP)

	Deviation from appropriation
I. Central government revenues	**−0.2**
Payments by economic organisations	0.1
Consumption taxes	−0.2
Labour taxes	−0.1
II. Central government expenditures	**0.0**
Housing subsidies	−0.2
Net expenditures related to EU funding	0.2
III. Other effects	**0.2**
Partial blocking of the Country Protection Fund	0.1
Other items	0.1
Total (I.+II.+III.)	**0.0**

Note: The positive and negative signs indicate deficit-reducing and deficit-increasing effects, respectively, compared to the appropriations.

Our projection for the 2017 deficit has increased considerably compared to the forecast in the March Inflation Report. In addition to the tax cuts announced since March (targeted reductions of VAT), pursuant to the bill, public investment (priority public road investment, Modern Cities Programme) and the amount of public wage expenditures may exceed our earlier expectations.

3. Expected developments in government debt

Using an unchanged end-2015 exchange rate of EUR/HUF 313.1, **the gross general government debt-to-GDP ratio according to the EDP methodology** is forecast to decline from 75.3 per cent at end-2015 to around 74.5 per cent in 2016, and then to decrease further to 73.7 per cent by end-2017. The favourable downward trend in the debt ratio since 2011 will continue to be supported by disciplined fiscal management as well as the decline in interest expenditures resulting from the historically low interest environment, and by the dynamic growth in the real economy. In addition, the decline in the debt ratio in 2016 will also be attributable to the dividend of HUF 50 billion paid by the MNB to the state. In terms of developments in debt, the following major risks may arise: lower-than-expected EU fund inflows, strengthening of the US dollar against the euro or a possible weakening of the forint against the euro. Although the share of foreign currency in government debt has declined considerably in recent years, contributing significantly to the decrease in Hungary's external vulnerability, government debt remains sensitive to exchange rate movements. Each change of 1 forint in the HUF/EUR exchange rate changes the government debt-to-GDP ratio by nearly 0.1 percentage point. Using the EUR/HUF 312.0 exchange rate included in the Budget Act, compared to the figure given in the table below, a slightly better debt ratio of 73.6 per cent may evolve by end-2017.

Table 3
Government debt calculated using to the EDP methodology

	HUF billion	as a percentage of GDP
1. 2016 initial EDP government debt	26 517	74.5
2. 2017 GFS deficit*	1 152	3.1
3. Other effect	−13	0.0
4. 2017 expected EDP government debt (1+2+3)	27 656	73.7
5. Change in government debt-to-GDP ratio in 2017 (4-1)		−0.8

*Note: * MNB projection with partial blocking of free reserves.*

4. Evaluation of the macroeconomic assumptions underlying the bill

With regard to economic growth, the forecast in the submitted budget bill is similar to the MNB's March Inflation Report and is within the range of market analysts' expectations (Chart 2). The forecast of 2016 GDP growth is lower than the MNB's projection, with this primarily explained by the developments in whole-economy investment, stemming from the assumption of **a different scheduling of using EU funds**. The budget forecast indicates a decline in investment for this year, but projects strong expansion for 2017 as a result of the home creation package and in line with a pick-up in the drawdown of EU funds. In terms of household consumption expenditures, the bill anticipates slightly higher increase this year and a significantly higher increase for next year. The difference for 2017 is attributable to wage bill growth, which exceeds the level projected in the Inflation Report, and to the much lower inflation forecast. In terms of exports and imports, the fiscal projection assumes similar rate of expansion for this year and falling net exports for 2017. Next year's import growth is justified by the pick-up in gross fixed capital formation, which exceeds the MNB's projection, as well as by a considerable increase in consumption.

The inflation forecast in the budget bill for this year is practically identical to the projection in the MNB's March Inflation Report, but it is much lower for next year and is below the range of market analysts' expectations. The underlying reason for the difference may be that the fiscal macro path takes account of new tax measures as well. The developments in the GDP deflator indicated in the budget bill are somewhat different from the MNB's expectation, and this is presumably mainly due to the different assumptions regarding the terms of trade.

In line with the March Inflation Report, the fiscal forecast projects a further increase in employment and wage dynamics. Compared to the MNB's forecast, the bill projects higher headcount and wage dynamics in the private sector for both 2016 and 2017.

Chart 2
Comparison of GDP and inflation forecasts
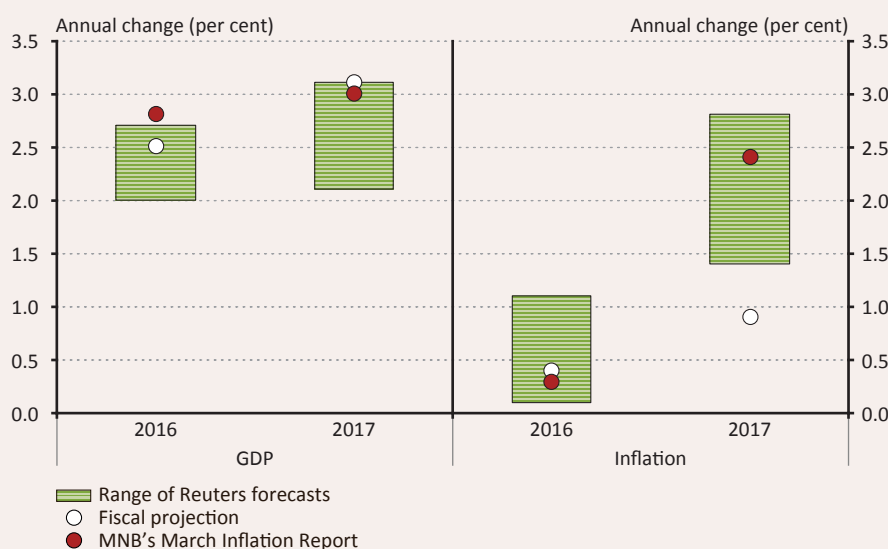
Source: 2017 budget bill, Inflation Report (March 2016), Reuters (March 2016)

Table 4
Comparison of macroeconomic forecasts
(percentage change compared to the previous year)

	2015	Budget		MNB		Difference	
		2016	2017	2016	2017	2016	2017
GDP	**2.9**	**2.5**	**3.1**	**2.8**	**3.0**	**0.3**	**−0.1**
Household consumption expenditure	3.1	3.9	3.7	3.5	2.8	−0.4	−0.9
Public consumption	0.6	0.5	1.5	0.8	0.7	0.3	−0.5
Gross fixed capital formation	1.9	−1.8	9.1	0.3	4.1	2.1	−5.0
Exports	8.4	6.7	6.3	6.3	6.7	−0.4	0.4
Imports	7.8	6.4	7.4	6.1	6.7	−0.3	−0.7
GDP deflator	**1.8**	**1.8**	**2.7**	**2.7**	**2.3**	**0.9**	**−0.4**
Inflation	**−0.1**	**0.4**	**0.9**	**0.3**	**2.4**	**−0.1**	**1.7**
Gross wage bill	**6.9**	**7.1**	**6.8**	**6.5**	**6.0**	**−0.6**	**−0.8**
Gross average earning	4.2	4.3	5.1	4.6	4.1	0.4	−1.0
of which: private sector	3.9	4.8	5.0	4.3	4.7	−0.5	−0.3
Number of employed	2.7	2.5	1.7	1.8	1.7	−0.7	0.0
of which: private sector	3.0	2.2	2.0	1.7	1.3	−0.5	−0.7

Source: 2017 budget bill, Inflation Report (March 2016)

5. Detailed evaluation of the budget bill

5.1. PRIMARY REVENUES

According to our forecast, the **primary revenues of the central sub-sector of the budget** may fall short of the appropriations in the bill by 0.2 per cent of GDP, i.e. by HUF 75 billion in total (Table 5). The difference is mainly attributable to the consumption taxes. Our forecast regarding the value added tax is HUF 90 billion below the estimate in the bill, which may be attributable to lower public investment resulting from lower utilisation of EU funds and the different assumptions concerning the effect of the new measures in terms of combating the hidden economy.

Our forecast regarding **payments by enterprises** exceeds the appropriation by HUF 22 billion. Within that, revenues from corporate income tax exceed the appropriation by HUF 8 billion, which may be justified by the different expectations regarding the recourse to tax allowances. Compared to 2015, the higher corporation income tax revenue is a result of the growth tax credit introduced last year, which means that if a company's pre-tax profit increases significantly from one year to another, the additional tax arising as a result of the growth can be paid to the budget over 2 years, in 8 equal instalments. According to government announcements, within the growth tax credit programme, additional cash revenues of HUF 271 billion are expected for this year and next year as well.

In addition, based on the bill, the government's estimate with regard to the willingness to change over to the small taxpayers' itemised lump sum tax (KATA) is higher than our assumption, as a result of which the bill expects the tax revenue under this tax type to be higher by HUF 7 billion (at the same time, the expected lower use of the KATA increases the revenues from other tax types, and thus on the whole it has a positive impact on the budget). According to the bill, in 2017, revenues from penalties may decline considerably within other revenues of the central sub-sector, which we do not consider well grounded for lack of any announced measures; therefore, our expectation exceeds the appropriation by HUF 14 billion.

The **special tax of financial institutions** is affected by several measures, as a result of which the revenues expected for 2017 will decline according to the appropriation and our forecast as well. In the case of credit institutions, the upper rate of the tax will be reduced from the current 0.24 per cent to 0.21 per cent. An additional change is that, in the case of credit institutions, the tax base will have to be defined on the basis of the adjusted balance sheet total calculated from the data of the annual accounts for the second tax year preceding the tax year rather than on the basis of the 2009 adjusted balance sheet total, i.e. in 2017 the tax base will be calculated on the basis of the year 2015. These two measures alone (primarily the rate cut and, to a lesser extent, the change in the tax base) reduce revenues from the levy on financial organisations by HUF 9 billion in 2017. A further change concerning the sector's tax burden is that the **contribution of credit institutions** will be terminated as of 2017, resulting in a nearly HUF 7 billion loss in revenues for the budget.

The government expects to collect revenues of HUF 1,030 billion from the **excise duty**, which is HUF 20 billion lower than the revenue estimated by the MNB. Our projection takes into account the expected increase in the excise tax on tobacco products, although the rise in the tax on fuels has not been taken into account. The underlying reason is that in the submitted draft of the tax law there are two scenarios concerning the oil price

level below which the tax increase will be effective (USD 40 or 50). As according to our forecast the price of oil will be between the two aforementioned values next year, the potential extra revenue resulting from this measure has not been taken into account. An explanation for the deviation from the estimate may be that the 2016 budget appropriation is HUF 952 billion, while according to our expectations the revenue from the excise tax may reach HUF 1,005 billion this year.

On the basis of the budget bill, the government expects revenues of HUF 3,531 billion from the **value added tax** (on a cash basis), which is HUF 90 billion more than our estimation. The primary reason for the difference may be that the government's estimate for the recourse to EU funding and for the additional revenues stemming from combating the hidden economy in 2017 is higher than that of the MNB. Besides, our projection for 2016 is also lower than the estimate in the bill, which may cause a difference between the forecasts through the base effect. There is no major difference in terms of the expected developments in the macroeconomic variables that have a decisive impact on the size of the value added tax (e.g. household consumption).

Our forecast for next year includes the expected impact of the tax cuts indicated in the bill (poultry, milk, egg, restaurant services, Internet subscription), which is estimated to reduce the revenues from this type of tax by HUF 63 billion. The budget bill also mentions several measures (expanding the use of online cash registers, increasing the number of POS terminals, introducing an online invoicing system, developing the Electronic Trade and Transport Control System) that serve to combat the hidden economy. Due to the lack of details of the provisions and the high degree of uncertainty related to the forecasting of these types of measures, only the further increase in the use of online cash registers was taken into account in preparing our projection: this measure is estimated to improve next year's balance by HUF 30 billion. Accordingly, we assume that the reason for the difference between the forecast and our projection is that the government took into account a stronger impact from combating the hidden economy in preparing the budget bill. In addition, our estimate for the expected recourse to EU funding in 2017 is lower than in the budget bill. Tax must be paid on the portion of the funding used by the state itself. Therefore, EU funding adds to VAT revenues as well (state-owned companies and private sector agents may apply for a refund of the VAT on the funds that were utilised). The explanation for next year's low dynamics calculated on a cash basis is that the system of VAT transfers will change in 2017. As a result, the ESA bridge will amount to HUF 115 billion in 2017, although none of this will change the accrual-based tax revenues.

Our forecast for **personal income tax** revenues is HUF 46 billion lower than the appropriation. Taking into account the increase in the wage bill of the public sector, we added HUF 15–20 billion to our forecast compared to the March Inflation Report, but still there is a major difference, which may be attributable to the higher 2016 base expected by the budget bill. One of the underlying reasons of the higher base is that the bill takes 7.1 per cent growth in the gross wage bill as a basis for 2016, while the relevant figure in the MNB's March Inflation Report is 6.5 per cent. We have already taken into account the measures that were previously known (increase in the family tax allowance of families with two children); therefore, they do not affect the change in our forecast.

We consider the appropriation for **tax and contribution revenues of the social security funds** to be justified; according to our forecast, among the revenues of the National Health Insurance Fund, the revenues related to the healthcare contribution and the social contribution tax are expected to be HUF 12 billion and HUF 5 billion higher, respectively. A change compared to previous years is that in 2017 the social security funds will not manage 100 per cent of the social contribution tax, as 7.89 per cent of these tax revenues will belong to the Labour Market Fund.

Starting from 2017, companies that have a negative tax base as a result of a tax base reduction implemented on the basis of their research and development activity carried out within their own scope of activities may use a social contribution tax benefit for a part of the remaining negative tax base. Recourse to this tax benefit is estimated to reduce the revenues from the social contribution tax by HUF 9 billion.

Table 5
Cash-flow revenues of central government – comparison of forecasts
(HUF billion)

	2016			2017		
	Statutory appropriation	MNB forecast	Difference	Statutory appropriation	MNB forecast	Difference
TAX REVENUES AND CONTRIBUTIONS OF CENTRAL GOVERNMENT	**12 987**	**13 005**	**18**	**13 703**	**13 628**	**−75**
Payments by businesses	**1 557**	**1 591**	**35**	**1 616**	**1 638**	**22**
Corporate income tax	690	704	14	735	743	8
Special tax of financial institutions	79	76	−4	67	67	0
Sector-specific tax	0	0	0	0	0	0
Simplified entrepreneurial tax	75	82	7	81	76	−5
Mining royalty	32	24	−8	30	29	−1
Gambling tax	41	34	−7	31	35	4
Energy suppliers' income tax	41	45	3	56	49	−6
Small taxpayers' itemised lump sum tax	70	64	−7	76	69	−7
Small business tax	14	12	−2	14	12	−1
E-road toll	141	148	8	155	153	−2
Utility tax	52	52	0	52	52	0
Other taxes and payments	462	500	37	477	508	31
Consumption taxes	**4 678**	**4 686**	**8**	**4 875**	**4 808**	**−67**
Value-added tax	3 389	3 369	−20	3 531	3 441	−90
Excise duties	981	1 005	24	1 030	1 050	21
Registration tax	21	21	0	23	21	−2
Telecom tax	56	57	1	54	58	4
Financial transaction levy	201	203	2	206	205	−1
Insurance tax	30	32	2	32	33	2
Payments by households	**1 875**	**1 833**	**−42**	**1 987**	**1 943**	**−44**
Personal income tax	1 688	1 648	−40	1 787	1 742	−46
Duties, other taxes	141	140	−1	156	156	0
Motor-vehicle tax	46	45	−1	44	46	2
Tax revenues and contributions of Extrabudgetary Funds	**359**	**359**	**0**	**535**	**531**	**−3**
Tax revenues and contributions of Social Security Funds	**4 519**	**4 536**	**17**	**4 690**	**4 707**	**17**
Social security contributions	4 230	4 243	13	4 388	4 395	7
Other contributions and taxes	289	293	4	301	312	11
OTHER REVENUES	**379**	**553**	**174**	**290**	**296**	**6**
Other revenues of central government	263	440	177	169	169	0
Other revenues of Social Security Funds	36	36	−1	39	39	0
Other revenues of Extrabudgetary Funds	79	77	−2	83	89	6
INTEREST REVENUES	**74**	**151**	**77**	**43**	**120**	**77**
TOTAL REVENUES OF CENTRAL GOVERNMENT	**13 439**	**13 709**	**270**	**14 036**	**14 045**	**9**

Note: The appropriations for 2016 also contain the amendments of Bill T/10534 on the amendment of Act C of 2015 on the 2016 Central Budget of Hungary.

5.2. PRIMARY EXPENDITURES

Under **subsidies to economic units**, the bill contains an appropriation of HUF 311 billion, which practically corresponds to the base year appropriation. Taking into account the recent railway developments, the modernisation of railway rolling stock and the improvement in the profitability of MÁV Start year by year, we do not expect any exceeding of the appropriation on this row.

The appropriation for **consumer price subsidy** is HUF 104 billion, which is an unchanged amount since 2014; this appropriation was not exceeded in the past two years. In the first four months of 2016, expenditures were similar to last year, and there is no information on any new measures, so no overrun of these expenditures is expected for this year or next year.

Under **housing grants**, the bill expects expenditures to amount to HUF 211 billion, while our forecast in the March Inflation Report was HUF 287 billion. The difference is attributable to the different assumptions regarding the expected developments in applications for the family home creation allowance for new homes. According to our assumptions, the HUF 10 million grant for 3 children will be used for about three quarters of the 13,000 new homes to be built this year, while compared to them the number of those who utilise it for 2 children or 1 child will be significantly lower due to the progressive increase in grants. The ratios are expected to be similar in 2017. Accordingly, the family home creation allowance used for new homes means fiscal subsidies amounting to HUF 110–115 billion in 2016 (0.3 per cent of GDP), which will grow to HUF 150–160 billion next year (0.4 per cent of GDP). Assuming that – in addition to the HUF 10 million grant – half of the beneficiaries also borrow loans with an interest rate subsidy, the subsidy means a burden of HUF 3 billion this year and HUF 5 billion next year for the budget. The budget appropriation indicates that the government expects fewer applicants. For the time being, there are no data that could help to reduce the uncertainty of the forecast.

Net expenditures on a cash basis of **budgetary institutions and central budgetary chapters** – excluding EU settlements – are more than HUF 800 billion higher in the 2017 bill compared to our assumption in the March Inflation Report. The growth rate of net own expenditures is close to 19 per cent compared to the 2016 statutory appropriations. As opposed to expectations, the investment programmes that offset the temporary decline in EU funding will not reverse, but investment expenditures from own funds will continue to increase (a good example of this is the priority public road development programme, which will grow by more than 70 per

Chart 3
Composition of government investment expenditures
(as a percentage of GDP)
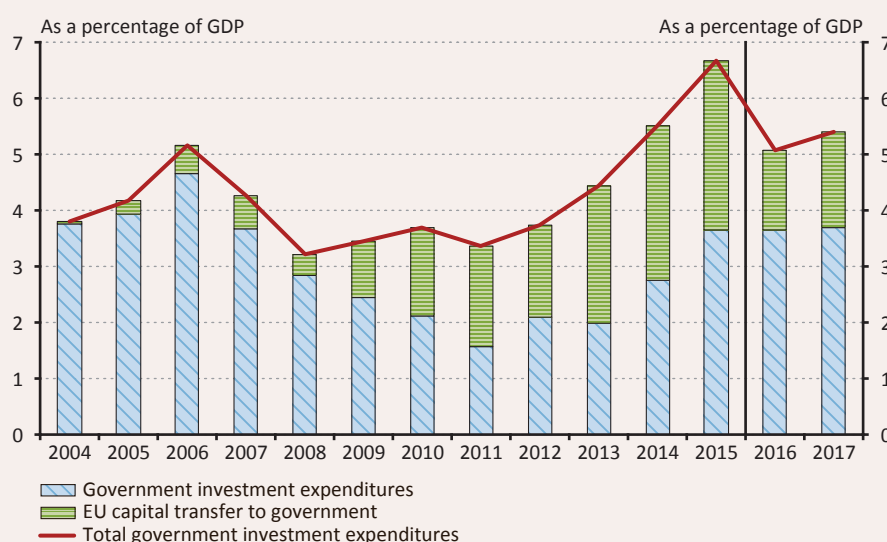
Source: HCSO, MNB

cent next year compared to the 2016 expenditure estimate). The 2017 budget bill expands various investment programmes, and contains several new investment and renewal appropriations as well. The developments in investment expenditures are shown in Chart 3; we prepared our own estimate for the investment activity of the local government sub-sector on the basis of the trends observed in recent years.

The high growth index of budgetary institutions' so-called *chapter expenditure* appropriations is primarily related to the increase in investment and accumulation expenditures, but the rise in other operating expenditures and transfer expenditures will also be above real value. At the same time, based on past experiences, the strong investment activity entails implementation risks. Therefore, our baseline scenario uses the assumption that HUF 30 billion of the planned investment expenditures will be carried over to the following year. Budgetary *institutions'* expenditures (typically wages, purchases of products and services, institutional investment and renovation) are HUF 267 billion higher compared to the projection in the March Inflation Report, as our updated projection is based on the appropriations of the budget bill. It is assumed in our projection that the National Tax and Customs Administration will meet the conditions of bonus payments next year as well, and thus in the case of institutional expenditures we expect wage outflows of HUF 20 billion in addition to the budgetary appropriations. The appropriations of public education expenditures (vocational training centres, Klebelsberg Institution) take into account the appropriation modifications planned for 2016 and the consolidation of the institutional system in 2016. Accordingly we consider the public education appropriations of the bill justified.
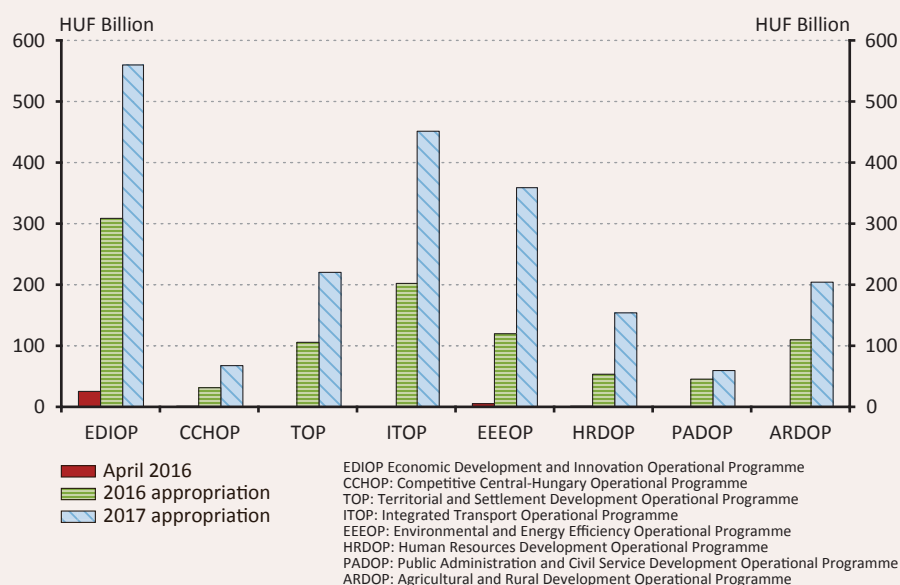
According to the 2017 budget bill, within the consolidated expenditures of the general government HUF 1,900 billion was appropriated for education, which exceeds that of the 2016 budget by HUF 270 billion. Educational expenditures reach 5.1 per cent of GDP, which is 0.5 percentage points higher than the previous year's appropriation. In 2017, 0.7 per cent of GDP will be spent on preparation for school and on elementary education and 0.6 per cent of GDP on secondary education, which roughly corresponds to the 2016 levels. By contrast, higher education expenditures will increase from 1.4 per cent to 1.6 per cent, while other educational expenditures (including the financing of the KLIK – Klebelsberg Institution Maintenance Centre) will rise from 1.9 per cent to 2.2 per cent of GDP in 2017. However, the 2016 appropriation does not yet include the amounts of HUF 92 billion and HUF 18 billion (representing additional expenditures of 6.8 per cent on education and the supporting of vocational training and adult education) by which the 2016 Budget Act is expected to be amended, and a major portion of which will be spent on the operating costs and debt repayment of the KLIK.

Regarding the institutional appropriations, it should be emphasised that the listing of institutions and the planning of institutional appropriations is still based on the old institutional structure. The planned decline in wage costs appears only in an aggregate manner as subsidy to be repaid to the central budget by all the institutions, and it may reach around HUF 30 billion according to our calculations. Moreover, it is questionable whether the material expenditures, investment and renewal appropriations planned for the institutions that will cease to exist will actually be justified after the termination and incorporation of such institutions. Presumably, the bill contains expenditure reserves in the case of several expenditure appropriations, but the possible size of the reserves cannot be established on the basis of the bill.

The 2017 budget bill indicates HUF 2,239 billion in connection with the **expenditures related to EU funds**, complemented with domestic co-financing. According to the bill, HUF 2,111 billion will be disbursed within the framework of the 2014–2020 EU budget cycle; the rest is related to other EU funding. All of this represents a major increase compared to the 2016 appropriation of HUF 1,432 billion, and is only slightly below the – historically very high – average of the last three years. The bill includes cash-based revenues of HUF 1,545 billion related to the disbursement of HUF 2,239 billion. The difference partly reflects the amount of domestic co-financing as well as the 10 per cent of the funding that is reimbursed by the European Commission only after the verification of the programmes; therefore it has to be advanced from the budget. The latter can be accounted for as accrual-based revenue, and thus it does not affect the ESA balance, but adds to the financing requirement and the public debt.

According to our forecast, disbursements of EU funds may be HUF 550 billion lower than the appropriation, while the related savings on co-financing are estimated to equal 0.2 per cent of GDP. According to our projection,

Chart 4
Disbursement of funds in 2016–2017 related to the 2014–2020 Operational Programmes

HUF Billion (left axis) HUF Billion (right axis)

Legend:
- April 2016
- 2016 appropriation
- 2017 appropriation

EDIOP Economic Development and Innovation Operational Programme
CCHOP: Competitive Central-Hungary Operational Programme
TOP: Territorial and Settlement Development Operational Programme
ITOP: Integrated Transport Operational Programme
EEEOP: Environmental and Energy Efficiency Operational Programme
HRDOP: Human Resources Development Operational Programme
PADOP: Public Administration and Civil Service Development Operational Programme
ARDOP: Agricultural and Rural Development Operational Programme

*Source: 2016 and 2017 Budget Acts, palyazat.gov.hu*

disbursements related to EU programmes may amount to HUF 1,678 billion in 2017, with cash-based revenues of HUF 1,114 billion belonging to this item. The underlying reason for the lower disbursement shown in our forecast is that, in our opinion, the upturn in the drawdown of funds related to the 2014–2020 cycle may be lower than what is indicated in the bill. This is justified by the fact that until end-April 2016 a mere HUF 34 billion was paid from the new cycle (Chart 4).

In the case of **labour market active and passive expenditures**, there is no difference between our forecast and the appropriation. We expect HUF 325 billion to be spent on the Start Labour Programme from the budget, which corresponds to the appropriation. Passive expenditures are expected to amount to HUF 51 billion.

Within expenditures related to health insurance benefits in kind, the **net balance of the drug budget** and the **reimbursement of therapeutic equipment** may exceed the appropriation included in the budget bill by HUF 12 billion in total. For 2017, our forecast calculated for the net expenditures of the drug budget exceed the estimate by HUF 7 billion. Drug reimbursement expenditures may slightly decline in 2017 compared to 2016, as the 2017 statutory appropriation does not contain the special procurement drug reimbursement that amounts to some HUF 16 billion.

In the case of **medical and preventive care**, we adopt the appropriation included in the budget bill. The appropriation for 2017 exceeds the expenditure level expected for 2016 by HUF 57 billion, which represents an increase of around 6 per cent. The planned magnitude of the increase in expenditures exceeds the values observed in previous years and is also higher than the expected growth rate of nominal GDP. At the same time, a part of the increase in funds (approx. HUF 20 billion) may provide cover for the additional tasks appearing in this budget. Firstly, HUF 4.5 billion was appropriated for the development of primary care and general health. Secondly, the special procurement drug reimbursement, which was among the drug reimbursements in the previous years and amounted to some HUF 16 billion, may presumably be transferred into the medical and preventive budget in 2017. The remaining increment may ensure the maintenance of the real value of material expenditures.

Except for the National Health Insurance Fund, the expenditures related to the sectoral wage raises planned in the healthcare sector are shown among the provisions within the chapter of the Prime Minister's Office. However, the appropriation does not contain any subdivision concerning the size of the wage raise which

Chart 5
Outstanding debt of budgetary institutions and healthcare institutions between January 2010 and March 2016
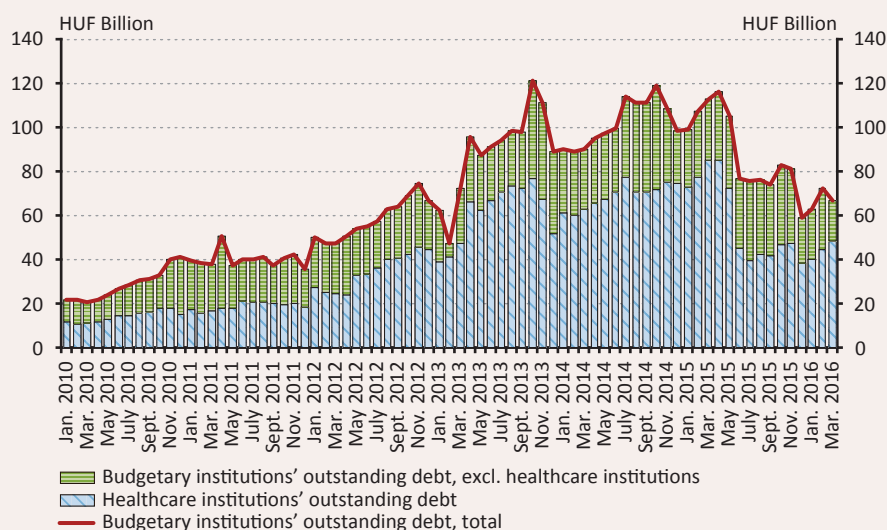
Note: The time series of healthcare institutions includes institutions for both outpatient and hospital services, the background institutions of the healthcare sector, as well as universities with clinical centres.
Source: Hungarian State Treasury

Chart 6
Expenditures of pensions and pension-type benefits between 2001 and 2017
(as a percentage of GDP)
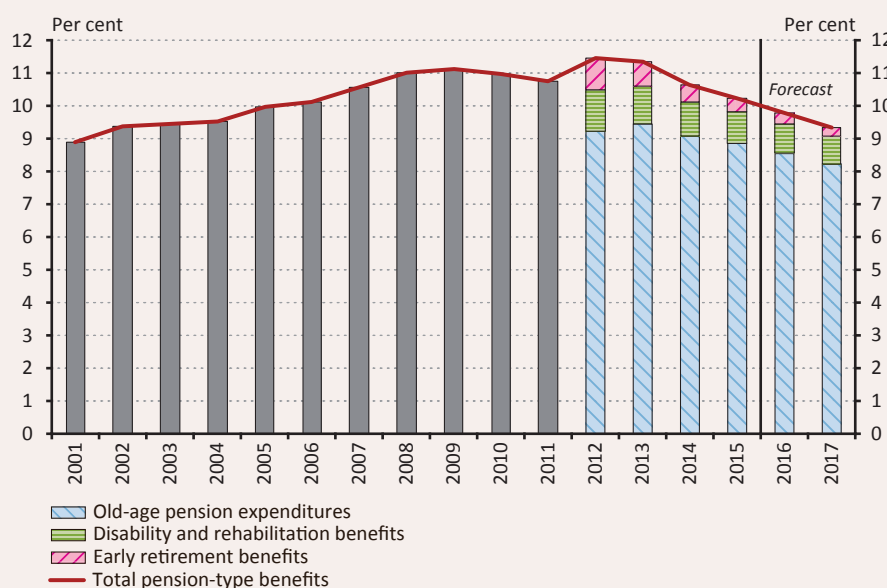
Note: Data between 2001 and 2011 indicate spending on pension-type benefits based on the final budgetary accounts; they do not correspond to the categories of the accounting regime introduced in January 2012. From 2012, the category of 'old-age benefits' includes above retirement age benefits, above retirement age disability benefits, the service dependent pension available for women with 40 years of service, and provisions to dependents. Values for 2015 indicate preliminary cash data, while the 2016 and 2017 time series show our forecast.
Source: HCSO, Hungarian State Treasury, MNB, final accounts

the item 'Sectoral career paths and wage measures' would result in in the various sectors. The career model of civil servants, the wage raise for the employees of the National Tax and Customs Administration as well as other wage measures together do not amount to additional funds of HUF 180 billion, and thus the provision appropriation presumably provides cover for the wage raise in the healthcare sector and for further unannounced wage measures.

In terms of the operation and financing of health institutions, the gradually recurring debts to suppliers represent a negative risk. Based on the data of the Hungarian State Treasury, these debts amounted to a total HUF 48 billion at end-March 2016 (Chart 5). Outstanding debts increased by a monthly average of HUF 4 billion in the past months. The risks appearing on this row may amount to 0.1 per cent of GDP in 2017.

Our forecast for **pensions and pension-type benefits** is below the statutory appropriation by some HUF 22 billion in total. The difference is attributable to two contrasting factors: firstly, we assumed a higher consumer price increase for 2017 than the 0.9 per cent inflation indicated in the budget bill and this suggests a higher

Table 6
Cash-flow expenditures of central government – comparison of forecasts
(HUF billion)

	2016			2017		
	Statutory appropriation	MNB forecast	Difference	Statutory appropriation	MNB forecast	Difference
PRIMARY EXPENDITURES	**13 153**	**13 293**	**140**	**14 247**	**14 162**	**−85**
Subsidies to economic units, support to the media	**380**	**380**	**0**	**381**	**381**	**0**
Consumer price subsidy	**104**	**104**	**0**	**104**	**101**	**−3**
Housing grants	**154**	**223**	**69**	**211**	**281**	**70**
Family benefits, social subsidies	**571**	**573**	**2**	**562**	**565**	**3**
Early retirement benefits	**113**	**112**	**−1**	**96**	**90**	**−6**
Net expenditures of central government agencies and chapters	**4 504**	**4 539**	**35**	**5 387**	**5 248**	**−140**
Net own expenditures	3 961	4 019	58	4 693	4 683	−10
Net expenditures related to EU funds	542	519	−23	694	564	−130
Support to local governments	**674**	**674**	**0**	**668**	**668**	**0**
Contribution to EU budget	**315**	**315**	**0**	**317**	**317**	**0**
Expenditures related to MNB	**0**	**0**	**0**	**0**	**0**	**0**
Central reserves	**361**	**361**	**0**	**375**	**375**	**0**
Debt assumption	**0**	**0**	**0**	**0**	**0**	**0**
Other expenditures	**430**	**460**	**30**	**439**	**439**	**0**
Expenditures of Extrabudgetary Funds	**581**	**556**	**−25**	**594**	**594**	**0**
NEF – Passive allowances	52	53	1	51	51	0
NEF – Active allowances	340	315	−25	325	325	0
Other expenditures	189	188	−1	218	218	0
Expenditures of social security funds	**4 965**	**4 995**	**30**	**5 112**	**5 102**	**−10**
PIF – Pensions	3 042	3 039	−3	3 102	3 085	−17
HIF – Disability and rehabilitation benefits	323	323	0	321	322	1
HIF – Cash benefits	249	258	9	276	270	−6
HIF – Medical and preventive care	982	982	0	1 040	1 040	0
HIF – Net expenditures related to drug subsidies	247	264	17	247	254	7
Other expenditures	122	128	7	127	132	5
INTEREST PAYMENTS	1 048	1 081	33	955	1 043	88
TOTAL EXPENDITURES OF CENTRAL GOVERNMENT	14 201	14 374	173	15 202	15 205	3

Note: The appropriations for 2016 also contain the amendments of Bill T/10534 on the amendment of Act C of 2015 on the 2016 Central Budget of Hungary.

expenditure level; secondly, our estimate for the number of beneficiaries may be lower than the number assumed in the bill. The largest difference in the pensions is due to women after a 40-year eligibility period: compared to the expenditure of HUF 233 billion included in the budget bill, our estimate is HUF 21 billion lower, which may be attributable to the difference in the headcount forecasts. Our projection is based on a gradual increase in the number of women choosing early retirement: compared to 2016, it assumes expenditure higher by HUF 10 billion and a 5.3 per cent higher number of beneficiaries. Compared to the inflation indicated in the bill, the appropriation for pension expenditures seems to be somewhat high. After all, compared to the expenditures expected for 2016, our 2017 forecast includes only a slight increase in expenditures. Accordingly, pension expenditures as a proportion of GDP may decline next year as well, similarly to this year. In addition to the fact that the pension indexation is lower than the nominal GDP rate, the decrease in proportion to GDP is attributable to the measures affecting the number of beneficiaries (Chart 6).

5.3. INTEREST BALANCE

Our projection for **net cash interest expenditures** roughly corresponds to the estimate (our forecast is HUF 10 billion higher) – adjusted for other costs that can be considered as non-interest expenditure – in the budget bill.

In the case of net cash-based interest expenditures, the similarity between our projection and the appropriation is attributable to the fact that our forecast for gross interest expenditures and interest revenues is also higher – to a similar degree – than the appropriation. The underlying reason for the difference may be that without knowing the exact financing plan for 2017, we prepare an estimate for swap auctions on the basis of the previous years, which increases the interest expenditures and interest revenues on a cash basis nearly to the same extent, and therefore it does not affect the net interest expenditures.

In our forecast, the **accrual-based net interest expenditure** is HUF 14 billion lower than the values stated in the bill. It means that according to our projection the repricing of government debt may continue at a rate similar to that in the bill in the environment of low domestic government securities market yields.

According to our projection, the accrual-based net interest expenditure of the general government will continue to decline over the entire forecast horizon, and thus compared to the end-2015 value this expenditure will decline by some 0.6 percentage point to 2.7 per cent of GDP by end-2017. Our forecast suggests that the low yields may remain in place over the longer term as well, and interest expenditures may further decline as a result of the gradual repricing of the government debt. On the other hand, an indication of a further decline in interest expenditures is that in the case of retail securities the debt manager, complying with the continuous yield declines and the favourable liquidity situation, was able to reduce the demand stimulating interest rates which were slightly higher than the market rate.

6. Legal compliance of the bill

6.1. THE DEBT RULE OF THE FUNDAMENTAL LAW

The (non-Maastricht) gross public debt-to-GDP ratio defined in line with the Stability Act will decline both according the bill and our forecast, and thus the bill complies with the provisions of the debt rule laid down in the Fundamental Law. According to the MNB's projection, an accrual-based general government deficit corresponding to 2.4 per cent of GDP is expected for 2017, which may result in a 1.7 percentage point decline in the debt ratio assuming an unchanged exchange rate. The size of the decline in debt expected by the MNB slightly exceeds the decline indicated in the bill, as the latter is presumably based on net government securities issuance that exceeds the financing requirement.

The most important element of the change in debt in 2017 is the expected net financing requirement of the government sector. In line with the provisions of the Stability Act, no change in the exchange rate is taken into account in our projection. We have not taken into account any change in the government's liquid deposit portfolio (single treasury account) and a possible classification of Eximbank and the MFB into the government sector either, and the expected borrowing for investment related to the expansion of the Paks nuclear power plant is also not included in our forecast.

There is a slight difference between the debt indicators defined according to the Stability Act and the EDP methodology, which is attributable to statistical methodological reasons. The difference between the 2017 dynamics of the two indicators is mainly caused by the fact that the debt increment due to the lack of EU funding must be disregarded when calculating the debt indicator defined in line with the Stability Act.

Table 7
Developments in public debt according to the Stability Act

	Bill	MNB	Bill	MNB
	HUF billion		as a percentage of GDP	
1. Gross public debt according to the Stability Act at the end of 2016*	25 855	25 855	73.5	72.6
2. 2017 ESA deficit**	895	895	2.4	2.4
3. ESA bridge	292	257	0.8	0.7
4. Correction of the debt increment resulting from the delay in EU funding	−440	−404	−1.2	−1.1
5. Other effect	219	−13	0.6	0.0
6. Expected gross public debt according to the Stability Act in 2017 (1+2+3+4+5)	26 821	26 590	71.9	70.9
7. The change of the public debt-to-GDP ratio in 2017 (6-1)			−1.5	−1.7

Note:

* The MNB and the Ministry of National Economy use different annual nominal GDP figures in their respective calculations.

** MNB projection with partial blocking of free reserves.

6.2. REQUIREMENT PERTAINING TO THE STRUCTURAL BALANCE OF THE GENERAL GOVERNMENT

In our opinion, the balance target in the 2017 budget bill is not in line with the achievement of the medium-term fiscal target. Article 3/A (2) a) of Act CXCIV of 2011 on the Economic Stability of Hungary provides that the balance of the government sector must be determined in a way that should be in line with the achievement of the medium-term fiscal target. This target level (medium-term objective, MTO) is given by the structural deficit that was set out in the Convergence Programme and reduced as of 2017 (from the previous 1.7 per cent) to 1.5 per cent, net of the cyclical impacts of the economy and net of one-off items.

According to the bill, the fiscal deficit of 2.4 per cent according to the EU methodology may correspond to a 2.1 per cent structural deficit in 2017, which exceeds the medium-term fiscal target of 1.5 per cent set forth in the Convergence Programme. At the same time, the bill emphasises that in the coming years the government intends to gradually and significantly reduce the structural deficit of the Hungarian budget to the expected level or below, reaching 1.7 per cent in 2018, 1.5 per cent in 2019 and 1.2 per cent by 2020.

6.3. THE 3 PER CENT DEFICIT RULE OF THE STABILITY ACT

The 2.4 per cent general government deficit-to-GDP ratio expected for 2017 meets the 3 per cent deficit criterion. Article 3/A (2) b) of Act CXCIV of 2011 on the Economic Stability of Hungary provides that the general government deficit-to-GDP ratio must not exceed 3 per cent. According to our forecast, assuming the blocking of the Country Protection Fund, the general government deficit may be around 2.4 per cent of GDP in 2017. Accordingly, the 2017 budget bill satisfies this legal requirement.

6.4. THE DEBT FORMULA SPECIFIED IN THE STABILITY ACT

The bill complies with the valid debt formula specified in the Stability Act. The numerical rule that precisely determines the degree of government debt reduction is set forth in Article 4 (2) and (2a) of the Act on the Economic Stability of Hungary, and the application of this debt rule first entered into force during the planning of the 2016 budget. The currently effective debt rule set forth in the Stability Act stipulates that if the rates of inflation and real economic growth forecast for the fiscal year exceed 3 per cent, the balance of the budget should be planned in a way that the annual growth rate of the nominal government debt must not exceed the rate of the difference between the planned inflation and half of the real growth. If, however, at least one of the rates of the forecast inflation or economic growth is below 3 per cent, the rule only requires a minimum decline of 0.1 percentage point in the gross government debt-to-GDP ratio.

As the 2017 budget bill assumes a 0.9 per cent inflation and 3.1 per cent real GDP growth, pursuant to the rule the government debt ratio must decline by a minimum of 0.1 percentage point. The reduction of the general government debt-to-GDP ratio in 2017 will be achieved according to both the bill and the MNB projection.

6.5. RULES OF THE CORRECTIVE ARM OF THE STABILITY AND GROWTH PACT

The rules belonging to the corrective arm of the European Union's Stability and Growth Pact contain two relevant fiscal requirements for Hungary with regard to 2017:

• The ESA deficit should not exceed 3 per cent of GDP. In accordance with the above, the budget **complies** with this.

• The debt ratio should decrease at an appropriate rate (annually, on average, adjusted by one twentieth of the part that exceeds 60 per cent). Based on the MNB's forecast, the developments in debt will **comply** with this in 2017.

Box 1

Debt rule of the European Union

The debt rule of the European Union applies to Hungary in its current form from 2016 for the first time. This is explained by the fact that in the first three years after the termination of the excessive deficit procedure (EDP), i.e. from 2013 until 2015, Hungary had to comply with the temporary rule applicable to the structural balance instead of the public debt rule. Therefore, the debt rule of the European Union is presented briefly below.

The debt rule of the European Union is defined by the Treaty on the Functioning of the European Union and Council Regulation (EC) No 1467/97 of 7 July 1997. Accordingly, the ratio of the government debt to the gross domestic product (GDP) must not exceed 60 per cent. If the government debt exceeds this reference value, the debt rule of the European Union prescribes that that difference from the reference value must decrease on average by one twentieth of the previous three years' benchmark per annum, based on the changes in those previous three years in respect of which data are available. The debt criterion requirement is also satisfied if, according to the Commission's budget forecasts, the difference will decrease at the prescribed rate in the three-year period that covers the two years following the last such year in respect of which data are available. Upon applying the reference value of the adjustment of the debt ratio, the impact of the cycle on the rate of the debt reduction must be taken into consideration. According to our forecast, the 2017 budget complies with the debt rule of the European Union.

6.6. RULES OF THE PREVENTIVE ARM OF THE STABILITY AND GROWTH PACT

• The bill **is not in line with** the medium-term objective (MTO) concerning the structural deficit, which is 1.5 per cent of GDP as of 2017. The structural deficit calculated in line with the methodology of the European Commission is expected to exceed 1.5 per cent; therefore, the bill does not comply with this rule.

• The bill **is not in line with** the EU rule regarding the increase in expenditures.

Breaching the rules belonging to the preventive arm may not result in an EDP, but the European Commission prepares recommendations for the correction of the deviation.

Box 2

The medium-term objective (MTO)

Pursuant to Council Regulation (EC) No 1466/97 of 7 July 1997, both the stability and convergence programmes must contain a medium-term objective regarding the structural balance of the budget. Its value depends on the potential growth rate and the government debt of the country, the interest rate level and the ageing rate. States struggling with sustainability problems must set stricter objectives. If a euro area member country fails to fulfil the medium-term objective and, in spite of several warnings, no effective intervention takes place in order to achieve it, the Commission may oblige the given country to place a non-interest-bearing deposit (0.2 per cent of GDP). In the case of non-euro area member countries, the Commission only makes a proposal for carrying out the fiscal adjustment. Until 2016, Hungary undertook a 1.7 per cent structural deficit, but revising it in the 2016–2020 Convergence Programme, it set a structural balance target of 1.5 per cent of GDP.

The structural balance is consistent with different statistical deficits depending on the situation the economy is in. The structural balance is calculated by correcting the official statistical balance indicator – after the exclusion of temporary

items – with the impact of the economic cycle (cyclical component). The result is how much the balance would be if the performance of the economy was exactly equal to its potential level. For example, if the output gap is negative, i.e. the level of actual output is below potential, the structural balance is more favourable than the general balance indicator, as the starting point is the assumption that if the performance of the economy reaches the potential level, tax revenues increase automatically. Accordingly, the size of the cyclical component depends on the output gap and the relevant sensibility of the budget.

7. Special topics

7.1. AMENDMENT OF THE 2016 BUDGET ACT

In early May, the Minister for National Economy introduced a bill regarding the amendment of the 2016 Budget Act. Prior to that, the draft bill had been analysed and commented on by the Fiscal Council, and in its opinion the amendments do not have a material impact on the expected decline in the government debt ratio, and increasing the fiscal reserves reduces the risk of the feasibility of the budget. The planned amendments are in conformity with the mid-year fiscal developments and with the earlier decisions of the Government. According to our forecast updated with the proposed amendments, the 2 per cent deficit target of the Government is still achievable by the partial or complete blocking of the Country Protection Fund.

The planned amendment to the Budget Act does not affect the cash-based deficit target as both total revenues and total expenditures change by the same amount (HUF 407.3 billion). The changes in the revenue side appropriations are almost entirely attributable to the increase in tax and tax type revenues; in addition to a significant rise in the corporation tax payment obligation, as a result of the amendment the appropriations also grow in the case of the taxes related to consumption and earned incomes. However, the bill does not contain an amendment of the estimated revenues that can be realised from land sales, which may pose a positive risk on the revenue side.

The changes in the expenditure side appropriations concern both the increase in personnel expenditures, the rise in expenditures that can be spent on the purchase of products and services, further growth in investment expenditures from own funds and – to a lesser extent – the increase of transfers from the state. Of the expenditure side measures, the following ones need to be highlighted: the increase in educational expenditures (Klebelsberg Institution Maintenance Centre, vocational training centres, higher education) by HUF 114 billion, the expansion of the public road development programme by nearly HUF 70 billion, increasing the amount allotted to the Modern Cities Programme by HUF 50 billion, raising the appropriation of the housing subsidy expenditures (family home creation programme) by HUF 50 billion and adding HUF 30 billion to the fiscal reserves.

The amendment of the appropriations of the educational expenditures terminates the previous underfinancing of the public education institutional system, and the restructuring of the institutional framework and the provision of additional funds may also improve the future competitiveness of the country. It should be noted that the appropriations amended in the bill are in line with the corresponding appropriations of the year 2017 budget bill introduced before. A precondition of the feasibility of the 2017 appropriations is the settlement of the accumulated debts, for which the appropriations of the bill provide adequate funds.

Compared to the appropriations of the original Budget Act, **the investment expenditures of the government sector** are raised by nearly HUF 140 billion in total by increasing the public road development expenditures, expanding the Modern Cities Programme and increasing the expenditures related to state property. Firstly, the additional expenditures further offset the macroeconomic effects of the temporary downturn in EU funding, and secondly, they aim to improve the competitiveness of the country.

Increasing the appropriation of housing subsidy expenditures stems from the government's home creation programme. Based on the proposed amendment, the new appropriation is some HUF 69 billion lower than what was assumed when preparing the March Inflation Report. More details of this difference are given in Subchapter 5.2. If the realisation of the housing subsidy appropriation is in line with the government's

expectations, it also means that the deficit we expect will also be lower by the size of the difference, provided that other conditions remain unchanged.
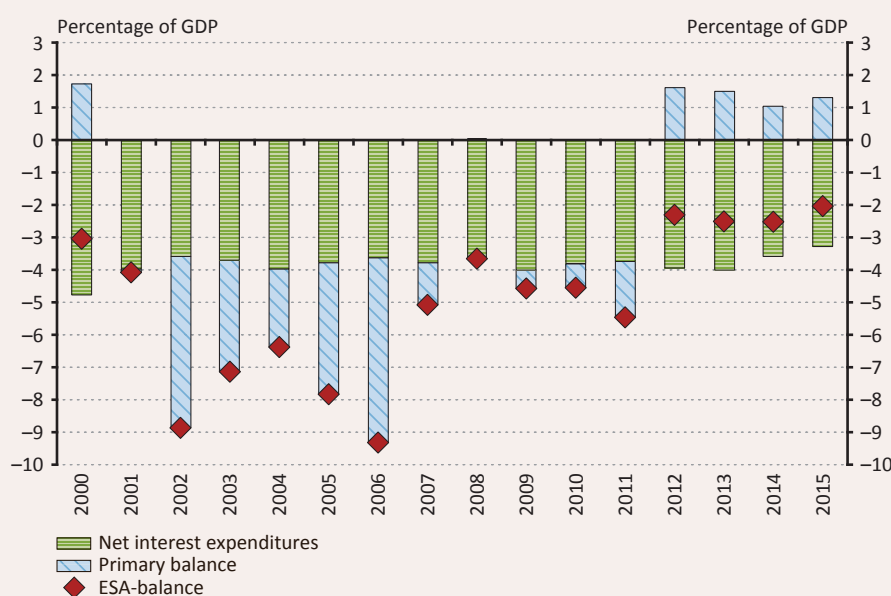
The total increase of reserves by HUF 30 billion reduces the risks related to the fulfilment of the fiscal deficit target. According to our projection updated by taking account of the static effects of the amendment to the 2016 Budget Act, the 2 per cent deficit target calculated in line with the EU methodology can be achieved by the partial or complete blocking of the Country Protection Fund.

Before knowing the amendment to the Act, we estimated the expected deficit to be 1.7 per cent by already taking into account a significant portion of the additional expenditures included in the amendment, as they had been announced by the government before (e.g. the cost of the family home creation allowance as well as the funding requirement of the KLIK and the public road development). Accordingly, as a result of the amendments, the expenditures are increasing by HUF 187 billion (0.5 per cent of GDP) compared to our forecast. However, the deficit is growing to a lesser extent because it is partly offset by the additional tax revenue (0.1 per cent of GDP) due to the additional expenditures and the assumption of the partial cancellation of the Country Protection Fund (0.1 per cent of GDP). As a result of the amendments, our projection for the 2016 deficit increases from 1.7 per cent to 2.0 per cent.

7.2. CHANGES IN THE BALANCE OF THE GOVERNMENT SECTOR IN INTERNATIONAL COMPARISON[1]

After 2011, the ESA deficit of the government sector declined considerably, as a result of which in the past four years the deficit was below the three per cent threshold required in the Maastricht convergence criteria, even sinking to 2 per cent of GDP in 2015. Both the primary balance surplus that evolved from 2012 and the remarkable fall in net interest expenditures contributed to the decline in the deficit. Before 2012, the last time that the primary balance had a surplus occurred more than a decade earlier, in 2000 (Chart 7).

Chart 7
**Decomposition of the government sector's ESA balance in Hungary**
2000–2015

Note: Excl. imputed interest expenditures.
Sources: Eurostat, MNB

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[1] Based on https://www.mnb.hu/letoltes/lovas-zsolt-berta-david-a-kormanyzati-szektor-egyenlegenek-alakulasa.pdf.

The decline in net interest expenditures is attributable to several factors: the favourable international environment, the decrease in the country risk premium since 2011, then, after 2012, the MNB's base rate cut cycle and self-financing programme, moderate inflation and the decrease in the debt-to-GDP ratio. Following the 2007–2008 financial crisis, as a result of central banks' liquidity increasing measures, the developments in the international interest rate and yield environment were extremely favourable, and policy rates sank to historical lows in the developed economies of the world and in the majority of EU Member States. Fiscal consolidation as well as the decline in the external debt of the national economy and the phasing out of the FX loans of the household sector contributed significantly to the decline in the country risk premium. The MNB's base rate cut cycle was rapidly followed by changes in short-term yields and changes in longer yields with larger or smaller deviations.

The historically low fiscal deficit also means a favourable balance position in international comparison as well. In 2015, the primary balance of the Hungarian budget was among the five lowest in the European Union (Chart 8). The primary surplus is coupled with declining but – due to the level of the outstanding debt – still high interest expenditures. Therefore, looking at the complete ESA balance, the ranking of Hungary is less distinguished, but still better than the average, as the weighted average of Member States' total balance was -2.4 per cent in 2015.

Chart 8
ESA balances and primary balances of EU Member States in 2015
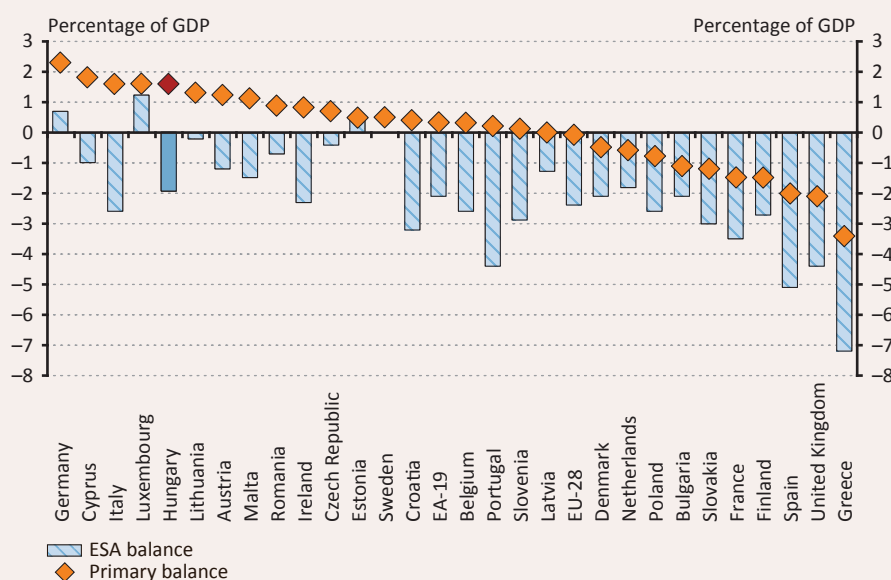
Source: Eurostat and MNB

The favourable general government deficit achieved in the past years also means that **compared to the pre-crisis period, the largest improvement among all EU Member States was seen in Hungary's budget** (Chart 9). It is also important to note that the improvement meant a shift from a rather low base, as with an average 7.1 per cent of deficit-to-GDP ratio, Hungary's general government deficit was the highest, equalling that of Greece. The average deficit in Hungary in 2014 and 2015 was around 2.2 per cent of GDP, and thus the change represents an almost 5 percentage point improvement. This was mainly attributable to the improvement in the primary balance, but in 2015 interest expenditures already represented an approximately 1 percentage point lower burden as a proportion of GDP for the Hungarian general government than in the pre-crisis years.

Examining the structural, cyclically adjusted balance published by the Commission, these developments are even more visible. In the period between 2003 and 2007, the structural balance adjusted for the fiscal impact of the economic cycle showed an average deficit of 8.5 per cent, while the same indicator for 2014–2015 is only around 2 per cent, i.e. the balance improved by 6.5 percentage points between the two periods. Prior to the crisis, as a result of the loose, procyclical fiscal policy, the structural deficit was also higher than the official, statistically measured deficit. Following the crisis, however, in recent years just the opposite of the above was observed: a disciplined fiscal policy was typical, despite the relatively weak European economic activity and negative domestic output gap, and thus the deficit of the structural balance stayed in a range between 0.7 and 2.1 per cent in each year since 2012.

Chart 9
EU Member States' ESA balances as an average of 2003–2007 and 2014–2015, and the change between the two periods
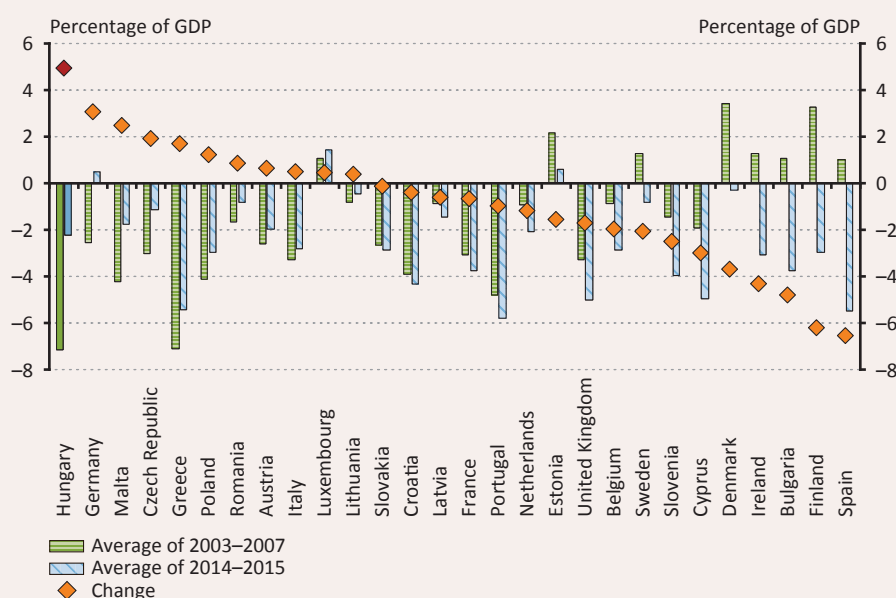
Source: AMECO and MNB

The success of the fiscal consolidation efforts taken in the Hungarian budget in the period after 2010 is shown by the fact that the EU excessive deficit procedure (EDP) against Hungary was abrogated in 2013 (Chart 10). In none of the years following 2011 did the fiscal deficit exceed the 3 per cent upper value defined in the Maastricht convergence criteria, the transitional debt rule concerning the developments in the structural balance was complied with, and the gross government debt-to-GDP ratio also declined gradually during these years. The importance of the abrogation of the EDP against Hungary is shown by the fact that previously Hungary was the only Member State that was subject to an EDP starting from the year of the accession until 2013. While the procedure was launched against a number of other Member States in 2009, the year in which the crisis spread, and the procedure is still ongoing or was closed recently for many of them, the procedure against Hungary was abrogated in the period of the recovery following the crisis.

Chart 10
EU Member States subject to EDP since 2004
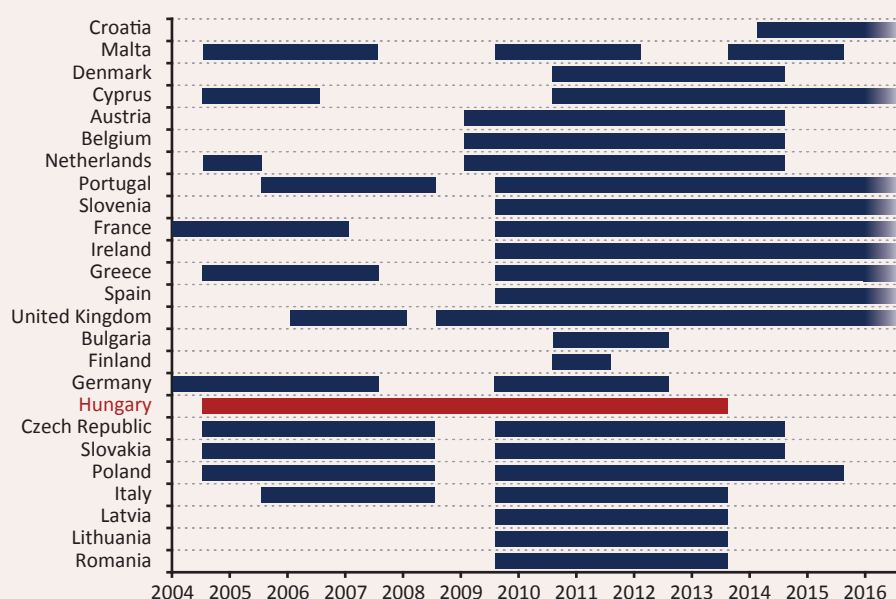
Source: European Commission

## 7.3. INTEREST SAVINGS DUE TO THE DECLINE IN YIELDS[2]

Compared to earlier high yields, interest savings of the state are estimated to have amounted to some HUF 300 billion in 2015 and may be more than HUF 500 billion in 2017 as a result of the low interest rate environment, which is the result of the significant contribution of the central bank base rate cuts and the self-financing programme. The decline in interest expenditures may continue in the coming years according to the European Commission's forecast as well, and within the entire EU it may be the largest in Hungary. An important advantage of the low interest expenditure is that it allows fiscal measures to be taken to stimulate the economy without deterioration in the fiscal balance.

The central bank base rate cuts and the self-financing programme contributed considerably to the decline in government securities market yields, and as a result, the interest expenditures of the general government are expected to decline by 1.4 per cent of GDP between 2013 and 2017. The MNB's monetary policy, during which the Monetary Council kept in mind the developments in domestic inflation in line with the central bank's primary objective, had a favourable impact on government securities market yields from a budgetary point of view. As a result of the gradual repricing of the debt, interest expenditures will decline for several years, and the rate of this decline may remain dynamic in the next two years as well.[3]

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[2] Based on http://www.mnb.hu/kiadvanyok/szakmai-cikkek/monetaris-politika/kicsak-gergely-magyarorszagon-csokkennek-a-leginkabb-az-allami-kamatkiadasok-az-eu-ban.

[3] For more details on the correlation between the decline in yields and central bank programmes see also: A jegybanki programok hatása az állam-háztartás kamatkiadásaira and A 2012-2015-ben bevezetett jegybanki intézkedések hatása az államháztartás finanszírozására.

Chart 11
Changes in gross interest expenditures on accrual basis
(as a percentage of GDP)
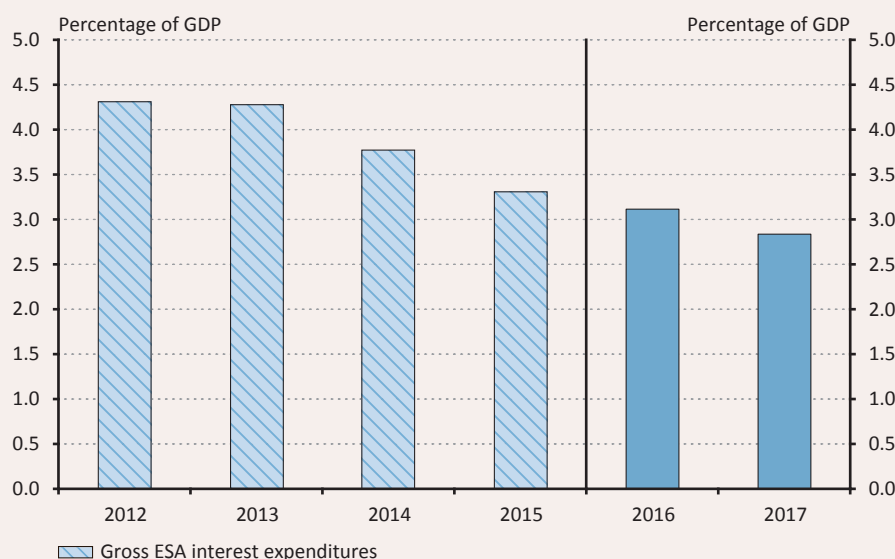
Note: Data do not include imputed interest expenditures.
Source: Eurostat and MNB (2016 and 2017 MNB forecast)

The declining interest expenditures are reflected in the 2017 budget bill as well as in the Convergence Programme for 2016–2020. Accrual-based interest expenditures show a declining trend on the basis of the 2017 budget, both as a proportion of GDP and in nominal terms. The accrual-based net interest expenditure of HUF 1,010 billion indicated in the budget represents interest savings of some HUF 100 billion in nominal terms compared to the 2015 interest expenditures, and – due to considerable GDP growth – corresponds to a decline of around 0.5 percentage point as a proportion of GDP, similarly to the cash-based expenditures.
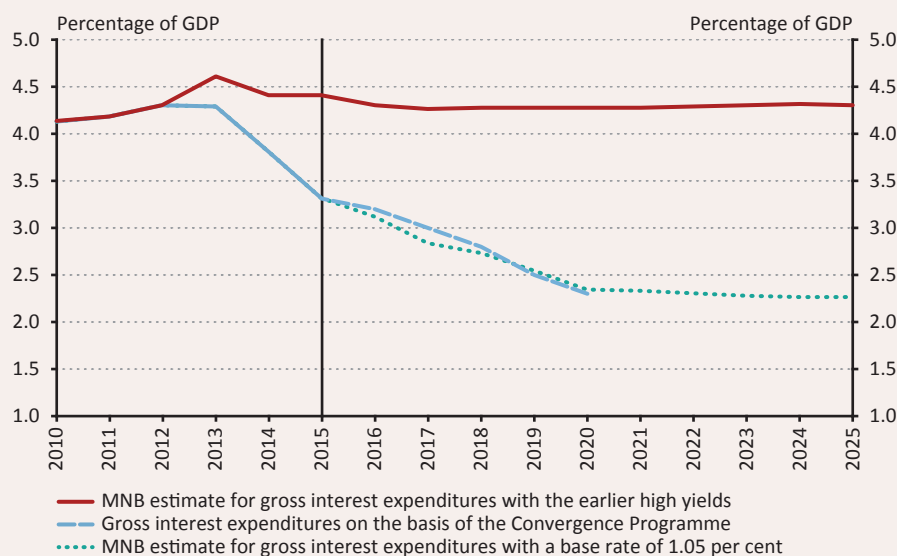
Over the long term, interest expenditures as a proportion of GDP may decline by nearly fifty per cent compared to the 2013 value. In the long run, gross public interest expenditures may fall to 2.3 per cent of GDP, i.e. with the current base rate the annual interest saving of the general government may be 2.0 per cent of GDP compared to 2013. Due to the downward shift in the yield curve in 2015, the latest Convergence Programme assumes lower interest expenditures than a year before over the entire horizon. Therefore, according to the Convergence Programme, interest expenditures may decline to 2.3 per cent of GDP by 2020, from the more than 4 per cent recorded in 2013 and before.

As a result of the low government securities market yields, the interest savings of the general government may have amounted to some HUF 300 billion in 2015, whereas in 2017 it may reach more than HUF 500 billion compared to the expenditures estimated on the basis of the earlier high yields. The central bank base rate cuts and the self-financing programme contributed to the decline in government securities market yields significantly. If the low yields may remain in place over the long term, due to the gradual repricing of the debt, the size of the annual interest saving may increase further.

Table 8
Estimated annual interest saving
(HUF billion)

	2012	2013	2014	2015	2016	2017	2018	2019	After 2020
Annual interest saving as a result of the decline in yield	12	93	192	304	423	530	600	700	800–

Source: MNB estimate

Chart 12
Interest expenditures of the general government in the case of two yield paths and on the basis of the Convergence Programme
(as a percentage of GDP)

MNB estimate for gross interest expenditures with the earlier high yields
Gross interest expenditures on the basis of the Convergence Programme
MNB estimate for gross interest expenditures with a base rate of 1.05 per cent

Note: Interest expenditures do not include the interest expenditures imputed due to the restructuring of the pension system for the period under review and in the case of the MNB forecast.
Source: Eurostat, Convergence Programme, MNB, own calculations

According to the projection of the European Commission, within the EU the accrual-based interest expenditure of the general government may fall to the largest degree in Hungary. The yield environment is low everywhere in the world, and has shown a declining trend in recent years in parallel with the monetary easing programmes of the largest central banks. Nevertheless, the most substantial decline may be realised in

Chart 13
Change in gross interest expenditures from 2013 to 2017 on the basis of the Commission's projection
(percentage of GDP)

Change in interest expenditures from 2013 to 2017
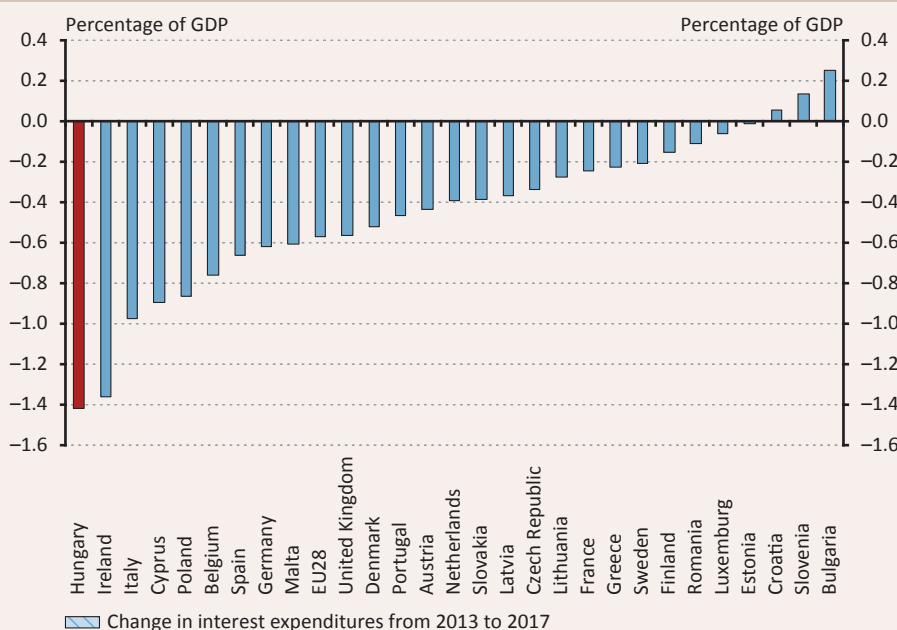
Source: Ameco

Hungary in terms of the interest expenditures of the general government. This decline, which is significant in itself as well, is remarkable because in this period Hungary practically changed over to market – and increasingly domestic – financing.[4]

7.4. SUMMARY OF THE HUNGARIAN FISCAL RULES[5]

Including the complemented debt formula, at present there are four different national level fiscal rules that determine the framework of fiscal policy in Hungary. Below is a presentation of the size of the budget balance required by the rules under different macroeconomic circumstances (output gap, inflation, growth). According to the simulations presented, in the majority of cases – and thus probably in 2017 as well – compliance with the structural balance related to the medium-term objective is the effective limit for the budget.

At present, there are four different national level fiscal rules in force in Hungary, and several provisions belong to one of these (see Table 9). The various rules limit fiscal policy through different channels. Of the rules, the provision in the Fundamental Law and the supplement to the debt formula relate to the debt-to-GDP ratio, the original debt formula comprises the change in nominal debt, the Maastricht deficit limits fiscal policy through the budget balance, while the medium-term objective does so through the structural balance. For calculating the required fiscal indicators, in most cases it is sufficient to know the debt ratio, the nominal debt and the expected growth and inflation. However, because of the medium-term objective, it is necessary to take account of the cyclical position of the economy as well.

Table 9
National fiscal rules in Hungary

	Rule	Legal regulation	Description	Escape clause
1.	Debt ratio reduction	Fundamental Law Article 36(4)–(5)	As long as state debt exceeds 50 per cent of the gross domestic product, the National Assembly may only adopt an Act on the central budget which provides for state debt reduction in proportion to the gross domestic product.	Any derogation shall only be allowed during a special legal order and to the extent necessary to mitigate the consequences of the circumstances triggering the special legal order, or, in case of an enduring and significant national economic recession (according to the definition in the Stability Act, in the case of a decline in the real value of the annual gross domestic product), to the extent necessary to restore the balance of the national economy.
2. a.	Debt formula	Stability Act Article 4 (2)	The growth rate of the government debt may not exceed the difference between the inflation expected for the fiscal year and half of real growth.	If at least one of inflation and real growth does not exceed three per cent.
2. b.	Supplement to the debt formula	Stability Act Article 4 (2a)	The decline in debt ratio compared to the previous year has to reach at least 0.1 percentage point.	If the real value of the annual gross domestic product decreases.
3.	Maastricht deficit	Stability Act Article 3/A (2b)	The balance of the government sector may not exceed 3 per cent of GDP.	If the real value of the annual gross domestic product decreases.
4.	Medium-term objective	Stability Act Article 3/A (2a)	The balance must be in line with the fiscal target determined in the form of structural balance in the Convergence Programme. (As of 2017, the Hungarian medium-term objective will be 1.5 per cent of GDP.)	–

[4] See also: Az EU hitel utolsó részletének visszafizetése
[5] Based on http://www.mnb.hu/letoltes/toth-g-csaba-osszefoglalo-a-magyar-koltsegvetesi-szabalyokrolmnbhonlap.pdf.

Below is a presentation of what kind of balance is required by the rules using three different simulations: 1) in the case of a crisis, 2) if the economy is performing just at its potential level, and 3) if its performance is well over the potential level. It is possible to comply with all four fiscal rules at the same time by always obeying the strictest of them. Therefore, in the following we examine which rule requires the strictest fiscal balance under the different circumstances. The starting point for this is our forecast for the 2016 gross domestic product (HUF 35,589 billion) and government debt (74.5 per cent of GDP). In the simulations, an unchanged exchange rate is taken into account, and for the sake of simplicity it is assumed that inflation and the GDP deflator are identical, and that changes in government debt only depend on the budget balance. When calculating the structural balance, in line with the European Commission's relevant estimate, we set out from the assumption that a 1 per cent output gap changes the balance by 0.5 per cent of GDP and that one-off items offset one another's impacts.

1) **When potential output corresponds to actual output, three of the four rules limit fiscal policy as a function of growth and inflation (Table 10).** In the vast majority of cases, the medium-term objective is the strictest, i.e. the budget deficit as a proportion of GDP may not exceed 1.5 per cent, because in the case of a closed output gap the official and the structural balances are identical. It means that with an interest expenditure of around 2.5–3 per cent of GDP, in this cyclical position the government is compelled to pursue a relatively tight fiscal policy through the primary balance. If inflation and real growth are above 3 per cent, in certain cases the debt formula requires an even tighter fiscal policy. A similar rule is implied by the debt ratio reduction included in both the Fundamental Law and the supplement to the debt formula. The debt ratio reduction regulates the balance when inflation is low or negative and growth is moderate.

Table 10
Budget balance as a proportion of GDP required by the rules when the output gap is 0

Output gap: 0%		Change in real GDP									
		−1.5%	−0.5%	0.5%	1.5%	2.5%	3.5%	4.5%	5.5%	6.5%
Inflation	−1.5%	−1.5	−1.5	−1.5	0.9	0.1	−0.6	−1.3	−1.5	−1.5	−1.5
	−0.5%	−1.5	−1.5	−1.5	0.1	−0.6	−1.4	−1.5	−1.5	−1.5	−1.5
	0.5%	−1.5	−1.5	−1.5	−0.6	−1.4	−1.5	−1.5	−1.5	−1.5	−1.5
	1.5%	−1.5	−1.5	−1.5	−1.4	−1.5	−1.5	−1.5	−1.5	−1.5	−1.5
	2.5%	−1.5	−1.5	−1.5	−1.5	−1.5	−1.5	−1.5	−1.5	−1.5	−1.5
	3.5%	−1.5	−1.5	−1.5	−1.5	−1.5	−1.5	−1.2	−0.9	−0.5	−0.2
	4.5%	−1.5	−1.5	−1.5	−1.5	−1.5	−1.5	−1.5	−1.5	−1.2	−0.8
	5.5%	−1.5	−1.5	−1.5	−1.5	−1.5	−1.5	−1.5	−1.5	−1.5	−1.5
	6.5%	−1.5	−1.5	−1.5	−1.5	−1.5	−1.5	−1.5	−1.5	−1.5	−1.5
	7.5%	−1.5	−1.5	−1.5	−1.5	−1.5	−1.5	−1.5	−1.5	−1.5	−1.5
	8.5%	−1.5	−1.5	−1.5	−1.5	−1.5	−1.5	−1.5	−1.5	−1.5	−1.5
		1. / 2.b Debt ratio reduction and supplement to the debt formula									
		2.a Debt formula									
		4. Medium-term objective									

2) **If the output gap is minus 2 per cent, i.e. the cyclical position of the economy is unfavourable, depending on growth and inflation, three rules determine the balance (Table 11).**

a) *When real GDP also declines*, the majority of the fiscal rules included in national legislation are suspended, and only the target concerning the structural balance remains in force. Consequently, the medium-term objective maximises the deficit-to-GDP ratio at 2.5 per cent (the sum of the 1.5 per cent structural deficit and the 1 per cent cyclical component). It means a close-to-equilibrium primary balance, i.e. in spite of the negative output gap, due to the relatively high interest expenditures, there is no room for loose fiscal policy.

b) *If the performance of the economy is increasing while the output gap is negative* (for example in the recovery period), the escape clauses do not enter into force, but in a large number of the cases under review the medium-term objective still proves to be the strictest rule. However, with a positive but low change in GDP and negative or moderate inflation the reduction of the debt ratio requires an even stricter balance (light blue area in Table 11). It means, for example, that with 0.5 per cent growth and 0.5 per cent inflation, in order to reduce the debt ratio, the deficit may not exceed 0.6 per cent of GDP, which corresponds to a more than 2 per cent primary surplus. Accordingly, in this case even if the output gap is negative, the rules require a tight, procyclical fiscal policy to be conducted by the government, which decelerates the recovery from the crisis.

c) The debt formula becomes effective *if both inflation and growth exceed 3 per cent*; then the rules also become strict. Exceeding the threshold, the higher the growth and the lower the inflation, the lower deficit is allowed by the rule. Although allowing a higher deficit in parallel with higher inflation is procyclical, its practical relevance is lower, because overly high growth is not typical at such an unfavourable point of the economic cycle.

Table 11
Budget balance as a proportion of GDP required by the rules when the output gap is -2 per cent

Output gap: −2%		Change in real GDP									
		−2.5%	−1.5%	−0.5%	0.5%	1.5%	2.5%	3.5%	4.5%	5.5%	6.5%
Inflation	−1.5%	−2.5	−2.5	−2.5	0.9	0.1	−0.6	−1.3	−2.0	−2.5	−2.5
	−0.5%	−2.5	−2.5	−2.5	0.1	−0.6	−1.4	−2.1	−2.5	−2.5	−2.5
	0.5%	−2.5	−2.5	−2.5	−0.6	−1.4	−2.1	−2.5	−2.5	−2.5	−2.5
	1.5%	−2.5	−2.5	−2.5	−1.4	−2.1	−2.5	−2.5	−2.5	−2.5	−2.5
	2.5%	−2.5	−2.5	−2.5	−2.1	−2.5	−2.5	−2.5	−2.5	−2.5	−2.5
	3.5%	−2.5	−2.5	−2.5	−2.5	−2.5	−2.5	−1.2	−0.9	−0.5	−0.2
	4.5%	−2.5	−2.5	−2.5	−2.5	−2.5	−2.5	−1.9	−1.5	−1.2	−0.8
	5.5%	−2.5	−2.5	−2.5	−2.5	−2.5	−2.5	−2.5	−2.2	−1.8	−1.5
	6.5%	−2.5	−2.5	−2.5	−2.5	−2.5	−2.5	−2.5	−2.5	−2.5	−2.1
	7.5%	−2.5	−2.5	−2.5	−2.5	−2.5	−2.5	−2.5	−2.5	−2.5	−2.5
	8.5%	−2.5	−2.5	−2.5	−2.5	−2.5	−2.5	−2.5	−2.5	−2.5	−2.5
		1. / 2.b Debt ratio reduction and supplement to the debt formula									
		2.a Debt formula									
		4. Medium-term objective									

3) **In the case of a favourable cyclical situation, it is almost always the structural deficit that poses the strongest limit (Table 12).** If output is 2 per cent above its potential level, the deficit, pursuant to the rule concerning the structural balance, may only be 0.5 per cent of GDP, which is the sum of the 1.5 per cent structural deficit and the -1 per cent cyclical component. As this means a primary surplus of 2–2.5 per cent, the rule requires a countercyclical policy that complies with the economic cycle. In exceptional cases – against the background of a slight positive change in GDP and negative inflation – the provision regarding the debt ratio reduction included in the Fundamental Law and the supplement to the debt formula become effective, while in the case of high growth the debt formula is applicable. In these cases a budget that is still tight but at the same time countercyclical must be adopted.

In summary, based on the simulations presented, in the majority of cases compliance with the structural balance related to the medium-term objective is the effective limit for the budget. Setting out from the macroeconomic forecast in the March Inflation Report of the MNB, the provision regarding the structural deficit continues to be the strictest rule for the budget in 2017 as well. Although the calculation of the indicator in practice is surrounded by serious professional debates, theoretically it is able to handle the developments in

Table 12

Budget balance as a proportion of GDP required by the rules when the output gap is +2 per cent

Output gap: 2%		Change in real GDP									
		−1.5%	−0.5%	0.5%	1.5%	2.5%	3.5%	4.5%	5.5%	6.5%
Inflation	−1.5%	−0.5	−0.5	−0.5	0.9	0.1	−0.5	−0.5	−0.5	−0.5	−0.5
	−0.5%	−0.5	−0.5	−0.5	0.1	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5
	0.5%	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5
	1.5%	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5
	2.5%	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5
	3.5%	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5	−0.2
	4.5%	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5
	5.5%	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5
	6.5%	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5
	7.5%	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5
	8.5%	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5	−0.5

	1. / 2.b Debt ratio reduction and supplement to the debt formula
	2.a Debt formula
	4. Medium-term objective

economic cycles, i.e. it at least allows the automatic stabilisers work. However, when the actual performance of the Hungarian economy is below potential, with a positive but low change in GDP and negative or moderate inflation, the rules require a rather tight, sometimes close-to-equilibrium budget, which may result in a procyclical economic policy, and may decelerate the recovery from the crisis.

7.5. EU FUNDS RELATED TO THE 2014–2020 CYCLE AND DEVELOPMENTS IN THE DRAWDOWN OF FUNDS[6]
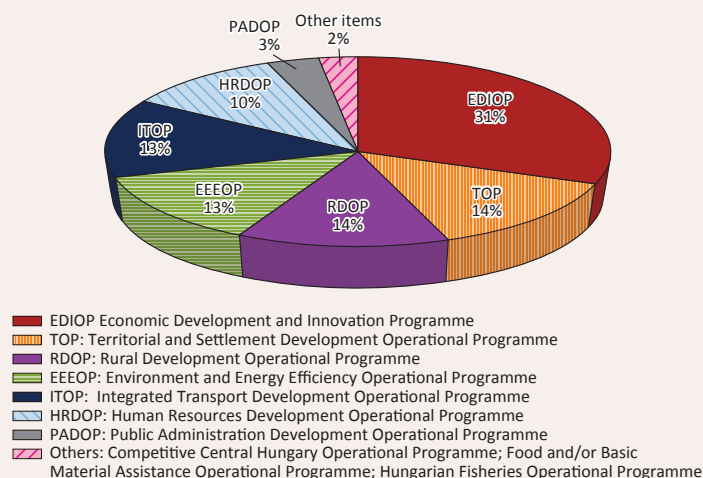
In the 2014–2020 cycle Hungary is receiving the highest amount of funds as a proportion of GDP in the European Union. For comparability, it is worth measuring the sizes of the appropriations provided to individual countries relative to the development and size of these countries. As a proportion of 2013 GDP, Hungary is entitled to receive funds in excess of 20 per cent, which is the most favourable figure in the European Union. This means approximately EUR 25 billion (some HUF 7,800 billion). This amount is complemented by the Hungarian state, so – depending on the exchange rate – roughly HUF 9,000 billion is available for applicants.

In the years ahead, more emphasis will be placed on economic development, and infrastructure investment will play a less significant role. Compared to the 2007–2013 cycle, the structure of funds and the main thematic objectives have changed considerably. In the previous cycle, the development of infrastructure was the top priority, while in the new, 2014–2020 cycle the focus will be on economic development, employment and environmental protection. Between 2007 and 2015, within the framework of the previous cycle, in the Economic Development Operational Programme, which primarily supported economic development, approximately HUF 1,000 billion was disbursed to beneficiaries. By contrast, in the new cycle the allocation for the Economic Development and Innovation Operational Programme is nearly HUF 2,600 billion. In the 2007–2013 cycle, the highest amount was allocated to the Transport Development Operational Programme; within that, applicants were awarded a total HUF 2,500 billion, while between 2014 and 2020 HUF 1,216 billion can be spent on transport development, including the state's own contribution.

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[6] Based on http://www.mnb.hu/letoltes/babos-daniel-p-kiss-gabor-2016-ban-fel-kell-keszulni-az-eu-tol-erkezo-tamogatasok-atmeneti-csokkenesere.pdf.

Chart 14
The available funds for Hungary in the 2014–2020 EU fiscal cycle by operational programmes

EDIOP Economic Development and Innovation Programme
TOP: Territorial and Settlement Development Operational Programme
RDOP: Rural Development Operational Programme
EEEOP: Environment and Energy Efficiency Operational Programme
ITOP: Integrated Transport Development Operational Programme
HRDOP: Human Resources Development Operational Programme
PADOP: Public Administration Development Operational Programme
Others: Competitive Central Hungary Operational Programme; Food and/or Basic
Material Assistance Operational Programme; Hungarian Fisheries Operational Programme

Source: Hungary's Partnership Agreement for the 2014–2020 development period

The Government is committed to using the funds as soon as possible and took several steps accordingly. Hungary can use the funds of the 2014–2020 budgetary framework in the period between 2014 and 2023. For a faster drawdown of funds, at end-2015 the Government decided that all the tenders related to the funds must be announced by 31 June 2017.[7] In our opinion, the announcements are progressing satisfactorily, as tenders corresponding to approximately HUF 4,800 billion, i.e. more than half of the available amount, were announced by end-April 2016. All transport development programmes have been announced completely, and significant amounts of tenders have been made public related to development of settlements and economic development. If this trend continues, all tender announcements may be published by mid-2017 in line with the Government's objectives.

The amount of funds disbursed in relation to the 2014–2020 cycle reached HUF 34 billion by the end of April 2016. Based on end-April data, 2,400 applicants have been awarded support to date within the framework of the 2014–2020 budget cycle, in a total amount of more than HUF 1,000 billion. From the magnitude of successful applications it can be concluded that the disbursement of the new programmes will speed up in the second and third quarters of the year. The upswing in disbursements may add to the financing need of the budget, but may facilitate a major acceleration in the dynamics of economic growth in the second half of the year.

Compared to 2015, the amount of EU funds utilised will decline significantly in 2016 in spite of the acceleration of the disbursements. In the past three years, Hungary utilised a considerable amount of EU funds; the disbursements amounted to an average of HUF 2,300 billion in these years. In the 2016 Budget Act, the Government projected disbursements amounting to HUF 1,432 billion, which is in line with our current forecast, but represents a major decline compared to previous years.

Compared to the lower 2016 value, higher utilisation of EU funds is expected for 2017. In line with the Government's intentions, compared to the lower 2016 value, the disbursements of funds from the new cycle may increase considerably in 2017. Disbursements in 2017 are forecast to amount to HUF 1,700 billion, i.e. 1 per cent of GDP more than in 2016. Based on the Convergence Programme, the Government would like to draw down a significant portion of the funds by 2018, which means that in 2018 the magnitude of the funds used may grow further.

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[7] Government Resolution 1580/2015 (IX. 4.).

Chart 15
**Drawdown of EU funds related to the 2014–2020 cycle**
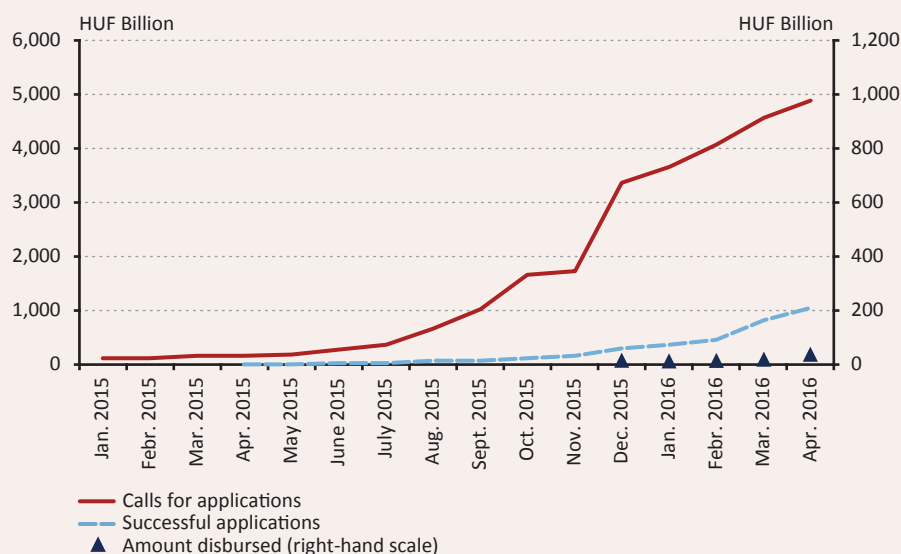
Source: Prime Minister's Office, palyazat.gov.hu

7.6. CHANGE IN THE STRUCTURE OF DEBT AND THE REPAYMENT OF THE EU–IMF LOANS[8]

In the past five years, the decline in the share of foreign currency and non-residents' ownership within government debt resulted in a lower vulnerability of the country, further supported by the repayment of the EU loan on 6 April 2016. The continuous improvement in the structure of debt financing is facilitated by the increase in households' government securities portfolio as well as the rise in banks' government securities holdings supported by the central bank's self-financing programme. As a result of the latter, there is a shift in financing from discount treasury bills towards longer-term paper, i.e. the average residual maturity of the government debt is becoming longer. Due to the declining government securities market yields, debt financing became cheaper, also contributing to the development of a more stable debt structure. According to our projection, interest expenditures will continue to decline as a result of debt repricing, which is also supported by the repayment of the EU loan, as the interest rate on the EU loan was higher than the currently available forint yields. On the other hand, based on the latest measures, the interest rate on retail securities, which is slightly higher than the market rate, is declining continuously, adapting to the low yield environment.

The decline in the share of foreign currency and non-residents' ownership within government debt may further improve Hungary's risk assessment in addition to the fact that the decline in government debt itself points to lower vulnerability. The decline in the share of foreign currency within government debt considerably reduced the exchange rate risk related to government debt, while the increase in domestic sectors' ownership share facilitated the evolution of a more stable financing structure. From the earlier level of above 50 per cent, the share of foreign currency may decline close to 30 per cent in 2016. In parallel with that, non-residents' ownership share may decrease to nearly 40 per cent following a decline of some 25 percentage points.

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[8] Based on http://www.mnb.hu/letoltes/kicsak-az-eu-hitel-utolso-reszletenek-visszafizetesemnbhonlapra.pdf.

Chart 16
Share of foreign currency in government debt and non-residents' ownership share
(as a percentage of total debt)

Per cent   Per cent

Ratio of non-residents within government debt
Foreign currency ratio within government debt
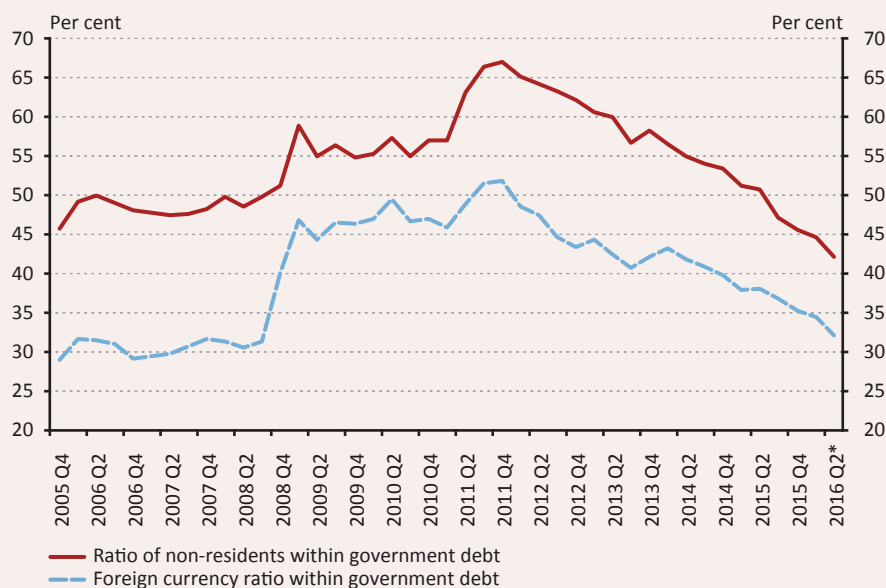
Note: Data for the end of the first and second quarters of 2016 are MNB estimates.
*Source: Government Debt Management Agency (ÁKK) and MNB*

The repayment of the last instalment of the EU loan from forint issuance further reduced Hungary's vulnerability, as the share of foreign currency and non-residents' ownership share within the debt declined. In recent years, the refinancing of FX maturities by issuing forint-denominated debt instruments has become a central part of the debt management strategy, which is also supported by the central bank's self-financing programme. As a part of the strategy, no major FX bond issues took place in 2015 and none are planned for 2016, while the average value of annual FX maturities exceeds HUF 1,200 billion. The repayment of the last instalment of the EU loan itself may have reduced the FX share of government debt and the ownership share of non-residents by some 2 percentage points. Through the decline in exchange rate risk, the lower external debt may contribute to Hungary's more favourable credit rating as well.

Between 2011 and 2016, the repayment of FX loans borrowed in 2008 was a heavy burden, but it was successfully resolved by the debt management strategy supported by the self-financing programme (Chart 17). Hungary can finance maturing EU loans by lower-yield forint bonds. The renewal of the annual maturities, which account for more than three times the average FX repayments between 2005 and 2010, was a major challenge for the debt management in the past five years. With support from the self-financing programme announced by the central bank, as a result of domestic sectors' increased demand, the ÁKK was able to finance maturing FX loans as well as other FX instruments mainly from forint issues. In addition, the declining domestic government securities market yields allow debt refinancing at favourable costs, as even the currently longest-term forint interest rates are lower than the interest rate on the EU loan.

As a result of the increase in households' and banks' government securities holdings, more than half of government securities have been held by domestic sectors since the beginning of 2015. Within domestic net forint issues, the weight of government bonds is significant, which is mainly attributable to the rise in banks' government securities holdings. This increase is strongly supported by the central bank's self-financing programme. The dynamic growth in households' government securities holdings also contributes to the increase in the holdings of forint-denominated government securities. The monthly issuance of retail securities shows a historically high value, which is firstly attributable to the fact that alternative investment yields declined in parallel with the central bank's rate-cutting cycle, and secondly, the debt manager – in line with its strategic goals – kept the interest rate on retail securities relatively high.

Chart 17
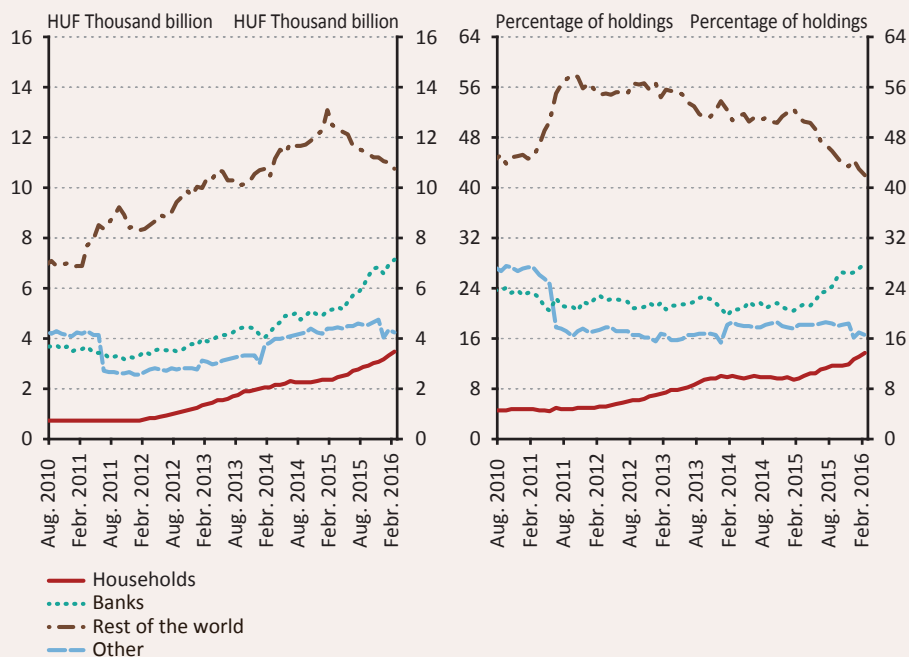**Repayment of the EU loan, the IMF loan and other FX instruments by the state**
(EUR billion)

EUR Billion

EUR Billion

- EU
- IMF
- Other
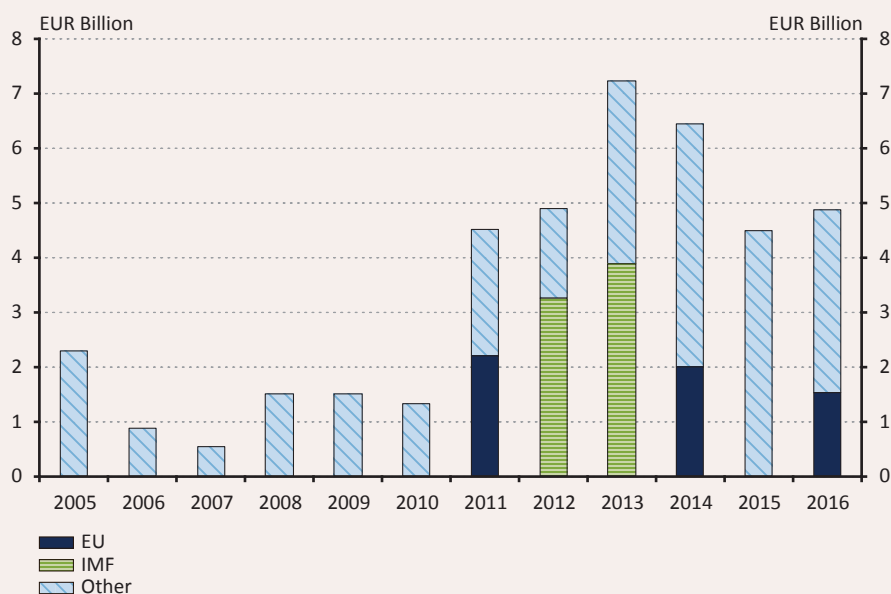
Note: Excluding the part of principal drawn by the central bank.
Source: ÁKK

Chart 18
Domestic sectors' and non-residents' government securities holdings
(in nominal terms and as a percentage of holdings)

HUF Thousand billion HUF Thousand billion

Percentage of holdings Percentage of holdings

- Households
- Banks
- Rest of the world
- Other

Note: The HUF- and FX-denominated government securities are shown on the basis of securities statistics data, at market value.
Source: MNB

Based on the past two years' data, within government debt the weight of the discount treasury bill follows a declining trend, leading to longer average residual maturity of the debt. Domestic sectors' demand for government securities shifted towards bonds in the case of banks and towards 6-month treasury bills, interest bearing treasury bills and retail bonds in the case of households. As the demand factors change, the debt manager strives to extend the average residual maturity of the debt, adjusting supply to demand. The extension of maturity reduces the risk of the rollover of debt, also contributing by this to the development of a more stable financing structure.

## 7.7. CHANGES IN THE VALUE ADDED TAX IN 2017

The scope of product groups under the preferential VAT rate will be amended in several points in 2017. According to the bill submitted, the value added tax on poultry meat and eggs will decline from 27 per cent, while that of fresh milk will drop from 18 per cent to 5 per cent. In addition, the VAT on Internet services and meals in restaurants will be reduced from 27 per cent to 18 per cent.[9]

As a result of the measure, revenues from the value added tax are estimated to fall by HUF 63 billion next year. Within that, the largest item is the reduction of the tax on poultry meat, followed by the lowering of the tax on Internet use and the tax to be paid on eggs.

Table 13
Fiscal effect of the reduction of VAT rates in 2017

Product group	Old VAT rate	New VAT rate	Estimated impact of VAT cut (HUF billion)
Egg	27%	5%	11
Milk	18%	5%	5
Poultry meat	27%	5%	27
Meals in restaurants	27%	18%	6
Internet usage fee	27%	18%	14
Total	—	—	**63**

Chart 19
Savings stemming from the tax cut as a proportion of expenditures by income deciles
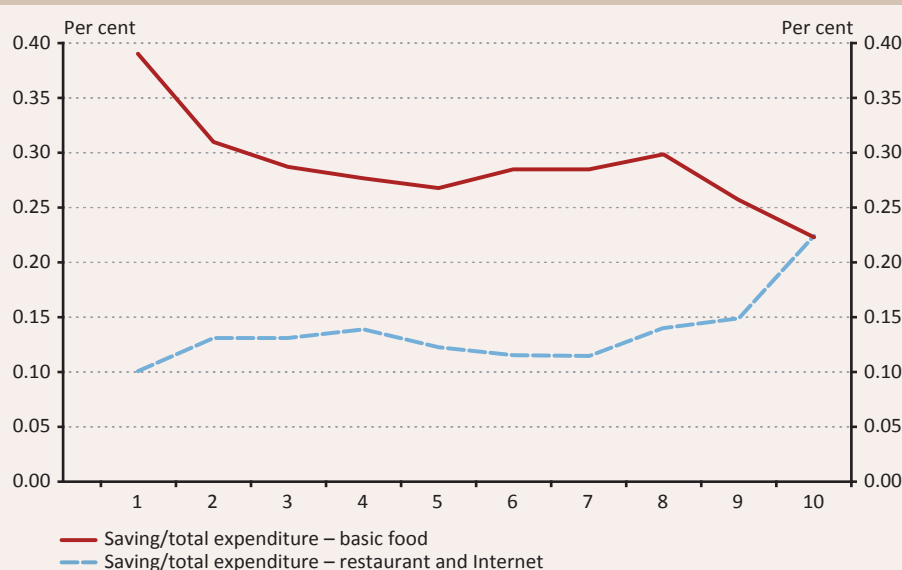
Source: MNB estimate based on the data of the 2013 Household Budget and Living Conditions Survey (HBLS)

[9] Bill No. T/10537 on the amendment to certain tax laws and other related laws as well as to Act CXXII of 2010 on the National Tax and Customs Administration.

The measure has different impacts on the households belonging to different income deciles. Based on the findings of the simulation conducted on the data of the Household Budget and Living Conditions Survey (HBLS), the largest saving from the VAT cut on basic food as a percentage of their total expenditures arises in the households that belong to the lower five income deciles (0.4 per cent of their spending). Savings as a proportion of expenditures decline gradually, although not continuously, and in the tenth decile amount to 0.22 per cent. On the other hand, the savings stemming from the VAT on Internet and restaurant services follow a contrasting pattern. On average, the VAT cut reduces households' expenditures by 0.2–0.4 per cent in the case of basic food and by 0.1–0.2 per cent in the case of the Internet and eating out, assuming that the effects of the tax reduction will be reflected in the prices.

7.8. CHANGES IN THE WAGE EXPENDITURES OF THE GOVERNMENT SECTOR

Of the government sector's economic classification expenditures, following social benefits (social expenditures), public wage cost is the next major expenditure item; the state spends more than 10 per cent of GDP on labour costs, including the wage costs of public workers. Restructuring of the public wage system started in past years, and both average wages and the wage bill paid increased as a result of the introduction of career path models. On the other hand, rationalising the number of employed in the general government and shaping a more economical general government have become a fiscal policy objective.

The government sector's wage expenditures as a proportion of GDP (HCSO, national accounts) declined markedly during the crisis, but increased again from 2013. This change was caused by the joint effect of three factors: the increase in public works expenditures, the introduction of sectoral career path models and the implementation of other, typically sectoral wage corrections (e.g. pay rise in the health sector). As a result of the measures, in 2015 the public wage expenditures reached the value observed at the beginning of the decade again, i.e. 10.5 per cent of GDP, and may reach 11 per cent of GDP by 2016–2017. In the following, however, we intend to analyse the employment and wages in the general government excluding public workers.

Information on the government sector's headcount and wage data – excluding public workers – is provided by the institutional statistics of the HCSO. However, not only public workers but the companies classified into the government sector as well as the public employees employed at non-profit institutions are also missing from these statistics. Accordingly, the institutional statistics of the HCSO cover about four fifths of the government sector. The wage bill calculated on the basis of the institutional statistics is 4–4.5 per cent of GDP lower than the

Chart 20
Wage costs in the government sector as a percentage of GDP

Annual gross wage bill as a percentage of GDP
Government sector wage cost as a percentage of GDP

Note: The wage cost contains the social contribution tax. MNB projection for 2016–2017.

Chart 21
Gross wage bill of budgetary institutions' employees
*as a percentage of GDP*
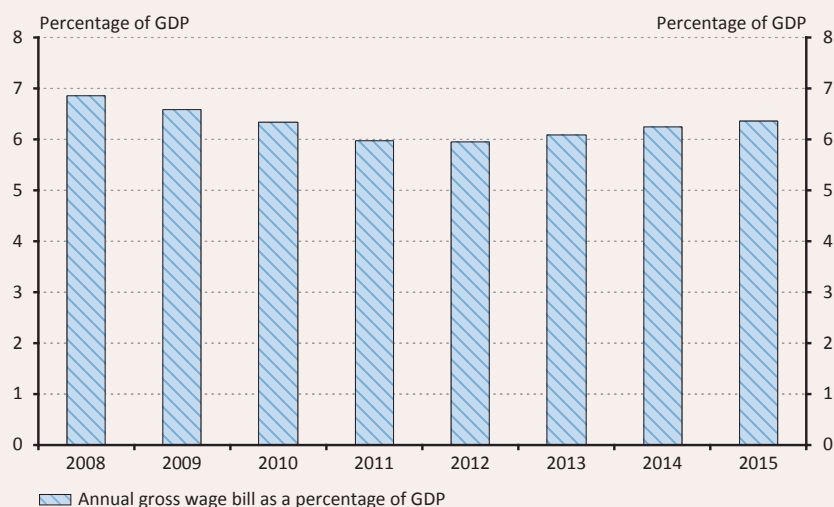
Note: The wage bill does not contain the social contribution tax.

category according to the national accounts, and its dynamics are also different to some extent (mostly because it does not contain the effect of the growing public works programmes). Half of the reason for the difference in level is the different coverage, and the other half is that the wage cost contains the social contribution tax, while the wage bill does not.

Changes in the number of public employees on the basis of the institutional statistics of the HCSO

According the HCSO's institutional statistics, the annual average headcount of public employees (excluding public workers) increased from 686,000 in 2010 to 698,000 in 2015. In 2015, the annual average number of employees in public administration was some 12,000 higher than in 2010. In the same period, the annual

Chart 22
**Annual average headcount of budgetary institutions' employees**
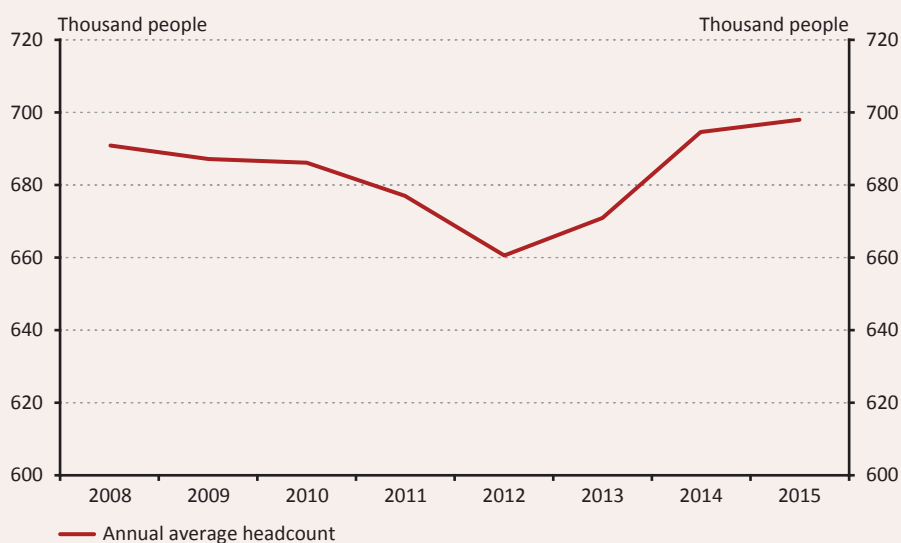
Source: HCSO

average headcount declined by nearly 16,000 people in the educational sector. According to our estimate, the fusion and streamlining of the background institutions of the central government may entail a staff cut of 6,000 people, whereas the further downsizing of around 10 per cent planned for early 2017 may reduce the number of public employees by 4,000 people (concrete decisions have not been taken yet).

Changes in public employees' gross average earnings

Public employees' gross average earnings (excluding the social contribution tax) have increased by 23 per cent since 2010, while the price level has risen by 11.5 per cent; thus, the annual average real growth amounted to 2.3 per cent. The last major fall in average earning was observed in 2009, it declined slightly in 2010–2011, and has increased considerably since 2012, as a result of launching the career path models.

Chart 23
Changes in annual gross average earnings at budgetary institutions

Gross average earnings (2008=100%)
Annual change in gross average earnings
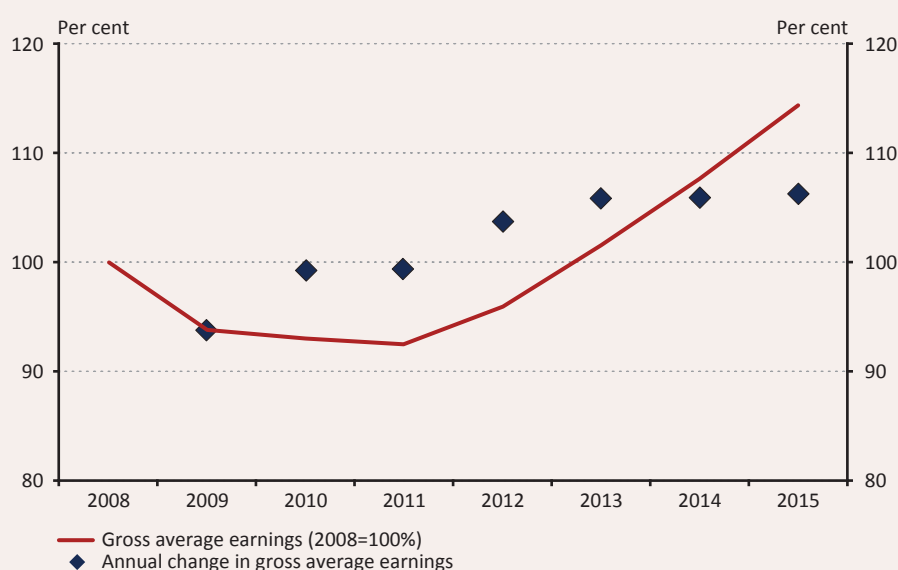
Source: HCSO

Career path models

The restructuring of the wage system of public employees started in 2013, mainly with the introduction of the sectoral career path models as well as with sectoral wage correction measures (health and social sectors). Another dimension of the state wage policy was the reduction of the income tax burden, which ensured an increase in net earnings for a wide range of employees even in the case of an unchanged payroll.

Firstly, the introduction of the career path models means a significant wage correction in the priority sectors; secondly, it makes the wage system more transparent and predictable. According to the statements of the institutional statistics, the increase in average earning together with the effect of the change in headcount resulted in a rise in the gross wage bill as a proportion of GDP of those employed in the public institutional system.

Two career path models were introduced before the end of last year (for teachers employed in public education and for law enforcement employees). The first stage of the civil servants' career path model is being introduced as of July this year, and its expansion is planned by the Government starting from January 2017. The gradual introduction of the career path models takes account of the limits of the funds available and gives time for the institutional system to adapt to the new circumstances.

Table 14
Career path models – parametric changes in salaries
(per cent)

	2013	2014	2015	2016	2017
1. Teachers' career path model	23.0	3.8	3.8	3.8	3.8
2. Regrading of teachers*			13.0	13.0	13.0
3. National defence career path model			30.0	5.0	5.0
4. Law enforcement career path model			30.0	5.0	5.0
5. Career path expected at government offices**				35.0	25.0
6. Career path model for the employees of the National Tax and Customs Administration***					25.0

MNB estimate; more precise data will be available only after the final accounts of the 2015 budget.
**MNB estimate, as the complete details of the career path model are not known yet.*
***MNB estimate, taking into account that the bonus of the staff of the National Tax and Customs Administration will not be terminated.*

In interpreting the above table, it must be taken into account that the career path models are usually introduced during the year, and thus upon the calculation of the effective pay rise of the introductory year the impact of the incomplete year also has to be considered. The effect of the wage adjustment in higher education is not included in the table, in view of the fact that formally the revision of wages is not related to the introduction of a career path model. The cost of the wage adjustment in higher education may amount to a total HUF 10–12 billion in 2016–2017.

The 2016 Convergence Programme envisages a decline in the government sector's wage expenditures as a proportion of GDP for the period of 2018–2020. The rate of decline may indicate that following the complete introduction of the career path models the Government plans to valorise public employees' earnings by using the whole-economy earnings index.

We have prepared estimates for the additional costs related to the career path models; the relevant findings are summarised in the table below. It should be noted that the estimates do not contain the impact of other government measures on the wage system, such as the effects of the adjustments and measures concerning the system of fringe benefits. The table also does not contain the planned pay rise in the health sector, with special regard to the circumstance that there is still no decision on the specific date of the rise and its concrete size.

Table 15
Aggregate impact of the introduction of career path models
(HUF billion)

	2013	2014	2015	2016	2017
1. Teachers' career path model	35	185	235	284	333
2. National defence career path model			11	32	37
3. Law enforcement career path model			33	94	107
4. Career path expected at government offices*				12	42
5. Additional cost of career path models (1+..+4)	**35**	**185**	**279**	**422**	**519**

The expected cost is only an estimate; the data presented here may change in the future.

In addition to increasing public employees earned income, the career path models contain various elements the positive effects of which may prevail over the longer term. From the employees' aspect, elements like this are the predictability of the expected earned income and the knowledge of the circumstances belonging to the career path, while from the aspect of the budget the relevant elements are the transparency of the wage system, the better plannability of wage expenditures, the improvement in the quality of data concerning the structure of wage expenditures as well as the identification of the skills and abilities that can be expected of employees. The above listed elements of the career path models jointly created one of the necessary preconditions for the monitoring of the performance of public employees, which may have a further positive impact on the competitiveness of the country through the expected improvement in the quality of public services.

8. Appendix

Table 16		
Main measures in the 2017 budget		
(HUF billion)		
Items	**Description**	**MNB forecast**
New measures		
Modern Cities Programme	Various projects will be implemented in more than 20 cities within the framework of the programme aiming at the development of country towns.	−152
High-priority public road investment	Development of public road connections	−279
Government officials' career path model	Government officials' career path will be launched at the Budapest and county government offices as well starting from 1 January 2017.	−73
Wage of the employees of the National Tax and Customs Administration	The career path of the employees of the National Tax and Customs Administration to be launched in 2016 ensures the same rate of increase for government officials and customs officers as well.	−24
Credit institutions' contribution	The credit institutions' contribution will be cancelled as of 1 January 2017.	−7
Value added tax	The tax rate of milk, eggs and poultry will decline to 5 per cent. At the same time, in addition to food products, the VAT rate of restaurant and Internet services will be reduced to 18 per cent.	−63
Value added tax	Expansion of the mandatory use of online cash registers	30
Excise tax	The excise tax on tobacco products will increase as of 1 January 2017.	26
Social contribution tax	From now on, the tax base allowance for R+D that cannot be used in the case of the corporation tax can be taken advantage of as social contribution tax allowance.	−9
Continuation of previous programmes		
Law enforcement and national defence career path	Professional employees in law enforcement and national defence will receive a 5 per cent pay rise, and the wages of civil servants in law enforcement and national defence will also increase.	−101
Pay of higher education employees	The pay of those working in higher education will increase by 5 per cent as of 1 January 2017.	−17
Teachers' career path	In 2017, teachers' income will grow as set forth by law.	−26
Family tax allowance	In the case of those with two children, the family tax allowance will rise to HUF 15,000 per child.	−18
Bank levy	In the case of credit institutions, the upper rate of the levy will be reduced to 0.21 per cent.	−9

Note: measures that impair the balance have a negative sign, while balance improving measures have a positive sign

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Table 17

Changes in the accrual-based revenues of the central subsystem between 2015 and 2017

(percentage of GDP)

	2015	2016	2017
	Actual	MNB forecast	MNB forecast
Tax revenues and contributions of central government	**37.5**	**36.6**	**36.7**
Payments by businesses	**4.4**	**4.5**	**4.4**
Corporate tax	1.6	2.0	2.0
Special tax of financial institutions	0.4	0.2	0.2
Sector-specific tax	0.0	0.0	0.0
Simplified entrepreneurial tax	0.3	0.2	0.2
Mining royalty	0.1	0.1	0.1
Gambling tax	0.1	0.1	0.1
Income tax of energy companies	0.1	0.1	0.1
Lump sum tax on small enterpreneurs (KATA)	0.2	0.2	0.2
Small business tax (KIVA)	0.0	0.0	0.0
E-road toll	0.4	0.4	0.4
Utility tax	0.2	0.1	0.1
Other taxes and payments	1.0	1.0	0.9
Consumption taxes	**13.7**	**13.2**	**13.1**
Value added tax	9.8	9.4	9.5
Excise tax	2.9	2.8	2.8
Registration tax	0.1	0.1	0.1
Telecom tax	0.2	0.2	0.2
Financial transaction levy	0.6	0.6	0.5
Insurance tax	0.1	0.1	0.1
Payments by households	**5.6**	**5.1**	**5.2**
Personal income tax	5.0	4.6	4.7
Duties, other taxes	0.4	0.4	0.4
Motor vehicle tax	0.1	0.1	0.1
Tax and contribution revenues of Extrabudgetary Funds	**0.9**	**1.0**	**1.4**
Tax and contribution revenues of Social Security Funds	**13.0**	**12.8**	**12.6**
Social contribution tax and contributions	12.1	12.0	11.8
Other contributions and taxes	0.8	0.8	0.8
OTHER REVENUES	**0.9**	**1.5**	**0.8**
Revenues related to state property	0.3	0.9	0.3
Other revenues of the central government	0.2	0.2	0.2
Other revenues of social Security Funds	0.1	0.1	0.1
Other revenues of Extrabudgetary Funds	0.2	0.2	0.2
INTEREST REVENUES	0.0	0.2	0.1
TOTAL REVENUES OF CENTRAL GOVERNMENT	**38.4**	**38.3**	**37.7**

[10] Partly consolidated data.

Table 18

Changes in the accrual-based expenditures of the central subsystem between 2015 and 2017

(percentage of GDP)

	2015	2016	2017
	Actual	MNB forecast	MNB forecast
PRIMARY EXPENDITURES	**37.1**	**37.2**	**37.3**
Subsidies to economic units, support to the media	**1.1**	**1.1**	**1.0**
Consumer price subsidy	**0.3**	**0.3**	**0.3**
Housing grants	**0.3**	**0.6**	**0.8**
Family benefits, social subsidies	**1.7**	**1.6**	**1.5**
Benefits under retirement age	**0.4**	**0.3**	**0.2**
Net expenditures of central goverment agencies and chapters	**13.3**	**12.8**	**13.6**
Net own expenditures	10.5	11.5	12.5
Net expenditures related to EU funds	2.7	1.3	1.1
Support to local governments	**2.0**	**1.9**	**1.8**
Contribution to the EU budget	**0.9**	**0.9**	**0.8**
Expenditures related to MNB	**0.0**	**0.0**	**0.0**
Central reserves	**0.0**	**1.0**	**1.0**
Debt assumption	**0.4**	**0.0**	**0.0**
Expenditures related to state property	**0.6**	**0.8**	**0.8**
Other expenditures	**0.2**	**0.3**	**0.3**
Expenditures of Extrabudgetary Funds	**1.5**	**1.6**	**1.6**
NEF – Passive allowances	0.1	0.1	0.1
NEF – Active allowances	0.8	0.9	0.9
Other expenditures	0.6	0.5	0.6
Expenditures of Social Security Funds	**14.5**	**14.0**	**13.6**
PIF - Pensions	8.8	8.5	8.2
HIF - Disability and rehabilitation benefits	0.9	0.9	0.9
HIF - Cash benefits	0.7	0.7	0.7
HIF - Medical and preventive care	2.8	2.8	2.8
HIF - Net expenditures related to drug subsidies	0.8	0.7	0.7
Other expenditures	0.4	0.4	0.4
INTEREST EXPENDITURES	**3.3**	**3.1**	**2.8**
TOTAL EXPENDITURES OF CENTRAL GOVERNMENT	**40.4**	**40.3**	**40.0**

[11] Partly consolidated data.

Charles Robert

(1308 – 1342)

King Charles I. was one the most significant rulers of Hungary. He eliminated the anarchy that came about at the end of the Arpadian age, restored the prestige of royal power and its real influence as well as managed to put the economy back on its feet again. King Charles could well be called the new founding father of Hungary, since he could make Hungary a unified and great economic power even in the state of feudal division. A Hungarian king of French ancestry, the descendant of the Capeting dynasty and member of the Anjou family with great influence in Europe, Charles could only take the throne after considerable struggle.

Charles laid royal power onto new foundations and introduced profound reforms. The old and rebellious nobility was replaced by noblemen loyal to him and seized lands were divided up among them, but only as an office fief for the time they held a royal office. The king became even stronger after establishing a new military organisation with the royal banderium, shire banderium and cuman light cavalry.

He pursued a peaceful foreign policy establishing dynastic ties with neighbouring states, which enabled his son to become heir to the Polish crown. At the congress of Visegrád in 1335 (which is also the basis of our current neighbourhood policy) with the Polish and Czech king present, among others decision was made to create a new trade route,

Charles strengthened royal power in terms of finances as well by filling up the treasury. Since Hungary was the primary source of gold and silver in Europe, Charles put mining and trading under close royal control. Charles shared a significant part of royal revenues from mining lease paid for mining precious metals with the owner of the land to facilitate the discovery of new mines. He forbade the export of precious metals; gold and silver had to be given to newly established minting chambers at a price set by the king.

Instead of numerous various currencies, he started minting the silver denarius with a permanent value, then coining golden florins modelled on the golden coins of Florence with the silver farthing becoming its change. Charles abolished the practice of former rulers to inflate money by occasionally reducing the precious metal content of minted coins.

He increased royal revenues by imposing a new tax. Gate tax was levied for each land that had a gate wide enough to let through a cart laden with hay. Customs duty was introduced set at 1/30 of the value of goods exported to or imported from the west or north and 1/20 of southbound goods. Relying on sound economic foundations, in the second part of Charles' reign numerous gothic buildings were constructed, e.g. the royal palace in Visegrád and the Diósgyőr Castle. However, only traces of many of these buildings were left to posterity due to the Turkish devastation.

A Hungarian king with a truly outstanding life, Charles passed away after his 40-year-long reign, and left a strong and rich kingdom to his son. The political ambitions of the Hungarian Anjou dynasty were embodied in Louis the Great, Sigismund and Matthias Corvinus who restored the bygone glory of royal power, but the first stones in this path were laid by Charles I.