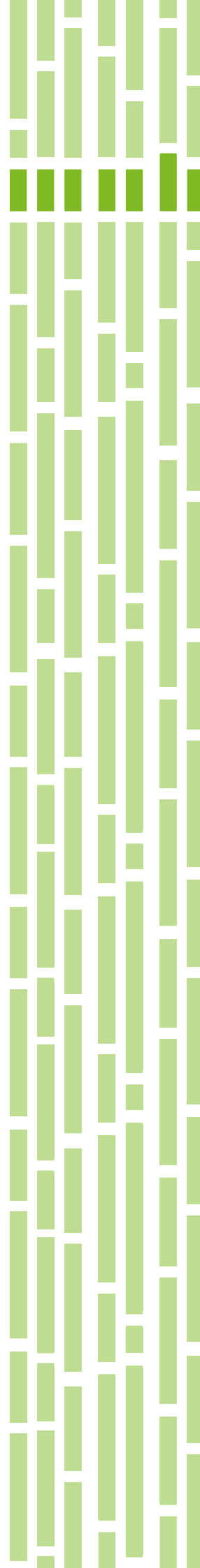


PUBLIC FINANCE REVIEW
July 2011



MAGYAR NEMZETI BANK



**Economic developments
affecting the room for manoeuvre
in the 2012 budget**

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The Governor of the Magyar Nemzeti Bank is a member of the Fiscal Council, and the Magyar Nemzeti Bank is one of the professional workshops which support the work of the Fiscal Council. In connection with these tasks, the Magyar Nemzeti Bank issues a regular publication entitled *Public Finance Review*. The purpose of this series of publications is to provide transparent support for the Fiscal Council in performing its tasks as set out by law and by the Constitution entering into force on 1 January 2012. The conclusions of the analyses reflect the opinions of the relevant Departments of the Magyar Nemzeti Bank and cannot be considered as the official position of the Fiscal Council, the Governor of the Magyar Nemzeti Bank or the Magyar Nemzeti Bank.

This analysis was compiled with the participation of the Financial Analysis and Monetary Strategy and Economic Analysis Departments, under the general direction of Director Áron Gereben. The publication was approved by Governor András Simor.

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Summary

The purpose of our analysis is to provide – during the period of planning the 2012 budget – information on this year’s developments in the budget and on the changes expected to occur next year in the budget items determined by macroeconomic and demographic developments. This information may function as a basis for the Fiscal Council’s opinion on the feasibility and credibility of the 2012 budget bill and contribute to the preparation of the budget bill. The analysis processes relevant information in the period to 30 June 2011; therefore it also takes account of the amendment to the 2011 Budget Act submitted on 22 June.

The ESA balance of the government sector shows a surplus in 2011, as a result of the transfer of private pension fund assets, while the cash-based deficit of the general government may reach 6.4 per cent of GDP. Excluding most of the one-off items with a significant effect this year (the portion of transferred private pension fund assets above the HUF 529 billion that is included in the budget as a revenue, debt consolidation of MÁV (Hungarian State Railways) and BKV (Budapest Public Transport Company), buyout of PPP contracts), the government aimed at attaining a 2.9 per cent ESA deficit. According to our forecast this target is achievable, and the ESA deficit excluding the one-off items may amount to 2.8 per cent in 2011.

After deducting extraordinary expenditure items, the 2011 cash-based deficit of the central government (central budget, social security fund and extrabudgetary funds) may be slightly more favourable than the current statutory target. Total tax and contribution revenues may achieve the target, although with a different structure. The amendment to the Budget Act reduced the envisaged amount of tax revenues by HUF 176 billion, bringing it to a level more realistic than the overly optimistic earlier target figures. According to our forecast, tax revenues may nevertheless fall short of the target, which may be offset by the lower-than-envisaged deficit of the social security funds.

Under a less optimistic scenario, the risks related to the underlying fiscal developments and government measures may worsen the 2011 general government balance by 0.5–0.6 per cent of GDP in total. The most important risk is related to the cancellation of the stability reserve, which was taken into account in our projection. Without permanent expenditure reducing measures, this cancellation may result in financial difficulties in the second half of the year, which may lead to an increase in arrears and unpaid bills and to a partial suspension of the obligation to keep the carry-over balance at the previous year’s level. In addition, macroeconomic developments differing from our expectations may significantly divert the development of the budget 2011.

Along with the government’s deficit target, during the planning period the room for manoeuvre in the 2012 budget is primarily determined by developments in items which, assuming unchanged legislation, depend on demographic and macroeconomic developments (exogenous items), such as most of the tax revenues. Taking into account the anticipated effects of 2011 fiscal developments in 2012, the balance of exogenous items as a proportion of GDP may worsen slightly in 2012 (by 0.2 percentage points), as the total increase in revenues will remain below the nominal GDP growth rate. This is attributable to the continued export-driven growth as well as certain government measures.

Our forecast suggests that achieving the government’s ESA deficit target of 2.5 per cent of GDP for 2012 will require a balance improvement of more than 2 per cent of GDP in the discretionary items of the central government compared to the 2011 base. This is considered to be significant, even if the measures of the Széll Kálmán Plan and of the convergence programme affecting discretionary items are also taken into account. However, for the time being, our 2012 projection does not take account of the savings of the stability reserve, as currently we do not have sufficient information to form an opinion on the sustainability of the measure.

Introduction

At the end of the first half of each year, as a part of the publication series *Public Finance Review*, the Magyar Nemzeti Bank releases an analysis of the economic developments affecting the room for manoeuvre available for the subsequent year's budget.

The beginning of the second half of the year marks the period of preparing and planning the budget for the next year. Precise forecasting of the expected changes in budget items (for example consumption and income tax revenues) determined by macroeconomic and demographic developments is of the utmost importance during this period of the year. This is because, taking into consideration the government's deficit target, on the basis of a realistic projection of these items it becomes possible to determine the room for manoeuvre available for the next year's budget, in view of other, typically expenditure-side budget items which can be more directly influenced by the government over the short run.

In the past, it was observed on numerous occasions that in the submitted and adopted budget bill the appropriations for items determined by macroeconomic and demographic developments were more favourable than what could reasonably be expected, i.e. the relevant plans were overly optimistic. It is no surprise that in past years failure to meet the unrealistically high revenue targets often contributed to the development of a fiscal deficit which was higher than planned.

In determining the room for manoeuvre in the next year's budget, it is necessary to prepare a detailed estimate of the expected cash-based developments in the current year's budget, based on the actual figures for the first half of the year and our best current macroeconomic forecast. As a next step, it is possible to examine how fiscal developments

in the current year affect developments in the coming year, i.e. what should be taken as a reasonable basis for planning next year's budget.

Accordingly, the objective of our analysis is to present, relying upon the detailed forecast of the cash-based developments in the 2011 budget, a basis for the Fiscal Council to give its opinion on the feasibility and credibility of the 2012 budget bill prior to submission of the bill to Parliament as regulated by law. In addition, the analysis, as expert background material, may also contribute to the preparation of the budget bill itself.

The analysis is based on the macroeconomic and general government forecasts presented in the *Quarterly Report on Inflation* published by the MNB on 22 June 2011. We have expanded the scope of information with relevant factors which became known in the period up to 30 June 2011 and which affect the general government's budget (e.g. adopted laws and certain submitted bills and cash-based developments in the budget observed before the end of June), while our other exogenous assumptions concerning the macroeconomic forecast remained unchanged.

First, the analysis summarises our latest forecast for the 2011 cash-based and accrual-based general government balance. Second, we present the cash-based revenue and expenditure processes of the central subsystem of the general government in detail. The third part evaluates the main risks related to our forecast. Finally, we discuss the changes in the budget items determined by macroeconomic and demographic developments expected for 2012 according to our current assumptions. The summary of our methodological assumptions used in the preparation of our forecast can be found in the appendix, together with other background tables of the analysis.

1 Developments in the general government balance in 2011

Our analysis focuses on the cash-based balance of the central government regulated by the Budget Act. However, due to its special importance in the Convergence Programme, the ESA balance of the government sector is also presented in brief.¹

According to our forecast, the ESA balance of the government sector may show a surplus of 2.8 per cent of GDP in 2011 (Table 1). A general government surplus may develop, despite the expected large deficit in the cash-based (GFS) balance. This year, the total cash-based deficit of the central government and local governments may increase to 6.4 per cent of GDP, representing a deterioration of 2.3 percentage points compared to the value of the previous year. One of the peculiarities of fiscal 2011 which reduces transparency is the considerable difference between the cash-based and the ESA

accounting of fiscal developments. First, the most important underlying reason is that only a smaller portion of the assets transferred from the private pension funds appears as revenue on a cash basis, and second, the purchase of the MOL shares does not influence the ESA balance (see the Box 1).

The general government surplus is entirely the consequence of the **one-off portfolio revenue** related to the reorganisation of the private pension fund system, and a considerable deficit would have evolved without this revenue. In 2011, in addition to the reduction of government debt, the government is spending some of the revenues on expenditures: partly on current expenditures in line with the Budget Act (1.9 per cent of GDP) and partly on one-off expenditures (2 per cent of GDP, for debt assumptions and buyout of PPP contracts).

Table 1
Summary data of the 2011 general government balance

	2010 fact	2011 MNB forecast	2010 fact	2011 MNB forecast
	billion HUF		percentage of GDP	
1. Balance of central government	-870	-1,688	-3.2	-5.9
2. Balance of local governments	-252	-149	-0.9	-0.5
3. Balance of general government (1+2)	-1,122	-1,837	-4.1	-6.4
4. GFS-ESA difference:	-31	2,631	-0.1	9.2
- additional private pension funds portfolio transferred to general government ¹		2,167		7.6
- correction due to purchasing of the MOL shares		499		1.8
- accrual-based corrections		-35		-0.1
5. ESA balance of general government (3+4)	-1,153	795	-4.3	2.8
6. One-off items in ESA balance: ²		1,590	0.0	5.6
- additional private pension funds portfolio transferred to general government ¹		2,167		7.6
- debt assumption of MÁV and BKV, the buyout of PPP contracts		-577	0.0	-2.0
7. ESA-balance without one-off items ² (5-6)	-1,153	-795	-4.3	-2.8

¹ The additional private pension fund portfolio improving the ESA balance refers to the portion of the transferred assets above the HUF 529 billion forints indicated in the Budget Act as revenue.

² The sum of the one-off items was taken into account from the aspect of the official deficit target of the government and not in terms of economic content; therefore, it does not contain the part of the assets taken over from the private pension funds which has been included in the budget.

¹ The ESA balance is derived in a technical manner from our forecast for the cash-based, so-called GFS, balance of the central and local government subsystems, using the latest ESA-GFS methodological bridge expected by the government; we prepare an independent estimate only for the accrual-based adjustment of the interest expenditure. There is a very small difference between the ESA balance and EDP balance applied in the excessive deficit procedure (EDP) and mentioned in the convergence programme as well. The underlying reason for the difference is the adjustment of interest expenditure for the effect of swap and FRA transactions. The extent of the difference has not reached 0.1 per cent of GDP in recent years, and its sign also changes frequently. Accordingly, our forecast assumes that the expected value of the difference is zero.

Our projection for the ESA balance is more favourable than the government's expectation of a surplus of 2 per cent of GDP disclosed in the April EDP report related to the excessive deficit procedure of the European Union and in the Convergence Programme. While the assessment of the underlying fiscal processes is similar, the deviation is mainly attributable to the difference in assumptions regarding assets transferred from the private pension fund system to the state. Preliminary data suggest that the revenue resulting from this may be some 0.5 per cent of GDP higher than previously expected.²

According to our projection, the official deficit target calculated net of one-off items is also achievable, as the government intends to adhere to its original target of a **-2.9 per cent ESA balance** as well, in a way that the balance net of one-off revenues and expenditures which have arisen since the adoption of the Budget Act should remain at this level. For this purpose, revenues should be adjusted for the part of the portfolio revenue originating from the private pension funds which is above the level set out in the Budget Act, whereas expenditures should be revised in consideration of the debt assumptions announced in the Convergence Programme (MÁV, BKV) and the buyout of PPP contracts. Disregarding these items

results in an ESA deficit of 2.8 per cent on the basis of our forecast.

One can come to a similar conclusion on the basis of the cash-based deficit of 2.8 per cent, which was originally determined upon adoption of the 2011 budget and which includes the local governments. Deducting the one-off extraordinary expenditure items would modify the 6.4 per cent cash-based deficit which we have calculated to 2.7 per cent (in this case, the GFS balance also has to be adjusted for the expenditure related to the MOL transaction, in addition to the debt assumptions and the PPP buyouts).³

The MNB projection of the general government balance incorporates the **effect of the interim savings measures** which became known prior to 30 June. The changes taken into account in our forecast resulted in a balance improvement of approximately 0.6 percentage points. Of this, certain elements of the Kálmán Széll Plan affecting this year account for 0.1 per cent of GDP. The net fiscal effect of the package of measures (final reduction of the expenditures blocked on the appropriations within the framework of the stability reserve and the raising of certain expenditure items) set out in the amendment to the Budget Act can be estimated at a further 0.5 percentage points.

Box 1

The differences between cash-based accounting and ESA accounting in 2011

Of the assets transferred from the private pension funds to the Pension Reform and Debt Reduction Fund only that part is shown in the cash-based (GFS) balance which is also included in the Budget Act (HUF 529 billion). On a cash basis, other revenues of the Fund remain outside the general government. However, the ESA balance uses a wider interpretation of the government sector, and contains the Pension Reform and Debt Reduction Fund as well. Accordingly, the total portfolio revenue, which, based on preliminary information, is expected to be 7.6 per cent of GDP higher than in the Budget Act, improves the ESA balance as a revenue.

The other significant difference is related to the purchase of the MOL shares, which is an expenditure on a cash basis, but is a financial transaction on an ESA basis (exchange of financial assets

for shares), and therefore it is not included in the expenditures on an ESA basis. This item results in a difference of 1.8 per cent of GDP (HUF 499 billion) between the general government balances of the two accounting systems.

Accordingly, the aforementioned two items result in a higher revenue and lower expenditure on an ESA basis, i.e. they both point to a more favourable ESA balance than the value on a cash basis. In contrast, the sum of the adjustments stemming from the fact that revenues and expenditures on a cash basis are entered on the date of the actual payment, whereas the real time of the occurrence of the financial claim matters on an accrual basis, is insignificant (0.1 per cent of GDP). Our forecast is based on the current value of the official ESA bridge, amended by the accrual-based adjustment calculated for the interest expenditures.

² Based on the announcement of the Hungarian Financial Supervisory Authority dated 14 June 2011, the assets transferred from the private pension fund portfolio to the state amount to HUF 2,956 billion, equalling 10.4 per cent of GDP. Of this, real yield due to members who return to the public pension system amounts to some HUF 260 billion.

³ At the same time, within the cash-based balance of the general government the deficit of local governments is projected to be somewhat less favourable. In the medium-term outlook of the Budget Act, the government expects a deficit of HUF 110 billion in the local government sector in 2011; the MNB projection envisages a nearly HUF 40 billion higher deficit, which is still a significant improvement compared to the 2010 cash deficit, which reached HUF 252 billion according to preliminary actual data.

2 Developments in the central government on a cash basis in 2011

The analysis below focuses on developments in the central government on a cash basis. Proceeding along the main budget lines and groups of items, we present our forecast for performance in 2011, and compare our projection to the values set out in the statutory appropriations. Our detailed projections for the budget items are included in Tables 2 and 3 of the appendix. The assumptions serving as a basis for our forecast and the estimation methods applied are also summarised in the appendix (Tables A.4-A.6).

Depending on the economic content, we applied different approaches for individual budget items in our projection.

- In the case of most **appropriations sensitive to economic and demographic developments** (the so-called exogenous items according to the Fiscal Responsibility Act typically fall into this group), we prepared independent estimates using the variables derived from the macroeconomic forecast of the MNB, and corrected them with the estimated effect of possible government measures as well as with the shifts which are taking shape in the actual figures of the first half of the year and are considered to be systematic.
- In the case of **discretionary appropriations** (typically the so-called discretionary items; most central budget

expenditures belong in this group), however, we set out from the statutory appropriations, and provided different forecasts only where it was justified by government measures already implemented or ones that will most likely be implemented, as well as on the basis of our observations regarding cash flows during the course of the year.

2.1 BALANCES ON A CASH BASIS

The MNB projection for developments in the budget of the central government on a cash basis is presented in **comparison to the current, amended targets**. The changes in the target figures were taken into account on the basis of the bill on the amendment of the 2011 Budget Act submitted under number T/3636 on 22 June and the amendment related to the purchase of MOL shares (T/3489) adopted earlier. Accordingly, our forecast also takes account of the cancellation of the stability reserve as included in the targets as well as an increase in certain subsidies (subsidies to local governments, allocations for public educational and social, church purposes). (An overview of the main changes in the Budget Act is presented in the appendix.)

Based on our forecast, the cash-based balance of the central government calculated in a comparable manner may reach a

Table 2
Cash-based balance of the central government in 2011

(HUF billion)

	Statutory target	MNB forecast	Difference
Balance of central budget	-1,138	-1,732	-594
Balance of central budget without extraordinary additional expenditures	-1,138	-1,155	-17
Balance of the Extrabudgetary Funds	41	54	13
Balance of the Social Security Funds	-88	-10	78
Balance of central government	-1,184	-1,688	-503
Balance of central government without extraordinary additional expenditures	-1,184	-1,111	74
of which:			
Interest payment balance	-1,008	-974	34
Primary balance	-177	-714	-537
Primary balance without extraordinary expenditure	-177	-137	40

Note: Extraordinary expenditures comprise the assumptions of the debts of MÁV and BKV as well as the buyout of PPP contracts; the MOL transaction is already included in the amended statutory target.

Table 3
Quarterly changes in central government deficit on a cash basis; preliminary actual data and projection
(HUF billion)

	Central budget	Extrabudgetary funds	Social security funds	Total
1st quarter*	-688	44	-98	-743
2nd quarter*	-219	18	-90	-292
3rd quarter	-365	2	96	-268
4rd quarter	-459	-9	83	-385
Annual cash-based balance	-1,732	54	-10	-1,688

* Preliminary actual data.

level more favourable than the statutory target by 0.25 per cent of GDP (Table 2). Although our forecast for the deficit figure exceeds the target by some HUF 500 billion, it is the consequence of large one-off expenditure items which are not yet included in the amended Budget Act, but were already announced by the government; these are estimated to amount to HUF 577 billion (consolidation of MÁV and BKV, buyout of PPP contracts). After deducting these one-off expenditure items, the deficit deduced from our forecast is already HUF 74 billion lower than the statutory figure. Within that, we expect the balance of interest revenues and expenditures to be HUF 34 billion more favourable, and the balance of primary revenues and expenditures to be more favourable by HUF 40 billion.

At the same time, the difference between our estimate for the aggregate cash deficit and the statutory target is the result of shifts in different directions observed in individual subsystems:

- Even after deduction of the extraordinary expenditures, the MNB's forecast for the deficit of the **central budget** is slightly higher than the target figure, by some HUF 17 billion. The main underlying reason is that our expectation regarding the developments in tax revenues at an annual level is even more pessimistic than the targets that were revised downwards, which are not completely offset by the balance improving differences identified by us in other budget lines (primarily in the case of net interest expenditures).
- As far as **extrabudgetary funds are concerned**, we expect a surplus in excess of the statutory target by HUF 13 billion, mainly due to the anticipation of more restrained realisation of passive unemployment provisions.
- In respect of **social security funds**, we expect the deficit to be lower than the target by HUF 78 billion, as a result of higher-than-planned social contribution revenues on

the revenue side and savings in pensions and health-care provisions in cash on the expenditure side.

Due to the significant number of one-off revenue and expenditure items, developments in the central government deficit on a cash basis are not following the usual seasonal pattern in 2011. Based on preliminary actual data, 88 per cent of the deficit set forth in the Budget Act has already been reached in the first half of the year, while the expenditure related to the MOL transaction has not been realised yet. However, this does not contradict our expectation regarding the developments in deficit, as the cash-based accounting of the revenue of HUF 529 billion planned to be received by the Pension Reform and Debt Reduction Fund from the transfer of the assets of private pension funds is also due in the remaining part of the year. Our projection shown in Table 3 distributes this revenue of the social security funds evenly during the second half of the year, while the portion due to the central budget is booked for the third quarter. The purchase of the MOL shares also has an effect in the third quarter, whereas debt assumption has an impact in the fourth quarter.

Our forecast for some budget items is different than the estimate which takes into account only the effect of macroeconomic developments and of the measures (Table 4). The difference reflects the shifts taking place as a result of developments during the year and one-off impacts. In the main scenario, it is assumed that the effect of the difference is permanent, which is standard practice in the case of tax optimisation (efficiency of collection). In the case of the examined main budget items sensitive to macro variables, economic developments would result in an increase equalling 1 per cent of GDP compared to the 2010 base values, but the estimated effect of the measures reduces it by 0.7 per cent of GDP. The one-off balance improving effects which cannot be explained with these two factors amount to 0.2 per cent of GDP, while the sum of the shifts worsening the balance is nearly 0.3 percentage points. Consequently, the net difference is insignificant.

Table 4
Decomposition of the changes in selected items sensitive to macroeconomic developments

(HUF billion)

	2010 fact	Effect of macro-economic developments	Effect of measures		Unique effect	2011 MNB
			permanent	transitory	permanent	
	I.	a.	b.	c.	d.	II. (I.+a+b+c+d)
Corporate income tax	323	17	-108		54	286
Simplified entrepreneurial tax	182	5		4	-10	180
Value-added tax	2,314	130	6	-26	-3	2,420
Social security contributions	2,820	88	292	38	-48	3,189
Personal income tax	1,768	57	-470	51	-15	1,391
Passive allowances	138	4	-5		-16	120
Balance	7,269	293	-275	67	-6	7,346

2.2 DEVELOPMENTS IN REVENUES

Revenues of the central budget

On the revenue side of the central budget we see developments with a negative overall effect on the fiscal balance. As we estimate, tax revenues may fall short of the current targets by HUF 58 billion, in spite of the fact that the amendment to the Budget Bill has already reduced the target figures by HUF 176 billion. The lower performance in tax revenues is partly attributable to base effects as well as to economic developments that are less favourable in 2011 than expected. The overly optimistic plan was mostly remedied by the amendment in June. Approximately half of the shortfall in tax revenues still remaining after the amendment may be offset by higher interest revenues and additional payments from the subsystems of the general government (mainly from local governments).

At the same time, total revenues may exceed the target by HUF 264 billion, as in the case of central budgetary units and chapters the expected revenue is considerably higher than planned. However, this will not result in an improvement in the fiscal balance, because it is primarily a result of accumulations (reallocation of appropriations), and is coupled with an increase of a similar size across the expenditures of budgetary chapters and institutions.

The expected changes in tax revenues are discussed in detail below. The revenues of institutions and chapters as well as interest revenues are discussed together with the processes on the expenditure side.

Payments by economic organisations

Our projection suggests that total revenues from payments by enterprises may fall short of the target only marginally (by barely HUF 6 billion). A major negative difference (HUF

17 billion at annual level) can be detected in connection with the already repealed surtax of corporations, as the effect of refunds has not been taken into account in the amendment to the Budget Act. The resulting shortfall may be offset by higher revenues from extra taxes and the mining royalty. At the same time, in the first half of the year, revenues from less significant taxes (ecological taxes, company car tax) to some extent failed to reach the pro rata values that can be deduced from the statutory targets. Our forecast already takes into account the effect of the public health product tax, which becomes effective as of September, and which may generate additional revenue of up to HUF 4 billion this year.

Our projection for **corporate tax revenue** is broadly identical with the new target. We consider it justified that the amended target is the result of a reduction of HUF 84 billion. The weaker performance of this type of tax is the consequence of base effects and changes in regulations. Following the economic crisis, in 2009 and 2010 corporate tax payments fell more strongly than expected, which may be attributable to the effect of several factors. The decline in the operating profit of the corporate sector exceeded the extent of the economic downturn, especially in the financial sector. In addition, reducing the stock of accrued corporate losses accumulated during the crisis is a protracted process that takes several years. The common feature of the above two effects is that the initial major shortfall in taxes may turn around in a couple of years. At the same time, the effect of the measures taken in 2010 in order to enlarge the tax base is extremely uncertain, and only full knowledge of the corporate tax returns will provide a more precise picture of it.

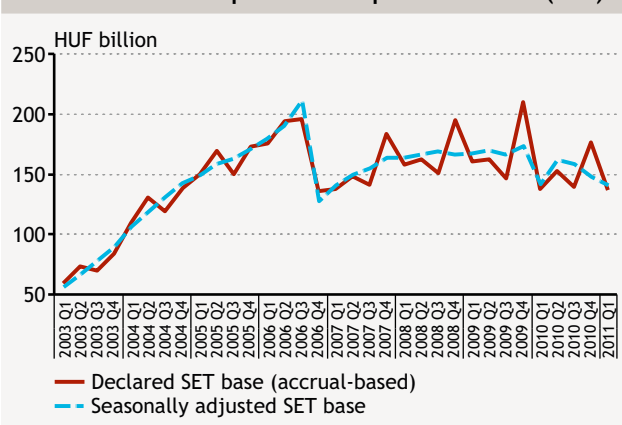
Increasing the value of the 2010 base with the index of the nominal GDP would result in corporate tax revenues of HUF 340 billion for 2011. By contrast, our expectation is a mere HUF 286 billion. The difference is mainly attributable to the effects of government measures (see the Box 2).

Box 2

Measures and one-off effects affecting the developments in corporate tax revenues in 2011

- The total annual effect of the extension of the 10 per cent reduced tax rate to companies with sales revenues of up to HUF 500 million results in a loss of HUF 80 billion compared to the base year;
- the amount of the tax that can be offered for sports financing purposes is estimated to be HUF 21 billion;
- the secondary effects of surtaxes imposed on financial institutions and certain sectors and new measures affecting the pharmaceutical industry are expected to result in a HUF 9 billion shortfall in tax revenues compared to the base year;
- the increase in revenues resulting from the easing of the rules related to the tax topping-up at the end of the year (bureaucracy reducing programme) is estimated to amount to HUF 2 billion;
- based on the information available for us, the additional amounts originating from the reduction of tax allowances on investment may increase tax revenues by HUF 19 billion;
- our picture of the business cycle makes us assume that the operating profit of the corporate sector grows by 2 percentage points faster than the real GDP growth rate, which may result in additional revenues amounting to HUF 7 billion; in 2012 and 2013 the effect of the business cycle will change to around 3 per cent, in accordance with the cyclical estimate stemming from the macroeconomic model;
- according to our assumption, in 2010 write-offs for losses may have exceeded the level average of previous years by around HUF 43 billion. A decline in write-offs for losses is expected for 2011, which will result in an estimated revenue of HUF 28 billion in addition to the baseline scenario.

Chart 1
Tax base of the Simplified Entrepreneurial Tax (SET)



Our annual forecast for the **simplified entrepreneurial tax (SET)** is identical with the new target. Actual data show that the dynamics of revenue increase broke, which may be attributable to the raising of the tax rate (the tax advantage of the SET declined considerably) as well as to the bureaucracy reducing measures. The trend of the declared sales revenue stagnates at a lower level following the tax increase in 2010. Therefore, the reduction of the original target by HUF 16 billion is in line with our projection.

During the first half of the year, revenue from the **mining royalty** grew dynamically: by the end of May, budget revenue from this type of tax was nearly 20 per cent higher than in the same period of the previous year. This

development is primarily attributable to the high oil price level. Based on the historical production trend and our projection for changes in oil prices, compared to the 2010 base net of one-off effects, additional revenue amounting to HUF 14 billion is expected for 2011.

Compared with cash-based revenue in 2010, revenue from **gambling tax** is expected to decline in 2011. The underlying reason is the fall in income from slot machines, which is a result of the steady decline in the number of machines since 2003. As for the main lottery-type games, we do not expect any major accumulation in 2011 that could generate unforeseeable additional revenues.

In the case of the **sector-specific extra taxes**, we expect a surplus exceeding the target by HUF 10 billion. The underlying reason is that net payments related to the 2010 tax year exceeded expectations until the end of May. However, this extra revenue is reduced by the expected fall in the volume of sales revenues by some 3 per cent in the telecommunications sector, and the increase in sales revenues of energy suppliers is also significantly limited due to the comprehensive price regulation by the state.

Taxes related to consumption

A considerable shortfall in revenues is projected in the case of consumption taxes; even compared to the amended target, fulfilment is expected to be HUF 75 billion lower.⁴ Within this, there is a difference of HUF 68 billion between

⁴ The amendment to the Budget Act reduced planned revenues by HUF 69 billion. The adjustment of the target figure is justified by the fact that during the parliamentary debate of the original Budget Act the revenue target was increased by the same amount as this reduction, but it was not supported by relevant measures.

the target and our estimate for **value added tax (VAT)**. The weaker performance of VAT which we expect is basically caused by macroeconomic developments: the growth rate of purchased consumption may fall short of the value assumed during planning by 2 percentage points. In addition, cancellation of the stability reserve also has a negative effect on revenues, further increasing the gap between our projection and the amended target.

We expect that the revenue from the **excise tax** will fall short of the statutory target by HUF 9 billion, in spite of the fact that we have already taken into account the effect of the raising of the excise tax on tobacco during the year. The difference is mainly attributable to the base effect, because in 2010 the excise tax on alcohol and tobacco products fell significantly short of the target (by some HUF 20 billion). At the same time, our forecast for the **registration tax** exceeds the target figure by HUF 2 billion. Actual data in the first half of the year may indicate additional revenue from this item.

Payments by households

In contrast to other types of taxes, additional revenues are expected from the taxes paid by households. Our expectation exceeds the statutory target by HUF 24 billion: within this, we expect an additional HUF 28 billion from the personal income tax (PIT) and HUF 5 billion less from duties.

Despite the assumed 3.2 per cent growth rate of the wage bill, which determines developments in **PIT revenues**, revenues in 2011 are expected to be HUF 377 billion (21 per cent) lower than in the previous year, which is primarily attributable to the adoption of the flat rate system. At the same time, our forecast, which is higher than the statutory target, is the result of the following factors:

- our estimate for the amount of the tax credit may result in revenue which is HUF 22 billion higher,
- our estimate for the so-called withholding taxes may result in a HUF 24 billion higher revenue,
- in the case of incomes subject to separate taxation, the changes in law and in the tax base may result in revenue which is HUF 5 billion higher,
- however, the estimated change in the calculated amount of tax (the super gross tax rate projected to the tax base), adjustments on a cash basis and expenditure side effects (cancellation of the stability reserve) together will result in lower fulfilment by approximately HUF 8 billion,

- as the actual data for the first half of the year suggest that payments will fall short of expectations, we reduced our forecast for the expected annual revenue by HUF 15 billion.

The annual level of **revenues from fees and duties** is expected to amount to HUF 77 billion, i.e. 6 per cent less than the new target, which is already a result of a downward revision. The difference is related to the expected considerable shortfall in the revenues from the capital acquisition duty, which is confirmed by the actual fulfilment data as well.

Revenues of the extrabudgetary funds

In our projection, total revenues of the extrabudgetary funds may exceed the target by HUF 7 billion. This is mainly attributable to additional other revenues at the smaller funds, especially the Bethlen Gábor Fund. However, the revenue from the rearrangements of some appropriations in the central budget does not affect the balance, because it increases the expenditures as well to a similar extent.

In the first half of the year, **autonomous revenues** of the extrabudgetary funds (labour market contribution, vocational training contribution, innovation contribution and the portion of the gambling tax due to the Cultural Fund) failed to reach the level of the same period of the previous year, which can rather be considered as a consequence of different seasonal developments. Therefore, the fulfilment of these items is expected to be broadly identical with that of last year and only slightly (by around HUF 3 billion) lower than this year's target.

Revenues of the social security funds

According to our forecast, the revenues of the social security funds may exceed the target by HUF 67 billion (roughly 1.5 per cent). Nearly three quarters of the estimated additional revenue is related to revenues from social contributions and the health-care contribution, whereas the remaining nearly one quarter is related to payments by pharmaceutical producers and distributors.

Our forecast for social **contribution revenues** (excluding other contributions) is basically determined by the fulfilment in the previous period and the changes in wage bill dynamics. Increasing the 2010 base with the change in the wage bill and assuming an unchanged effectiveness projected to the extent of the contribution would result in contribution revenues amounting to HUF 2,908 billion. However, our projection for 2011 is HUF 282 billion higher

than that, at HUF 3,189 in total. The difference is a result of changes in legislation and of one-off effects:

- in the case of the individual pension contribution, the high number of people returning to the state pillar, the complete temporary redirection of payments for 14 months and the one half percentage point increase in the contribution rate result in total additional revenue of HUF 338 billion;
- at the time of the payments in January 2010 the health contribution paid by employers was still higher on average; this results in lower revenue by HUF 8 billion for 2011;
- as a result of a 1.5 per cent decline in contribution effectiveness, revenues may fall by HUF 48 billion.⁵ (Effectiveness declined gradually during 2010, an important underlying reason for which may be that during the first half of 2010 several companies settled their overdue social contribution payment obligations. Another reason may be the cyclical situation of the economy, which could also provide explanation for the fact that effectiveness started to grow again in the first half of 2011.)

Of the above factors, only the redirecting of the contribution payments of the remaining private pension fund members is considered to be temporary; the other measures and developments are deemed permanent, to be included in the base. As a result of all of the above, contribution revenue is expected to exceed the target by HUF 39 billion. However, based on actual data for the first half of the year, other contributions are expected to fall short of the target figure by HUF 4 billion.

Our forecast for the **health-care contribution revenues** exceeds the statutory target by HUF 15 billion. Our estimate reflects the changes in legislation introduced for this type of tax, and is also consistent with the developments observed in the first half of the year (by the end of May fulfilment had already exceeded two thirds of the original target).

Estimated additional revenue from **payments by pharmaceutical producers and distributors** amount to

nearly HUF 13 billion, which partly results from measures taken during the year and partly from the expected changes in pharmaceutical price subsidies (this issue is discussed together with the pharmaceutical expenditures). A further HUF 4 billion increase in revenue will result from our assumption that the revenue from the **public health product tax** will be transferred by the central budget to the Health Insurance Fund (HIF) in the form of a subsidy, which will be spent on expenditures for therapeutic and preventive provisions. Accordingly, the effect of the new tax is neutral for the balances of both subsystems.

2.3 DEVELOPMENTS IN EXPENDITURES

Expenditures of the central budget

In respect of most expenditure items of the central budget there is no major difference between the targets and their expected realisation. The expenditures of budgetary units and chapter-managed appropriations are higher in our forecast because their revenues are also higher. However, debt consolidation of MÁV and BKV, and the buyout of PPP investment represent a considerable difference. Their expected costs have been included in our forecast, in a total amount of HUF 577 billion. In addition to these two items, as a result of variations with different signs, a savings effect amounting to approximately HUF 11 billion was identified in other items of the central budget, which is mainly attributable to the lower level of expenditures related to our forecast for debt servicing.⁶

Taking into account all the above, total expenditures are expected to exceed the statutory appropriation by HUF 841 billion. In the following section, we take a closer look at the developments in only the two most significant items: the expenditures of institutions and chapters as well as net interest expenditures.

Net expenditures of central budgetary institutions and chapters

There is only a negligible difference between the 2011 appropriation and our projection calculated for net expenditures, i.e. the difference between the sum of the expenditure and revenue lines concerning the organisations and chapters.

⁵ The effectiveness rate of contributions shows the actually received contribution revenue compared to the theoretical revenue calculated on the basis of the whole-economy wage bill and the percentage rates set out by law.

⁶ Although it does not represent a significant change, because of the measure taken into account we mention that our projection for the family and social allocations also reflects the expected tightening in the allowance to people with changed working abilities, which may enter into force as one of the elements of the Széll Kálmán Plan as early as in the second half of 2011, as it is included in the convergence programme (the estimated effect for this year is a mere HUF 2 billion).

Table 5
Net expenditures of budgetary units and chapter-managed appropriations in 2011

(HUF billion)

Items	Statutory target	MNB forecast	Difference
1. Own revenues of the budgetary units and chapters	648	1,128	480
2. EU subsidy target in chapters	1,147	960	-187
3. Payment of the budgetary organisations to central budget	33	36	3
4. Total revenues (1+2+3)	1,828	2,124	296
5. Gross expenditures of the budgetary units and chapters	4,083	4,375	292
6. Utilisation of targeted reserves	17	17	0
7. 50 per cent utilisation of other reserves	45	45	0
8. Total expenditures (5+6+7)	4,145	4,437	292
9. Total net expenditures (8-4)	2,317	2,313	-5

In the case of the institutions and chapters, the analysis of net expenditures instead of a separate examination of revenues and expenditures is justified because the reorganisation of public administration as well as the handover-takeover of tasks between institutions and chapters add to both revenues and expenditures (accumulation), while the balance remains unchanged. For comparability, the lines of the central budget are grouped in Table 5 in a way to reflect important relations on a cash basis. Accordingly, based on experience from earlier years, a part of the provisions and reserves was also taken into account in the expenditures of institutions and chapters.⁷ In addition, payments due to the budget from central budgetary units were also included in net expenditures, as these payments originate from institutional and chapter revenues, and thus also appear in the expenditures of the institutions and chapters.

The current statutory appropriation calculated in this manner for net expenditures, including the portion of the reserves that was taken into account, amounts to HUF 2,317 billion. Our annual projection is around HUF 2,313 billion. Accordingly, our forecast contains a saving of nearly HUF 5 billion in the items of institutions and chapters. This is because we assumed that budgetary units do not spend a part of their additional revenues stemming from external sources, but transfer such to the central budget, in line with earlier practice.⁸

In contrast to the statutory target of HUF 648 billion, our projection for **own revenues** of budgetary units and

chapters is HUF 1,128 billion; most of the HUF 480 billion difference results from accumulation related to the reallocation of tasks and appropriations. (For example, based on data for the first half of the year, own revenues of chapters already significantly exceeded the statutory target.)

However, in terms of the use of **EU funds** our projection is more conservative than the target; our estimate was prepared on the basis of the trend which has developed in recent years. Accordingly, we expect that the use of funds will be HUF 187 billion lower than planned. Until the end of June, revenues from EU transfers failed to reach the level of the same period of the previous year, while the statutory target for 2011 exceeds last year's actual figure by some HUF 330 billion. However, no far-reaching conclusions can be drawn from interim actual data, as utilisation of funds during the year is very volatile.

The latest available information suggests that the amount of carry-over balance of budgetary units and chapters remaining from last year is not much different from the stock at end-2009. Therefore, also taking into account the 2011 **obligation to keep carryover balances at a binding level**, no significant additional expenditures on a cash basis are expected for the rest of the year in the baseline scenario, as opposed to what could be expected on the basis of the surge in expenditures at the beginning of the year. However, this expectation of ours may be significantly amended by fiscal strains which may evolve due to cancellation of the stability reserve (we will return to this issue upon in discussion of risks).

⁷ More precisely, we assumed that the remaining part of the provisions (after deducting the HUF 17 billion reallocated to local governments for the purpose of wage supplements at the beginning of the year) and half of the general provisions will be included in the expenditures of the institutions and chapters.

⁸ Table 5 only shows HUF 3 billion of the transferred additional revenue in the line of payments; another HUF 2 billion was transferred to extraordinary government expenditures as a result of a measure taken during the year.

Net interest expenditures

Since adoption of the Budget Act, the value of interest expenditures expected for 2011 has been significantly influenced by the one-off effect stemming from the restructuring of the private pension fund system. The government securities included in the portfolio transferred by the private pension funds to the Pension Reform and Debt Reduction Fund were withdrawn by the Government Debt Management Agency; consequently, the relevant interest payment obligation ceased to exist, which reduces interest expenditures in 2011 already. The debt manager withdrew government securities with a total face value of HUF 1,343 billion. As a result, the budget can save interest expenditures amounting to HUF 35 billion on a cash basis in the second half of the year. With the management of the remaining assets of the portfolio, the Fund may collect revenue from yields, but as far as we know, this revenue appears in the Pension Reform and Debt Reduction Fund, i.e. outside the general government pursuant to Hungarian regulations.⁹

Originally, the Budget Act included net interest expenditures of HUF 993 billion, which was raised by the amendment to HUF 1,008 billion, referring to the additional interest stemming from the issue of US dollar bonds. In our own forecast – also taking into account the withdrawn government securities portfolio as well as the foreign-exchange denominated bond issues – we expect net interest expenditures to amount to HUF 974 billion in 2011, resulting from gross expenditures of HUF 1,050 billion and interest revenues of HUF 77 billion. There is a 50/50 ratio between interest expenditures and interest revenues in the difference of HUF 34 billion compared to the amended target.

In respect of the annual net interest expenditures which we project, 48.5 per cent materialised by the end of May, but the pro-rata fulfilment is not relevant for interest expenditures expected for the whole year, as they develop during the year according to the order of interest payment of the outstanding securities as well as the premia and discounts accounted for upon issues and also in line with accrued interest. For example, the interest payment in February increased considerably compared to the previous year, because a significant portion of the government securities issued in the meantime pays coupons in that month.

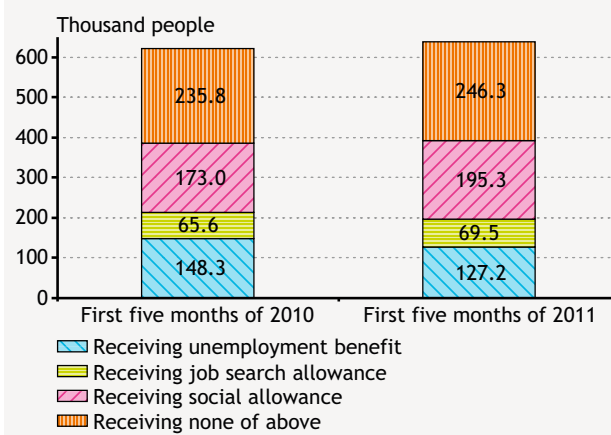
Expenditures of the extrabudgetary funds

The amendment of the Budget Act reduced the total expenditures of the extrabudgetary funds by HUF 36 billion. Taking account of the modification of statutory appropriations we expect expenditures to be lower by another HUF 6 billion. The difference is the result of the use of the already mentioned additional revenues and expected savings of approximately HUF 15 billion in passive provisions.

Considering the seasonal features of this item, **unemployment benefits** were characterised by a deceleration in expenditure dynamics in the first half of the year. In the first five months of 2011, the average number of people entitled to unemployment benefits declined by 18,000 (8 per cent) compared to the same period of the previous year, and this decline was observed in the group of those who receive job search allowance, which means higher amounts of support (see Chart 2). The underlying explanation is not the decline in unemployment, but the fact that an increasing number of people who are no longer active in the labour market have lost their right to receive the benefit or have not been employed for long enough to become eligible. In parallel with this, the number of unemployed who do not receive any allowance and especially the number of those who receive social transfers increased considerably. This latter development also sheds light on the background of the reason why the appropriation for subsidies to local governments for the purpose of

Chart 2
Breakdown of registered unemployed people by types of benefits, 2010–2011

(thousand people)



⁹ According to the ESA methodology, the Pension Reform and Debt Reduction Fund is a part of the government sector; therefore, revenues as well as expenditures that arise there are shown in the ESA balance of the general government.

financing wage-substituting allowances increased in the amended budget. However, as a result of this **composition effect**, the annual amount of passive assistance may be lower by nearly HUF 13 billion (9 per cent) compared to the 2010 base.

Our projection also takes account of the changes to job search allowances to be implemented as a part of the Kálmán Széll Plan on the basis of the parameters of the bill submitted under number T/3500. The effect of the measure, which is expected to enter into force in September, on gross expenditures in 2011 will not reach HUF 6 billion (the saving excluding tax contents is estimated to amount to a net HUF 40 billion at an annual level), as the replacement of people who receive allowances and, in parallel with that, the shortening of the average eligibility period can only take place gradually.

Expenditures of the social security funds

Total expenditures of the social security funds are estimated to fall short of the statutory appropriation by nearly HUF 11 billion. Practically, the difference is entirely attributable to the Pension Insurance Fund.

Expenditures of the Pension Insurance Fund

Taking account of the developments in the course of the year and the uncertainties related to the expected effects of recently taken measures, annual expenditures for pensions of the Pension Insurance Fund are estimated to amount to HUF 3,044 billion, which is more than HUF 10 billion lower than the appropriation set out in the Budget Act.

Expenditures on provisions in the first half of the year are somewhat below the pro-rata expenditure level as well as below what could be expected on the basis of past experience. This is partly attributable to the fact that the effects of the regulation that allows the retirement of women who spent 40 years in employment irrespective of their age have not been felt yet, and partly to the assumption as to whether the recently observed decline in the number of pensioners will continue in 2011 or the slow increase seen in past years will continue. Our estimate for the increase in the number of pensioners and expenditures expected as a result of the inflow of women with long eligibility periods has not been modified, in consideration of the possibility of determining pensions with a retroactive

effect; thus the difference is mainly justified by our assumptions regarding the numbers of people. As a result of all the above, **old-age expenditures** (old-age as well as above-age-limit disability and accident disability pensions) are expected to reach a level of HUF 2,389 billion.

In the case of the **below-age-limit** disability and accident disability pensions we expect a slight decline in expenditures on the basis of developments observed in previous years, which is explained by the tightening of inflow, the higher-than-average mortality and the milder or reversed replacement effect.¹⁰ In addition, the effect of the measures indicated in the Kálmán Széll Plan aiming at the reduction of the number of disability pensioners was also taken into account for the second half of the year and this effect amounts to approximately HUF 7 billion according to the estimation of the MNB. As a result of the above, expected annual expenditures on below-age-limit disability and accident disability pensions amount to a total HUF 298 billion. Developments in **relative's pensions** during the year are very stable; therefore, based on the average expenditures in the first half of the year, the annual expenditure on this item is estimated to amount to HUF 357 billion.

Expenditures of the Health Insurance Fund

Our forecast for the expenditures of the Health Insurance Fund is broadly identical with the statutory appropriation, although its structure is different. In spite of the government measures, we expect pharmaceutical expenditures to exceed the target, which may partly be offset by the savings in sick-allowances and maternity allowances (maternity leave payment and pregnancy confinement benefit) and partly by the cancellation of the special reserves for in-kind provisions.

Sick-allowance expenditures have shown a declining trend since 2009. This is attributable to earlier measures that made the conditions of eligibility stricter, but the decline in the days on sick leave due to the crisis also played a role. Another two expenditure reducing measures were taken within the framework of the Kálmán Széll Plan: the ceiling of active sick pay allowance fell to one half, whereas the passive sick allowance is expected to be terminated in July 2011. On the other hand, the fact that women with high-risk pregnancies will be entitled to sick pay instead of sick-leave increases expenditures to some extent. As a result of the measures, our calculations suggest an estimated saving of HUF 5 billion in 2011. Also taking account of the fall in the

¹⁰ It is typical of the replacement effect in the case of the below-age-limit disability pensions that the average of newly determined pensions only slightly exceeds or sometimes does not even reach the average of provisions terminated due to death, rehabilitation or reaching the age limit. This is partly attributable to the age distribution and partly to the distribution across disability categories of new pensioners as well as a result of stricter disability assessments.

Table 6
Pharmaceutical balance in 2011

(HUF billion)

	Target	Without measures	Projection
Drugs subsidy	296	368	356
Others expenditure dues	16	17	17
Provision	31	-	-
Total expenditures	344	385	373
Payments	44	52	56
Balance	300	332	317

spending on sick allowances, the forecast of the MNB is HUF 14 billion lower than the appropriation.

Actual data for **maternity allowances** in the first half of the year are close to the pro-rata target, but the dynamics of expenditures are expected to decline during the rest of the year. Firstly, this is attributable to the 10 per cent decline in the number of births in the past one year; secondly, the conditions of eligibility became stricter for children who were born after 1 May 2010. Therefore, the number of those who receive the pregnancy confinement benefit fell by 15 per cent until April 2011. Our forecast suggests that the tightening will not result in any further decline in the remaining part of the year. In the case of the maternity leave payment, the effect of the measure will be felt more slowly, lasting until the end of 2012. As a result of all the above, the MNB projection is HUF 12 billion lower than the appropriation.

Pharmaceutical expenditures have gradually been increasing since the second half of 2010. This was exacerbated by the outflow of subsidies, which reached a record level following the announcement of the Széll Kálmán Plan, presumably because of purchases of pharmaceuticals for stockpiling. Partly as a result of less significant measures as well, a smaller adjustment already took place in May. In addition, our forecast also takes into account the changes in legislation effective as of 1 July, which may promote price competition among products with fixed subsidy, and also create further means for excluding certain medicines from being subsidised. However, the savings effect of all of the above may only be insignificant

this year; it may, however, be sufficient to prevent distributors from passing the increased burdens of producers on to consumers over the short run. Additional expenditures amounting to HUF 30 billion in total are expected in the case of pharmaceutical subsidies in 2011.

In parallel with the additional expenditures, the revenues of the **pharmaceutical balance** would have overperformed by HUF 9 billion even in absence of measures. The cash-based effect of the increase in the burden of producers and distributors effective since July as a part of the Széll Kálmán Plan may be felt only in the last quarter, but this year the effect is also reduced by the temporary deductibility of R+D expenditures. Therefore, as a result of the measures, payments by producers may increase by a mere HUF 4 billion in 2011. Accordingly, taking everything into account, the pharmaceutical deficit may increase by HUF 17 billion compared to the original plan (see Table 6).¹¹

Meeting the target in the case of **therapeutic and preventive care provisions** is ensured in line with the appropriation; expenditures may be increased by the revenues from the public health product tax. However, we do not expect reallocation of the provisions of HUF 15 billion that were originally intended for therapeutic and preventive purposes in the Budget Act but, by law, cannot be utilised in the case of overspending for pharmaceuticals. Namely, the deficit will be higher not only in the field of pharmaceutical expenditures, but the subsidies for therapeutic equipment are also expected to exceed the appropriation by HUF 5 billion.

¹¹ Even if the amount is HUF 17 billion this year, based on our calculations, only HUF 3 billion is expected from payments by distributors according to the band system in March 2012, with no advance payment at all this year. Namely, pursuant to the prevailing regulations, the Health Insurance Fund covers the whole amount of exceeding the appropriation up to HUF 14 billion. The underlying reason is that since 2011 the so-called calculated deficit, which serves as basis for the payment in the band system, is reduced by the total amount of the contractual payments (not only by their surplus).

3 The most important risks related to our forecast

Taking our macroeconomic forecast as given, we consider the fiscal risks that are related to our projection to be of medium size. Under a less optimistic scenario, the risks related to the underlying fiscal developments and the risks related to government measures may result in a worsening of the balance by 0.2-0.3 per cent of GDP and 0.3 per cent of GDP, respectively. There may be a greater difference between the developments in the budget in 2011 and our projection if macroeconomic developments deviate considerably from our expectations in the rest of the year, with special regard to the nominal change in GDP, households' consumption expenditure and the total wage bill in the economy. This chapter discusses in detail the risks related to budgetary developments themselves, whereas the symmetrical risks related to our macroeconomic forecast and individual risk scenarios are presented in the *Quarterly Report on Inflation* published on 22 June 2011.

Fiscal risks related to the baseline scenario

In relation to our assumption regarding the developments in carry-forward losses, our forecast for **corporate tax revenues** contains uncertainties. Namely, if the effect of carry-forward losses in 2010 did not reach the level which we estimated (and thus our 2011 projection for the effect of the decline in carry-forward losses is also too high), then the effect of the 2010 measures to widen the tax base is weaker than our assumption. In this case, corporate tax revenues may persistently remain below our expectations by HUF 10-20 billion.

In terms of revenues from **sector specific extra taxes**, we perceive a downside risk of HUF 5-10 billion. Meeting this tax payment obligation completely may cause difficulties for businesses that are loss-makers even without the extra burden. This is indicated by the fact that of the sector specific extra taxes amounting to more than HUF 150 billion and due at the end of 2010 HUF 19 billion was paid only as late as May 2011.¹²

In the first half of the year, revenues from the **value added tax** fell short of the pro-rata part of our forecast. Monthly

developments in VAT refunds are too volatile, but it cannot be ruled out that refunds will increase in the rest of the year, resulting in slightly lower annual net VAT revenue compared to our forecast.

Projecting the fulfilment of **revenues from fees and duties** in the first six months on the basis of the previous year's seasonality to the expected annual revenues would result in the attainment of revenues amounting to around HUF 70 billion. This represents a revenue shortfall risk of HUF 7 billion compared to our baseline scenario.

Interest expenditures during the year are mainly influenced by demand for government securities, the required yields and changes in the forint's exchange rate. A 5 per cent change in the exchange rate of the forint alters the forint value of the interests to be paid in foreign currency in the second half of the year by approximately HUF 8 billion. As most government securities are fixed-rate instruments, the required yields of government securities do not significantly influence the interest to be paid on the outstanding stock in 2011. On the other hand, at each auction, the difference between the face value of the government security and the price reached upon issue has to be accounted for in the net interest expenditure on a cash basis. Depending on the developments in the required yields of Hungarian government securities in the second half of the year, this premium or discount upon issue may fluctuate in a risk band of HUF 10-20 billion around the baseline scenario.

Fiscal risks related to government measures

The amendment of the Budget Act during the year in relation to the stability reserve reduced **institutional and chapter expenditures** belonging to the central budget by HUF 184 billion. Nevertheless, the effect of blockings has not yet been reflected in the developments in net expenditures in the first half of the year. In principle, the cancellation of the stability reserve should mean expenditure adjustment, but implementation may result in considerable financial difficulties in the second half of the year. The obligation to keep carryover appropriations at

¹² Moreover, in certain segments it also is legally possible to avoid tax payment (e.g. participation in trading electric energy from abroad).

previous year's level may ensure cash flow control over the short run, but it will not terminate underlying financial tensions. In the event that budgetary units and chapters are unable to handle the cancellation of the blocked appropriations through effective measures, it may result in an increase in arrears or unpaid bills and/or a partial suspension of the obligation to keep carryover appropriations. Also taking account of the fact that more than HUF 60 billion of the general reserve can still be used, and roughly HUF 16 billion of the stability reserve has not yet been included in the appropriations, the negative risk related to the expenditures of budgetary units and chapters in 2011 is estimated to be one third of the measure, i.e. HUF 60 billion.

One major risk related to the balance of the **Health Insurance Fund** is spending of the special reserves for in-kind provisions. Section 23 (2) of the Budget Act makes the use of the special reserves dependent on fulfilment of the appropriation for pharmaceutical expenditures. The calculations underlying our forecast suggest that pharmaceutical expenditures will exceed the appropriation; therefore, we assume that the reserves will be saved. On the other hand, the Budget Act does not provide an automatic numerical rule regarding the usability of the reserves at the end of the year. Therefore, if the government – taking account of the balance of the Health Insurance Fund, which is expected to be more favourable than the

target – still decided to spend the reserves, it may worsen the balance projected by us by HUF 15 billion.

The fiscal effects of the **retirement** of women with an eligibility period of 40 years cannot be captured yet. No information is available for us on the basis of which we could judge whether the additional inflow expected by the government will in fact take place – with a delay, but with retroactive effect – or the effect of the measure will fall short of the expectations. Overall, the risks related to the measure are thought to be balance improving, because it is more likely that the expenditure increasing effect of the measure will fall short of expectations, instead of exceeding them.

Implementation of the measures concerning the system of **disability pensions** (and pensions for persons with reduced work abilities), the details of which have not yet been disclosed, involves a negative risk in 2011 already. However, the expected impact of the planned changes in rules for 2011 is relatively insignificant: HUF 9 billion, i.e. a mere 0.2 per cent of total pension expenditures. At the moment, we cannot see any risk related to the supplementary raising of pensions. However, it is a negative risk that the previous years' trend of changes in the number of those who receive these provisions – a temporarily decelerating increase or an accelerating decline – may gradually reverse in the second half of the year.

4 Expected changes in items determined by demographic and macroeconomic developments in 2012

In the following, presuming unchanged legislation, the main revenue and expenditure groups are discussed, the developments in which are determined by demographic and macroeconomic developments. It means that the legislator cannot directly influence the magnitude of the item, only through specialised legislation at best. With some minor differences, the examined budgetary appropriations are broadly identical to the exogenous items specified in the annex to the Budget Act. The underlying reason for the difference is that we examined certain items in an aggregated manner, and thus exogenous and discretionary elements (for example family allowances and social benefits) may be mixed in the aggregated category. On the other hand, some less significant items were not examined separately. The mentioned differences do not substantially affect the reliability of the disclosed estimate and our expectations regarding the changes in the balance.

Our projection for developments in the examined revenue and expenditure items in 2012 is based on our macroeconomic forecast relying on information available prior to publication; material changes in the forecast may occur before the budget bill is submitted. Attention is called to the fact that our macroeconomic path was prepared with the assumption that the cancellation of the **stability reserve** is mostly not included in the 2012 appropriations of the discretionary

items, as the sustainability of the savings implemented in this year's budget cannot be judged in a well-founded manner.¹³ In the event that the cancellation of the stability reserve proves to be sustainable in 2012 as well, the amount of revenue items expected for 2012 may decline slightly compared to this forecast, due to the direct tax content and indirect fiscal effects of the expenditure reductions. At the same time, in addition to enacted legislation, our projection also takes account of the **measures** that have already been announced and are likely to be implemented. The majority of these measures were formulated in bills prior to 30 June; the expected effects were estimated on this basis, but, of course, the content of relevant laws that have an impact on 2012 may be significantly different from our assumptions.

The 2011 balance of exogenous items taken into account according to the above is expected to amount to HUF 5,256 billion, which is somewhat higher than the targeted balance. The balance projected for 2012 amounts to HUF 5,528 billion, which does not represent an improvement as a proportion of GDP, but results in a minor deterioration (0.2 percentage point) in the balance compared to the fulfilment expected for this year. This is related to the moderate 5.2 per cent growth rate of the balance calculated for the exogenous items, while nominal GDP is expected to

Table 7
Expected changes in the balance of budget items affected by macroeconomic developments
(as a percentage of GDP)

	2011 MNB forecast	2012 MNB forecast	Change
1. Total exogenous revenues	33.4	32.6	-0.7
2. Total exogenous expenditures	14.9	14.4	-0.5
3. Balance of exogenous revenues and expenditures (1-2)	18.5	18.3	-0.2

¹³ An amount of HUF 30 billion of the expenditure reduction carried out at the extrabudgetary funds is an exception. In our opinion, it could be included in the base, partly because the affected lines that are also included in the 2012 measures of the Széll Kálmán Plan, or because carrying the reduced appropriations over to 2012 does not require any special measures (e.g. the cancellation of the risk management reserve of the Labour Market Fund). As a result, a contingent of HUF 206 billion was not included in the 2012 appropriations. By contrast, the assumptions of the convergence programme regarding the nominal freeze in the wage bill and the purchase of goods and services were taken into account for 2012. In this context it is less possible to consider it restrictive that the feasibility of further expenditure reduction is assessed under stricter conditions.

grow by 6.3 per cent in 2012. Within this, the sum of revenues will decline by 0.7 per cent as a proportion of GDP, while expenditures are expected to decline by 0.5 per cent of GDP (Table 7). Accordingly, the relatively unfavourable change in the balance is a consequence of revenue-side developments. The increase in revenues from household taxes and social security funds from contributions as well as in payments by corporations (with the exception of green [‘eco’] taxes and the corporate tax) will be much lower than the nominal GDP growth rate.

The developments in 2012 in the balance of exogenous budget items – and in revenues in particular – as a proportion of GDP are partly explained by the characteristics of the **macroeconomic path** and partly by the **effect of measures**. Although the GDP growth rate is expected to accelerate to some extent in 2012, growth will continue to be export-driven, and due to the continued weakness of domestic demand and the loose labour market, tax bases – and thus household consumption and especially the wage bill – may grow at a slower pace. This is also reflected in the cyclical position of the budget, and according to our calculations published in the June issue of the *Quarterly Report on Inflation* this position will even slightly deteriorate in 2012, explaining some 2 percentage points of the deficit-to-GDP ratio. Moreover, the changes in the tax and contribution rules also have an unfavourable effect on the balance (e.g. the full-year effect of the reduction of the PIT in 2011, the further tax reduction in 2012, the phasing out of the temporarily re-channelled pension contribution of those who remain private pension fund members). The tax elasticity of income will also decline: the flat rate PIT, the family tax benefit, which can be used in an increasing extent depending on income levels, or the sizeable sector specific surtaxes all point in this direction.

4.1 OVERVIEW OF THE MNB PROJECTION FOR 2012

Revenue items

Payments by economic organisations

In 2012, exogenous items related to payments by corporations may grow by 5.2 per cent (see Table 8). It deserves attention that one half of the increase is attributable to new or increased **green taxes** (public health product tax, environmental product fee). Additional budget revenues

from this source may amount to HUF 30 billion in 2012, although we assume that most of this additional revenue will finance additional expenditures.¹⁴

Apart from the green taxes, the **corporate tax** is the only tax paid by corporations which is expected to grow dynamically in 2012. Growth in the operating surplus of the corporate sector may exceed the economic growth rate by nearly 3 per cent, and the tax-base reduction from carry-forward losses may continue to decelerate (reducing the negative effects on taxes) and return to the earlier trend. By contrast, extension of the pharmaceutical market measures and the partial phasing out of investment tax credits reduce tax revenues. As a result of the above assumptions, corporate tax revenue is expected to amount to HUF 317 billion, representing an around 11 per cent increase compared to 2011.

The increase in revenues from the **simplified entrepreneurial tax** is tied to the real growth rate, assuming that the process of accommodation to the tax rate increase will end in 2011. Our projection took account of the fact that the applicability of this type of tax is limited (subject to sales revenue ceiling), and the raising of the tax rate carried out in 2010 does not make this type of tax attractive. Consequently, the number of taxpayers concerned is not expected to grow. In 2012, revenues from the **mining royalty** may fall short of the fulfilment expected for 2011 by HUF 13 billion in nominal terms due to the assumed decline in crude oil prices. A nominal HUF 10 billion fall in **sector-specific extra taxes** is expected, because we assume a slight erosion of the tax base, and for 2012 we do not expect any carried-over payments to be effected at the beginning of the year as it was observed in 2011.

Taxes related to consumption

Revenues belonging to this type of tax are expected to grow by approximately 6 per cent in 2012. Within this, **VAT revenues** will increase by nearly 6.5 per cent, whereas the index of purchased consumption of households is 5.3 per cent. The reason for the higher growth rate is that for 2012 we do not expect a permanent effect from the cancellation of the stability reserve carried out in 2011, i.e. the tax revenue reducing effect of expenditure cuts. At annual level, revenues from **excise taxes** are expected to grow by 5 per cent; within that, in the case of tobacco products we expect an annual effect from tax increases of 3.6 per cent

¹⁴ These types of taxes can practically be considered as earmarked taxes. Pursuant to the Semmelweis Plan, the public health product tax will serve the purpose of supplementing the funds of health services, while half of the environmental product fee and its portion above HUF 24.5 billion will cover the expenditures of the National Waste Management Agency as set forth by law.

Table 8
Changes in items sensitive to macroeconomic developments in 2012: MNB projection

(HUF billion)

	2011 Statutory target	2011 MNB	2012 MNB	MNB change
REVENUES				
PAYMENTS BY ECONOMIC UNITS	1,126	1,123	1,184	62
Corporate income tax	288	286	317	32
Surtax of corporations	0	-17	0	17
Fees of financial institutions	11	11	11	0
Special tax of financial institutions	187	182	182	0
Sector-specific extra taxes	161	171	161	-10
Simplified entrepreneurial tax	180	180	185	5
Green taxes	27	22	23	0
Mining royalty	88	102	89	-13
Gambling tax	51	50	49	-1
Energy companies' income tax	20	18	18	0
Car tax	28	26	26	1
Healthcare product tax	0	4	15	11
Environmental protection fee	21	21	40	19
Rehabilitation contribution	64	67	68	1
TAXES ON CONSUMPTION	3,402	3,327	3,531	204
Value-added tax	2,489	2,420	2,577	157
Excises	881	873	916	43
Registration tax	32	34	38	4
PAYMENT OF HOUSHOLD	1,446	1,470	1,497	27
Personal income tax	1,363	1,391	1,417	27
Fees and duties	82	77	79	2
Other taxes paid by households	1	2	0	-2
EXTERNAL REVENUES OF THE EXTRABUDGETARY FUNDS	3,535	3,581	3,667	86
LMF – health insurance contributions and contributions to the Labor Market Fund	188	186	193	7
LMF – vocational contribution	49	46	48	2
R&D Fund – innovation contribution	23	23	25	1
NCF – revenues from lottery	9	9	10	1
PIF – contributions	2,593	2,642	2,691	49
HIF – contributions	638	623	646	23
Per capita health contribution	36	50	53	2
TOTAL EXTERNAL REVENUES	9,509	9,500	9,879	378
EXPENDITURES				
FAMILY BENEFITS, SOCIAL SUBSIDIES	628	627	607	-20
EXPENDITURES RELATED TO MNB	0	0	94	94
CONTRIBUTION TO EU BUDGET	258	258	278	20
EXTERNAL EXPENDITURES OF STATE FUNDS	3,411	3,359	3,371	12
MPA – Passive allowances	135	120	63	-57
Pensions	2,390	2,389	2,490	101
Disability pension benefits below age limit	305	298	254	-44
Survivors' benefits	359	357	372	15
Sick allowance	86	72	71	-1
Child care allowances	135	123	121	-2
TOTAL EXTERNAL EXPENDITURES	4,298	4,244	4,350	106
BALANCE OF SELECTED ITEMS	5,211	5,256	5,528	272

on average. As for the excise tax on fuels, we assumed that consumption will gradually return to the earlier trend. In the case of the **registration tax** an increase of HUF 4 billion (corresponding to 11 per cent) is expected. A major fall in registration tax revenues was seen in the past period; therefore, we think that the growth rate of this item may temporarily exceed the earlier trend.

Considering the extraordinary magnitude of the risk, we have to point out that the **court proceedings related to the so-called VAT deductibility right** result in considerable uncertainty in terms of the developments in VAT revenue in 2012. Earlier, the European Commission objected to the VAT refund practice in Hungary, which is not in compliance with the provisions of EU legislation in the opinion of the Commission. The debate has arrived the a court stage, and if the European Court of Justice rejects the Hungarian position, enforcement of the judgment, as we estimate, may reduce VAT revenue by **HUF 240-250 billion** in the year of the reverting, adding this amount to the deficit both on a cash basis and on an accrual basis.

Payments by households

Payments by households are expected to increase by HUF 27 billion compared to the 2011 base, and nominal growth will not reach 2 per cent. In the case of the **personal income tax** we assumed that next year the transition to the so called 'half super gross' system incorporated into law will be implemented, and a parametric change in tax credits will also take place. This latter change included in the convergence programme will reduce the amount of the effective tax credit to one half of the amount in 2011. The effective amount of family tax benefits will be slightly higher than in the base year, as some of the taxpayers are expected to be able to use a portion of the benefit only in their annual tax returns. The forecast for revenues in 2012 was calculated with a 3.9 per cent wage bill index, which takes account of the estimated effect of public work programmes. In the projected **revenues from fees and duties** the base value was increased with the real growth index, in line with the government's calculation disclosed in the multi-year outlook in the 2011 budget bill.

Social security contributions

A 2.2 per cent increase in contributions is expected, which will be lower than the wage bill index. One of the underlying reasons is that, according to our estimation, after phasing out of the temporarily re-channelled pension contribution

of those who remain private pension fund members 95 per cent of the pension contributions will be paid to the Pension Insurance Fund, which may result in a HUF 38 billion shortfall in revenues. As a result of cuts in unemployment benefits, revenues from contributions may fall by a further HUF 17 billion.¹⁵

Expenditure items

Family allowances, social benefits

Based on the convergence programme, a freezing of the value of family allowances is expected for 2012, and due to the expected decline in the number of recipients we expect a decline of HUF 4 billion in allowances in total. As a result of the measures affecting the allowance of people with reduced work abilities (in line with the Széll Kálmán Plan), in parallel with the assumed reduction of the number of people concerned, the actual figure for these benefits may be HUF 16 billion lower. Overall, expenditures in this group of items may decline by 3.2 per cent in nominal terms in 2012.

Expenditure related to the MNB accounts

According to the projection updated in the *Quarterly Report on Inflation*, due to the expected 2011 loss of the MNB, the central budget will have a HUF 94 billion loss refund obligation in 2012. Compared to this year, this represents an additional expenditure in the cash-based balance: in the multi-year outlook prepared for the 2011 budget bill the government has not planned any appropriation for this purpose, and the effect of the refunding of the loss was not included in the convergence programme disclosed last spring either.

Contribution to the EU budget

Our forecast uses the appropriation included in the multi-year outlook of the 2011 budget bill. For 2012, the government envisages an expenditure that is HUF 20 billion higher than the appropriation for 2011, corresponding to an increase of 8 per cent. This growth rate is in line with the experience of earlier years.

Exogenous expenditures of the extrabudgetary funds and of the social security system

In the case of **passive (unemployment) provisions** a nearly 50 per cent fall in the expenditure volume is expected in

¹⁵ Unemployment benefits are subject to contribution payment, but are not included in the changes in the wage bill index, which serves as a basis for our estimate.

2012. The effect of the restructuring of the unemployment insurance system which is expected to enter into force in September will have a full effect after the first months of the year, and thus this measure may result in a further saving of HUF 55 billion next year.

Pensions are expected to reach HUF 3,117 billion in 2012, which, compared to the 2011 base, represents a lower increase (2.4 per cent) than the consumer price index. The expenditures were estimated on the basis of the expected number of pensioners, the average increase in provisions and the replacement (composition) effect, whereas the result was amended taking account of the effects of the already announced measures, which were not codified as of the cut-off date of this evaluation. In our estimate, the measures of the Széll Kálmán Plan affecting the pension system may result in a considerable total decline of nearly HUF 60 billion in expenditures in 2012. The likelihood of the realisation of the measures taken into account varies: the introduction of raising the pensions according to the price index is very probable; we consider the drastic decline in the number of disability pensioners as an optimistic, but not unfounded assumption, while, in our opinion, the implementation risk of the withdrawal of the employment and service exemption by age with a retroactive effect is high.

In the case of **sick pay expenditures** the measures will exert a full-year effect in 2012, resulting in a growth of total savings to HUF 10 billion. Accordingly, expenditure volume is expected to decline by 2 per cent. The tightening in 2010 of the conditions of eligibility to receive **maternity leave payment** and **pregnancy confinement benefit** will have a prolonged effect on 2012 as well; therefore, a nominal decline (of around HUF 2 billion) in expenditures is expected in this group of items as well.

4.2 BALANCE TARGET FOR 2012 AND THE STABILITY RESERVE

The MNB's forecast shows that in 2012 the balance of exogenous items will not improve, but rather will deteriorate to some extent as a proportion of GDP. Considering that next year the budget will not be able to rely on the revenues from the private pension funds, our projection suggests that the achievement of the government's target of a 2.5 per cent ESA deficit will require a 2.9 percentage point balance improvement as a proportion of GDP in the discretionary items and other items of the general government compared to the 2011 base.¹⁶

For 2012, our forecast expects a total improvement of around 0.7-0.8 percentage points as a proportion of GDP in the other items of general government, i.e. the balance of local governments, the interest balance and the balance of accrual based adjustments. Accordingly, as a proportion of GDP, at least a further 2 percentage point balance improvement must be ensured in the discretionary items of the central government in order to meet the deficit target. This improvement is considered significant, even taking account of the measures in the Széll Kálmán Plan and the convergence programme affecting the discretionary items. Sustained inclusion of the savings of the stability reserve in the 2012 appropriations may contribute to the improvement of the balance by 0.6 per cent of GDP. This requires the cancellation of the stability reserve to be underpinned by permanent expenditure reducing measures that represent additional balance improvement compared to the Széll Kálmán Plan and the convergence programme.

¹⁶ The 2.8 per cent ESA deficit reduced by the one-off items presented in Table 1 changes to 4.6 percentage points if the part of the transferred pension assets included in the Budget Act (HUF 529 billion) is also deducted from it. Adjusted for the estimated balance effect of the stability reserve, which is not included in the planning base, the 2011 deficit increases further to 5.2 percentage points. Compared to this 2011 base value, the achievement of the deficit target would require a 2.7 percentage point balance improvement in 2012. However, the gap continues to increase as a result of the 0.2 percentage point worsening of the balance calculated for the exogenous items.

Appendix 1

Changes in the budget act

Compared to the target indicated in the Budget Act adopted in December, the planned deficit of the central government increased by HUF 497 billion as a result of amendments during the year. This growth is entirely the result of the one-off expenditure related to the MOL transaction. The other shifts practically offset one another at the level of appropriations, which reflects an opinion on fiscal developments that is significantly less favourable than assumed originally, as well as the effect of the measures counterbalancing it.

The official balance worsened by nearly HUF 191 billion in total in the lines where the actual developments are basically determined by macroeconomic developments: the government reduced tax revenue targets by HUF 176 billion, and added HUF 15 billion to its expectation regarding interest expenditures. In addition, increasing the amount of certain spending categories (public education and social human allocations) results in a negative effect of HUF 44 billion in the balance, which is partly also a consequence of exogenous factors and the enacted legislation. This is offset by HUF 236 billion by the inclusion of the cancellations and measures related to the stability reserve in the appropriations.

Amendments to the appropriations that can be recorded as part of the **stability reserve** include:

- the payment obligation of budgetary units increased by HUF 4.2 billion (HUF 1.7 billion of which was already included in the March amendment to the Budget Act);

- a total reduction of HUF 185.4 billion of the expenditure appropriations of institutions and chapters (also including the budgetary organisations of social security funds); 46 per cent of which is related to material expenditures, the reduction of transfers for operating purposes accounts for 17 per cent, 15 per cent is the reduction of the wage bill, the limitation on investment expenditures amounts to 14 per cent, and other items to 8 per cent;
- the cutting of the expenditures of the central budget related to state assets and its other expenditures by HUF 11 billion;
- as well as the nearly HUF 36 billion saving enforced at the expenditures of the extrabudgetary funds.

In addition to the above, the detailed table of the stability reserve presented in general explanation of Bill T/3636 also includes additional payments by institutions amounting to HUF 3.7 billion and also a HUF 12.7 billion reserve for the chapters that belong to the direct authority of the Parliament. However, these items have not been included in the statutory appropriations, and therefore, we do not take them into account as effective measures.

Originally, the government decree on establishing the stability reserve also included a provision on reducing the consumer price subsidy of public transport by HUF 10 billion (at the same time this measure is a part of the Széll Kálmán Plan). As the prospective amendment to legislation was not implemented, the amendment to the Budget Act made up

Table A.1
Changes in the statutory target regarding the balance of the central government
(HUF billion)

	Central budget	Extrabudgetary Funds	Social Security Funds	Total
1. Original (2010 December) statutory target	-613	15	-89	-687
2. Purchase of the MOL shares	-499			-499
3. Modification of targets regarding tax revenues and interest expenditure	-191			-191
4. Other modifications, effect of additional expenditures	-43	0	-1	-44
5. Change in central budgetary balance reserve	207	27	2	236
6. Modified target (1+2+3+4+5)	-1,138	41	-88	-1,184

for this by a further HUF 10 billion reduction of the expenditures of extrabudgetary funds.

The MNB's forecast in the June issue of the *Quarterly Report on Inflation* only took account of HUF 40 billion of the stability reserve, as the actual cancellation of the blocked appropriations did not take place until after the cut-off date of the publication, and the actual data

observed during the first half of the year also did not justify a greater adjustment. However, the amendment to the statutory appropriations means the actual cancellation of most of the stability reserve that amounts to HUF 250 billion. Accordingly, compared to the *Quarterly Report on Inflation*, this projection of the MNB for 2011 includes additional savings amounting to HUF 151 billion (also including the increase in expenditures).

Appendix 2

Background tables

Table A.2
MNB projection, statutory target and actual data 2011 – revenues

(HUF billion)

REVENUES	2010			2011			2011	
	Annual fulfillment	I-V. months	%	Statutory target	I-V. months	%	MNB	MNB difference
CENTRAL BUDGET								
PAYMENTS BY ECONOMIC UNITS								
Corporate income tax	323.4	133.8	41.4	288.0	131.2	45.5	285.8	-2.2
Surtax of corporations	-32.4	10.3	-31.7	0.0	-10.0	n. a.	-17.0	-17.0
Fees of financial institutions	10.0	2.8	27.8	10.8	2.4	22.4	10.8	0.0
Special tax of financial institutions	182.3	0.0	0.0	187.0	51.1	27.4	182.3	-4.7
Sector-specific extra taxes	151.7	0.0	0.0	161.0	10.0	6.2	170.6	9.6
Simplified entrepreneurial tax	181.9	43.8	24.1	180.1	43.6	24.2	180.0	-0.1
Green taxes	23.5	11.6	49.4	26.5	11.1	42.0	22.4	-4.1
Mining royalty	108.9	40.0	36.8	88.0	47.7	54.2	102.2	14.2
Gambling tax	53.4	22.6	42.3	51.3	20.4	39.9	50.1	-1.1
Other payments	36.3	12.7	35.0	32.0	11.6	36.3	32.0	0.0
Other centralized payments	44.1	20.2	45.9	109.8	56.0	51.0	113.6	3.8
Energy companies' income tax	17.0	0.3	1.6	20.0	0.6	3.2	18.0	-2.0
Car tax	25.9	12.7	49.0	28.1	12.1	42.9	25.5	-2.6
TOTAL	1,125.8	310.7	27.6	1,182.6	387.8	32.8	1,176.3	-6.3
TAXES ON CONSUMPTION								
Value-added tax	2,313.6	929.2	40.2	2,489.0	986.9	39.6	2,420.4	-68.6
Excises	856.5	290.9	34.0	881.1	311.3	35.3	872.6	-8.6
Registration tax	30.0	11.7	38.9	32.3	14.1	43.5	34.3	2.0
TOTAL	3,200.1	1,231.8	38.5	3,402.4	1,312.2	38.6	3,327.2	-75.2
PAYMENTS OF HOUSEHOLD								
Personal income tax	1,767.9	763.7	43.2	1,363.0	598.6	43.9	1,390.9	27.9
Fees and duties	83.5	35.9	43.0	81.9	30.4	37.1	76.7	-5.2
Other taxes	12.1	9.6	78.9	1.3	2.8	214.1	2.1	0.8
TOTAL	1,863.5	809.1	43.5	1,446.2	631.8	43.7	1,469.7	23.5
CENTRAL BUDGETARY INSTITUTIONS AND CHAPTER ADMINISTERED APPROPRIATIONS								
Revenues of central budgetary institutions	891.1	375.3	42.1	567.4	352.4	62.1	817.4	250.0
Chapter administered professional appropriations	173.5	48.4	27.9	80.7	213.7	264.7	310.7	230.0
EU support of chapter administered professional appropriations and central investments	813.6	301.0	37.0	1,146.6	278.4	24.3	960.0	-186.6
TOTAL	1,878.2	724.8	38.6	1,794.7	845.5	47.1	2,088.1	293.4
PAYMENTS FROM FUNDS OF THE GENERAL GOVERNMENT								
PAYMENTS RELATED TO STATE PROPERTY	66.4	10.3	15.4	43.5	4.6	10.7	43.5	0.0
OTHER REVENUES	125.2	80.2	64.1	24.1	7.8	32.4	24.1	0.0
REVENUES FROM EU	-0.1	21.4	n. a.	29.2	8.6	29.6	29.2	0.0
REVENUES OF PENSION REFORM AND DEBT REDUCTION FUND	n. a.	n. a.	n. a.	95.6	0.0	0.0	95.6	0.0
REVENUES RELATED TO DEBT SERVICE	131.8	59.1	44.9	59.5	38.5	64.7	78.3	18.7
TOTAL REVENUES OF CENTRAL BUDGET	8,467.8	3,267.6	38.6	8,110.6	3,252.3	40.1	8,374.8	264.2

Table A.2
MNB projection, statutory target and actual data 2011 – revenues (cont'd)

(HUF billion)

REVENUES	2010			2011			2011	
	Annual fulfillment	I-V. months	%	Statutory target	I-V. months	%	MNB	MNB difference
EXTRABUDGETARY FUNDS								
LMF – Health insurance and labour market contributions	186.8	80.8	43.2	187.7	76.9	41.0	186.2	-1.5
LMF – Vocational contributions	46.9	21.7	46.3	49.0	20.0	40.9	46.1	-2.9
R&D Fund – Innovation contributions	22.1	10.9	49.6	22.8	10.6	46.4	23.2	0.4
NCF – Revenues from lottery	9.3	3.5	37.5	8.7	4.7	53.6	9.3	0.6
Revenues of other funds	144.4	62.8	43.5	147.6	63.1	42.8	157.9	10.4
TOTAL REVENUES OF EXTRABUDGETARY FUNDS	409.4	179.7	43.9	415.7	175.3	42.2	422.7	7.0
SOCIAL SECURITY FUNDS								
PENSION INSURANCE FUND	2,914.7	1,224.8	42.0	3,073.6	1,113.7	36.2	3,122.9	49.4
Contributions	2,303.9	944.0	41.0	2,592.9	1,092.7	42.1	2,642.3	49.4
Benefits and subsidies from central budget	234.7	249.0	46.6	0.4	0.4	108.3	0.4	0.0
Revenues of Pension Reform and Debt Reduction Fund	n. a.	n. a.	n. a.	433.2	0.0	0.0	433.2	0.0
Other revenues	76.1	31.8	41.8	47.0	20.5	44.2	47.0	0.0
HEALTH INSURANCE FUND	1,385.3	587.1	42.4	1,370.9	584.8	42.7	1,389.0	18.1
Contributions	633.5	271.0	42.8	637.5	262.6	41.2	623.4	-14.1
Per capita health contribution	41.2	24.3	58.9	35.9	23.8	66.4	50.4	14.5
Benefits and subsidies from central budget	617.3	257.2	41.7	642.4	267.7	41.7	646.2	3.8
Other revenues	93.4	34.6	37.0	55.1	30.7	55.6	69.0	13.9
TOTAL REVENUES OF SOCIAL SECURITY FUNDS	4,300.0	1,811.9	42.1	4,444.5	1,698.5	38.2	4,512.0	67.5
TOTAL REVENUES OF CENTRAL GOVERNMENT	13,174.1	5,259.2	39.9	12,970.8	5,126.0	39.5	13,309.4	-12,970.8

Table A.3
MNB projection, statutory target and actual data 2011 – expenditures

(HUF billion)

EXPENDITURES	2010			2011			2011	
	Annual fulfillment	I-V. months	%	Statutory target	I-V. months	%	MNB	MNB difference
CENTRAL BUDGET								
SUBSIDIES TO ECONOMIC UNITS	201.4	64.8	32.1	214.9	61.5	28.6	214.9	0.0
SUPPORT TO THE MEDIA	45.8	20.7	45.3	58.7	26.0	44.3	58.7	0.0
CONSUMER PRICE SUBSIDY	107.3	46.7	43.5	109.0	47.8	43.9	110.2	1.2
HOUSING GRANTS	147.4	56.8	38.5	126.0	47.9	38.0	126.0	0.0
FAMILY BENEFITS, SOCIAL SUBSIDIES	632.4	263.2	41.6	628.3	261.4	41.6	626.6	-1.7
GOVERNMENT AGENCIES AND CHAPTERED-ADMINISTERED APPROPRIATIONS								
Expenditures of central budgetary institutions	2,371.5	1,004.1	42.3	1,849.4	982.8	53.1	2,115.0	265.6
Chapter administered professional appropriations	1,833.2	757.7	41.3	2,233.1	964.0	43.2	2,321.6	88.5
RESERVES			n. a.	123.9		n. a.	45.0	-78.9
TRANSFERS TO FUNDS OF GENERAL GOVERNMENT	2,424.4	1,111.1	45.8	1,897.4	810.3	42.7	1,919.1	21.6
SUPPORT TO CIVIL ORGANISATIONS	5.0	2.4	48.5	3.8	1.8	47.2	3.8	-0.0
EXPENDITURES RELATED TO STATE PROPERTY	80.8	35.7	44.1	594.4	25.8	4.3	594.4	-0.0
EXTRAORDINARY AND OTHER GOVERNMENTAL EXPENDITURES	41.1	20.0	48.6	36.4	6.1	16.7	38.1	1.7
EXPENDITURES RELATED TO STATE GUARANTEES	33.5	14.4	42.9	35.4	16.3	46.2	35.4	0.0
DEBT ASSUMPTION AND RELEASE	0.1	0.1	100.0	0.4	0.4	95.9	577.5	577.1
CONTRIBUTION TO EU BUDGET	230.2	101.4	44.1	258.1	117.6	45.5	258.1	-0.0
DEBT SERVICE, INTEREST PAYMENT	1,146.3	497.2	43.4	1,079.4	509.3	47.2	1,062.6	-16.8
TOTAL EXPENDITURES OF CENTRAL BUDGET	9,300.5	3,996.2	43.0	9,248.7	3,878.9	41.9	10,107.0	858.3
EXTRABUDGETARY FUNDS								
LMF – Passive allowances	138.3	68.4	49.4	135.5	60.8	44.9	120.3	-15.1
LMF – Active and other expenditures	159.5	59.0	37.0	176.5	43.8	24.8	175.7	-0.8
Expenditures of other funds	50.1	25.0	49.9	62.3	14.3	23.0	72.5	10.2
TOTAL EXPENDITURES OF EXTRABUDGETARY FUNDS	347.8	152.4	43.8	374.3	119.0	31.8	368.5	-5.7
SOCIAL SECURITY FUNDS								
PENSION INSURANCE FUND	2,918.3	1,213.2	41.6	3,073.6	1,258.3	40.9	3,063.2	-10.3
Pensions	2,887.8	1,200.1	41.6	3,054.4	1,248.8	40.9	3,044.1	-10.3
Old-age pension benefits	2,227.1	922.4	41.4	2,390.4	972.4	40.7	2,389.2	-1.2
Disability pension benefits below age limit	345.4	144.0	41.7	304.7	128.8	42.3	298.1	-6.6
Survivors' benefits	315.3	133.6	42.4	359.4	147.6	41.1	356.8	-2.6
Other expenditures	30.5	13.1	42.8	19.1	9.5	49.7	19.1	0.0
HEALTH INSURANCE FUND	1,477.2	630.7	42.7	1,458.6	594.0	40.7	1,458.4	-0.2
Sick allowance	79.4	35.2	44.3	86.1	31.2	36.2	72.0	-14.1
Child care allowances	131.1	54.8	41.8	135.4	52.7	38.9	122.9	-12.5
Drugs	357.2	143.2	40.1	343.5	156.1	45.4	373.2	29.6
Medical and preventive care	791.0	348.8	44.1	770.1	308.3	40.0	773.9	3.8
Other provisions and expenditures	118.5	48.7	41.1	123.5	45.8	37.1	116.3	-7.1
TOTAL EXPENDITURES OF SOCIAL SECURITY FUNDS	4,395.5	1,843.8	41.9	4,532.1	1,852.3	40.9	4,521.6	-10.5
TOTAL EXPENDITURES OF CENTRAL GOVERNMENT	14,043.8	5,992.4	42.7	14,155.1	5,850.2	41.3	14,997.1	842.0

Table A.4

Summary table of macroeconomic variables, annual growth rates

	2010	2011	2012
	Actual	Forecast	
CPI	4.9	4.0	3.7
Pensioners' CPI	4.7	4.4	3.9
Household consumption expenditure	-2.1	1.4	1.6
Real GDP	1.2	2.4	2.8
Nominal GDP	4.1	5.0	6.3
Total wage bill	1.8	3.2	4.3
Whole-economy gross average earnings	1.5	2.5	1.7
Whole-economy employment	0.0	0.6	1.9

Note: The macroeconomic parameters originate from the partial update of our forecast presented in the Quarterly Report on Inflation published on 22 June 2011, taking account of information on the general government available until 30 June, while our other exogenous assumptions concerning our macroeconomic projection have remained unchanged.

Table A.5
Applied estimation methods – revenues

REVENUES	Applied methodologies
CENTRAL BUDGET	
PAYMENTS BY ECONOMIC UNITS	
Corporate income tax	base 2010 multiplied by growth rate of a nominal GDP, corrected with the effects of measures and economic cycle (eg. Degree of carryforwarded losses used)
Surtax of corporations	estimation using actual data
Fees of financial institutions	kept fixed at base 2010
Special tax of financial institutions	kept fixed at base 2010
Sector-specific taxes	estimated weighted revenue growth of relevant branches of economy multiplied by corrected base 2010
Simplified entrepreneurial tax	due to monthly development of tax revenues in 2011 affected by the tax-rate increase in 2010, it is kept fixed at base 2010
Green taxes	base 2010 multiplied by the growth rate of real GDP
Mining tax	corrected base 2010, oil price futures, trend of oil and gas exploitation
Gambling tax	projected change in real disposable income for lottery games taking into account recent price-policy, tax revenues from slot machines is projected using historical trend of the number of such machines
Other payments	
Other centralized payments	kept fixed at 2010 level (for the discretionary items)
Rehabilitation contribution	estimation based on ARIMA-modell
Environmental protection fee	statutory target of sub-items augmented by tax increase, modified with the estimated effect of possibly stricter tax-exemption rules
Healthcare product fee	forecasting volumes and turnovers (relevant CPI and consumption) of taxed products based on HKF-database, estimated price-elasticities
Energy companies' income tax	kept fixed at base 2010
Car tax	base 2010 multiplied by the growth rate of real GDP
TAXES ON CONSUMPTION	
Value-added tax	base 2010 multiplied by household consumption expenditure corrected by government consumption and investment expenditure; correction using expert judgement for the effects of certain measures (eg. simplified clearance procedure)
Excises	expert judgement on fuel consumption and tax reimbursement; a tobacco: estimated behavioral effect due to tax increase, assuming no change in volume consumed; alcoholic beverages: base 2010 indexed by forecasted consumption volume
Registration tax	base 2010 multiplied by the growth rate of nominal GDP modified with an assumption that the building-up of tax base is faster than its trend
PAYMENTS OF HOUSEHOLD	
Personal income tax	calculated tax liability indexed by the growth of wage bill corrected by the effect of changes in tax rate; expert judgement on tax allowance in line with tax code; for income items taxed separately tax base indexed by nominal GDP growth rate; estimation for all separable items' tax base in the case of withholding tax; sum of claimed tax credit given in the tax proposal corrected by expert judgment
Fees and duties	statutory target and taking into account actual revenue development
Other taxes	statutory target
CENTRAL BUDGETARY INSTITUTIONS AND CHAPTER ADMINISTERED APPROPRIATIONS	
Revenues of central budgetary institutions	statutory target with correction
Chapter administered professional appropriations	statutory target with correction
EU support of chapter administered professional appropriations and central investments	statutory target with correction
PAYMENTS FROM FUNDS OF THE GENERAL GOVERNMENT	
PAYMENTS RELATED TO STATE PROPERTY	statutory target
OTHER REVENUES	statutory target
REVENUES FROM EU	statutory target
REVENUES OF PENSION REFORM AND DEBT REDUCTION FUND	statutory target
REVENUES RELATED TO DEBT SERVICE	estimation (based on yields curves, exchange rates and expected issuance schedule)

Table A.5 Applied estimation methods – revenues (cont'd)	
REVENUES	Applied methodologies
EXTRABUDGETARY FUNDS	
LMF – Health insurance and labor market contributions	base 2010 multiplied by forecasted growth of wage bill, modified with the effect of measures and changes in effective level of tax compliance
LMF – Vocational contributions	base 2010 multiplied by forecasted growth of wage bill
R&D Fund – Innovation contributions	base indexed by nominal GDP growth rate
NCF – revenues from lottery	consistent with the estimated gambling tax revenue
Revenues of other funds	statutory target and taking into account actual revenue developments
PENSION INSURANCE FUND	
Contributions	base 2010 multiplied by forecasted growth of wage bill, modified with the effect of measures and changes in effective level of tax compliance
Revenues of Pension Reform and Debt Reduction Fund	statutory target (discretionary item)
Other revenues	statutory target (discretionary item)
HEALTH INSURANCE FUND	
Contributions	base 2010 multiplied by forecasted growth rate of wage bill, modified with the effect of measures and changes in effective level of tax compliance
Per capita health contribution	2011Q1 revenue indexed by forecasted quarterly growth rate of wage bill
Benefits and subsidies from central budget	statutory target (discretionary item)
Other revenues	Payments of the pharmaceutical companies is assumed to be consistent with projected pharmaceutical expenditures and expected relevant, other revenues are assumed to meet the statutory targets.

Table A.6

Applied estimation methods – expenditures

EXPENDITURES	Applied methodologies
CENTRAL BUDGET	
SUBSIDIES TO ECONOMIC UNITS	appropriation
SUPPORT TO THE MEDIA	appropriation
CONSUMER PRICE SUBSIDY	appropriation and taking into account actual revenue developments
HOUSING GRANTS	appropriation
FAMILY BENEFITS, SOCIAL SUBSIDIES	appropriation and taking into account actual revenue developments
GOVERNMENT AGENCIES AND CHAPTERED-ADMINISTERED APPROPRIATIONS	
Expenditures of central budgetary institutions	appropriation with corrections
Chapter-administered professional appropriations	appropriation with corrections
RESERVES	appropriation with corrections
TRANSFERS TO FUNDS OF GENERAL GOVERNMENT	appropriation with corrections
SUPPORT TO CIVIL ORGANISATIONS	appropriation
EXPENDITURES RELATED TO MNB	MNB projection
EXPENDITURES RELATED TO STATE PROPERTY	appropriation
EXTRAORDINARY AND OTHER GOVERNMENTAL EXPENDITURES	appropriation
EXPENDITURES RELATED TO STATE GUARANTEES	appropriation
DEBT ASSUMPTION AND RELEASE	appropriation
CONTRIBUTION TO EU BUDGET	appropriation and taking into account actual revenue developments
DEBT SERVICE, INTEREST PAYMENT	estimation (based on yields curves, exchange rates and expected issuance schedule)
EXTRABUDGETARY FUNDS	
LMF – Passive allowances	base 2010 multiplied by forecasted growth rate of wage bill and change in the number of unemployed, corrected with the developments in the number and composition of dependants observed so far in 2011
LMF – Active and other expenditures	appropriation with corrections
Expenditures of other funds	appropriation with corrections
SOCIAL SECURITY FUNDS	
PENSION INSURANCE FUND	
Pensions	
Old-age pension benefits	base 2010 multiplied by pensioners' CPI corrected with actual data and seasonal developments based on recent years
Disability pension benefits below age limit	base 2010 multiplied by pensioners' CPI corrected with actual data and seasonal developments based on recent years and with estimated effect of relevant measures outlined in Szell Kalman Plan
Survivors' benefits	base 2010 multiplied by pensioners' CPI corrected with actual data and seasonal developments based on recent years
Other expenditures	statutory target (discretionary item)
HEALTH INSURANCE FUND	
Sick allowance	base 2010 multiplied by forecasted growth of wage bill, modified with the effect of measures come into force recently
Child care allowances	base 2010 multiplied by forecasted growth of wage bill augmented by the effect of measures and demographical developments
Drugs	projected using the corrected subsidy-outflow on monthly basis, taking into account the effects of expected measures
Medical and preventive care	appropriation increased by the amount of reserves
Other provisions and expenditures	appropriation increased by the amount of reserves corrected with actual data

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