PUBLIC FINANCE REPORT

2023

NOVEMBER

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

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

PUBLIC FINANCE REPORT

Semi-annual analysis of public finance developments

2023

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

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

The analyses in this Report were prepared under the direction of Gergely Baksay, Executive Director for Economic Analysis and Competitiveness. This report was prepared by the staff of the Directorate for Fiscal and Competitiveness Analysis and the Directorate Economic Forecast and Analysis. It was approved for publication by Governor György Matolcsy.

The analysis is based on information available for the period ending on 3 October 2023.

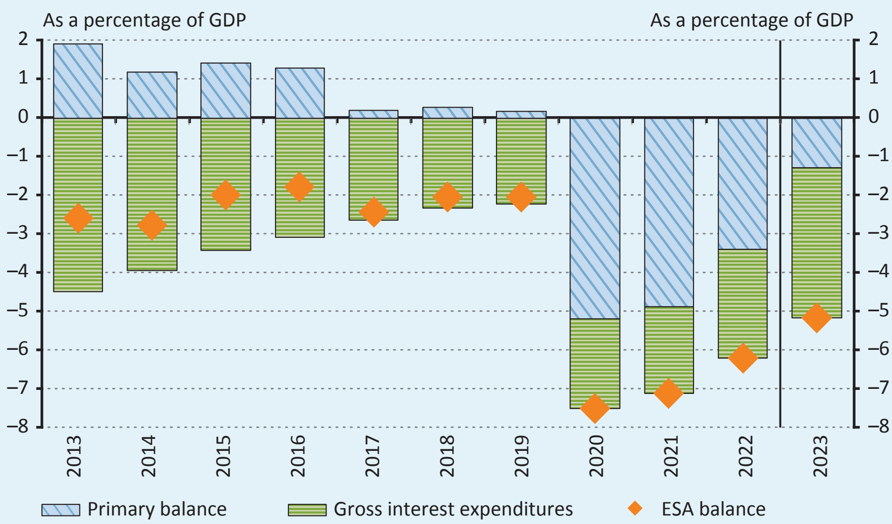
Contents

1 Summary

The purpose of this analysis is to present the developments in public finance in 2022 and the expected fiscal developments for 2023, on the basis of budget figures available for the first eight month of the year and the MNB's forecast prepared for its September Inflation Report. In view of the above, the actual compliance with the national and European Union rules related to the budget balance and government debt for 2022, as well as the expected compliance for 2023 are assessed.

The deficit of the Hungarian general government has significantly increased in the period of the coronavirus crisis. The budget deficit is decreasing year by year, nevertheless the deficit has consistently exceeded the targets (Chart 1). High inflation imposes an increasingly significant burden on the general government both on the revenue and the expenditure sides. According to our forecast the government debt rate continues to decrease, which ensures meeting the debt rule stipulated by the Fundamental Law and the Stability Act. As a result of the tax reform implemented at the beginning of the 2010s, the Hungarian budget has put consumption and sales taxes in the focus of revenues. However, in 2023, due to the fall of real wages the rapid rise in inflation significantly curbed consumption, and thus it had a negative impact on one of the largest taxes bases in the budget. Simultaneously, expenditures also rose as a result of inflation, since several of the budgetary expenditures (pensions and part of interest expenditures) are directly linked to inflation.

Chart 1
Balance of the general government sector as a percentage of GDP



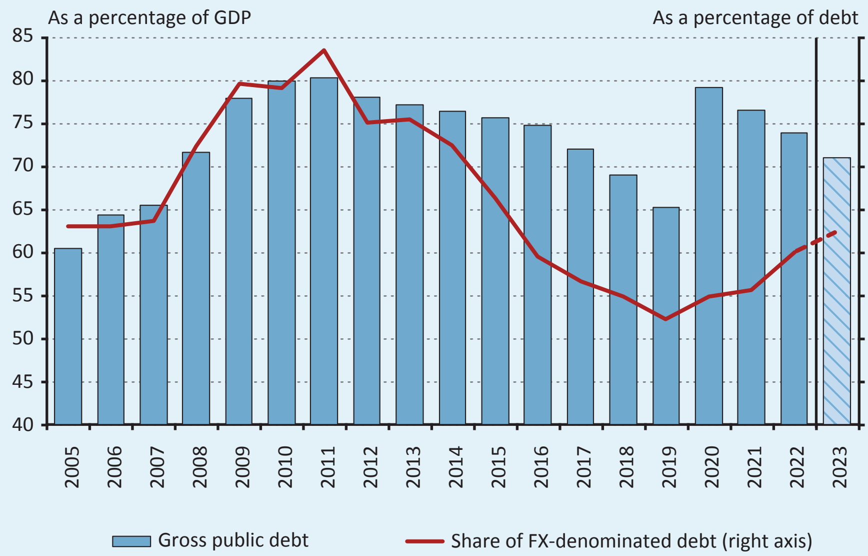
Source: HCSO, MNB

Last year the general government deficit amounted to 6.2 per cent of GDP, while according to our projection, this year – in line with the government's expectations, raised simultaneously with the publication of the EDP notification – the deficit may decline to 5.2 per cent of GDP. Close control of the expenditures is necessary in the remaining months of the year even under the new deficit target. The Budget Act has set a deficit target of 5.9 per cent for 2022, which was reduced by the government to 4.9 per cent in its December 2021 expectation, then raised to 6.1 per cent in September 2022. The raising of the deficit target was justified by the accumulation of special natural gas reserves, which increased the ESA deficit by 1.2 per cent of GDP. Last year, tax and contribution revenues realised a large surplus amounting to more than HUF 2,700 billion, while the level of expenditures exceeded the appropriation by almost HUF 3,700 billion due to the soar in government energy expenditures and the rise in expenditures related to pensions and interest payments. Based on the Act adopted last July with regard to the 2023 fiscal year, the budget deficit target was 3.5 per cent of GDP, which was amended by the government at the end of 2022 to 3.9 per cent of GDP, followed by yet another increase to 5.2 per cent in October 2023.

This year the first eight months' cash deficit of the central sub-sector was almost HUF 3,300 billion, which amounted to 97 per cent of the annual appropriation, while the accrual-based deficit in the first half-year amounted to 6.3 per cent of the semi-annual GDP. Our projection reckons with more unfavourable macroeconomic assumptions than those included in the Budget Act, as a result of which tax and contribution revenues may fall short of the appropriation significantly, i.e. by some HUF 1,450 billion. We anticipate material savings, i.e. almost HUF 1,000 billion, in primary budgetary expenditures; however, roughly half of this will be offset by the higher-than-expected level of interest expenditures. Based on the October EDP notification, the expected cash deficit may exceed the appropriation and amount to HUF 4,450 billion.

By the end of 2022, the gross government debt as a percentage of GDP declined from 76.7 per cent registered at the end of 2021 by 2.8 percentage points to 73.9 per cent. According to our forecast, this year the gross government debt-toGDP ratio will continue to decline, and it may decrease to 71 per cent by the end of 2023 (Chart 2). According to our projection, by the end of 2023 the gross government debt-to-GDP ratio may exceed 69.7 per cent, i.e. the rate stated in the Budget Act, while the impact of the budget deficit exceeding the statutory appropriation, is somewhat offset by the MNB's higher nominal GDP expectation. As a result of the foreign currency bond issuances this year, the foreign currency ratio of the central government debt may rise over 27 per cent from 25 per cent registered at the end of 2022.

Chart 2
Expected developments in gross public debt-to-GDP



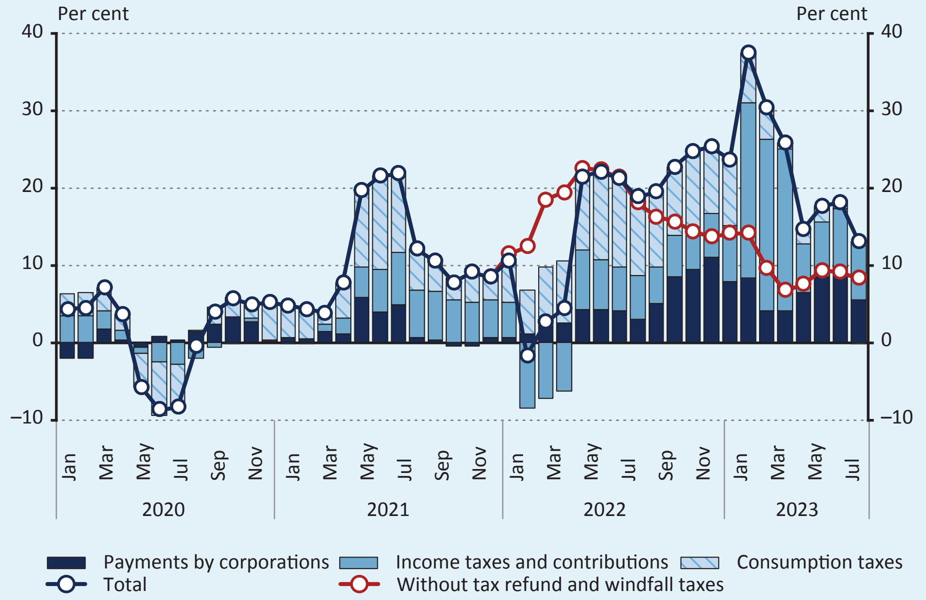
Note: The chart shows actual data between 2005 and 2022, while data for 2023 are projected by the MNB.
Source: Government Debt Management Agency, MNB

In order to stabilise the budget, the government announced comprehensive consolidation measures in May 2022, a dominant part of which includes the application of taxes on windfall profits and a substantial cut in budgetary expenses, primarily investments, this year and the coming years. The primary objective of the measures is to restore balance rapidly, and thereby to achieve the budgetary path that ensures a gradual decline in the general government deficit. According to our estimate, revenues from taxes levied on windfall profits may have amounted to some HUF 700 billion in 2022, and this year those may contribute to the moderate reduction in the budget deficit by an even higher amount.

The level of the budget's tax and contribution revenues as a percentage of GDP was up by around 1.2 percentage points in 2022, which is, however, attributable to the impact of the accounting of the personal income tax refund. Last year tax and contribution revenues registered a rapid nominal growth, as cash revenues rose by some 18 per cent in 2022 compared to the previous year (Chart 3). The growth was primarily attributable to a significant nominal increase in payments by enterprises and in consumption taxes. Income taxes and social security contributions also contributed positively to the growth in revenues last year; however, on a cash basis, this impact was mitigated in the first half of 2022 by the personal income tax refund to taxpayers with children. However, on an accrual basis, the PIT refund, the amount of which corresponds to roughly 1 per cent of GDP, has been accounted for in 2021, thus significantly reducing the tax-to-GDP ratio in the base year.

Excluding the one-off effect of the personal income tax refund, tax centralisation would have stagnated in 2022. The revenue increasing effect of the taxes levied on windfall profits during last year together with dynamic macroeconomic developments determining the tax bases of the major tax types of higher fiscal importance, resulted in a fast nominal growth in tax and contribution revenues, while nominal GDP, representing the denominator of the tax-to-GDP ratio, also rose by almost 20 per cent during 2022. The amount of taxes on production and imports as a percentage of GDP and of income taxes adjusted for the personal income tax refund rose by 0.5 and 0.1 percentage point respectively, while the amount of net social security contributions as a percentage of GDP declined by 0.7 percentage point, which is primarily attributable to the reduction of the rate of employers' tax burden by 4 percentage points.

Chart 3
Annual change in the central sub-sector's tax and contribution revenues (3-month moving average)



Source: Hungarian State Treasury

According to our forecast, in 2023, tax and contribution revenues of the central sub-sector of the budget may fall short of the statutory appropriation by HUF 1,450 billion, which is primarily attributable to stagnating VAT revenues resulting from inflation. The 20 per cent growth dynamics of tax and contribution revenues registered in the first eight months was partly attributable – in addition to the underlying macroeconomic trends – to the lower base of previous year resulting from the tax refund in the first half of 2022, as well as to the impact of the taxes on windfall profits introduced in the second half of 2022, also appearing in the first half of this year. Excluding these two factors, tax and contribution revenues rose by 9 per cent until August compared to the previous year. According to the MNB's expectations, VAT revenues of the central sub-sector may significantly fall short of the appropriations due to declining consumption resulting from high inflation. Based on our projection, revenues from the income tax of energy providers and, to a smaller extent, other corporate and labour tax revenues may also fall short of the appropriation.

Government expenditures significantly exceeded the appropriation in 2022, while in 2023 it may fall short of budget expectations. In 2022, the excess expenditure was primarily attributable to the government's high energy spending and the rise in pension and interest expenditures. This year the expected savings compared to the appropriation results mostly from the lower realisation of the expenditures related to EU programmes as well as from the public energy expenditures, which are still high but presumably fall short of budget expectations. Housing subsidies, support to local governments, pension expenditures and interest expenditures are likely to exceed the appropriation in 2023.

The expected budgetary processes, subject to applying the relevant escape clauses, will be in line with the Hungarian and supranational requirements pertaining to the government balance and public debt. The Maastricht deficit criterion, included in both the Hungarian and the EU fiscal framework, specifies that the accrual-based deficit of the general government may not exceed 3 per cent of GDP. The Hungarian budget deficit in 2022 was 6.2 per cent of GDP, and the

5.2 per cent deficit expected for this year is also above the threshold, but the Maastricht deficit target is subject to an escape clause under both the EU and Hungarian fiscal frameworks. According to the decision of the EU institutions, the general escape clause continues to be applied this year as well, while in the Hungarian legislation the 3 per cent deficit criterion and the rules related to reaching the medium-term budgetary objective have been temporarily suspended for the 2021-2023 fiscal years. According to our assessment, the decrease in government debt complies in both years with the debt rule of the Fundamental Law, which is nevertheless suspended due to the state of emergency, and also with that of the Stability Act.

2 Balance of the general government sector in 2022

The government sector's ESA deficit of 2022 was 6.2 per cent of GDP according to the October EDP notification. The 2022 Budget Act contained a deficit target of 5.9 per cent of GDP, which was first reduced to 4.9 per cent by the government's expectation, and then raised to 6.1 per cent, taking into account the accumulation of special natural gas reserves. Last year, the Russia-Ukraine war and the rise in energy prices deteriorated the economic environment, as a result of which the government decided on the implementation of stabilisation measures (postponement of investments, introduction of windfall taxes imposed on certain sectors) in May. Based on the deficit of 6.2 per cent, in 2022 the general government deficit exceeded the Maastricht reference value by 3.2 per cent; however, exceeding the deficit criterion was permitted both by the EU escape clauses and those taking effect in the Hungarian budgetary framework in 2022. **Due to the significant growth in nominal GDP, the fall in the gross government debt-to-GDP ratio continued in 2022 as well:** from 76.7 per cent registered at the end of 2021 by roughly 2.8 percentage points to 73.9 per cent at the end of 2022.

According to the October EDP notification of the HCSO, the ESA deficit of HUF 4,126 billion reflects the balance of the central sub-sector's (balance of the central government and the social security funds) deficit in the amount of HUF 3,963 billion and the local government sub-sector's deficit of HUF 163 billion. As a result of the positive statistical corrections, the accrual-based deficit fell short of the cash-based deficit in the case of the central sub-sector, while that of the local government sub-sector exceeded it. Following the surpluses registered in 2020 and 2021, the accrual-based balance of the local governments turned to a deficit in 2022 (Table 1).

The 2022 **cash-based deficit of the general government** (the central and local government subsector) amounted to HUF **4,725** billion. **The cash-based deficit of the central sub-sector was HUF 4,672 billion in 2022.** According to the EDP notification, the annual cash-based deficit exceeded the HUF 3.153 billion deficit target specified in the Budget Act by HUF 1,519 billion.

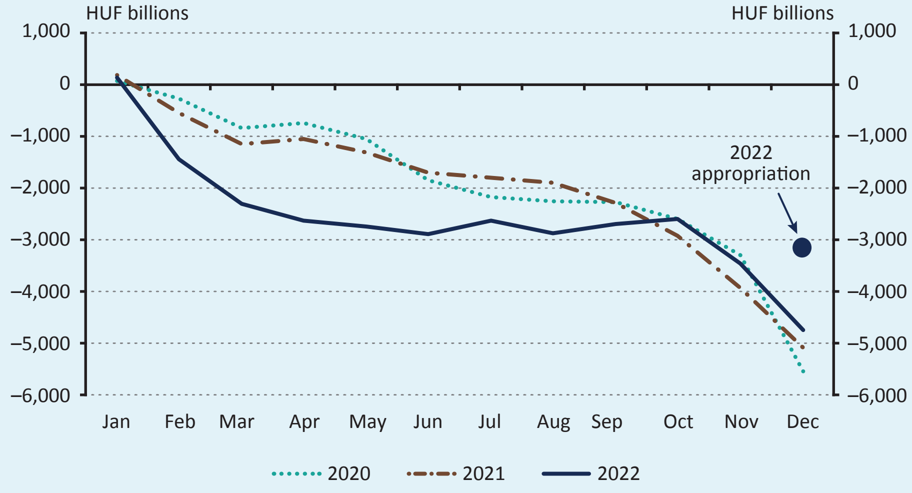
Table 1
Budget balance indicators in 2022

	Cash-based balance	**ESA-bridge**	**ESA balance**
	HUF Billions		
Central sub-sector	-4,672	709	-3,963
Local governments	-52	-111	-163
Total general government	**-4,725**	**599**	**-4,126**
	As a percentage of GDP		
Central sub-sector	-7.1	1.1	-6.0
Local governments	-0.1	-0.2	-0.2
Total general government	**-7.2**	**0.9**	**-6.2**

Note: Due to rounding, differences may occur in the table.
Source: HCSO, October 2023 EDP notification

Cash revenues of the central sub-sector exceeded the revenues specified in the Budget Act by HUF 2,150 billion in total. Rapid nominal growth in wages and consumption along with the special taxes paid in the second half of the year had a material role in developments of the revenue surplus. As a result of the higher-than-expected consumption expenditures, net VAT revenues exceeded the appropriation by HUF 1,373 billion, whilethe special taxes introduced mid-year generated surplus revenues of HUF 704 billion according to our estimate.

Chart 4
Intra-year developments of cash-based deficit of the central subsector (cumulative value)

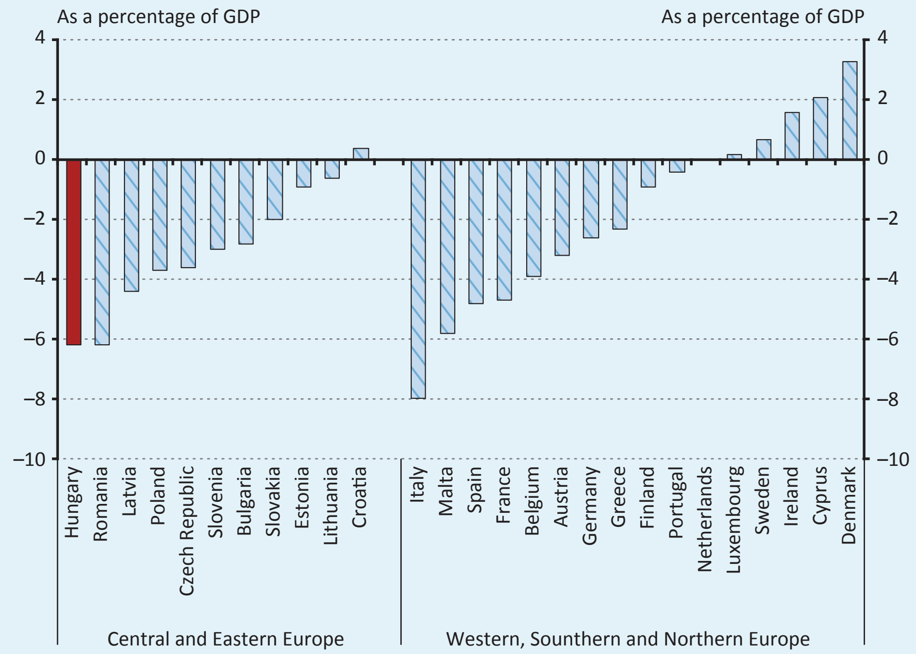


Note: According to the EDP notification, the cash-based deficit differs from the preliminary data published by the Hungarian State Treasury by some HUF 80 billion.
Source: 2022 Budget Act, Hungarian State Treasury preliminary data

According to our partially consolidated data, **cash expenditures of the central sub-sector** exceeded the appropriation in the Budget Act by HUF 3,751 billion in total. The excess expenditure was generated primarily by the rise in energy prices and the high inflationary environment. A dominant part of the primary excess expenditures was registered at the budgetary organisations, the special and normative subsidies paid from the Utility Protection Fund, the pension expenditures and the expenditures related to state asset management. In addition, net interest expenditure exceeded the statutory appropriation by HUF 580 billion.

Hungary's 2022 budget deficit was the second highest in the European Union (Chart 5). Hungary's accrual-based deficit of 6.2 per cent was exceeded only by Italy with a deficit of 8 per cent, while in the CEE region the highest deficit was registered in Hungary and Romania. In the European Union the average budget deficit was 3.6 per cent; however, 15 countries managed to achieve a deficit lower than 3 per cent, 7 of which already had a surplus balance in 2022.

Chart 5
Budget balance in the EU countries in 2022



Source: Eurostat

2.1 REALISATION OF THE MACROECONOMIC PROJECTIONS UNDERLYING THE BUDGET

The performance of the Hungarian economy increased by 4.6 per cent in 2022. The growth rate was below the 2022 Budget Act's expectation of 5.2 per cent, which was primarily attributable to the more moderate growth in investments than expected. In 2022 gross fixed capital formation grew by 1.2 per cent, a shortfall of 6 percentage points compared to the budgetary expectation. Households' consumption expenditures, public consumption, exports and imports exceeded the growth dynamics expected in the Budget Act by 0.5, 0.6, 1.3 and 1.1 percentage points, respectively.

In 2022, total employment rose by 1.3 per cent and reached a historically high level. The impact of the Russia-Ukraine war on the labour market was less than expected, while economic growth and the post-pandemic recovery of the economy both supported the rise in the number of people in employment. **In 2022, the growth rate of gross average earnings was 17.4 per cent**, which substantially exceeded the expectations in the Budget Act. The large raise in the minimum wage and guaranteed wage minimum at the beginning of the year along with the high inflationary environment made major contribution to the annual wage dynamics.

Table 2
Comparison of the macroeconomic projection in the 2022 Budget Act and the actual figures (per cent)

	Budget Act	Actual
Change in GDP in real terms	**5.2**	**4.6**
Exports	10.5	11.8
Imports	10.0	11.1
Gross fixed capital formation	7.2	1.2
Consumption expenditure of households	6.0	6.5
Public consumption	-1.9	-1.3
Inflation	**3.0**	**14.5**
Average gross earnings	**7.7**	**17.4**

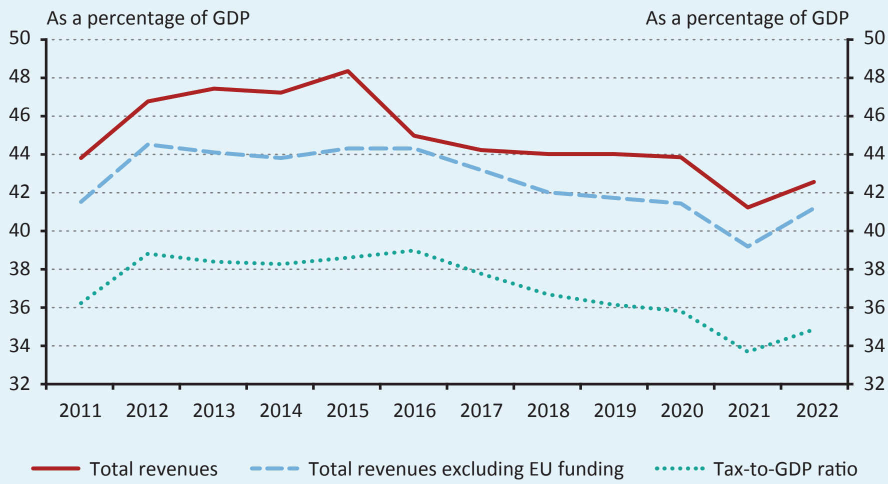
Source: HCSO, 2022 Budget Act

In 2022, the consumer price index was 14.5 per cent instead of 3.0 per cent assumed upon compiling the 2022 Budget Act in spring 2021. From the supply side, annual inflation developments were significantly impacted by the rise in food, commodity and energy prices. This was supplemented on the demand side by the increased inflation effect of households' consumption resulting from the government transfers disbursed in the first half of last year (personal income tax refund, armed forces' benefit, pension-related disbursements, sectoral wage increases). The favourable demand environment made it possible for enterprises to raise their prices to a higher extent than justified by their rising costs, and thus the growing margins and profit mark-ups, i.e. the phenomenon of profit-driven inflation, also contributed to the rise in inflation.

2.2 BUDGET REVENUES

In 2022, the accrual-based revenues of the general government rose to 42.6 per cent of GDP compared to 41.2 per cent of previous year. Excluding EU grants, revenues increased by 2.0 percentage points (Chart 6). Tax centralisation as a percentage of GDP rose by 1.2 percentage points to 34.8 per cent. The rise in tax revenues as a percentage of GDP is attributable to the lower basis resulting from the accrual-based recognition in 2021 of the tax refund early last year to taxpayers with children; excluding this, tax centralisation would have stagnated in 2022. Due to the surplus revenues from the windfall taxes introduced in the second half the year and to the macroeconomic developments, accrual-based tax and contribution revenues grew dynamically, excluding the impact of the tax refund by almost 19 per cent, while nominal GDP also rose at a rate of almost 20 per cent last year.

Chart 6
Accrual-based revenues of the government sector and degree of tax-to-GDP ratio



Source: HCSO, Eurostat

In 2022, partially consolidated cash revenues of the central sub-sector amounted to HUF 23,634 billion, of which HUF 21,234 billion was linked to tax and contribution revenues (Table 3). Tax and contribution revenues exceeded the original appropriation by HUF 2,737 billion, mainly as a result of the higher-than-expected consumption tax revenues and payments by economic organisations. EU revenues fell short of appropriation by HUF 958 billion.

Table 3
Partially consolidated revenues of the central sub-sector in 2022 (HUF billions)

	2022		
	Statutory appropriation	Actual	Difference
TAX AND CONTRIBUTION REVENUES OF THE CENTRAL SUB-SECTOR	**18,496**	**21,234**	**2,737**
Payments by economic organisations	**1,960**	**2,895**	**935**
Corporate income tax	589	747	158
Special tax of financial institutions	61	327	266
Lump sum tax of small entrepreneurs	237	186	-51
Tax of small enterprises	121	145	24
Utility tax	53	53	0
Eco-tax	6	5	0
Mining royalty	38	241	203
Gambling tax	34	46	13
Other taxes and payments	15	26	11
Other centralised revenues	520	552	32
Income tax on energy providers	55	204	149
Company car tax	39	50	11
Retail tax	76	177	100
Rehabilitation contribution	116	136	19
Consumption taxes	**7,243**	**8,718**	**1,475**
Value added tax	5,487	6,860	1,373
Excise duties	1,296	1,230	-67
Motor vehicle registration duty	25	16	-9
Telecommunication tax	53	97	43
Financial transaction levy	233	294	61
Insurance tax	115	169	54
Airline tax	0	15	15
Tourism development contribution	34	38	5
Payments by households	**3,156**	**3,144**	**-12**
Personal income tax	2,867	2,786	-81
Duties, other taxes	199	262	63
Motor vehicle tax	91	96	5
Tax and contribution revenues of extra-budgetary funds	**441**	**436**	**-5**
Tax and contribution revenues of social security funds	**5,697**	**6,040**	**343**
Social contribution tax and contributions	5,537	5,846	309
Other contributions and taxes	160	195	34
REVENUES RELATED TO EU FUNDS	**2,386**	**1,428**	**-958**
OTHER REVENUES	**573**	**972**	**400**
Revenues on public property	**276**	**470**	**194**
Other revenues of the central budget	**149**	**265**	**116**
Other revenues of social security funds	**35**	**42**	**7**
Other revenues of extra-budgetary funds	**113**	**196**	**83**
TOTAL REVENUES	**21,455**	**23,634**	**2,179**

Note: Partly consolidated data: the fiscal impact of the revenues and expenditures within the general government central sub-sector are stated in net terms.

Source: Closing accounts of the 2022 budget, 2022 Budget Act

Economic organisations paid HUF 2,895 billion to the budget in 2022. This amount is higher by HUF 935 billion than the amount expected in the 2022 Budget Act. Tax measures had a significant impact on developments.

The fiscal measures in 2022 may be classified in two groups in respect of the payments by economic organisations: a large part of the surplus revenues was paid to the budget due to measures of temporary effect; however, permanent changes to certain tax types also entered into force.

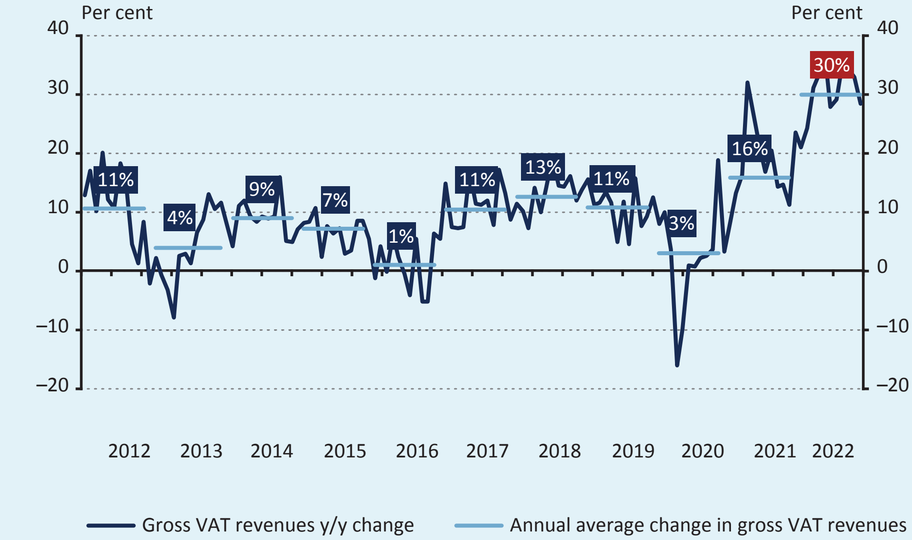
The surplus at the **special tax of financial institutions** (HUF +266 billion) is attributable to a temporary change to the rules, whereas credit institutions have to pay the new special tax from the second half of the year. The basis of the special tax is the fee and commission revenue collected by credit institutions, while the tax rate was 10 per cent. In the case of **mining royalties** (+ HUF 203 billion), the rate of the mining royalty payable on crude oil and natural gas temporarily trebled. In the case of **income tax on energy providers** (HUF +149 billion) the range of taxpayers has been expanded with bioethanol and bio-fuel producers, sunflower oil and starch producers. In addition, a special tax at 25 per cent has been imposed on the profit realised on the difference between the Brent and Ural prices. The rate of this tax was first raised to 40 per cent in August and then to 95 per cent in December.

In the case of **retail tax** (HUF +100 billion) during the year first a permanent change was announced (starting from February 2022, the highest rate of this tax was raised by 0.2 percentage point to 2.7 per cent), and later, in the spring package of measures, taxpayers were obliged to pay to the Treasury, in addition to the usual retail tax due in respect of 2022, also an amount corresponding to 80 per cent of the tax they paid in 2021. In addition to retail tax, company car tax was also increased permanently (HUF +11 billion), with the tax rate increasing on average by 1.8-1.9 times. The shortfall (HUF -51 billion) at the **lump sum tax of small entrepreneurs** (KATA) is attributable to a measure aimed at reducing the number of taxpayers. The reduction of the number of taxpayers entered into force on 1 September 2022. Pursuant to the changes, only those full-time self-employed taxpayers may apply the lump sum tax who issue invoices only to private individuals. For them the limit for the annual revenue was raised from HUF 12 million to HUF 18 million, while the possibility of opting for a higher KATA payment has been abolished. Due to the more favourable macroeconomic developments, compared to the Budget Act, revenues from **corporate income tax** (HUF +158 billion), **tax of small enterprises** (HUF +24 billion) and **rehabilitation contribution** (HUF +19 billion) were higher in 2022.

Compared to 2021, payments by enterprises increased by HUF 1,003 billion. Similarly to the departures from the appropriation, the increments were attributable to measures and to the favourable macroeconomic developments. Revenues from special tax of financial institutions (HUF +266 billion), mining royalty (HUF +188 billion), income tax of energy providers (HUF +127 billion), retail tax (HUF +98 billion) and company car tax (HUF +10 billion) rose compared to 2021, mostly as a result of the measures. The growth in revenues from corporate income tax (HUF +189 billion), small enterprise tax (HUF +34 billion), electronic road toll (HUF +29 billion), rehabilitation contribution (HUF +22 billion) and gambling tax (HUF +17 billion) is attributable to macroeconomic developments. The revision of the lump sum tax of small taxpayers in the last four months reduced the annual revenue in 2022 (HUF -10 billion).

Net revenues from **value added tax** amounted to HUF 6,860 billion in 2022, exceeding last year's revenues by HUF 1,463 billion and exceeding the appropriation by HUF 1,373 billion. 125 per cent of the appropriation was realised, while the growth rate of gross revenues was 30 per cent, showing the highest growth dynamics of the past 10 years (Chart 7). This figure was around 8-10 per cent on average since 2012. The volume of retail sales rose by 5.3 per cent in 2022, while consumer prices increased by 14.5 per cent on average.

Chart 7
Change in gross VAT revenues year-on-year



Source: Hungarian State Treasury

In 2022, **revenues from excise duties** amounted to HUF 1,230 billion, falling short of the appropriation by HUF 67 billion, due to the temporary reduction of the excise duty on petrol and diesel. Compared to the previous year, revenues from excise duties on fuels declined by 12 per cent, while revenues from excise duty paid on tobacco products rose by 13 per cent. Other revenues from excise duties, mostly paid on alcoholic products, grew by 23 per cent. Between February and December 2022, **excise duty on petrol and diesel** declined by HUF 5 and then by HUF 20 per litre, on a temporary basis, generating a shortfall of roughly HUF 100-120 billion for the budget. From 1 January 2023, the excise duty on petrol and diesel was reset to HUF 120/litre and HUF 110/litre, respectively, i.e. the amount prevailing before February 2023. **Excise duty on tobacco products** rose in July 2022 and April 2023 to ensure compliance with the EU regulation. The itemised tax part on cigarettes increased. In 2022, the two-step tax increase of roughly 13 per cent may have improved the balance of the budget by some HUF 15 billion. In addition, the excise duty on new tobacco products was also raised, approaching the price of cigarette per piece, also having a fiscal effect of roughly HUF 15 billion. The fiscal impact of raising tax on **energy and alcohol products** from 1 July may have been roughly HUF 5 billion last year.

In 2022, revenues of HUF 15 billion were realised in the **airline tax** revenue row. The departure tax, which was a new type of tax, first appeared in August 2022, i.e. the tax payable as part of air passenger services for each person departing from Hungary. In 2022, the amount of the tax was HUF 3,900 for those who fly within Europe and HUF 9,750 for those travelling to countries outside Europe. The taxpayer is the ground service provider, which may pass the tax burden on to the airlines.

Revenues from **insurance tax** amounted to HUF 169 billion in 2022, exceeding the 2022 appropriation by HUF 54 billion. The significant overrun is attributable to the windfall tax amounting roughly to HUF 50 billion, which was transferred to the newly launched National Defence Fund.

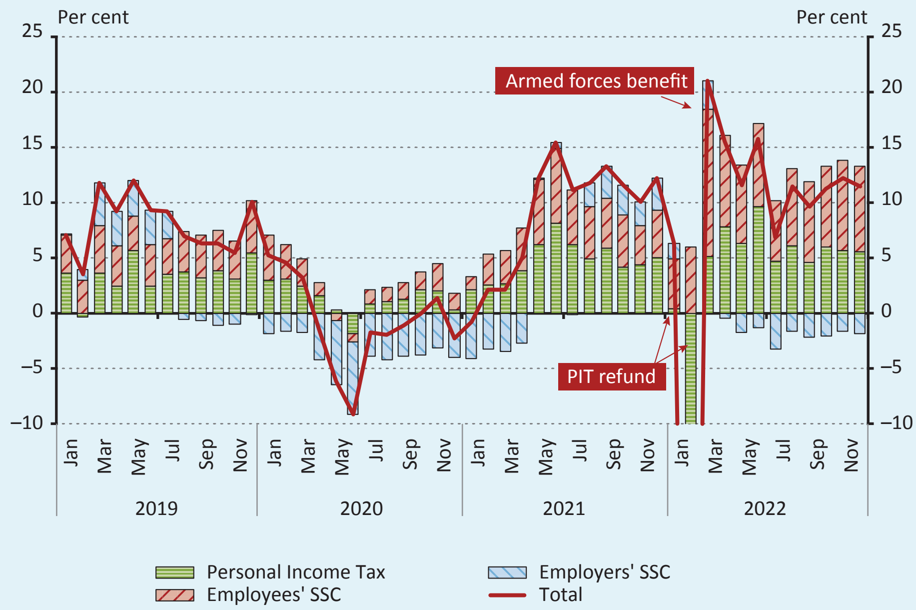
Revenues from **telecommunication tax** amounted to HUF 97 billion in 2022, exceeding the appropriation by HUF 43 billion. The overrun is attributable to the windfall tax imposed on the telecommunication sector, with its fiscal impact amounting to HUF 40 billion. While until now the telecommunication tax was paid by phone service providers on the calls and the number of subscribers, the scope of enterprises paying the new type of windfall tax is wider, as it covers internet service providers as well.

Revenues from **tourism development contribution** amounted to HUF 38 billion in 2022, which exceeded the statutory appropriation by HUF 5 billion. Since the extension of this tax type to the accommodation and catering sector in 2020, this was the first year when the budget received tangible revenues, exceeding the plan. Revenues exceeded the appropriation even though in the last 3 months of 2022 the respective sectors were exempted from the payment of the tax. The payment of the contribution was suspended between 1 October 2022 and 31 March 2023, thereby supporting catering and commercial accommodation providers with roughly HUF 20-25 billion. The measure affected roughly 48,000 restaurants and 2,600 commercial accommodation providers.

Revenues from financial transaction levy amounted to HUF 294 billion in 2022, which exceeded the original appropriation by HUF 61 billion, i.e. 26 per cent, and also by HUF 61 billion the reading in 2021. The significant overrun is attributable to the amendment in July 2022: the HUF 6,000 upper limit of tax payment on bank transfers rose to HUF 10,000, and – with an unchanged rate of 0.3 per cent – it was extended to securities transactions as well, except for the transactions performed by the Treasury and the Post.

Last year revenues from **duties** amounted to HUF 262 billion, generating by 32 per cent higher revenue compared to the statutory appropriation. In annual terms revenues from duties rose by 17 per cent compared to 2021. The growth is attributable to the increase in the **property transfer tax**, resulting from the rise in demand for real estate and in the property prices.

Chart 8
Structure of the annual change in labour taxes between 2019 and 2022

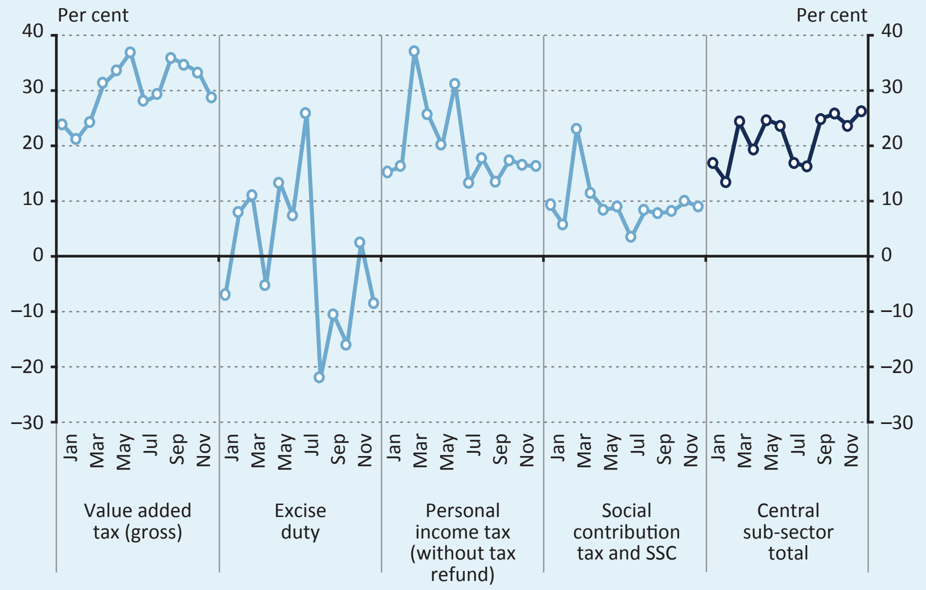


Source: Hungarian State Treasury, MNB

In 2022, 97.2 per cent of the **personal income tax** appropriation of net HUF 2,867 billion was realised. The cash revenue of HUF 2,786 billion was the combined effect of the significant divergence of gross revenues and refunds from the plan. The personal income tax appropriation for 2022 did not include the effect of the tax refund to those with children at the beginning of the year, which reduced net revenues by some HUF 660 billion in total. The stronger than expected growth of the gross wages and wage bill, and certain one-off measures, such as the payment of the armed forces benefit already in March 2022 (Chart 8) have partly offset this impact, and thus revenues fell short of the appropriation only by some HUF 80 billion in the entire year. Partial personal income tax exemption was introduced in 2022 for those below the age of 25, which provides eligible young people with tax exemption up to the gross average wage registered in July of the previous year.

In 2022 **tax and contribution revenues of social security and extra-budgetary funds** exceeded the relevant appropriation materially, by some HUF 338 billion. Revenues became significantly higher despite the fact that based on the Budget Act, the rate of employer tax and contribution would have been reduced only from the second half of the year and only by 2 percentage points, but due to the cancellation of the 1.5 per cent vocational training contribution and the 2.5 percentage points reduction of the social contribution tax the total tax cut amounted to 4 percentage points and it entered into force already from the beginning of the year. Accordingly, revenues from social contribution tax fell short of the appropriation by HUF 145 billion, while social security contributions exceeded the original appropriation by almost HUF 420 billion. As an additional tax change in 2022, most of the alcoholic beverages were removed from the scope of the **public health product tax**, while in the case of the remaining products the tax rate was raised in a tiered structure, or the tax type was levied on new product groups. The tax burden on **simplified employment** also rose as part of the 2022 consolidation measures.

Chart 9
Year-on-year change in the key tax and contribution types



Source: Hungarian State Treasury, MNB calculation

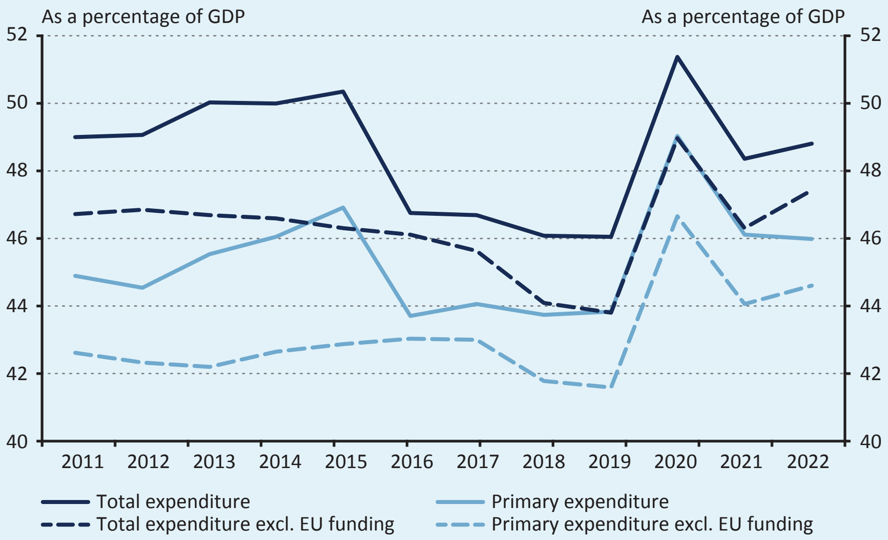
EU revenues significantly fell short of the appropriation, primarily due to the fact that the European Commission approved Hungary's Partnership Agreement and Recovery Plan much later than previously expected. Accordingly, no tangible budget revenue has been recognised in 2022 from the new programming cycle. Compared to the appropriation of HUF 2,386 billion, of the revenues – realised merely in the amount of HUF 1,428 –almost HUF 1,100 belonged to the Széchenyi 2020 programmes and HUF 240 billion to the Rural Development Programme.

Remaining **other revenues** amounted to HUF 942 billion in total, exceeding the appropriations by HUF 369 billion. Budget revenues related to **state asset management** amounted to HUF 470 billion, exceeding the appropriation by HUF 194 billion due to the significant overrun of the revenues related to the exercise of the state's ownership rights. **Other revenues of the central budget** together exceeded the appropriation in the Budget Act by HUF 99 billion.

2.3 DEVELOPMENTS IN EXPENDITURE

As a result of the expenses related to energy prices, pensions and interest expenses, accrual-based expenditures of the general government exceeded the preliminary plans in 2022 as well; however, compared to previous year they fell by 0.4 percentage point, to 48.8 per cent of GDP (Chart 10). Last year, primary expenditures net of the EU grants rose to 44.6 per cent of GDP.

Chart 10
Expenditures and primary expenditures of the government sector (as a percentage of GDP)



Source: HCSO

The consolidated cash expenditures of the central sub-sector amounted to HUF 28,306 billion, of which HUF 26,461 billion belonged to primary expenditure items (Table 4)**.** Primary expenditures exceeded the appropriation in the Budget Act by HUF 3,118 billion. The significant difference is primarily attributable to the growth in expenditures resulting from rising energy prices and the high inflationary environment. The excess expenditures mostly appeared at the expenditure of the central budgetary organisations, the normative and special subsidies disbursed from the Utility Protection Fund, pension expenditures and the expenditures related to state property. In addition to those, net interest expenditures exceeded the statutory appropriation by HUF 580 billion.

Table 4
Partially consolidated cash expenditures of the central sub-sector in 2022 (HUF billions)

	2022		
	Statutory appropriation	Actual	Difference
PRIMARY EXPENDITURE ITEMS	**23,343**	**26,461**	**3,118**
Special and normative subsidies and support to the public media	**590**	**1,106**	**516**
Social policy fare subsidy	**120**	**118**	**-2**
Housing grants	**382**	**635**	**253**
National Family and Social Policy Fund	**685**	**717**	**32**
Net own expenditures of central budgetary organisations and chapters	**6,937**	**8,448**	**1,511**
EU related expenditures	**3,001**	**2,989**	**-12**
Support to local governments	**873**	**1,082**	**209**
Contribution to the EU budget	**565**	**586**	**21**
Central reserves	**894**	**0**	**-894**
Other expenditures	**1,074**	**1,840**	**766**
Expenditures of extra-budgetary funds	**557**	**518**	**-39**
EREF - Passive allowances	105	114	9
EREF - Active allowances	120	120	0
Other expenditures	332	283	-48
Expenditures of social security funds	**7,665**	**8,421**	**756**
PIF - Pensions	4,163	4,790	628
HIF - Disability and rehabilitation benefits	301	338	37
HIF - Cash benefits	586	623	37
HIF - Medical and preventive care	2,123	2,203	80
HIF - Net expenditures of the drug budget	344	315	-28
Other expenditures	148	151	3
NET INTEREST EXPENDITURES	**1,265**	**1,845**	**580**
TOTAL EXPENDITURES	**24,608**	**28,306**	**3,698**
BALANCE	**-3,153**	**-4,672**	**-1,519**

Note: Partly consolidated data: the fiscal impact of the revenues and expenditures within the general government central sub-sector are stated in net terms.

Source: Closing accounts of the 2022 budget, 2022 Budget Act

The statutory appropriation for the **special, normative subsidies and support for the public media** was HUF 590 billion combined, while payments exceeded HUF 1,106 billion, thus the excess expenditure was HUF 516 billion, representing a more than twofold realisation of expenditures. The significant rise in expenditures is the consequence of the soaring energy costs. In order to offset the losses resulting from the rising energy costs at least partially, the government established the Utility Protection Fund during the year. The larger part of the Fund's expenditures, reaching HUF 699 billion, was recognised as special subsidies. In 2022, special expenditures related to offsetting of the utility protection service exceeded HUF 375 billion. On the other hand, the rise in energy and fuel prices in the second half of 2022 also increased the costs of public transport companies in excess of plans, and thus these companies received extra subsidies from the budget. The over-realisation of the expenditures by more than HUF 500 billion is the combined effect of the aforementioned developments.

The appropriation for the **social policy fare subsidy** was HUF 120 billion, while disbursements amounted to HUF 118 billion. Compared to the base period, the subsidy amount rose by HUF 23 billion due to the rising number of passengers resulting from the easing of the coronavirus pandemic.

Expenditures on housing subsidies reached HUF 635 billion, exceeding the subsidy paid in 2021 and the 2022 original appropriation by more than HUF 250 billion. High expenditures were primarily attributable to the disbursements related to the Home Improvement subsidies, since compared to the appropriation of HUF 155 billion, disbursements were made in the amount of HUF 395 billion since prior to the termination of the scheme on 31 December 2022 more than 100,000 applications were submitted, the processing of which and the related disbursements ran through to 2023. Expenditures related to the Home Purchase Subsidy for Families – for the construction and purchase of new and used homes, and investments realised in preferred settlements – exceeded the appropriated amount of HUF 103 billion by almost HUF 10 billion.

Expenditures of the **National Family and Social Policy Fund** amounted to HUF 717 billion, exceeding the appropriation by HUF 32 billion. **Family benefits and reimbursements disbursed under various titles** disbursed from the Fund, amounted to HUF 400 billion and HUF 24 billion, respectively. There was a more significant difference at the **early retirement benefits**: the expenditure of almost HUF 115 billion exceeded the appropriation by some HUF 18 billion and the figure registered last year by HUF 16 billion. The growth is primarily attributable to the early disbursement of the full amount of the 13th month pension and to the disbursement of the supplementary pension increase, also covering the 13th month benefit, with retrospective effect. Excess expenditures of almost HUF 14 billion were realised in **social benefits**. The benefit disbursed in the amount of HUF 177 billion exceeds previous year's figure by HUF 24 billion; the expenditures related to income substitute and income supplementing benefits together with those related to the discharging of district social duties exceeded the statutory appropriation.

The net expenditures – calculated without the EU revenues and payments – of the budgetary institutions together with the central budgetary payments amounted to HUF 8,448 billion in 2022. This is HUF 180 billion, i.e. 2.2 per cent, higher than in 2021. Net expenditure calculated from the appropriations of the Budget Act is HUF 6,937 billion, which was exceeded by HUF 1,511 billion, and thus the overrun of the statutory appropriations reached 21.9 per cent. On the other hand, the actual excess expenditure was lower taking into consideration the reserve appropriations of the Budget Act. The Central Reserve appropriations amounted to HUF 894 billion, of which the absorption of the Provisions appropriation, the Investment Fund and reserves of extraordinary government measures mostly took place at the budgetary organisations. Revenues of the budgetary organisation were realised in the amount of HUF 2,829 billion instead of the HUF 1,746 billion targeted; the greater part of the difference is the consequence of the accumulation due to the reallocation of the statutory appropriations between chapters. Payments by the budgetary organisations to the central budget were realised in the amount of HUF 922 billion instead of the anticipated HUF 26 billion. The difference between the appropriation and the realisation was primarily caused by the revenues of the Central Residue Settlement Fund, i.e. the revenues arising from the centrally ordered payment obligation related to previous year's appropriation residues. Overall, on the revenue side of the central budget, the statutory appropriations for the payments by budgetary organisations and centralised payments were realised in the amount of HUF 3,751 billion instead of the anticipated HUF 1,772 billion.

Gross expenditures of the budgetary organisation and chapter-administered appropriations exceeded by HUF 847 billion those of the base period by 7.4 per cent, while they exceeded the appropriations in the Budget Act by HUF 3,496 billion, i.e. 40.1 per cent. Since the fulfilment of the appropriations already contains the absorption of the budget reserves as well as the payments to the Central Residue Settlement Fund and the Savings Fund, also considering the total expenditure of roughly HUF 1,249 belonging to these items, an excess spending of HUF 2,248 billion occurred at the budgetary organisations, significantly exceeding the appropriation, representing an excess expenditure of 25.8 per cent.

Wage costs of the **budgetary organisations** increased by 10 per cent compared to the base year; excluding the reduction of the social contribution tax rate, the increase was 12 per cent, while considering the headcount effect of the reorganisation of the higher education institutions into public foundations and the payment of the law enforcement service benefits, the gross wage of the budgetary institutions – on average, under large variance – rose by more than 18 per cent in 2022, compared to previous year. In 2022, other operating expenses of institutions significantly declined compared to the base year; institutions spent HUF 287 billion on those expenditures, corresponding to 57.8 per cent of previous year's realisation. The investment and renovation expenses of government organisations grew by merely HUF 11 billion (1.5 per cent) in 2022 compared to previous year. Other expenditures fell to a fraction in 2022, with institutions spending HUF 61 billion on such expenditures, compared to HUF 414 billion in 2021.

Gross expenditures of the **professional chapter-administered appropriations** were realised in the amount of HUF 5,034 billion, exceeding the base year's gross expenditure determined by the Act of 2021 on Final Accounts by HUF 668 billion. Chapters used the excess expenditure in full on operating subsidies; the nominal spending growth was HUF 1,078 billion (52.8 per cent) compared to the base period. Expenditures for capital formation fell from HUF 1,899 billion of 2021 to HUF 1,435 billion, representing a decline of roughly 24 per cent. Subsidies for material expenditures moderately increased. The nominal increment in subsidies amounted to HUF 32 billion, representing a growth rate of 8.4 per cent.

The 2022 appropriation for **EU expenditures** of HUF 3,001 billion was realised to the extent of HUF 2,989 billion. Of this, almost HUF 1,400 billion related to the 2014-2020 cohesion programmes, more than HUF 400 billion to the Rural Development Programme, and HUF 660 billion was disbursed under the operative programmes of the 2021-2027 cohesion policy. The budget advanced HUF 500 billion for the programmes to be financed by the Recovery and Resilience Facility (RRF).

The Parliament approved the expenditure appropriation for **support to local governments** with a target figure of HUF 873 billion. The amount of the subsidies disbursed was HUF 1,082 billion, exceeding the statutory appropriation by 23.8 per cent. Last year's central support exceeded the support realised in 2021 by 6.6 per cent. The nominal excess expenditure was attributable to the usual utilisation of part of the provisions (e.g. wage measures concerning employees in the social sector) and to the additional grants implemented from the reserve entitled "Economy Restart Programmes". In the latter cases the government provided surplus resources primarily for development and investment projects.

The **contribution to the budget of the European Union** expenditure item exceeded the initial appropriation by HUF 21 billion. On the other hand, Hungary's contribution was lower by HUF 21 billion than a year ago, since in the base year of 2021 due to the higher GNI growth registered in previous years the Hungarian budget had to make additional contribution to the EU budget.

The original Budget Act contained an envelope of HUF 894 billion under the **central reserves'** expenditures appropriation. Overall, in 2022 reserve appropriations were significantly exceeded in the case of the appropriations entitled Central Reserve for Economy Restart Programmes, Provisions and Central Reserve for Disease Control. In the case of the absorption of central reserves, the overrun of the amount of HUF 1,547 billion was realised primarily through the Economy Restart Programmes, which exceeded the original appropriation of HUF 68 billion by HUF 1,281 billion. The Central Reserve for Pandemic Control appropriation over-implemented by HUF 81 billion. The provision of HUF 106 billion set aside for wage increases in 2022 was overrun by HUF 612 billion as a result of the government's additional wage measures. On the other hand, due to the partial blocking of the Investment Fund, the Fund realised savings on its expenditures in the amount of almost HUF 440 billion.

Other revenues of the central budget exceeded the statutory appropriation by HUF 766 billion. The difference is partly attributable to the overrun of expenditures connected to state asset management. **Expenditures related to state property** amounted to HUF 1,155 billion, exceeding the approved appropriation by HUF 355 billion. The high excess expenditure was partly attributable to the fact that part of the utility subsidy expenditures granted from the Utility Protection Fund, i.e. almost HUF 324 billion, was recognised among the expenditures related to state asset management.

Expenditures of extra-budgetary funds fell short of the appropriation by HUF 39 billion due to the higher revenues, and thus the 2022 balance of the funds exceeded the appropriation by HUF 117 billion. Expenditures of the Economy Restart Employment Fund, representing the highest weight, decreased by HUF 48 billion, which is almost fully attributable to the significant fall in the EU pre- and co-financing expenditures. Passive expenditures of the EREF were roughly in line with the appropriation.

Expenditures related to the Start Labour Programme were realised in accordance with the appropriation, in the amount of HUF 120 billion. According to the HCSO's report, the annual average number of public workers was 74,300, which represents a decline of almost 10,000 compared to previous year. Of the total expenditure, HUF 97 billion was spent on wages, while the part spent on material expenses and capital formation exceeded HUF 23 billion.

The consolidated amount of **the expenditures of social security funds** was HUF 8,421 billion in 2022, which exceeded the amount of the corresponding appropriations in the Budget Act by HUF 756 billion. The growth in the social security cash benefits (pensions, sickness benefit, maternity benefits) over the appropriation was primarily attributable to the differences between macroeconomic assumptions underlying the budget and the actual trends, with significant contribution by the faster reinstatement of the 13th month pension than previously planned, as one of the government measures.

Expenditures of the **Pension Fund** in 2022 amounted to HUF 4,806 billion, exceeding the appropriation in the Budget Act by HUF 636 billion (15 per cent). **Retirement provisions** disbursed from the Fund amounted to HUF 4,790 billion, while the amount of the Fund's **other expenditures** was almost HUF 16 billion. Compared to the 2021 actual figures, expenditures of the Pension Insurance Fund rose by HUF 684 billion (17 per cent) in 2022, which is almost fully attributable to retirement provisions. The significant rise in the retirement provision expenditures is mostly the combined result of the following factors:

- In 2022, **retirement provisions assessed in previous years** rose by 14 per cent in total, which – according to our calculations – contributed by almost HUF 480 billion to the rise in expenditures disbursed from the Pension Insurance Fund compared to the appropriation. In January 2022, **pensions were raised by 5 per cent**, which exceeded the rate of the start-of-year indexation planned by the Budget Act based on its inflation expectations of 3 per cent by 2 percentage points. The estimated impact of the rise in January is HUF 203 billion, of which the excess expenditure compared to the appropriations is roughly HUF 81 billion, according to our calculations. As a result of the price inflation exceeding the budget expectations, the government decided to implement a **supplementary pension increase of 3.9 per cent in July**, and **4.5 per cent in November**, the impacts of which were about HUF 162 billion and HUF 194 billion, respectively, disbursed from the Pension Insurance Fund. In addition, the carry-over effect of the pension increases implemented in 2021 contributed to the rise in expenditures by more than HUF 50 billion.

- In 2022, the faster-than-planned reinstatement of the **13th month pension** generated excess expenditures of HUF 173 billion compared to the appropriation (excluding the impacts of the higher-than-planned pension increases). In 2021, 25 per cent of the January benefit was paid, and at the time of planning the 2022 budget, the government calculated with a 13th month benefit corresponding to 50 per cent of the monthly provision. In 2022, the payment of the full amount of the 13th month pensions generated expenditures in the amount of HUF 363 billion in the Pension Insurance Fund (of which HUF 28 billion is attributable to the supplementary increases), which exceeds the amount registered in 2021 by HUF 283 billion.

- In November 2022, HUF 21 billion was disbursed from the provisions for **pension premium**, falling short of the appropriation by HUF 47 billion. Based on lower-than-expected real growth, the benefit paid in 2022 was set to a maximum amount of HUF 10,000.

In 2022, expenditures on **pensions and pension-type benefits** (old-age pensions, early retirement benefits, disability and rehabilitation benefits) amounted to HUF 5,243 in total, exceeding the appropriation amount by HUF 682 billion and the 2021 expenditures by HUF 723 billion.

Net expenditures of the **Health Insurance Fund** amounted to HUF 3,615 billion, which exceeded the appropriation in the 2022 Budget Act by some HUF 120 billion. The larger part of the deviation is connected to medical and preventive care items. Expenditures related to cash benefits exceeded the appropriations due to more favourable gross average wage data than the expectations underlying the Budget Act.

Medical and preventive care expenditures amounted to HUF 2,203 billion, exceeding the 2022 appropriation by HUF 80 billion. The significant difference is attributable to the disbursement of HUF 38 billion over the appropriation for operating expenses against the earmarked appropriations, while the expenditures of the high value drug financing exceeded the appropriation by HUF 58 billion.

Net expenditures of the drug budget amounted to HUF 315 billion, and thus fell short of the appropriation by HUF 28 billion. Gross expenditures fell short of the amount anticipated in the Budget Act by HUF 9 billion, while payments by pharmaceutical manufacturers and distributors exceeded the appropriation by HUF 19 billion.

Cash benefits amounted to HUF 623 billion, exceeding the appropriation by HUF 37 billion. The excess expenditure is primarily attributable to the fact that at the time of planning the budget labour market trends were assumed to be less favourable (more moderate wage dynamics) than in reality. Expenditures on **sickness benefit, childcare and adoptive parent allowance and infant care allowance** exceeded the appropriation by HUF 10 billion, HUF 21 billion and HUF 5 billion, respectively.

In 2022, expenditures on **disability and rehabilitation benefits** amounted to HUF 338 billion, HUF 37 billion higher than the appropriation in the Budget Act. The difference is explained by the supplementary pension increases implemented as a result of the inflation exceeding the expectations underlying the planning of the 2022 Budget Act – paid with retrospective effect also on the amount of the 13th month benefit – also covered the disability and rehabilitation benefits.

In 2022, **net accrual-based interest expenditures** amounted to 2.3 per cent of GDP, that was the result of the 2.8 per cent gross interest expenditures and interest revenues amounting to 0.5 per cent of GDP. The rise in interest expenditures was mostly caused by the government securities market yields, higher than in previous years and rising in parallel with inflation and the growth in expected interest rates attributable to inflation expectations. This impact was mitigated by the fact that only around a quarter of the government debt came from new issuance in 2022 due to the extension of the maturities of government debt, while the debt elements not extended paid interest at lower rates that had been typical in previous years. The rise in interest revenues is mostly related to interest received on government deposits. **Net cash-based interest expenses** were HUF 1,845 billion in 2022 and exceeded the budgetary appropriation by HUF 580 billion. This is because gross interest expenditures and revenues exceeded those anticipated by the Act by HUF 731 billion and HUF 151 billion, respectively. The higher-than-expected gross interest expenditure and interest revenue is mostly the result of the inflationary and yield environment being higher than in previous years.

2.4 BUDGET MANAGEMENT OF LOCAL GOVERNMENTS

Based on the October EDP notification, the local government sub-sector closed 2022 with a cash-based deficit of HUF 52 billion. ESA revenues of the sub-sector rose by 6.3 per cent compared to 2021. Revenues amounted to around HUF 3,540 billion, which corresponds to 5.3 per cent of GDP. On the other hand, expenditures of the sub-sector rose by 14.5 per cent compared to the base year and were around HUF 3,680 billion at the end of the year, corresponding to 5.5 per cent of GDP. Decomposing the expenditures, wage payments rose by 16.7 per cent, while local governments spent almost 20 per cent more on material expenses than in 2021. The high growth rate in material expenditures was primarily attributable to the soar in energy costs. Investment expenditures grew by 15.3 per cent and exceeded 1.3 per cent of GDP.

The sum of the statistical corrections performed by HCSO increased the cash-based deficit of the sub-sector by HUF 111 billion. Roughly four fifth of the correction is related to the recognition of EU grants. The ESA balance of the local government sub-sector shows a deficit of HUF 163 billion in 2022, which represents a deterioration of HUF 249 billion in the position compared to the 2021 balance. i.e. the surplus registered in previous year turned into a deficit in 2022. The underlying reasons for the deterioration of the balance include the recognition of EU grants and the increasing wage and material expenditures, which exceeded the growth rate of revenues.

2.5 STATISTICAL CORRECTION (ESA BRIDGE)

Reconciliation between the cash-based revenues and expenditure and the resulting cash-based balance and ESA balance calculated in accordance with the EU methodology is ensured by supplementary statistical corrections (ESA bridge) applied to the cash-based accounting. The statistical adjustments are necessary because some of the transactions must be recognised, based on the approach applied in the EU, at the time of settlement (accrual-based accounting), while the rules of Hungarian budget accounting transactions are considered upon cash movement (cash-based accounting). Moreover, EU regulations interpret the concept of general government (government sector) more broadly than the Hungarian legislation, as they classify certain non-profit institutions, certain state-owned companies other organisations under state control, as well as certain financial operations (e.g. loan operations) into the government sector. Therefore, the HCSO calculates the ESA balance obtained with the use of the EU methodology for the government sector, and thus this deficit ratio differs from the cash-based (GFS) balance of the general government also in terms of sectors.

The 2022 Budget Act defined the balance of the accrual-based statistical correction in 0.0 per cent of GDP (HUF -16 billion). According to the data of the EDP notification of October 2023, the ESA bridge was HUF 599 billion in 2022, i.e. 0.9 per cent of GDP. The difference is attributable to several factors. The most significant ones are the purchase of special natural gas stock by the Hungarian Hydrocarbon Stockpiling Association, reaching 1.2 per cent of GDP as well as the statistical corrections related to the personal income tax reimbursement, EU settlements and the interest burden on the government debt.

The reversal of the personal income tax reimbursed in 2022 in the 2021 records and the annual personal income tax statistical correction in the usual volume together increased the accrual-based personal income tax revenue by HUF 738 billion. Interest settlements related to the debt servicing (difference between the paid and accrued interest, excluding the swap settlements) contributed to the developments in an ESA balance more favourable than the cash-based balance by HUF 356 billion. The statistical accounting of the assets taken over from the private pension fund increased ESA revenues by HUF 31 billion.

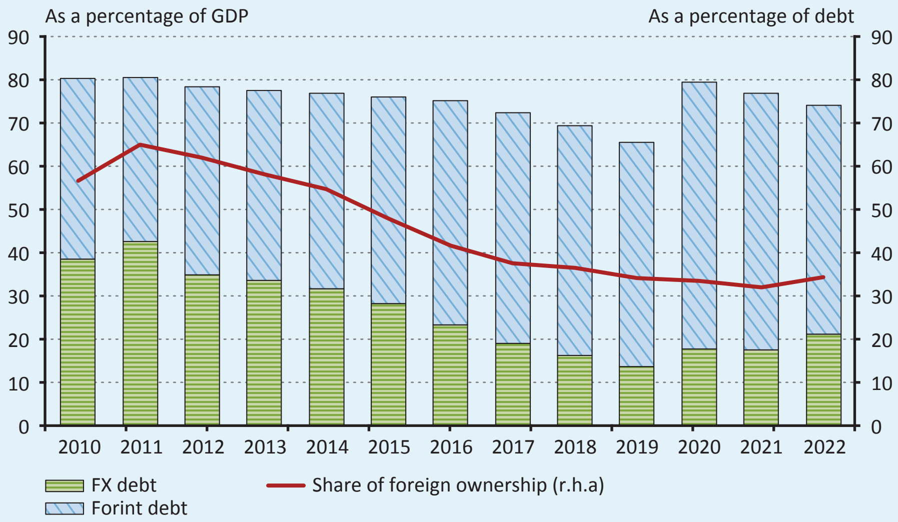
Corporations and non-profit institutions classified into the central government sector together worsened the ESA balance of the general government sector by HUF 831 billion compared to the cash balance. The correction, which increased the ESA expenditure signifantly, was primarily caused by the natural gas procurement by the Hungarian Hydrocarbon Stockpiling Association, classified into the general government sector, the major part of which was connected to the expenditure of over HUF 800 billion, used for emergency stockpiling. In connection with the pre-natal baby supports and other standardized guarantees, the HCSO recognised a total of HUF 78 billion in deficit-increasing statistical adjustments. Furthermore, the corrections related to the tax and tax-type revenues (excluding the personal income tax reimbursements in 2022) and other revenues together reduced the ESA bridge surplus by HUF 182 billion. Within this, accrual-based VAT revenues fell short of the cash-based revenues by some HUF 385 billion.

Material expenditures of the government sector's sub-sectors and the accrual accounting of the government sector's wage costs together increased the ESA expenditures by HUF 66 billion in total. The 2022 ESA bridge, being more favourable by HUF 615 billion than the ESA bridge included in 2022 budget bill, is the combined result of the aforementioned items.

2.6 DEVELOPMENTS IN GOVERNMENT DEBT

At the end of 2022, the gross government debt to GDP ratio fell to 73.9 per cent (Chart 11), which represents a decline of 2.8 percentage points compared to 76.7 per cent registered at the end of 2021. The fall in the government debt ratio was primarily caused by a significant growth in nominal GDP, which rose by almost 20 per cent. The rise in the debt of corporations classified outside the central debt, the net issuance of over HUF 3,900 billion, financing the high cash-based deficit and the revaluation of the foreign currency debt acted towards a rise in the government debt.

Chart 11
Developments in gross government debt, forint and FX debt within that and the share of foreign ownership



Source: MNB

As a result of the foreign currency bond issuances, the share of FX-denominated government debt increased further by the end of 2022, and the ratio of foreign ownership of government debt slightly rose compared to previous year. In 2022, net foreign currency issuance by the Government Debt Management Agency amounted to roughly HUF 2,270 billion, within which net wholesale foreign currency bond issuance accounted for HUF 1,910 billion. With the foreign currency bond issuances, the share of FX-denominated central government debt rose to 25 per cent from 20.6 per cent registered in 2021. One of the key objectives of the government's debt management strategy is to strengthen domestic financing, consequently the ratio of foreign ownership of government debt remained low, accounting for about one-third – 34.1 per cent – of it at the end of 2022.

3 Expected general government developments in 2023

3.1 EXPECTED ESA BALANCE OF THE GOVERNMENT SECTOR IN 2023

According to our forecast, in 2023 the accrual-based deficit of the general government may be 5.2 per cent of GDP, which suggests that the government's deficit target, raised to 5.2 per cent simultaneously with the publication of the EDP notification, may be achieved (Table 5). The 2023 Budget Act, adopted in July 2022, has set a deficit target of 3.5 per cent for 2023, which was raised by the government to 3.9 per cent at the end of 2022 and then, in parallel with publishing the 2023 October EDP notification, to 5.2 per cent. According to our latest forecast, revenues may fall short of those anticipated in the budget by HUF 1,979 billion; within that tax and contribution revenues of the central sub-sector and revenues related to EU grants may fall short of the appropriation by HUF 1,449 billion and HUF 510 billion, respectively. In addition to the savings of HUF 984 billion in primary expenditures, interest expenditures are expected to exceed the appropriation in the budget by HUF 493 billion in 2023. Based on the October EDP notification, the expected cash deficit may exceed the appropriation and amount to HUF 4,450 billion.

Table 5
Balance of the general government sector in 2023

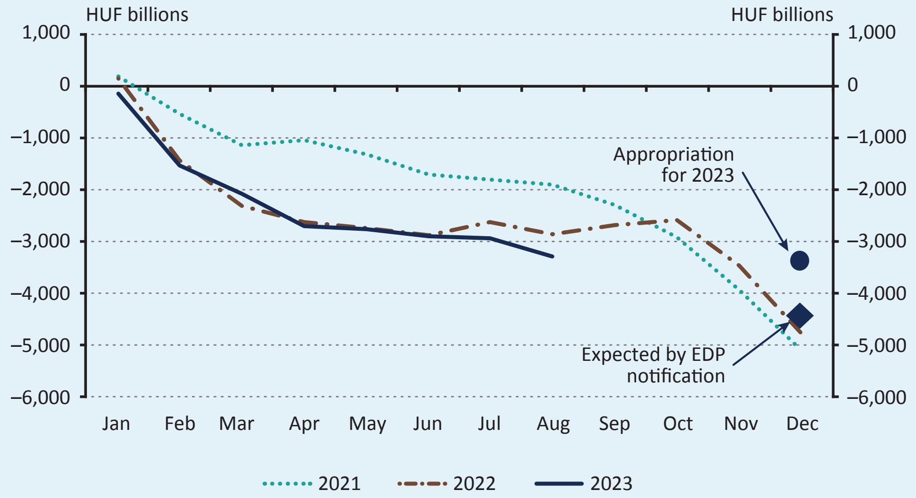
	Statutory appropriation	Expected by the EDP notification	MNB forecast	Statutory appropriation	Expected by the EDP notification	MNB forecast	Difference (MNB-EDP)
	HUF Billions			GDP %			
1. Balance of the central sub-sector	-3,400	-4,450	-4,888	-4.4	-6.0	-6.3	-0.3
2. Balance of local governments	-124	87	127	-0.2	0.1	0.2	0.0
3. Cash-based (GFS) balance of the general government (1+2)	**-3,524**	**-4,363**	**-4,761**	**-4.5**	**-5.8**	**-6.1**	**-0.3**
4. ESA-bridge	462	461	751	0.6	0.6	1.0	0.4
5. ESA balance of the general government sector (3+4)	**-3,062**	**-3,902**	**-4,010**	**-3.9**	**-5.2**	**-5.2**	**0.0**

Note: Due to rounding, differences may occur in the table. GDP-proportionate values are calculated based on different GDP forecasts.
Source: 2023 Budget Act, as amended in March 2023, October 2023 EDP notification, MNB September 2023 Inflation Report

Our projection calculates with lower economic growth, wage dynamics and consumption growth than that anticipated by the Act, due to which the tax and contribution revenues may significantly fall short of the appropriation. Our expectation regarding the balance of local governments is essentially the same, while our forecast for the statistical correction implies a deficit that is more favourable by 0.4 per cent of GDP, and thus overall our ESA balance projection corresponds to the deficit expected for this year, stated in the October 2023 EDP notification.

The cumulative deficit of the central sub-sector was HUF 3,299 billion until the end of August, which equals to 97 per cent of the annual appropriation, amended in March 2023 (Chart 12). Tax and contribution revenues of the central sub-sector were higher by more than HUF 2,600 billion in the first 8 months of the year, while expenditures of the central sub-sector exceeded the year-on-year figure by almost HUF 3,500 billion. The largest part of the rise in expenditures is attributable to pension and interest expenditures, which was partly offset by the windfall tax on extra profit introduced last year and the growth in revenues from labour taxes and contributions in the first eight months of the year. Due to the high inflation, consumption and sales taxes considerably fell short of the expectations, being the main reason for the higher budget deficit.

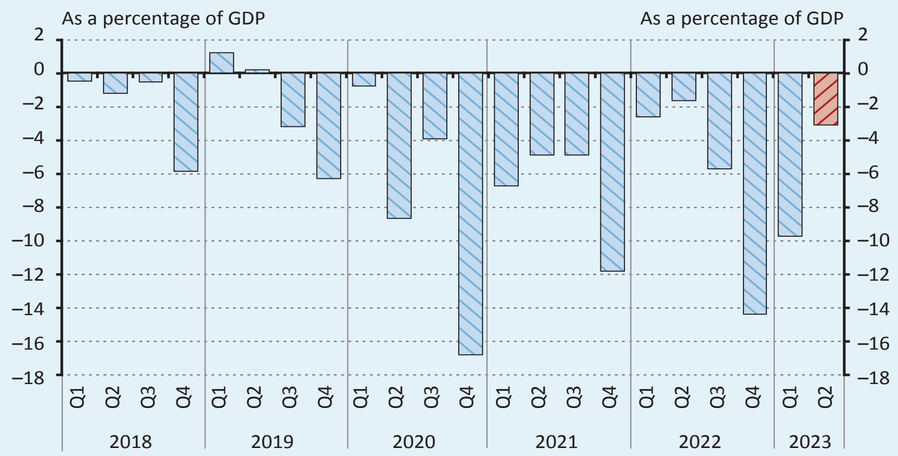
Chart 12
Intra-year cumulative cash-based balance of the central sub-sector



Source: 2023 Budget Act, as amended in March 2023, Hungarian State Treasury, October 2023 EDP notification.

In 2023 H1, the accrual-based deficit was 6.3 per cent of the semi-annual GDP. The first-quarter accrual-based deficit amounted to 9.7 per cent of the quarterly GDP, which is rather high compared to previous years, while in the second quarter, the rate was 3.1 per cent of the quarterly GDP (Chart 13). Subsidies paid on the increased energy costs have significantly contributed to the high deficit, the amount of which – based on the data provided by the Hungarian State Treasury – came close to HUF 1,200 billion in the first half of the year.

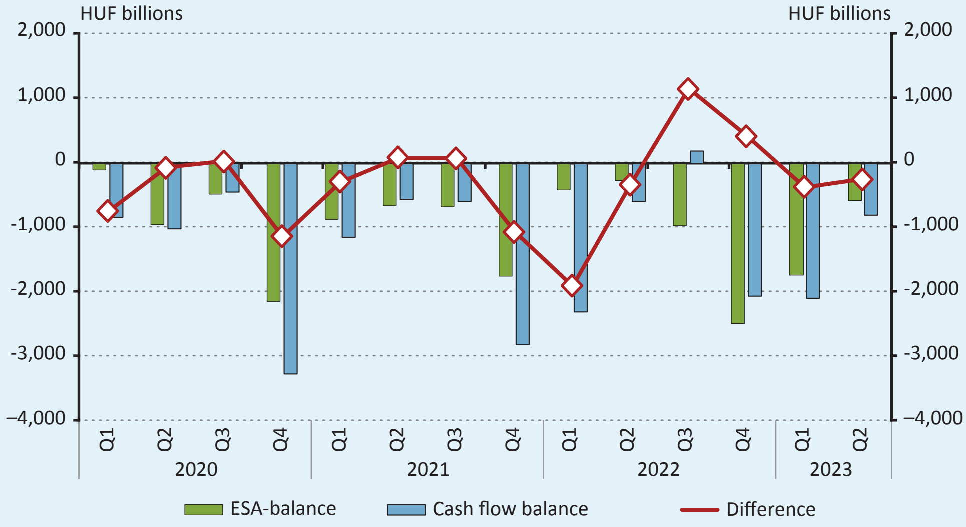
Chart 13
Accrual-based budget balance



Source: HCSO, MNB

The general government's cumulative accrual-based deficit in 2023 H1 was HUF 2,296 billion, which falls short of the cash-based deficit of HUF 2,896 billion by HUF 600 billion (Chart 14). The difference may have been majorly caused by the prefinancing of EU projects and the acquisition of Vodafone, recognised only on a cash-flow basis in the amount of roughly HUF 360 billion.This was partly offset by the fact that most of the EU funds recognised this year as revenue were received last year. In the first half of the year cash expenditures and revenues connected to EU grants amounted to HUF 1,461 billion and HUF 772 billion, respectively.

Chart 14
Difference between quarterly accrual-based (ESA) and cash balances



Source: HCSO, Hungarian State Treasury

3.2 MACROECONOMIC PROJECTION UNDERLYING THE BUDGET

The macroeconomic projection of the 2023 Budget Act, amended in March 2023, calculates with an economic growth of 1.5 per cent, while the MNB's September 2023 forecast anticipates an economic growth of (-0.5) - 0.5 per cent for this year. In 2023 Q2, Hungary's GDP contracted by 2.4 per cent year-on-year. In a quarterly comparison, economic activity has been declining in four consecutive quarters; however, in the third quarter of this year growth may have restarted on a quarterly basis. The central bank's forecast is lower than the budgetary projection for all items on the absorption side, with the largest difference appearing in gross fixed capital formation. According to the central bank's projection, the low economic performance in 2023 is primarily attributable to the high inflation and the curbing of public investments.

Table 6
Comparison of the macroeconomic paths included in the 2023 Budget Act and in the MNB's September 2023 Inflation Report (per cent)

	Budget Act	MNB	Difference
GDP	**1.5**	**-0.5 - 0.5**	**(-2.0) - (-1.0)**
Consumption expenditure of households	0.8	(-2.0) - (-1.8)	(-2.8) - (-2.6)
Public consumption	0.5	(-0.7) - (-0.3)	(-1.2) - (-0.8)
Gross fixed capital formation	-1.0	(-8.5) - (-7.5)	(-7.5) - (-6.5)
Exports	2.8	1.6 - 2.2	(-1.2) - (-0.6)
Imports	1.4	(-2.6) - (-2.0)	(-4.0) - (-3.4)
GDP deflator	14.9	17.9	3.0
Inflation	**15.0**	**17.6 - 18.1**	**2.6 - 3.1**
Gross wage bill	**15.8**	**13.8 - 14.1**	**(-2.0) - (-1.7)**
Average gross earnings	15.8	13.4 - 13.7	(-2.4) - (-2.1)
Number of employees	0.0	0.5 - 0.6	0.5 - 0.6

Source: 2023 Budget Act, as amended in March 2023, MNB September 2023 Inflation Report

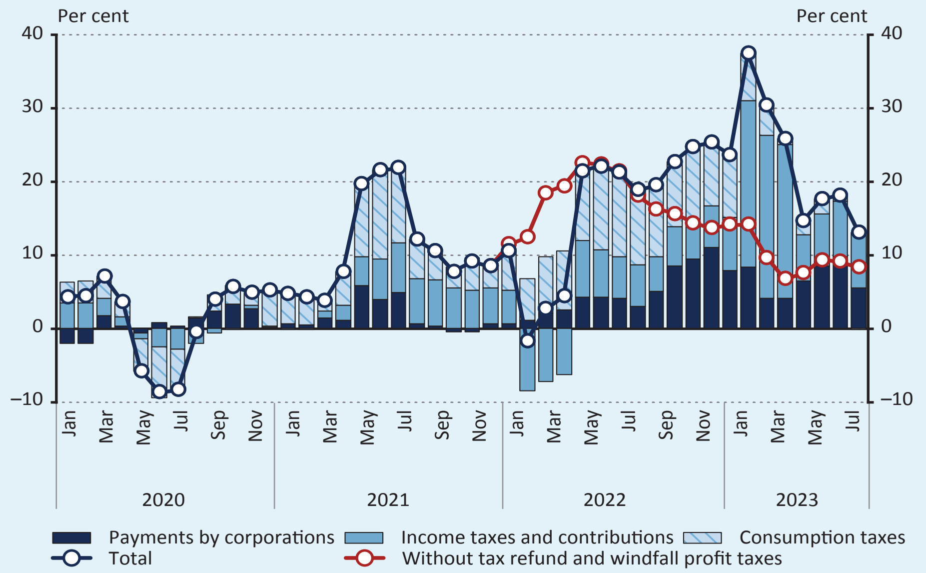
While in its forecast the MNB anticipates further growth in employment, the projection of the Budget Act, amended in March 2023, assumes that this year the number of people in employment may remain at the level registered in 2022. According to the MNB's latest forecast employment may rise by 0.5-0.6 per cent in 2023, while the Budget Act does not anticipate any material change in the number of people in employment. According to the MNB's September projection, the rise in whole-economy gross average earnings may fall short of the budget's expectations (15.8 per cent), i.e. by 13.4-13.7 per cent. Wage dynamics at the beginning of 2023 was determined by the significant raising of the minimum wage early this year and by the historically high tightness of the labour market, while the fall in inflation at an increasing pace and the consequent growth in real wages results in a more moderate wage dynamics in the second half of the year.

The 2023 Budget Act, amended in March 2023, was calculated with 15 per cent inflation, while in its September Inflation Report the MNB anticipates an inflation of 17.6-18.1 per cent this year. According to the MNB's forecast, the price reducing effect of the tight monetary policy, the more moderate global commodity prices, compared to last year, moderate domestic consumption and the government's measures aimed at boosting market competition will be present to an increasing degree in 2023. The rapid decline in this year's inflation is also supported by base effects. On the other hand, the rise in the world market price of crude oil, observed in recent months, strongly affected domestic fuel prices, which decelerates the process of disinflation.

3.3 CASH-BASED REVENUES OF THE CENTRAL SUB-SECTOR

According to our forecast, tax and contribution revenues of the central sub-sector may fall short of the statutory appropriation by HUF 1,449 billion. The 20 per cent growth dynamics of tax and contribution revenues registered in the first eight months was partly attributable – in addition to the underlying macroeconomic trends – to the lower base of last year resulting from the tax refund to families with children in the first half of 2022 as well as to the impact of the extra profit taxes (introduced in the second half of 2022) in the first half of this year. Excluding the effect of the measures above, tax and contribution revenues rose by 9.2 per cent in comparison to the same period of the previous year (Chart 15). According to our expectations, revenues of the central sub-sector may materially fall short of the appropriations, primarily due to the lower amount of tax and contribution, particularly the value added tax revenues. Based on our projection, revenues from the income tax of energy providers and, to a smaller extent, other corporate and labour tax revenues may also fall short of the appropriation. Accordingly, revenues of the sub-sector may fall short of the figure stated in the Budget Act by HUF 1,449 billion in total.

Chart 15
Annual change in central sub-sector's tax and contribution revenues (3-month moving average)



Source: Hungarian State Treasury, MNB

Corporate tax revenues may exceed the appropriation in the 2023 Budget Act by HUF 21 billion. The difference is attributable to the favourable macroeconomic developments, particularly to charges on large corporations. In the first eight months of the year, corporate income tax revenues were HUF 207 billion higher than a year earlier, reaching HUF 749 billion. This amount exceeds the total cash based corporate income tax revenue collected in 2022.

Revenues from the **special tax of financial institutions** may fall short of the appropriation in the 2023 Budget Act by HUF 8 billion. The tax type is still affected by the special tax introduced in connection with the fiscal adjustment. In the first half of the year, the basis of this special tax was the fee and commission revenue collected by credit institutions, while the tax rate was 8 per cent. In the second half of the year, the tax base of the windfall tax on extra profit was 50 per cent of previous year's pre-tax profit, with a tax rate of 13 per cent up to HUF 10 billion and 30 per cent above. In the first eight months, revenues from special taxes amounted to HUF 153 billion, exceeding the payments in the same period of the previous year by HUF 111 billion. In 2022, payments of the windfall tax on extra profit were concentrated in October and December, since the new rules were introduced from August 2022, while in 2023 credit institutions also had to pay the tax in June in addition to October and December.

Revenues from **retail tax** may exceed the appropriation in the Budget Act by HUF 18 billion. At this tax type, the additional tax applied in 2022 is replaced by the raising of the tax rates, thereby the progressivity of the tax rates also increases. The tax rate remained 0 per cent up to a net sales revenue of less than HUF 500 million, whereas between HUF 500 million and HUF 30 billion it increased to 0.15 per cent from the previous 0.1 per cent. Between HUF 30 billion and HUF 100 billion the 0.4 per cent rate increased to 1 per cent, while the tax rate above HUF 100 billion rose from 2.7 per cent to 4.1 per cent. Until the end of August, taxpayers paid HUF 116 billion to the Treasury, exceeding the revenues received in the first eight months of the last year by HUF 70 billion. In 2022, special tax obligations concentrated in the last 5 months of the year.

According to our expectations, revenues from **mining royalty** may fall short of the appropriation in the Budget Act by HUF 53 billion. The significant difference is due to the fact that world market prices of fuels are lower than assumed in the Budget Act. This tax type is also affected by the fiscal measures related to 2022-24, as part of which the rates of mining royalty payable on crude oil and natural gas were first significantly raised, then halved, and finally raised to roughly three times the rate that prevailed before the 2022 H2 measures. In the first eight months of the year, the budget received mining royalty in the amount of HUF 186 billion, exceeding the amount paid between January and August 2022 by HUF 81 billion, during which period most taxpayers had no prevailing obligation to pay special tax.

Revenues from **income tax on energy providers** may fall short of the amount stated in the Budget Act by HUF 247 billion, mainly as a result of the world market trends. In the case of this tax type the range of taxpayers has been expanded with bioethanol and bio-fuel producers, sunflower oil and starch producers, while the tax rate rose from 31 per cent to 41 per cent. A special tax at 95 per cent has been imposed on the profit realised on the difference between the Brent and Ural prices, which, however, generated a lower amount of surplus revenue for the budget than expected. Petroleum producer taxpayers are obliged to pay an additional special tax to the Treasury on their 2022 revenues at a rate of 2.8 per cent. Until the end of August, revenues from this tax type amounted to HUF 308 billion. This amount exceeds the year-on-year revenues by HUF 244 billion, which is attributable to last year's low base, not yet including any special tax.

Revenues from **tax on pharmaceutical manufacturers** may fall short of the appropriation in the Budget Act by HUF 18 billion. The tax type was introduced at the end of 2022 and the first tangible revenues under this title are received in the budget during 2023. In the first eight months of 2023, the Treasury received HUF 44 billion under this title, which amounts to 36 per cent of the appropriation.

The revenues expected from the **lump sum tax of small entrepreneurs** (KATA) may fall short of the appropriation in the Budget Act by HUF 12 billion. The difference arises from the different estimates with regard to the number of taxpayers. As a result of the measure taken in autumn 2022, only those full-time self-employed taxpayers remained under the effect of KATA who provide product or services only to private individuals (except for taxi services). The reduction of the number of taxpayers entered into force on 1 September 2022. In the first eight months of the year, revenues from lump sum tax of small entrepreneurs amounted to HUF 48 billion, HUF 96 billion below the level seen at the end of August 2022.

Table 7
Partially consolidated cash revenues of the central sub-sector (HUF billions)

	2023				
	Statutory appropriation	January - August realisation	Percentage of appropriation	MNB forecast	Difference: MNB - appropriation
TAX AND CONTRIBUTION REVENUES OF THE CENTRAL SUB-SECTOR	**26,171**	**15,878**	**61%**	**24,722**	**-1,449**
Payments by economic organisations	**3,939**	**2,380**	**60%**	**3,698**	**-240**
Corporate income tax	1,005	749	75%	1,026	21
Special tax of financial institutions	358	153	43%	350	-8
Lump sum tax of small entrepreneurs	81	48	59%	69	-12
Tax of small enterprises	184	135	73%	193	9
Utility tax	53	27	51%	50	-3
Eco-tax	5	3	51%	5	0
Mining royalty	334	186	56%	281	-53
Gambling tax	47	34	73%	60	14
Other taxes and payments	25	19	75%	29	4
Other centralised revenues	566	382	67%	597	31
Income tax on energy providers	716	308	43%	469	-247
Company car tax	79	59	74%	80	1
Retail tax	205	116	56%	223	18
Rehabilitation contribution	158	119	75%	162	4
Tax on pharmaceutical manufacturers	123	44	36%	104	-18
Consumption taxes	**10,188**	**5,729**	**56%**	**9,190**	**-997**
Value added tax	7,986	4,352	55%	7,096	-890
Excise duties	1,465	886	60%	1,373	-92
Motor vehicle registration duty	17	10	59%	19	2
Telecommunication tax	96	70	73%	90	-6
Financial transaction levy	332	223	67%	350	18
Insurance tax	219	142	65%	179	-40
Airline tax	35	22	64%	34	-1
Tourism development contribution	37	23	63%	47	11
Payments by households	**4,435**	**2,857**	**64%**	**4,371**	**-64**
Personal income tax	4,061	2,630	65%	4,031	-30
Duties, other taxes	274	161	59%	241	-33
Motor vehicle tax	100	66	65%	100	-1
Tax and contribution revenues of extra-budgetary funds	**515**	**349**	**68%**	**508**	**-7**
Tax and contribution revenues of social security funds	**7,095**	**4,564**	**64%**	**6,954**	**-141**
Social contribution tax and contributions	6,876	4,410	64%	6,720	-156
Other contributions and taxes	219	154	70%	234	15
REVENUES RELATED TO EU FUNDS	**2,286**	**1,063**	**47%**	**1,776**	**-510**
OTHER REVENUES	**1,230**	**718**	**58%**	**1,210**	**-20**
Revenues on public property	629	378	60%	625	-4
Other revenues of the central budget	457	239	52%	432	-25
Other revenues of social security funds	46	37	80%	57	11
Other revenues of extra-budgetary funds	98	64	65%	96	-3
TOTAL REVENUES	**29,687**	**17,660**	**59%**	**27,707**	**-1,979**

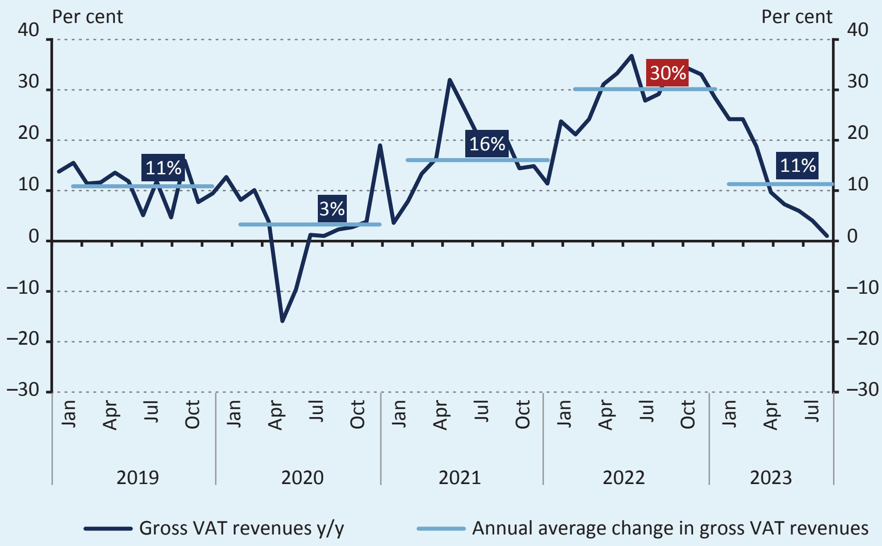
Note: Partly consolidated data: the fiscal impact of the revenues and expenditures within the general government central sub-sector are stated in net terms.

Source: Hungarian State Treasury, Amended 2023 Budget Act, MNB September Inflation Report

For the **tax of small enterprises** (KIVA), revenues in 2023 are expected to be HUF 9 billion higher than the Budget Act's appropriation, due to macroeconomic conditions. Until August, HUF 135 billion of tax of small enterprises revenue was collected. Revenues from **company car tax** may be close to the appropriation at the end of 2023. The tax rate was raised on average to 1.8-1.9 times the current rate, due to which the Treasury received HUF 59 billion until the end of August, exceeding the year-on-year receipts by HUF 29 billion. Revenues from **gambling tax** may exceed the appropriation by HUF 14 billion, partly due to the price rise in the last 4 months of the year, applicable to certain more popular game types. Until the end of August, the budget received HUF 34 billion under this title, which exceeds the cumulative receipts in the first eight months of 2022 by HUF 4 billion.

At an annual level, **revenues from other centralised revenues** may exceed the appropriation by HUF 31 billion. In the first eight months of the year, the Treasury received HUF 382 billion in payments from the revenues recognised in this group, which is HUF 18 billion higher than the payments in the base period. **Revenues from electronic road** toll may exceed the 2023 appropriation by HUF 13 billion, due to better-than-expected developments in the economic environment. On the other hand, revenues from **penalties** may exceed the appropriation by HUF 18 billion. Revenues from **product levies** may exceed the appropriation by HUF 7 billion. The EPR fees payable under the limited producer responsibility system, introduced from July, will reduce the payments expected from product levies in the second half of the year.

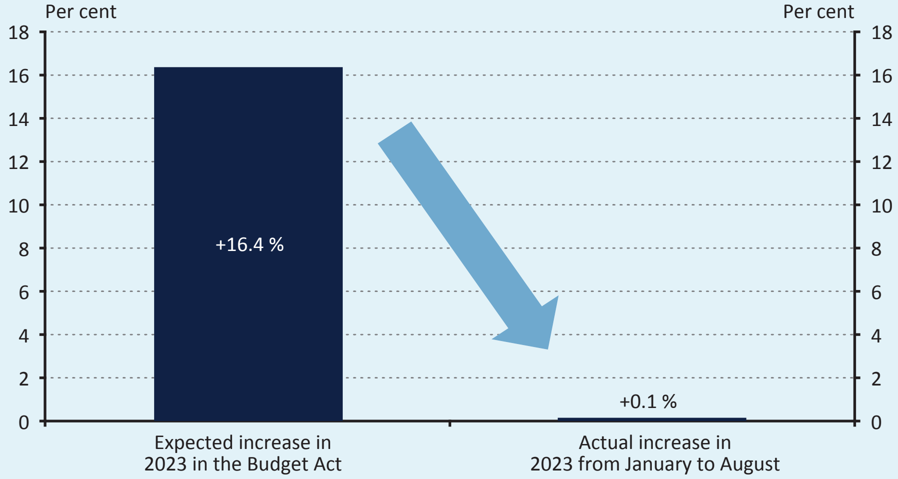
Chart 16
Change in gross VAT revenues year-on-year



Source: Hungarian State Treasury

According to our expectations, net cash revenues from **value added tax** may amount to HUF 7,096 billion in 2023, HUF 890 billion below the budgetary appropriation. In the first eight months of the year **gross VAT revenues** rose by 11 per cent on average, year-on-year, while last year the growth was outstandingly high, 30 per cent on average, throughout the year (Chart 16). In the first eight months of the year, 55 per cent of the appropriation was realised, and thus we expect that there will be a significant shortfall in the realisation of the annual appropriation. Between January and August **net VAT revenues** essentially stagnated year-on-year, as realisation this year exceeded the 2022 revenues by merely 0.1 per cent, i.e. HUF 6 billion (Chart 17). The low level of net VAT revenues is partly attributable to the higher disbursements, and partly to the significant decline in the growth dynamics of gross revenues. The fall in gross revenues was primarily caused by the decline in consumption resulting from the higher inflation: between January and August the volume of retail sales fell by 9.6 per cent year-on-year.

Chart 17
Change in net VAT revenues according to the budgetary appropriation and turnout data from the first eight months



Source: Hungarian State Treasury, Amended 2023 Budget Act

According to our forecast, in 2023 **revenues from excise duties** may amount to HUF 1,373 billion, falling short of the statutory appropriation by HUF 92 billion. Until August, 60 per cent of the appropriation was realised, and thus we expect a shortfall in the annual realisation in 2023. Since last July, the rate of all significant excise duty items increased: the tax per piece of cigarette was raised in two steps (in July 2022 and January 2023 and the excise duty on new **tobacco products** was also raised to match the price of cigarette per piece; from 1 January, the excise duty on **petrol and diesel** was also reinstated to the original level of HUF 120/litre and HUF 110/litre, respectively; in addition, the excise duty on **energy and alcohol products** also increased last July. Nevertheless, revenues from excise duties on fuels rose by merely 6.5 per cent, year-on-year, which is attributable to the fact that the volume of fuel retail sales declined by 21.3 per cent between this January and August.

In 2023 revenues of HUF 34 billion may be realised in the **airline tax** revenue row, in line with the appropriation in the budget. The windfall tax introduced last year was modified this year, now functioning as a green tax, providing allowances to less polluting aircrafts. In 2022, the amount of the tax used to be HUF 3,900 for those flying to European countries and HUF 9,750 for those travelling to other countries. This year this amount was distinguished based on emission. The taxpayer is the ground service provider, which may pass the tax burden on to the airlines.

According to our projection, this year revenues from **insurance tax** may amount to HUF 179 billion, a shortfall of HUF 40 billion compared to the appropriation in the 2023 Budget Act. The difference is attributable to the lower realisation of the special tax introduced last year. The special tax due in May fell short of the preliminary expectations by some HUF 40-45 billion. Revenues from **telecommunication tax** may amount to HUF 90 billion in 2023, falling short of the appropriation by HUF 6 billion. In 2023, revenues of HUF 47 billion may be expected from **tourism development contributions**, exceeding the figure anticipated in the Budget Act by HUF 11 billion. Revenues will be high even though in the first three months of the year the payment of the contributions was suspended. According to our forecast, revenues from **financial transaction levy** may amount to around HUF 350 billion in 2023, exceeding last year's revenues and the statutory appropriation by roughly HUF 57 billion and HUF 18 billion, respectively. In the first eight months of the year 67 per cent of the appropriation has been realised.

According to our forecast, in 2023 revenues from **personal income tax** may slightly fall short of the appropriation. Until August, tax revenues have significantly increased compared to the first eight months of last year, which is attributable – in addition to the dynamic growth in whole-economy gross average earnings and wage bill this year – to the low base developed as a result of the tax refund in 2022 to families with children. In the first eight months of this year net tax revenues rose by HUF 1,010 billion, and the growth in payments reaches HUF 350 billion even after adjusting for the impact of the tax refund. Excluding the amount of the tax refund last year, tax revenues exceeded the year-on-year figure by 15.3 per cent until August 2023. The partial tax exemption for young people was extended this year, and thus mothers below the age of 30 are also exempted from tax payment up to the amount of the average wage of last July, as long as they give birth to or adopt a child between their age of 25 and 30.

This year **revenues from the payment of duties** may amount to HUF 241 billion, falling short of the 2023 appropriation and the 2022 revenues by HUF 33 billion and HUF 21 billion, respectively. In the first eight months of this year 59 per cent of the appropriation was realised, falling short of year-on-year revenues by 9 per cent. The fall in revenues from duties is attributable to the slowdown in the housing market.

In the first eight months, **contribution revenues of extra-budgetary and social security funds** together exceeded the base of last year by HUF 651 billion. The growth is mostly attributable to the rise of HUF 420 billion in revenues from social security contribution, while revenues from social contribution tax also made a positive contribution of HUF 172 billion to the growth in payments. This year, the tax and contribution revenues of extra-budgetary and social security funds may fall short of the appropriation materially, by almost HUF 150 billion. As a new measure in 2023, social contribution tax payments were reduced in the first half of this year by the tax allowance under the labour force support scheme for enterprises, and from the second half of the year, social contribution tax was levied on most interest income. In addition, tax measures introduced in 2022 will already increase general government revenues in the whole of this year, including increases in several tax rates, such as the rate of the public health product tax, the levies payable on simplified employment and the payments by pharmaceutical distributors.

The budget appropriation for **EU revenues** is surrounded by significant risks due to the delay in the disbursement of the funds under the new programming cycle. In the first eight months of this year HUF 1,063 was recognised, and due to the materially slower receipt of the 2021-2027 cohesion and recovery funds than expected the annual realisation may fall short of the planned HUF 2,286 billion by some HUF 500 billion.

3.4 CASH-BASED EXPENDITURES OF THE CENTRAL SUB-SECTOR

According to our forecast, cash-based expenditures of the central sub-sector of the general government may fall short of the budget appropriation in 2023 by HUF 491 billion. The fall in expenditures is primarily caused by the lower realisation of expenditures related to EU grants and the anticipated savings related to the public energy expenditures expected for this year. Interest expenditures and pension expenses significantly exceeded the appropriation, i.e. by HUF 500 billion and HUF 222 billion, respectively.

In 2023, expenditures connected to subsidy titles **special and normative subsidies and support to the public media** may fall short of the appropriation by HUF 1,449 billion in total. Following the amendment of the Budget Act in March, the appropriation was changed to HUF 3,781 billion, while our forecast, consistent with the September Inflation Report, calculates with an expenditure of HUF 2,332 billion. By the end of August, the sum of disbursements reached HUF 1,918 billion. In this case, the large savings, compared to the appropriation, is attributable to the fact that part of the utility subsidies paid from the Utility Protection Fund was recognised not as special and normative subsidies, but appeared among the expenditures of budgetary organisations or at the support to local governments. Accordingly, these amounts qualify as reclassification of expenditures rather than budget savings. Until 31 August, the government decided on the absorption of a total amount of HUF 1,700 billion from the Utility Protection Fund envelope of HUF 2,610 billion. According to our current forecast, this year decision may be made on the absorption of HUF 2,185 billion from the Utility Protection Fund in total, and thus the expected savings exceed HUF 400 billion.

At the **social policy fare subsidy** our forecast calculates with an expenditure that exceeds the appropriation by HUF 11 billion. Disbursements in the first eight months reached HUF 78 billion, which corresponds to 74 per cent of the appropriation, and due this our projection is surrounded by risks pointing to higher expenditure.

According to our forecast, expenditures on **housing subsidies** may exceed the appropriation of HUF 383 billion by more than HUF 90 billion, primarily due to the carry-over of the expenditures connected to the Home Improvement Programme, launched in January 2021 to 2023. Prior to closing of the programme on 31 December 2022, more than 100,000 applications were submitted in the last month, the processing of which lasted until May 2023. The possibility of drawing on the home improvements subsidy was extended until the end of March 2023 for those applicants who also concluded a contract for improvements connected to solar cell by 31 July 2022 and also submitted their application for mains supply by 30 September 2022. As a result, based on the data received in respect of the first eight months, the expenditures related to housing grants stand at 96 per cent of the appropriation, at HUF 369 billion. The amount of the state subsidy granted for the already ceased home savings (LTP) is constantly decreasing, and it may be below HUF 30 billion in 2023. The forgiving of the mortgage loan of parents with three or more children may decline to HUF 21 billion in 2023 after a steady rise in previous years.

The expenditure appropriation of the **National Family and Social Policy Fund** is in line with our expectations at most of the items. The Budget Act appropriated HUF 755 billion for the expenditures of the Fund (and more than 40 per cent of that for the payment of family allowances). In the case of **family subsidies** realisation stands at almost 75 per cent of the annual appropriation, since – similarly to previous years – in order to ease the financial burdens connected to the start of the school-year, the family allowance, child protection benefit and child-raising subsidy due in September were disbursed already in August to the beneficiaries. Expenditures connected to **income substitute and supplementary social benefits**, **early retirement benefits** and the **discharging of district social duties** were realised on a pro rata basis. Based on the data for the first eight months, monthly expenditures were in line with the appropriation.

By the end of the year **net expenditures of budgetary organisations and chapters** may reach HUF 8,852 billion, which thus may exceed the net expenditure, derivable from the statutory appropriation, by HUF 1,083 billion. The difference included the impacts of the already implemented additional expenditure-increasing measures (e.g. the utility protection subsidy received from the Utility Protection Fund and the partial absorption of the payments received in the Central Residue Settlement Fund) as well as of the absorption of reserve appropriations. In the first eight months of the year, net expenditures of budgetary organisations were realised in the amount of HUF 5,575 billion, which corresponds to 72 per cent of the statutory appropriation.

In the first eight months of the year, revenues of budgetary organisations and **payments directly accruing to the central budget from budgetary organisations** exceeded the revenue planned for the whole year by about HUF 280 billion. The difference on the revenue side is partly attributable to the fact that the Budget Act contained no appropriation for the revenues of the Central Residue Settlement Fund and the Savings Fund; accordingly, the amounts received by the funds increased the gross revenue of budgetary organisations compared to the original statutory appropriations. Until end of August, the two funds together received payments in the amount of HUF 345 billion in total, while due to the high expenditures of the base period, the amount of the residues paid to the funds declined by HUF 520 billion year-on-year.

Table 8
Partially consolidated cash expenditures of the central sub-sector (HUF billions)

	2023				
	Statutory appropriation	January - August realisation	Percentage of appropriation	MNB forecast	Difference: MNB - appropriation
PRIMARY EXPENDITURE ITEMS	**31,013**	**19,524**	**63%**	**30,029**	**-984**
Special and normative subsidies and support to the public media	**3,781**	**1,918**	**51%**	**2,332**	**-1,449**
Social policy fare subsidy	**105**	**78**	**74%**	**116**	**11**
Housing grants	**383**	**369**	**96%**	**479**	**96**
National Family and Social Policy Fund	**755**	**541**	**72%**	**758**	**3**
Net own expenditures of central budgetary organisations and chapters	**7,769**	**5,575**	**72%**	**8,852**	**1,083**
Expenditures related to EU funds	**3,794**	**1,814**	**48%**	**2,880**	**-914**
Support to local governments	**969**	**785**	**81%**	**1,197**	**229**
Contribution to the EU budget	**662**	**423**	**64%**	**662**	**0**
Central reserves	**977**	**-**	**-**	**304**	**-673**
Other expenditures	**1,770**	**1,241**	**70%**	**2,142**	**373**
Expenditures of extra-budgetary funds	**579**	**392**	**68%**	**624**	**45**
NEF - Passive allowances	116	86	74%	136	21
NEF – Active allowances	118	75	64%	118	0
Other expenditures	346	231	67%	370	24
Expenditures of social security funds	**9,469**	**6,388**	**67%**	**9,682**	**212**
PIF - Pensions	5,546	3,859	70%	5,768	222
HIF - Disability and rehabilitation benefits	375	256	68%	380	6
HIF - Cash benefits	735	442	60%	687	-48
HIF - Medical and preventive care	2,306	1,512	66%	2,350	44
HIF - Net expenditures of the drug budget	354	228	65%	349	-5
Other expenditures	155	91	59%	147	-8
NET INTEREST EXPENDITURES	**2,074**	**1,435**	**69%**	**2,567**	**493**
TOTAL EXPENDITURES	**33,087**	**20,958**	**63%**	**32,595**	**-491**
BALANCE	**-3,400**	**-3,299**	**97%**	**-4,888**	**-1,488**

Note: Partly consolidated data: the fiscal impact of the revenues and expenditures within the general government central sub-sector are stated in net terms. In the case of central reserves, in the first eight months of the year already HUF 673 billion was spent on various budget lines, and according to our expectations reserves in an additional amount of HUF 304 billion will be spent in Q4. Accordingly, the actual figure for the first eight months is meaningless for this line.

Source: Hungarian State Treasury, Amended 2023 Budget Act, MNB September 2023 Inflation Report

In the first eight months **gross expenditures** of the budgetary organisations and chapters together were spent in the amount of HUF 8,039 billion, approaching 81 per cent of the statutory appropriation. The impact of the government measures aimed at curbing expenditures for capital formation is already visible in developments in investment expenditures, as these expenditures declined also in nominal terms compared to the base period, which represents a strong decline calculated in real terms. We expect this trend to persist in the coming months.

According to our expectations, due to the delay in the drawdown of the 2021-2027 funds, **expenditures related to EU grants** may fall short of the statutory appropriation materially, by more than HUF 900 billion, It also implies the realisation of expenditures in a lower amount and the curbing of advance payments that until the end of August EU expenditures amounted to HUF 1,814 billion, which corresponds to 48 per cent of the annual appropriation.

Under the title of **support to local governments** our projection calculates with excess expenditures of HUF 229 billion compared to the budget, and thus the annual amount of the support may be as high as HUF 1,197 billion. The excess expenditures result from the reallocations from the reserve appropriation on the one hand, and from the implementation of other government decisions, providing surplus subsidies primarily for fixed capital formation, on the other hand. In the first eight months of the year the budget provided HUF 785 billion for this purpose, which exceeds 80 per cent of the appropriation.

Our current forecast for the expenditure appropriation entitled **contribution to the EU budget** calculates with the realisation of the appropriation, amounting to HUF 662 billion. In the first eight months, expenditures in the amount of HUF 423 billion were realised under this expenditure title, which corresponds to 64 per cent of the statutory appropriation.

The **Central Reserve appropriations of** the Budget Act together contained a reserve of HUF 977 billion, of which HUF 304 billion is available to the government for the last four months of the year. Of the used reserve appropriations HUF 118 billion is available in the Provisions row for wage measures. The appropriation available in the Investment Fund amounts to HUF 108 billion, where the remaining less than HUF 80 billion has not been utilised in the extraordinary government measures and Reserve for Disease Control rows. According to our expectations, the full amount of the reserves will be utilised by the end of the year, with a risk of minor overspending in the case of provisions.

Other expenditure of the central sub-sector may amount to around HUF 2,142 billion this year, which is by HUF 373 billion higher than the amount of the expenditures classified here in the Budget Act. Within this, we anticipate an excess expenditure of HUF 287 billion under expenditures related to state asset management. The cash-based excess expenditure related to state asset management is connected to the cost of the acquisition of the stake in Vodafone, which has no impact on the ESA balance. Contrary to the practice of previous years, three quarters of the annual appropriation for guarantees has already been realised, and thus – unlike in previous years – no cost savings may be expected under this item at the end of the year.

Within the **expenditures** of the **extra-budgetary funds** the expenditures under the passive expenses of the National Employment Fund (unemployment benefit) may exceed the appropriation by roughly HUF 21 billion. The first eight months' passive expenditures reached 74 per cent of the appropriation; however, these expenditures usually concentrate in the second half of the year. This year, wage guarantee payments of the National Employment Fund may exceed the appropriation of 2.5 billion by HUF 20 billion, which is entirely connected to the payments related to Dunaferr.

According to our expectations, **expenditures of the central sub-sector for the Start Labour Programme** may be around HUF 118 billion, in line with the expenditure appropriation in the Budget Act. In the first eight months of 2023, expenditures of the labour programme exceeded the year-on-year payments by HUF 2 billion. Until the end of August, subsidies and subsidy advances were disbursed in the amount of HUF 75 billion, which corresponds to 64 per cent of the appropriation.

According to our forecast, **expenditures of the social security funds** may come close to HUF 9,682 billion, which exceeds the amount of the appropriations in the Budget Act by HUF 212 billion (2 per cent) in 2023. The vast majority of the expenditures over the appropriation is linked to the supplementary pension increase of 3.1 per cent to be implemented in November. Until the end of August 2023, partially consolidated expenditures of the social security funds amounted to HUF 6,388 billion in total, corresponding to 67 per cent of the statutory appropriation for this year. In the case of pensions and pension-type benefits actual payments reached 70 per cent of the appropriations, which is mostly the consequence of the disbursement of the 13th month pension in February, and thus the expenditures realised until August roughly correspond to the amount anticipated for the same period. The balance of drug reimbursements and expenditures on medical and preventive care corresponded to the pro rata amount in the first eight months of 2023, while expenditures for cash benefits fell short of the pro rata level of the appropriations.

According to our forecast, **retirement provisions disbursed from the Pension Insurance Fund** may generate expenditures for the budget in 2023 in the amount of HUF 5,768 billion, which exceeds the appropriation by HUF 222 billion. The excess in pension expenditures compared to the statutory appropriation is primarily attributable to the inflation exceeding that assumed upon the planning of the budget, due to which a supplementary pension increase of 3.1 per cent is likely to take place in November 2023. Cumulative expenditures realised until August 2023 amounted to HUF 3,859 billion, which exceeds the year-on-year payments by HUF 706 billion (22 per cent). The growth is primarily attributable to the 15 per cent pension increase in January, as well as to the carry-over effect of the 3.9 per cent and 4.5 per cent supplementary pension increase in July 2022 and November, respectively, to 2023. (Table 9). Cash expenditures realised until August are roughly in line with the pro rata amount based on the statutory appropriation.

Table 9
Pension and pension-like benefits expenditure in the first eight months of 2022 and 2023

	2022	2023	Difference
I. Pension Fund	**3,153**	**3,859**	**706**
1. Old-age pensions	2,502	3,077	575
1.1 Old-age pensions over the retirement age	2,261	2,788	527
1.2 Early retirement benefit for women	241	290	49
2. Retirement provision to relatives	297	350	53
2.1 Orphan’s pension	26	31	5
2.2 Widow’s pension	270	318	48
3. One-time subsidy	0	0	0
4. Provision for pension premium	1	0	0
5. 13th-month pension	347	425	78
Unaccounted pension expenditure	*6*	*6*	*1*
II. Early retirement benefits	**77**	**86**	**9**
III. Disability and rehabilitation benefits	**226**	**256**	**30**
Total pensions and pension-like benefits	**3,456**	**4,201**	**745**

Source: Amended 2023 Budget Act, Hungarian State Treasury, MNB

• Within the benefits disbursed from the Fund, expenditures related to **retirement provisions for those reaching the pensionable age** may amount to HUF 4,333 billion, which exceeds the appropriation by almost HUF 155 billion (3 per cent) in 2023 due to the pension increase in November. The rise in the pensionable age for old-age pension ended in 2022, as a result of which the fall in the number of beneficiaries gradually came to an end. Thus, in August 2023 the number of those benefiting from old-age pension after reaching the pensionable age exceeded the year-on-year figure by almost 15,500. In addition to this, due to the strong wage dynamics observed in recent years, the initial provisions are calculated using higher indexation multipliers, which also contributes to the rise in expenditures. Cumulative expenditures realised until August 2023 amounted to HUF 3,077 billion, which exceeds the 2022 year-on-year payments by 23 per cent.

• In 2023, the expenditure related to the provisions for **women retiring after 40 years of service** may amount to HUF 447 billion, which exceeds the appropriation by merely HUF 6 billion. The growth in the number of beneficiaries receiving women’s preferential old-age pension applicable stopped after the process of raising the pensionable age came to an end in 2022, and due to the setting of initial benefits for old-age pension under the pensionable age of 65 years, their number started to decrease due to reaching the pensionable age. In August 2023 the numbers of those benefiting from preferential retirement provision fell short of the year-on-year figure of 2022 by 6,500. The eight-month cumulative expenditure related to the preferential retirement provision was HUF 290 billion, representing a year-on-year growth of 20 per cent.

• Expenditures for **retirement provisions to relatives** may amount to HUF 542 billion in 2023, exceeding the appropriation by almost HUF 36 billion (7 per cent). The increase is almost fully connected to survivor’s pensions. In August 2023, the cumulative amount of expenditures was almost HUF 350 billion, exceeding last year’s level by 18 per cent. The number of those receiving survivor’s pension and allowance for orphans decreased by almost 9,000 and 700, respectively, compared to August 2022.

According to our forecast, in 2023 expenditures on **pensions and pension-type benefits** (old-age pensions, early retirement benefits, disability and rehabilitation benefits) may be over HUF 6,280 billion in total, which – primarily due to the supplementary pension increase of 3.1 per cent to be implemented in November – may exceed the appropriation by more than HUF 230 billion. Expenditures realised until August 2023 exceed the year-on-year payments by almost HUF 750 billion (22 per cent). On a cash basis, expenditures realised until August roughly correspond to the pro rata appropriations of the Budget Act.

Consolidated expenditures of the Health Insurance Fund may fall short of the appropriation of HUF 3,915 billion by HUF 10 billion. Expenditures of cash benefits disbursed from the Fund fall short of the proportional amount of the appropriations by 6 per cent, which is attributable to the utilisation being lower than assumed at the time of expectations underlying the budget. Expenditure on benefits in kind, except for the net drug budget, fall short of the appropriations on a pro rata basis. Expenditures reached HUF 2,529 billion at the end of August 2023, which is 65 per cent of the expenditure appropriation for the full year.

Expenditures on **medical and preventive care** may exceed the 2023 appropriation by HUF 44 billion, primarily due to the growth in material expenditures connected to health services resulting from the rising inflation. In the first eight months of 2023, expenditures were realised in the amount of HUF 1,512 billion, which is 66 per cent of the annual appropriation. The expenditure appropriation for medical and preventive care rose significantly, by HUF 102 billion in 2023 compared to previous year. In the first eight months the excess expenditure is mostly attributable to the wage review of doctors and ancillary workers in state and local government healthcare institutions, and to the gradual increase in the expenditures related to the third phase of raising wage subsidies for general practitioners and dentists operating as entrepreneurs, commencing in 2023. In 2023 H2, the first phase of the two-step wage review (from 1 July 2023 and 1 March 2024) for healthcare ancillary workers and healthcare employees increased the expenditures.

Net expenditures of the drug budget may fall short of the appropriation by HUF 5 billion, with the difference linked primarily to the higher gross revenues. Based on the available data – due to the relatively steady time profile in a historical comparison – it may be assumed that at the end of 2023 annual disbursements will exceed the appropriation. The net expenditure was HUF 228 billion at the end of August 2023, which corresponds to 65 per cent of the appropriation.

Cash benefits disbursed from the Health Insurance Fund may fall short of the appropriation by HUF 48 billion in total. Expenditures related to **sickness benefit**, **childcare and adoptive parent allowance** may fall short of the appropriation by HUF 32 billion and HUF 19 billion, respectively. The differences are primarily attributable to the utilisation being lower than assumed at the time of planning the budget. Cash benefits amounted to HUF 442 billion until August 2023, corresponding to 60 per cent of the appropriations.

According to our forecast, **disability and rehabilitation benefits** may exceed HUF 380 billion in 2023, which is roughly in line with the appropriation. Due to inflation exceeding the level expected when the 2023 budget was planned, eligible persons will benefit from a supplementary pension increase in November, which – according to our expectations (in line with the practice of previous years) – will also cover disability and rehabilitation benefits. On the other hand, the impact of the rise in the benefits will be offset by the fall in the number of beneficiaries, as in August 2023 almost 252,000 persons benefited from disability and rehabilitation benefits, which falls short of the headcount in the same month of previous year by almost 14,000 persons. The gradual decline in the number of beneficiaries, a trend observed for years, is the result of the reclassification of those reaching the pensionable age to old-age pension and of the lower number of new benefits settings. The eight-month cumulative amount of expenditures related to disability and rehabilitation benefits was close to HUF 256 billion, which exceed the year-on-year amount by more than HUF 30 billion (13 per cent). The amount of the expenditures realised until August 2023 corresponds to the pro rata amount assumed based on the appropriation in the Budget Act (also considering the disbursement of the 13th benefit in February).

According to our projection **gross accrual-based interest expenditure** may rise to 3.9 per cent of GDP at the end of 2023, which considerably exceeds the statutory appropriation, while it is lower than 4.4 per cent of GDP, i.e. the figure stated in the EDP notification published in October. The increase in interest expenditure is mostly attributable to the rising inflationary and yield environment, the dominance of which is decelerated by the increase in the average duration of the government debt, implemented in recent years. Inflation has a key role in the increase in interest expenditures: due to the rise in inflation and the inflation-indexed government securities portfolio, the related interest expenditures grew by HUF 560 billion between 2022 and 2023, which accounts for half of the rise in government interest expenses this year. Through the inflation expectations, inflation influences the government securities market yield indirectly as well. The cumulative year to date **net cash-based interest expenditure** amounted to roughly 69 per cent of the annual appropriation in the first eight months of 2023. However, due to the larger interest payments expected in the remaining part of the year, at the end of the year, the cumulative interest expenditure may exceed the appropriation. In our projection we expect net interest expenditures to exceed the statutory appropriation significantly, which is attributable - in addition to our almost identical expectation for interest revenues - to our forecast for higher gross interest expenditure.

3.5 BALANCE OF THE LOCAL GOVERNMENT SUB-SECTOR

Cash-based balance of local governments may be a surplus of HUF 125 billion compared to the plans in the budget. Compared to the balance assumed at the time when the Budget Act was drafted, essentially due to the higher subsidy received from the central budget and the higher-than-expected tax revenues, the sub-sector may realise a cash surplus. According to the preliminary H1 data of the Hungarian State Treasury, local governments closed the first six months of the year with a cash surplus of HUF 205 billion. Tax revenues of local governments rose dynamically year-on-year, with the growth rate reaching 34 per cent. As regards the structure of tax revenues, the 34 per cent growth in local business tax, accounting for some 60 per cent of the total tax revenue, is also a dominant factor. In the first six months of the year, material expenditures of local governments grew by 30 per cent, wage expenses rose by 12 per cent, while investment expenditures declined in nominal terms. The budget surplus of over HUF 200 billion developed as a combined result of the aforementioned factors by the end of June.

3.6 STATISTICAL CORRECTIONS (ESA BRIDGE)

In our forecast, we calculate with an ESA balance improving statistical correction amounting to 1 per cent of GDP, which exceeds the value of the statistical corrections stated in the October 2023 EDP notification by 0.4 per cent of GDP. The effective 2023 Budget Act defined the balance of the accrual-based statistical corrections ESA bridge) as 0.6 per cent of GDP (HUF 462 billion). In the EDP notification published on 3 October, the HCSO still shows for 2023 a cash balance-improving statistical correction of 0.6 per cent of GDP. Corrections related to tax and tax-type revenues exceed 0.3 per cent of GDP. The statistical correction related to the EU settlements contribute by further 0.4 per cent of GDP to ensuring that the ESA balance is more favourable than the cash-based balance. The correction of the EU settlements of a high amount is connected to the settlement of the EU advances paid by the budget. The balance-improving effect of cash transactions may also be around 0.4 per cent of GDP. Within that, the correction of expenditures related to state property reduces the accrual-based expenditures by 0.6 per cent of GDP. The largest expenditure of this type is the acquisition of a participation in Vodafone Magyarország Zrt., which involves the purchase of a financial instrument, and as such the transaction does not increase the accrual-based budget deficit. Statistical corrections related to expenditures (wages, material expenditures, investments) together may increase ESA expenditures by 0.4 per cent of GDP. On the other hand, of the corrections recognised among the financial transactions, the forgiving of loans under the prenatal baby support scheme and the adjustments related to loan transactions increase ESA expenditures. Interest and swap settlements together increase accrual-based net interest expenditure by roughly 0.1 per cent of GDP compared to the cash-based net interest expenditure.

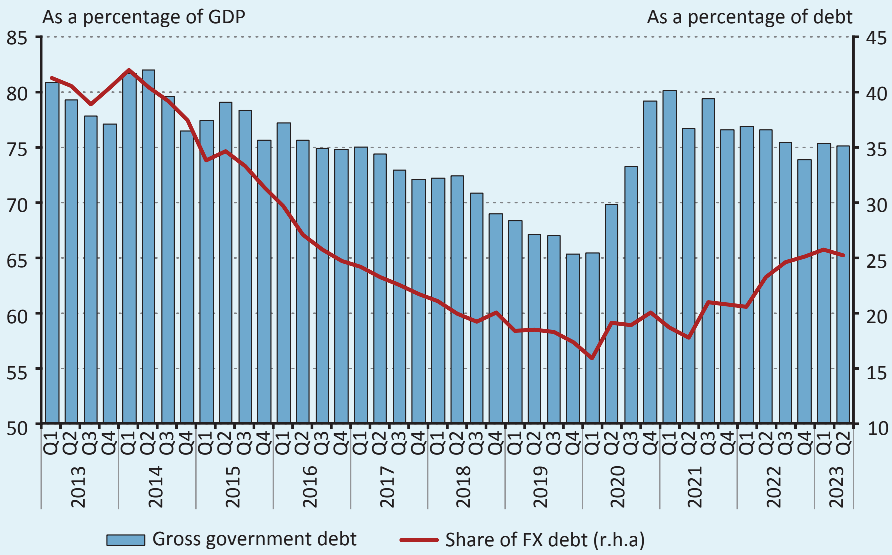
3.7 EXPECTED DEVELOPMENTS IN GOVERNMENT DEBT IN 2023

At the end of 2023 H1, the gross government debt-to-GDP ratio was 75.2 per cent (Chart 18). The debt ratio decreased by 1.5 percentage points compared with the same period of the previous year and increased by 1.3 percentage points compared to the end-2022 value. The rise in government debt was caused by the high net issuance, based on which the vast majority of the annual issuance was already completed in H1. As a result of the foreign currency bond issuances, the share of foreign currency within central government debt rose to 25.2 per cent in 2023 H1 from 25 per cent registered at the end of last year.

According to our forecast, the gross government debt-to- GDP ratio will decline to 71 per cent by end-2023 from 73.9 per cent at the end of last year. This year, if the issuance plan of the debt management agency materialises, the government debt ratio will decrease due to the dynamic growth in nominal GDP and the presumably more moderate debt issuance in the second half of the year. The government debt ratio may decrease annually by almost 2.5 percentage points on average over the forecast horizon and may thus fall to 66 per cent by the end of 2025.

According to our forecast, as a result of the substantial foreign currency debt issuance in 2023, the foreign currency ratio of central government debt may rise to 27.5 per cent at the end of the year. The changing EUR/HUF exchange rate affects the debt ratio even in the context of falling FX debt. The lower the share of foreign currency debt in government debt, the smaller the impact of foreign exchange rate change. . Currently, a 10-forint change in the EUR/HUF exchange rate modifies the government debt-to-GDP ratio by around 0.5 percentage point.

Chart 18
Gross government debt as a percentage of GDP and the share of FX debt within the central government debt



Source: Government Debt Management Agency, MNB

4 Compliance with the fiscal rules

There are a total of eight fiscal rules that pertain to the Hungarian general government in the budget years 2022-2023, with four Hungarian and four European Union requirements. There are two overlaps between the rules: the 3 per cent Maastricht deficit criterion and the regulations regarding the medium-term budgetary objective. The other two Hungarian rules include the debt rule in the Fundamental Law and the debt rule specified in the Stability Act. The requirements that only appear in the European Union's legal framework are the expenditure benchmark and the Maastricht debt rule.

As regards **the debt rule of the Fundamental Law**, Hungary's debt ratio was always over 50 per cent of GDP; therefore, in accordance with the rule, it must be reduced.[1] Compliance with the debt rule is a condition for the adoption of the budget, which is verified by the Fiscal Council. The 2022 Budget Act was passed in 2021 to include the expected reduction of the government debt ratio in line with the outlook at the time, thus compliance with the rule was ensured. However, on the basis of the escape clauses, the provisions of the rule may be deviated from during the year in the event of an enduring and significant national economy recession or the introduction of a special legal order.[2] Economic downturn should be interpreted as permanent and significant if the real value of the gross domestic product declines for a year or more, while special legal order means state of national crisis, state of emergency, state of preventive defence, state of terrorist threat, unexpected attack and state of danger.[3] The crisis developed as a result of the coronavirus pandemic and the state of emergency ordered due to the outbreak of the Russia-Ukraine war in 2022 have triggered the escape clause. Nevertheless, the debt ratio fell by 2.8 percentage points in 2022, and it is likely to decline this year as well, and thus the rule would be satisfied in both years.

The other Hungarian fiscal rule applicable to public debt is the **debt rule** of the Stability Act. Based on this requirement, parallel with the enforcement of EU regulations, the debt-to-GDP ratio must decrease by at least 0.1 percentage point per year.[4] The debt ratio declined by 2.8 per cent last year, and it may decline by further 2.9 per cent this year, which complies with the debt rule prescribed in the Stability Act.

The **Maastricht deficit criterion**, included in both the Hungarian and the EU fiscal framework, specifies that the accrual-based deficit of the general government may not exceed 3 per cent of GDP.[5] According to our forecast, the general government deficit is projected to be 6.2 per cent of GDP in 2022, which is although higher than the threshold set by the requirement, but the Maastricht deficit target is subject to an escape clause under both the EU and Hungarian fiscal frameworks. The general escape clause put in place in the EU allows for a temporary deviation from the budget balance reference value and from the medium-term budgetary objective and the adjustment path leading to it, provided that this does not endanger fiscal sustainability in the medium-term.[6] Subject to the escape clause, according to the rules in the corrective arm of the Stability and Growth Pact, thus, in the event of a deficit criterion, according to the discretionary decision, EU institutions will not initiate an excessive deficit procedure, and their activities are limited to formulating revised country-specific economic policy recommendations. Based on the decision of the EU organisations, the application of the general exemption clause is still in place in 2023. **In the Hungarian legal order**, the decrease in the real value of gross domestic product exempts from the compliance with the 3 per cent deficit rule.[7] The general government deficit as a percentage of GDP will exceed the 3 per cent threshold this year as well, but the relevant paragraph of the Stability Act has been amended, and thus - pursuant to the transitional provision - the rule does not apply in the 2021-2023 fiscal years.

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[1] Fundamental Law of Hungary, Article 36(4)-(6), Article 37(2)-(3)
[2] Fundamental Law of Hungary, Article 36(6), Article 37(3)
[3] Fundamental Law of Hungary, Articles 48 to 54
[4] Section 4(2a) of Act CXCIV of 2011 on the Economic Stability of Hungary
[5] Section 3/A(2b) of Act CXCIV of 2011 on the Economic Stability of Hungary
[6] Articles 5(1), 6(3), 9(1) and 10(3) of Council Regulation (EC) No 1466/97; Articles 3(5) and 5(2) of Council Regulation (EC) No 1467/97;
[7] Section 7(1)-(2) of Act CXCIV of 2011 on the Economic Stability of Hungary

Pursuant to the rules on the **medium-term budgetary objective** that are also part of the Hungarian and EU legal frameworks, the balance of the general government must be determined in a way that it should be in line with achieving the medium-term budgetary objective.[8] The objective is measured by the structural balance, which refers to the cyclically adjusted balance net of one-off and other temporary items. For Hungary, the medium-term budgetary objective (MTO) is -1 per cent of GDP between 2021 and 2023. Following the entry into force of the general escape clause in the European Union, during the period of its effect, the Commission will not sanction or examine compliance with the rules of the preventive arm of the Stability and Growth Pact. Thus, Member States will be temporarily exempted from the medium-term budgetary objective or, in the event of non-compliance, from the **expenditure benchmark** designating the adjustment path. The rule in the Hungarian legislation applicable to MTO has been modified, and thus - under the transitional provision of the Stability Act - it is not necessary to comply with this requirement between 2021 and 2023.

The **European debt rule** states that the Member States' government debt ratio must not exceed 60 per cent of GDP, or if it does, the debt ratio must be reduced at a satisfactory pace. The appropriate decrease in the debt is quantified by the one-twentieth rule, according to which the debt ratio should be reduced by one twentieth of the part that exceeds 60 per cent on average over three years. Based on its own forecast, the European Commission calculates the extent of the change of the debt ratio using three different methodologies (forward-looking, backward-looking and cyclically adjusted), and if the one-twentieth drop is satisfied based on any of them, the rule is deemed to have been complied with. Hungary's gross government debt ratio is over 60 per cent of GDP in all three years under review, requiring an annual reduction in debt. The general escape clause remained in force in 2023 as well; however, according to the assessment by the European Commission, Hungary's government debt to GDP ratio would nevertheless comply with the temporarily suspended debt rule last year and this year as well.[9]

[8] Section 3/A(2a) of Act CXCIV of 2011 on the Economic Stability of Hungary

[9] Report from the Commission - Report prepared in accordance with Article 126(3) of the Treaty on the Functioning of the European Union, European Commission, 24 May 2023, Tables 1 and 4

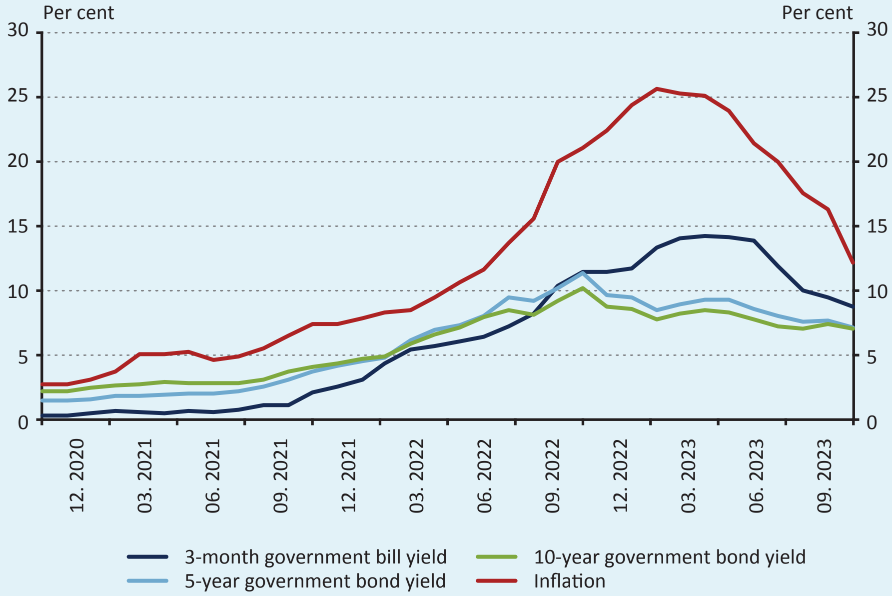
5 Special topics

5.1 INFLATION SIGNIFICANTLY INCREASES GOVERNMENT INTEREST EXPENDITURES

In 2023, government interest expenditures may rise by some HUF 1,170 billion to 3.9 per cent of GDP, where almost half of the increment is generated by the inflation-linked government securities due to high inflation. Inflation has a key role in the increase in interest expenditures: due to the rise in inflation and the inflation-indexed government securities portfolio, inflation-related interest expenditures grow by HUF 560 billion between 2022 and 2023, which accounts for half of the rise in government interest expenses this year. Accordingly, curbing inflation also directly reduces government interest expenditures. On the other hand, due to the high share of retail government securities, the unfavourable impact of the government's higher interest expenses is partly mitigated by the fact that the vast part of it is paid to households.

Of the factors affecting government interest expenses, inflation rose to the largest degree (Chart 19). Inflation, which increased to an annual average of 14.5 per cent last year, directly determines the interest rate on inflation-linked government securities, which accounts for 13 per cent of debt, while inflation expectations continue to have a significant impact on around 72 per cent of it (all fixed and floating rate forint denominated securities). The yields on medium- and long-term forint government securities averaged 7-9 per cent per annum in 2022, while the annual average for short-term yields was 7-8 per cent. In 2023, long-term yields averaged between 7-10 per cent, while the average of short-term yields was around 11-12 per cent.

Chart 19
Development of inflation and benchmark government bond yields



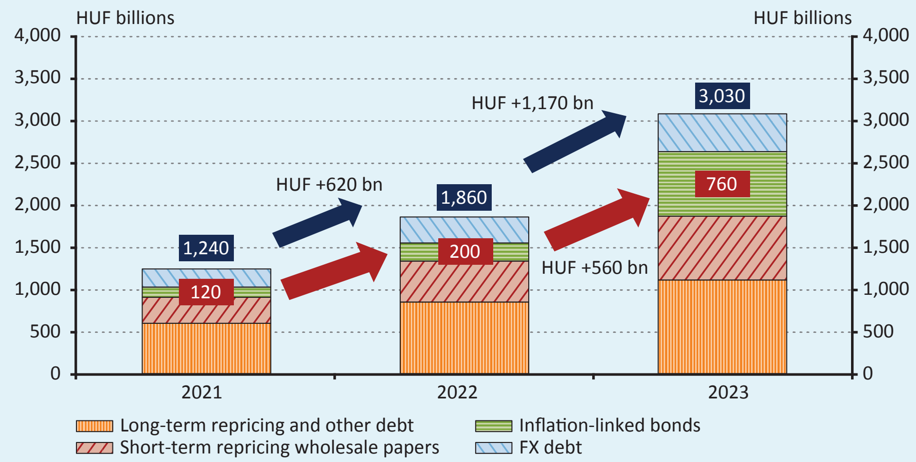
Source: Government Debt Management Agency, MNB

Inflation expectations materially influence the yield on forint government securities. A key element of the yield level is the inflation expectations and the premium resulting from the uncertainties surrounding that, and as such inflation influences the yield on government securities indirectly as well. Interest expenditures on Discount Treasury Bills of short repricing period, rapidly following the change in yields, and on floating rate securities together may rise by almost HUF 270 billion compared to last year (Chart 20). Interest expenditure on fixed interest wholesale and retail forint debt of long repricing period is likely to rise by some HUF 260 billion. This is mostly attributable to the rise in interest rates paid on fixed interest wholesale forint bonds. The anticipated decline in interest paid on Hungarian Government Securities Plus (MÁP+) is attributable to the significant fall in outstanding stock.

Interest expenditures on foreign currency denominated debt will rise by some HUF 130 billion in 2023, i.e. one and a half times that of last year. The growth in expenditures is attributable, in addition to the increasing yields, to the growth in outstanding stock resulting from the foreign currency issuances last year. In 2022, the Debt Management Agency issued foreign currency bonds in an amount of more than HUF 2,300 billion. In February 2022, foreign currency bonds in the amount of HUF 205 billion were issued in Japanese yen, followed by the issuance of two dollar- and one euro-denominated foreign currency bonds in June in the total amount of HUF 1,441 billion and by green euro and Panda bonds in November in the amount of HUF 521 billion. In addition to these, a HUF 158 billion tap issue was made on a previously issued dollar bond. In January 2023, there was a significant issuance of international foreign currency bonds in the amount of USD 4.25 billion, followed by, also in January, the issuance of bonds of short residual maturity in the nominal amount of USD 1 billion, while in September bonds were issued in the amount of EUR 1.75 billion.

The central bank's market stabilisation measures curbed the rise in foreign currency interest expenses by stabilising domestic risk spreads and the exchange rate. Changes in the forint exchange rate influence interest expenditures through several channels, while the foreign currency risk spread has a direct impact on the government's interest expenditures. Foreign currency interest expenses will rise in 2023; however, owing to the central bank's market stabilisation measures the increase will be more moderate.

Chart 20
Developments in interest expenditures 2021-2023

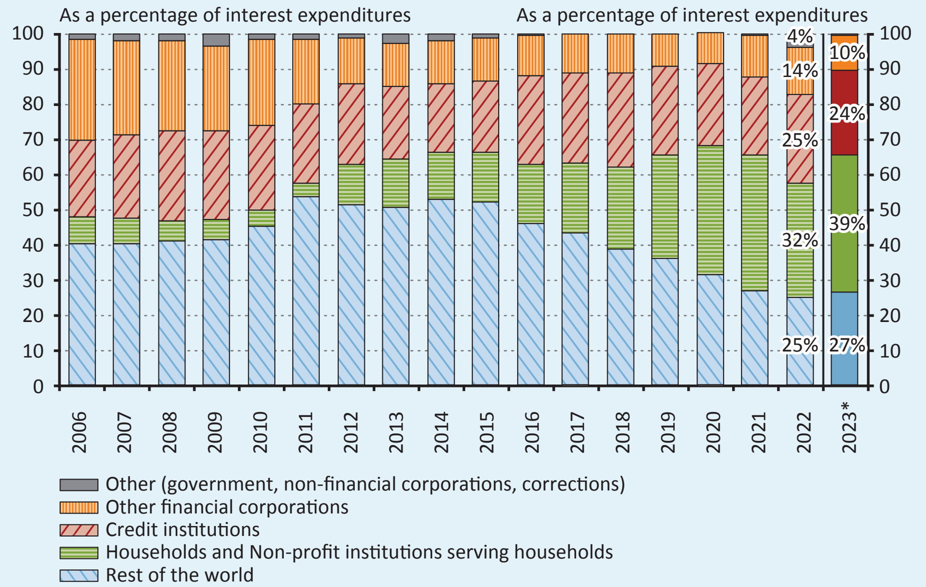


Source: Government Debt Management Agency, Eurostat, MNB

One-quarter of the interest payments by the government is paid for non-residents, while almost three quarters of the payments remains in Hungary. The share of residents in government interest payments has gradually increased since 2011, in parallel with the rise in resident ownership within the government debt, and while formerly roughly one-third of the debt was held by residents, in 2022 this share was already almost two-thirds. Within this, households' share last year was close to 16 per cent of GDP and exceeded 21 per cent of the total debt, being the highest within the EU, and this is likely to persist in 2023 as well. Last year, almost one third of the total government interest expenses were received by households (0.9 per cent of GDP), one quarter by credit institutions (0.7 per cent of GDP) and 14 per cent (0.4 per cent of GDP) by other financial corporations (insurance companies, funds, MNB). The share of non-residents in the total government interest expenses was merely one quarter (0.7 per cent of GDP) (Chart 21).

Within the interest expenditures, interest paid to households increases to the largest degree, and thus the share of households rises in 2023 from 32 per cent (0.9 per cent of GDP) registered in 2022 to 39 per cent (1.5 per cent of GDP) (Chart 21). According to our projection, in addition to households, the share of interest payments to non-residents may also increase due to the large foreign currency issuances this year, while the share of other sectors in the government's interest payments may decline this year.

Chart 21
Decomposition of government interest expenditures between sectors of the economy



*Note: *MNB forecast*
Source: MNB

Charles Robert

(1308 – 1342)

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

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

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

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

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

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

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

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