PUBLIC FINANCE REPORT

2020
OCTOBER

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

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

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Analysis of the public finance developments in 2019–2020

2020

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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 created 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 1 October 2020.

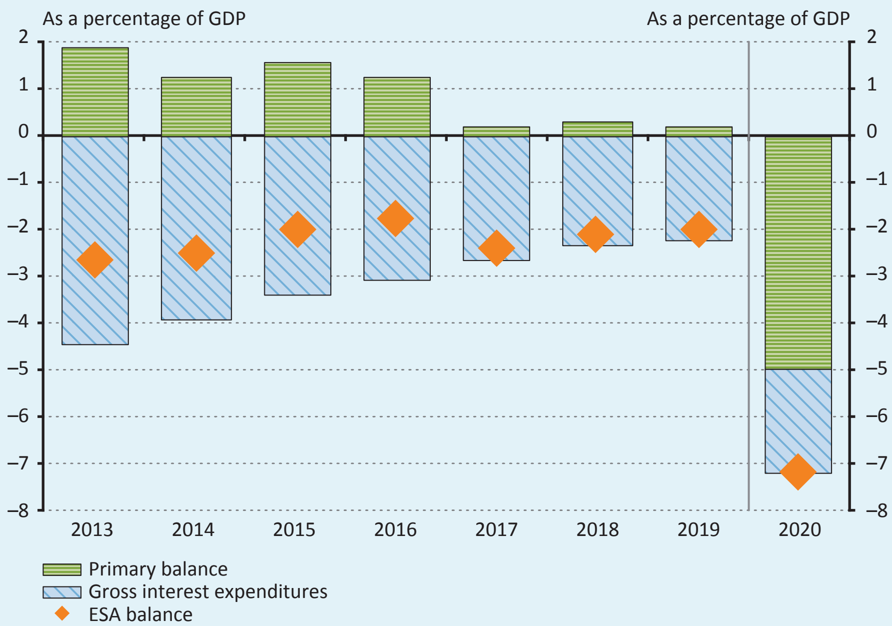
Contents

1 Summary

The purpose of this analysis is to present the developments in public finance in 2019 and the expected fiscal developments for 2020, on the basis of budget figures available for the first eight months and the MNB's forecast prepared for its September Inflation Report. In view of the above, actual compliance with the national and European Union's fiscal rules related to the budget balance and government debt for 2019 as well as the expected compliance for 2020 are assessed.

The dynamic expansion of the output of the Hungarian economy since 2013 resulted in a 4.6 percent increase in 2019, but as a consequence of the coronavirus epidemic, the MNB's September Inflation Report forecasts a real GDP decline by 5.1 to 6.8 percent this year. The coronavirus epidemic adversely affected the Hungarian economy, and within that, primarily the automotive industry, tourism and investment, which accounts for a significant share of growth. GDP may have hit a low in 2020 Q2; however, economic performance may remain subdued for the rest of the year due to the second wave of the epidemic, which could lead to a slower recovery. In an uncertain environment, both households and companies are adjusting to a slower-than-expected recovery. The measures taken against the epidemic had drastic consequences for the performance of most of our export market partners, thus, a slower-than-expected recovery in foreign markets is expected. After an increase of 11.4 percent in 2019, average gross wages in the national economy may increase by 8.7-9.2 percent in 2020. The rise in consumer prices may remain around last year's 3.4 percent, between 3.5 and 3.6 percent this year.

Chart 1
Development of the fiscal balance and interest expenditures



Note: The point estimate on the graph shows the midpoint of the deficit forecast bands.
Source: Hungarian Central Statistical Office (HCSO), MNB

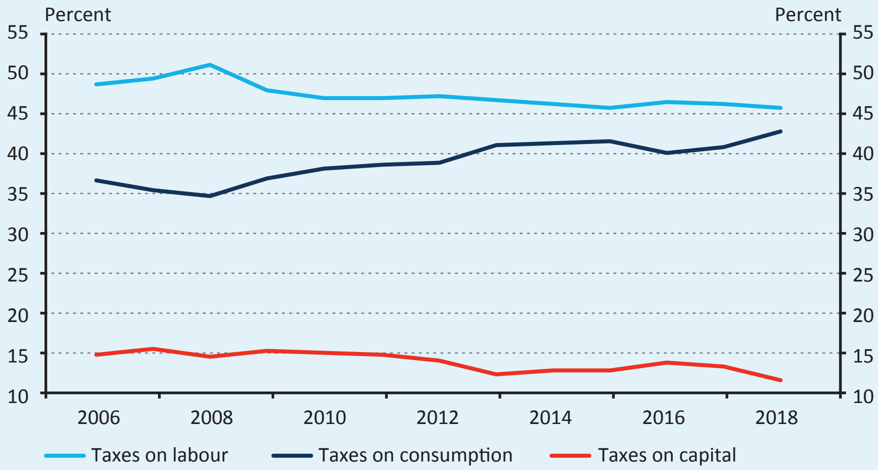
In 2019, the accrual-based budget deficit was 2.0 percent, which was 0.2 percentage points above the 1.8 percent deficit target, but at the same time it represented a decrease compared to 2018. The deficit was higher compared to the December forecast as well, which is primarily the result of higher expenditures of the central budget at the end of the year, which was partly offset by rapidly rising tax revenues as well as a higher-than-expected balance of local governments and companies classified into the government sector.

In 2020, the budget deficit as a percentage of GDP could be 7-7.5 percent. The 2020 Budget Act adopted in July 2019 stipulated an ESA deficit of 1 percent of GDP, with reserves equivalent to 1 percent of GDP. Owing to a lower-than-ever deficit target and high reserves, there was significant room for manoeuvre in the budget to address the health and economic effects of the pandemic. Measures with a direct budgetary impact may amount to 7.3 percent of GDP, a significant part of which may be covered from reallocations, the use of reserves, tax increases (special retail tax, contributions from financial institutions) and reallocations of EU funds. According to our estimate, the net balance effect may amount to 3.2 percent of GDP. The economic slowdown considerably reduces tax revenues compared to the previous estimates, which may thus fall short of the statutory appropriation by a total of HUF 1,160-1,300 billion (2.5-2.8 percent of GDP). Economic protection measures suggest that government investment (together from EU and own resources), accounting for 6 percent of last year's GDP, may remain high, contributing significantly to the counter-cyclical behaviour of the budget if actually implemented.

In the case of Hungary, the deficit expected for 2020 is considered to be average in an EU comparison. Governments expect the general government deficit to rise on average to 8.4 percent of GDP in the EU and to 9.8 percent of GDP in the V3 countries in 2020. Member States have embarked on major fiscal stimulus programmes to address the crisis, which, combined with the economic downturn, will lead to a significant deterioration in balance this year. The deficit could be exceptionally high in the United States, 18 percent is expected this year, and in the United Kingdom, where it could be around 16 percent of GDP.

As in previous years, the GDP proportionate level of budget tax and contribution revenues decreased also in 2019. Last year, tax revenues as a percentage of GDP declined more moderately than in previous years, by about 0.5 percentage points to 37 percent of gross domestic product. As in previous years (Chart 2), the decline in tax revenues was mainly due to a reduction in revenues from labour taxes and social security contributions, which was partly offset by an increase in certain consumption and sales taxes and the narrowing of the scope of various tax and contribution refund. In line with the 2016 tripartite wage agreement, the social contribution tax rate levied on employers fell by an additional 2-percentage-points in the second half of 2019, which tax also absorbed health contribution revenues. In parallel with the decrease in the social contribution tax, the small business tax rate also decreased. The tax burden on businesses was eased by the 2019 abolition of the obligation to top up corporate tax in December, and the increase of the personal VAT exemption limit. The earnings of elderly pensioners employed has been fully exempt from contributions since last year, and interest on households' government securities have also been exempted from taxes from the second half of the year. As the last phase of the increase of the tax allowance for families for households with two children, the amount of the monthly allowance available for dependents increased to HUF 20,000 in 2019, and the amount of job protection allowances increased to the all-time minimum wage. Targeted tax measures include the reduction of the VAT rate on milk last year, as well as the exemption from transaction tax for transfers below the HUF 20,000 threshold. In 2019, tax increases primarily affected consumption and sales taxes, representing a general increase in road tolls, excise duty on tobacco, and a public health product tax on unhealthy foodstuff. Within the scope of last year's tax measures, the system of fringe benefits narrowed significantly, and additionally, the number of people eligible for Job Protection Action Plan benefits fell approximately to half as a result of the recasting of job protection target groups.

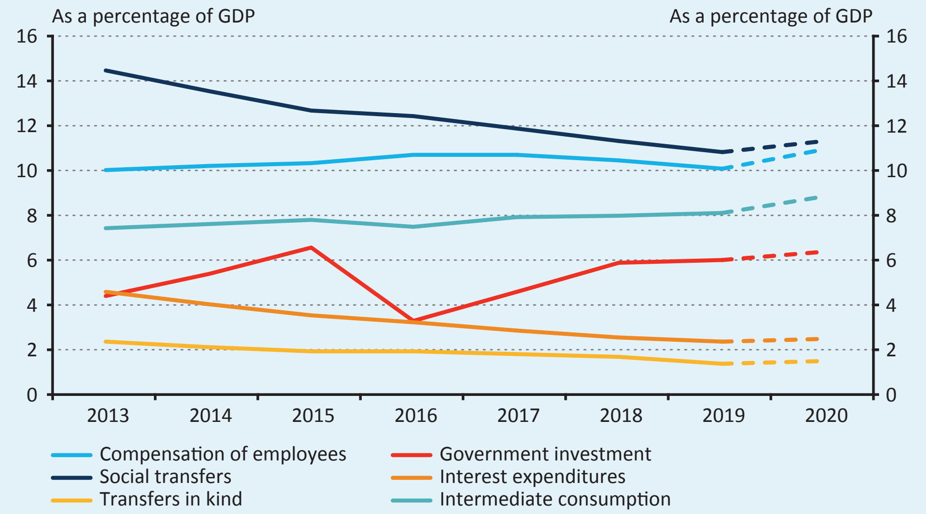
Chart 2
Distribution of labour, consumption, and capital taxes within total tax revenue



Source: European Commission

The tax changes affecting this year were introduced primarily as a measure to mitigate the economic impact of the coronavirus epidemic. The typically temporary and targeted rule changes and tax cuts have primarily reduced the tax and contributions incumbent on companies and employees. From a fiscal policy point of view, shifting the corporate tax and local business tax filing deadlines, the targeted exemption of lump sum tax of small entrepreneurs and other smaller tax types and the shortening of the VAT refund deadline have helped to reduce the tax burden on businesses and stabilise their liquidity position. The targeted partial four-month tax exemption for the sectors affected by the epidemic was designed to reduce labour taxes and contributions. Falling quarterly average oil prices due to the declining demand during the coronavirus epidemic resulted in an increase in the amount of excise duty on fuels in the second half of the year. Sector-specific special taxes have been introduced on the one hand on financial and on the other hand on retail sectors as a coverage for anti-epidemic measures. This year has also been affected by previous measures adopted or announced before the outbreak of the epidemic, such as a reduction in the VAT rate of commercial accommodation providers, a further increase in tobacco excise duties in line with EU harmonisation, and an increase in e-tolls. As of 2020, mothers with at least four children are granted complete personal income tax exemption. A number of new tax measures were introduced in the second half of this year: the online invoicing obligation introduced in 2018 was extended to all accounts regardless of the VAT threshold, and the complete contribution exemption for pensioners was extended to cover non-employment relationship forms of employment. Also since July this year, labour taxes were reduced by an additional 2 percentage point cut in the social contribution tax rate, and the previous four types of employee contributions were replaced by a single social security contribution, which, on the one hand reduces the minimum contribution base for entrepreneurs and, on the other hand it slightly expands the scope of making use of the family tax allowance.

Chart 3
Government sector expenditures as a percentage of GDP



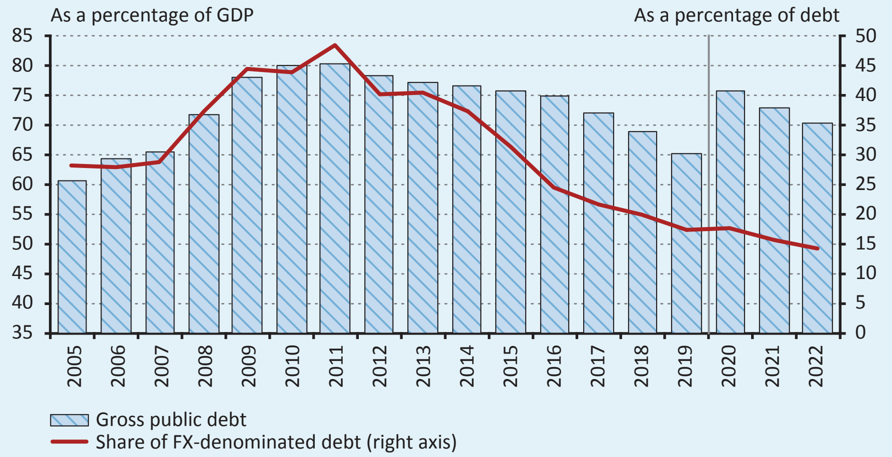
Source: HCSO, MNB

In 2019, GDP proportionate public redistribution calculated excluding EU subsidies decreased by 1.1 percentage points to 38.8 percent; however, according to our forecast, a temporary increase may take place in 2020, which may be followed by a continuous decline. About half of the decrease in 2019 is explained by the decline in financial transfers, which is caused by the unchanged nominal value of individual transfers (e.g. family allowance) and the slower growth rate of pensions than GDP dynamics, which is a consequence of the current impact of measures taken previously. A strong decline was also observed in interest expenditures due to the persistently favourable interest rate environment and the decline in public debt. However, there has been a significant increase in government investment, which has contributed to an outstanding national investment rate even in European comparison. In 2020, measures to address the health and economic effects of the coronavirus could lead to an increase in expenditure as a proportion of GDP, and the increase could be greater due to the economic downturn.

Due to the economic environment becoming increasingly unfavourable as a consequence of the coronavirus epidemic and the measures needed to mitigate the health and economic effects of the epidemic, the public debt-to-GDP ratio will increase temporarily to 76 percent in 2020 from 65.4 percent at the end of 2019. From 2021, however, the public debt ratio will decline again. Both rising expenditures as a consequence of measures addressing the health and economic consequences of the epidemic and declining revenues due to the slowdown in economic growth may contribute to an increase in debt this year; therefore, we forecast that the public debt-to-GDP ratio may rise temporarily to 76 percent in 2020. As a result of government foreign currency debt issuance, the foreign currency ratio of central government debt may rise to around 18 percent in 2020. Thereafter, the debt ratio may decline by an average of nearly 3 percentage points per year in 2021 and 2022, which may be accompanied by the decrease of the central government foreign currency share to below 15 percent.

In 2020, the fact that the MNB paid a historically high dividend of HUF 250 billion to the budget supports the financing requirement and thus contributes to the reduction in public debt. Pursuant to the decision of the Executive Board of the MNB on 1 April 2020, the majority of the profit for 2019, HUF 250 billion, was paid to the budget as dividend. The HUF 250 billion dividend (0.5 percent of GDP) will help finance the state, and of this amount, HUF 48 billion (0.1 percent of GDP) will improve the budget balance.

Chart 4
Expected development in gross public debt as a proportion of the GDP



Source: Government Debt Management Agency, MNB

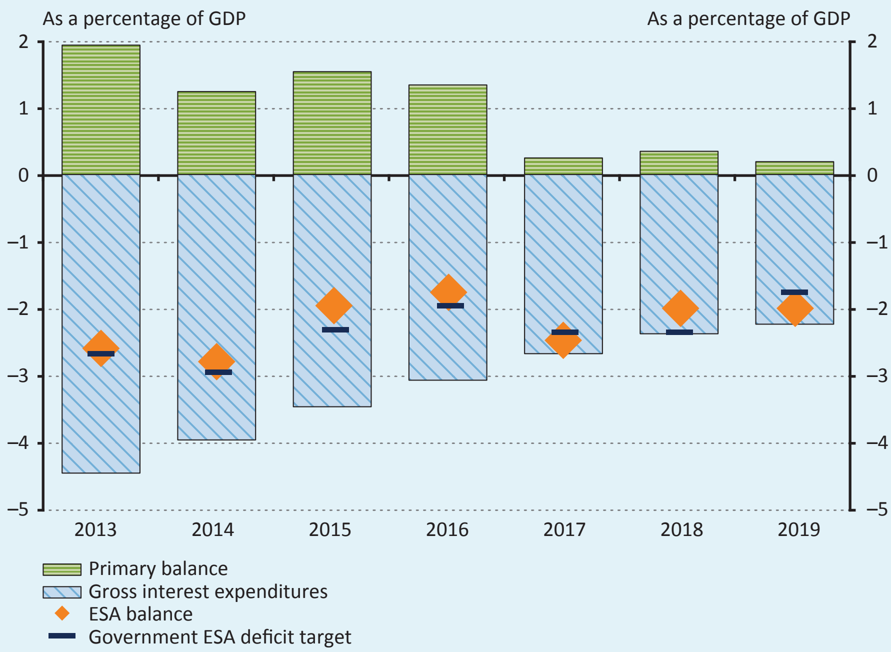
This year's increase in the debt ratio can be considered below average in international comparison. In 2020, gross public debt as a proportion of GDP may increase by an average of 16 percentage points for the EU and by 10 percentage points in the V4 countries compared to the previous year. Among the countries examined, the most significant growth may take place in the US (25 percentage points) and Italy (24 percentage points), but even in Greece an increase of 20 percentage points is expected this year, according to the European Commission's May forecast. Thus, the public debt-to-GDP ratio may increase to 95 percent in the EU Member States in 2020. The domestic debt ratio was 4 percentage points higher than the EU debt ratio in 2009, while in 2020 it could be lower by about 19 percentage points due to the continuous decline between 2012 and 2019.

In 2019, Hungarian fiscal developments mostly complied with the rules on the general government balance and public debt, and developments expected this year will be in line with the requirements due to the application of the escape clauses. The 3 percent GDP-proportionate deficit criterion included in both the Hungarian and EU fiscal frameworks was met last year; however, the 7.0-7.5 percent deficit expected for 2020 exceeds the threshold, but these rules will be suspended temporarily due to the epidemic situation and the economic downturn. The reduction in public debt complied with the debt rule of the Fundamental Law of Hungary and the requirements of the debt formula at the time of the adoption of the 2019 and 2020 budgets; however, this year's increase in public debt is also allowed by an escape clause, according to which a deviation from the provisions of debt rules may be permitted during an enduring and significant economic downturn, and during special legal order. The European Union's 1/20th debt rule is expected to be met, if following the temporary increase, the debt ratio declines at an appropriate rate in 2021 and 2022. The structural budget balance does not reach the MTO in any year, and developments concerning expenditures last year did not comply with the adjustment path described by the expenditure benchmark; however, the EU institutions suspended temporarily the examination of these rules on the grounds of exceptional economic circumstances.

2 Balance of the government sector in 2019

The government sector's ESA deficit of 2019 was 2.0 percent of GDP. The accrual-based deficit was below 3 percent of GDP in each of the past 8 years, and since 2015 it has been around 2 percent of GDP. The ESA deficit in 2019 was slightly above the 1.8 percent appropriation, but was lower than in the previous year. Compared to 2018, the primary surplus declined slightly, and it was 0.2 percent of gross domestic product in the reporting year, while gross interest expenditures amounted to 2.2 percent of GDP showing a 0.2 percentage point decrease. (Chart 5). With this, the trend of the positive primary balance and the decrease of interest expenditures also continued in 2019.

Chart 5
Balance of the general government sector (percentage of GDP), 2013-2019



Source: HCSO, MNB

The ESA deficit of HUF 973 billion consisted of the HUF 930 billion deficit of the central sub-sector (balance of the central government and social security funds) and the HUF 43 billion deficit of the local government sub-sector. The accrual-based deficit was lower than the cash-based deficit for both sub-sectors due to positive statistical adjustments (Table 1). The extent of the deviation is as high as 0.5 percent of GDP. After 8 years, the balance of local governments turned negative again in 2019, in line with the appropriation; however, the deficit was significantly lower than expected, only 0.1 percent of GDP.

Table 1
Budget balance indicators in 2019

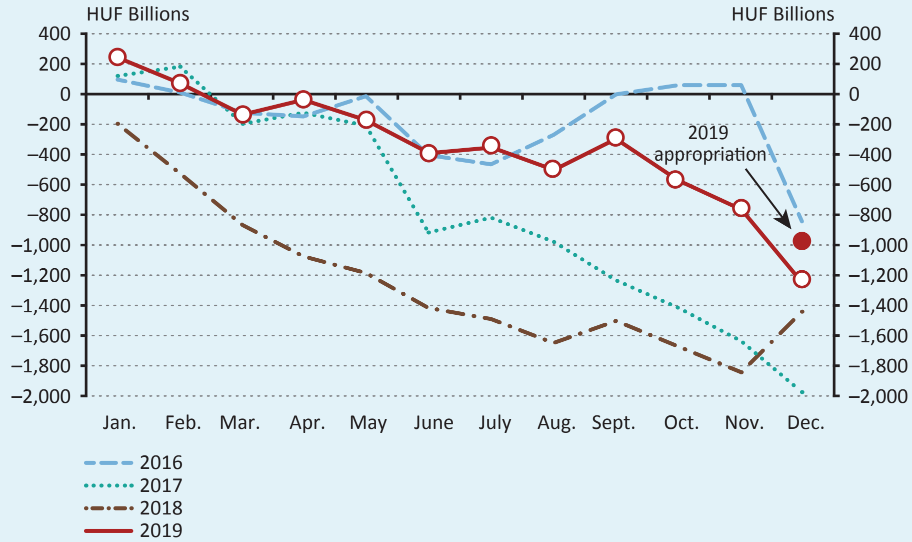
	Cash-based balance	ESA bridge	ESA balance
		HUF billion	
Central sub-sector	-1128	198	-930
Local governments	-76	34	-43
Total general government	**-1204**	**232**	**-973**
		As a percentage of GDP	
Central sub-sector	-2.4	0.4	-2.0
Local governments	-0.2	0.1	-0.1
Total general government	**-2.5**	**0.5**	**-2.0**

Source: EDP report, September 2020, HCSO.

Based on the data in the September 2020 EDP report, the 2019 **cash-based deficit of the general government** (the central and local government sub-sector) amounted to HUF 1,204 billion.

The cash-based deficit of the central sub-sector was HUF 1,128 billion in 2019. The annual cash-based deficit exceeded the HUF 998 billion deficit target specified in the Budget Act by some HUF 130 billion; however, it was substantially lower than the cash-based deficit of HUF 1,445 billion in 2018. (Chart 6).

Chart 6
Intra-year developments of cash-based deficit of the central sub-sector (year-to-date cumulative value)



Note: The preliminary cash-based deficit figure of HUF 1,219 billion shown in the Chart differs from the value of HUF 1,128 billion included in the final accounts bill. However, a monthly time profile is only available for preliminary data.

Source: Hungarian State Treasury

The high deficit is mainly due to the fact that on the last working days of December the expenditures of the central budgetary organisations were almost HUF 400 billion higher than in 2018. The higher expenditures were partly due to the fact that based on government decisions published in the last days of the year, the government decided upon expenditures amounting to over HUF 200 billion.

The other part of the higher-than-expected expenditure arose from higher-than-typical year-end expenditures by budgetary organisations and chapters compared to previous years. As part of this, higher expenditures were spent on, *inter alia,* key road projects, support for accrued expenditures of local governments, and the settlement of overdue obligations.

2.1 REALISATION OF THE MACROECONOMIC PROJECTIONS UNDERLYING THE BUDGET

The growth of the Hungarian economy, exceeding the expectations in line with the appropriation, was 4.6 percent in 2019. The 2019 Budget Act calculated with a real economic growth of 4.1 percent.

The growth rate of gross average earnings remained above 10 percent also in 2019, which was supported by the tight labour market environment, as well as the 8 percent increase in the minimum wage and the guaranteed minimum wage and the restructuring of the scheme of fringe benefits. Total national **employment** rose in 2019 by ca. 1.0 percent.

The law expected a 3.9 percent **increase in household consumption**, which was exceeded by the actual increase in expenditure by 0.3 percentage points.

Table 2
Comparison of the macroeconomic projection in the 2019 Budget Act and the actual figures

	Government's forecast	Actual
GDP	**4.1**	**4.6**
Exports	6.9	5.8
Imports	7.4	7.5
Gross fixed capital formation	7.5	12.2
Households consumption	3.9	4.2
Public consumption	1.0	4.7
Consumer prices index	**2.7**	**3.4**
Average gross earnings	**8.8**	**11.4**

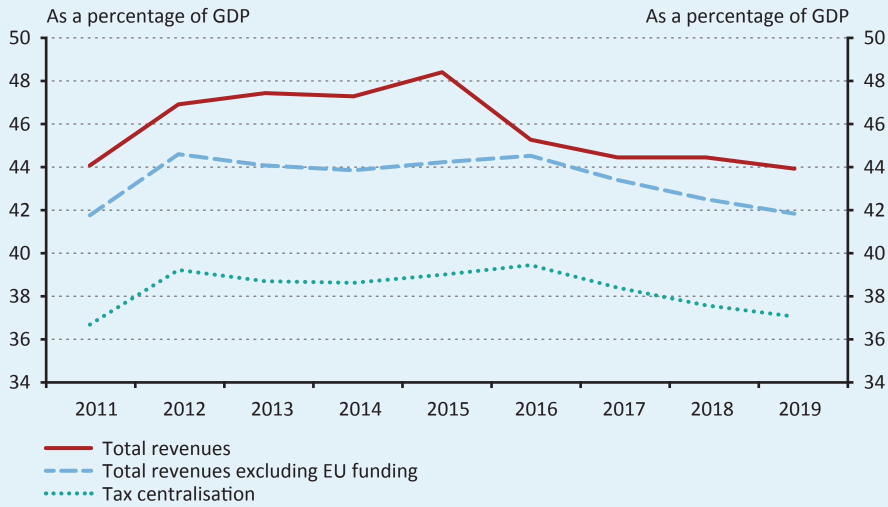
Source: HCSO, Budget Act 2019, Bill No. T/13089 on the implementation of Act L of 2018 on the central budget of Hungary for 2019

The **consumer price index** rose by 3.4 per cent instead of the 2.7 per cent expected by law, and within that core inflation excluding indirect tax effects rose by 3.8 percent. The rise in inflation was primarily caused by a growth regarding the price index of fuels and food products. The rise in fuel prices was attributable to the base effect and a sharp rise in global oil prices at the beginning of the year, while an increase in food prices was linked to pork, which became more expensive due the African swine fever, and processed products – meat products and milk.

2.2 BUDGET REVENUES

The accrual-based revenues of the government sector amounted to 44.0 percent of GDP in 2019, representing a decline of 0.5 percentage point compared to 2018. The decrease was caused mainly by a decline in the tax-to-GDP ratio that fell below 37 percent, while the EU transfers to the general government rose, similarly to previous years, also in 2019 (Chart 7).

Chart 7
Accrual-based revenues of the government sector and degree of tax-to-GDP ratio



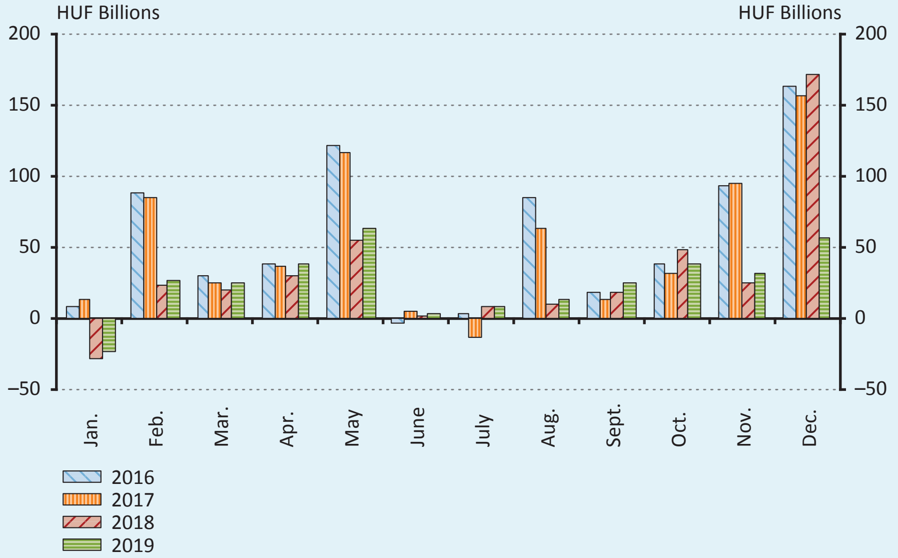
Source: HCSO, MNB

The cash-based revenues of the central sub-sector exceeded the appropriations by HUF 538 billion (Table 3)**.** A significant part of the higher fulfilment, over HUF 300 billion can be attributed to consumption taxes, but EU revenues and payments from the residents also exceeded the plan substantially.

Payments by enterprises fell short of the appropriation included in the Budget Act by HUF 29 billion; however, this difference was realised as the sum of the significant differences between the individual items. **Corporate tax payments** and the revenues from the **income tax on energy providers** fell short of the appropriation by HUF 96 billion and 33 billion respectively. Both tax types were affected by the same measure: the abolition of the obligation to supplement the tax advance in December in July 2019. Under the previous regulation, taxpayers with a turnover of over HUF 100 million had to supplement -by 15 December each year- the amount of tax advances paid in the tax year to the level of the tax expected in the tax year. This provision brought significant revenue to the budget at the end of the year; however, it posed a substantial administrative burden for companies (Chart 8). In addition, the December payment did not reduce the companies' tasks related to the annual tax return in May, as companies have reported discrepancies between the expected tax value calculated on 15 December and the actual tax liability determined at the end of December. Under the new rules, each taxable person pays or recovers the difference between the amount of tax advances and the actual tax liability concurrently with the submission of the corporate tax return for the tax year.

Small business tax (KIVA) revenues and **lump sum tax of small entrepreneurs (KATA)** revenues exceeded the estimate in the Budget Act by HUF 21 billion and HUF 23 billion, respectively. In both cases, the number of new taxpayers opting for these tax types became substantially higher than assumed by the estimate. The process partially affected the **simplified entrepreneurial tax (EVA)**, where payments fell short of the appropriation by HUF 2 billion. Part of the taxpayers that used to pay tax in accordance with the EVA rules, changed over to taxation under the rules of KATA or KIVA. The process was further strengthened by the fact that since 2019, corporate taxpayers were no longer permitted to opt for EVA, and on 1 January 2020, the tax type was abolished from the Hungarian tax system.

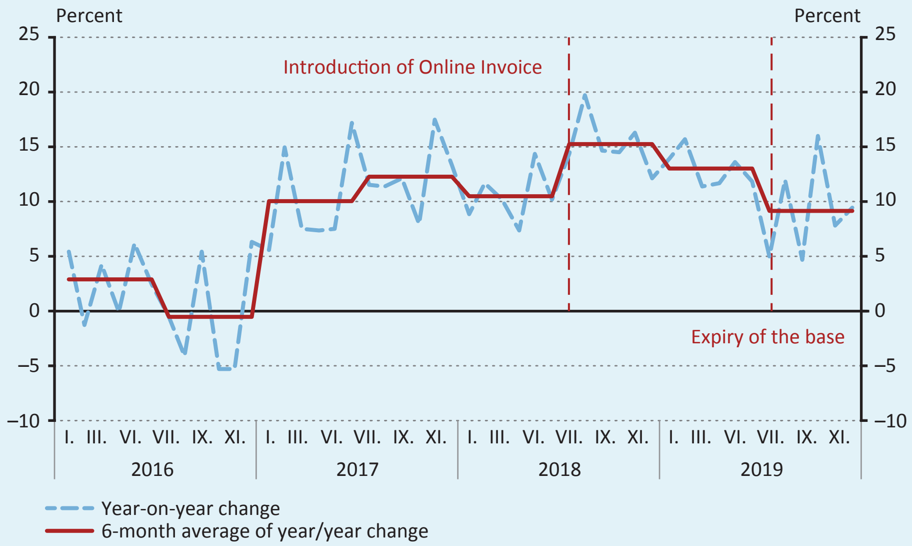
Chart 8
Monthly development of corporate income tax revenues



Source: Hungarian State Treasury

Net revenues from **value added tax** amounted to HUF 4,532 billion in 2019, which exceeds the statutory appropriation by HUF 242 billion. The growth rate of cash-based revenues reached 15 percent, resulting in approximately HUF 600 billion more revenue compared to the value added tax revenues realised in 2018. It can be assumed that the rise in revenues is partly linked to the introduction of mandatory online invoicing in July 2018, the effect of which was already felt in the first six months of 2019. After the expiry of the base, the annual rate of change in gross revenues slowed to the level of growth before the introduction of online invoicing in the second half of 2019 (Chart 9). The VAT rate reducing tendencies of previous years continued also in 2019: VAT on milk decreased from 18 to 5 percent; in addition, the extension of VAT exemption status to annual revenue of HUF 12 million from the previous HUF 8 million, also qualifies as a tax cutting measure.

Chart 9
Change in gross VAT revenues year-on-year (percent)



Source: Hungarian State Treasury, MNB calculation

Table 3
Partially consolidated revenues of the central sub-sector in 2019 (HUF billions)

	2019		
	Statutory appropriation (original)	Actual	Difference (actual – appropriation)
TAX AND CONTRIBUTION REVENUES OF THE CENTRAL SUB-SECTOR	**15,666**	**15,936**	**270**
Payments by economic organisations	**1,444**	**1,414**	**-29**
Corporate income tax	400	303	-96
Special tax of financial institutions	53	57	4
Sector-specific surtax	0	0	0
Simplified entrepreneurial tax	45	43	-2
Mining royalty	36	46	10
Gambling tax	31	28	-3
Income tax on energy providers	59	27	-33
Lump sum tax of small entrepreneurs	136	159	23
Small enterprise tax	50	70	21
E-road toll	198	216	18
Utility tax	55	55	0
Other taxes and payments	366	405	38
Advertising tax	15	6	-9
Consumption taxes	**5,837**	**6,140**	**304**
Value added tax	4,290	4,532	242
Excise duties	1,141	1,176	35
Registration tax	28	25	-2
Telecommunication tax	52	54	1
Financial transaction levy	228	243	15
Insurance tax	82	82	0
Tourism development contribution	16	27	11
Payments by households	**2,608**	**2,698**	**90**
Personal income tax	2,361	2,425	64
Duties, other taxes	199	223	24
Motor vehicle tax	48	50	3
Tax and contribution revenues of extra-budgetary funds	**468**	**466**	**-2**
Tax and contribution revenues of social security funds	**5,310**	**5,217**	**-93**
Social contribution tax and contributions	5,124	5,027	-96
Other contributions and taxes	186	190	4
REVENUES RELATED TO EU FUNDS	**1,374**	**1,586**	**212**
OTHER REVENUES	**410**	**466**	**56**
Other revenues of the central budget	271	312	41
Other revenues of social security funds	34	39	5
Other revenues of extra-budgetary funds	105	115	10
TOTAL REVENUES	**17,450**	**17,988**	**538**

Source: Budget Act 2019, Bill No. T/13089 on the implementation of Act L of 2018 on the central budget of Hungary for 2019, Hungarian State Treasury

Excise duty revenues amounted to HUF 1,176 billion last year, exceeding the amount foreseen in the budget by 3 percent. In 2019, the growth rate of the excise duty revenues was 5.8 percent compared to the previous year due to higher fuel and tobacco excise tax revenues. Last year, the rate of excise duty on tobacco was raised in 2 phases (in January and in July) as part of a process that began in September 2018 to comply with EU legislations.

Revenues from financial transaction levy amounted to HUF 243 billion in 2019, which exceeded the statutory appropriation by HUF 15 billion, i.e. by some 7 percent. Since 2019, transactions below HUF 20,000 have been exempted from paying the levy, and despite the tax relief, the annual growth rate of revenues was over 4 percent.

Revenues from duty payments amounted to HUF 216 billion last year, exceeding the statutory appropriation by 12 percent. The annual growth rate of duty income was 13 percent due to favourable housing market developments.

In 2019, **tax and duty payments by households** to the central budget amounted to HUF 2,698 billion in total, and thus they exceeded the statutory appropriation by HUF 90 billion, i.e. by nearly 4 percent. The payments by households rose by 11 percent, compared to the revenue recognised in 2018, which was caused in the personal income tax revenues by the dynamic national economy wage growth and in the duty revenues by the buoyant real property market turnover.

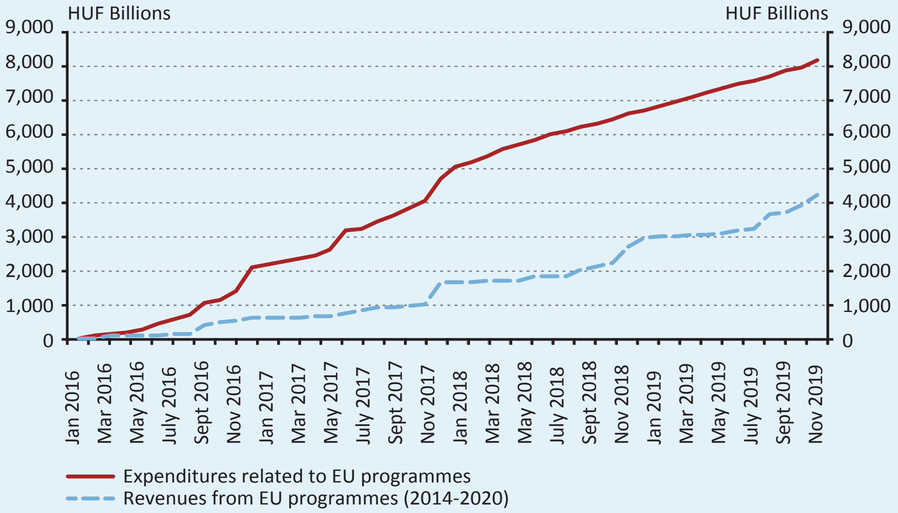
Revenues from personal income tax increased by 11.3 percent last year compared to payments in 2018. The increase in the gross salary and wage bill contributed to the substantial increase in revenues: average gross wages increased by 11.4 percent and employment by 1 percent in 2019. Personal income tax revenues were affected by three major measures last year. Significant narrowing of the fringe benefits scheme reduced personal income tax revenues on certain benefits. Revenues were also reduced by the last round of the expansion of the family tax allowance for families with two children and by the interest tax exemption on household government securities. Last year's revenue of HUF 2,425 billion from personal income tax exceeded the appropriation included in the Budget Act by HUF 64 billion.

In 2019, **the tax and contribution revenues of social security and extra-budgetary funds** fell short of the appropriation by almost HUF 100 billion. Employees' social security contributions were slightly higher than what was appropriated in the Budget Act, while social contribution tax revenues were significantly lower. The funds' labour taxes and social security contributions increased by 6.8 percent in 2019 year-on-year, to which employees' SSC's contributed 11.1 percent, while that of employers contributed 2.9 percent. Last year, a number of measures affected tax and contribution revenues of social security and extra-budgetary funds.

In the second half of the year, in line with the 2016 wage agreement, the **social contribution tax** rate was reduced by an additional 2 percentage points to 17.5 percent. Several tax and contribution types disappeared by having been merged with other items: health contribution was added to the social contribution tax, while accident tax was gradually merged into insurance tax revenues. The restructuring of the fringe benefits scheme and the contribution relief for employed elderly pensioners reduced the income of the funds. The range of the beneficiaries of the Job Protection Action Plan substantially declined; by narrowing the target groups, the number of beneficiaries was roughly halved, while the allowances per capita rose as a result of the expansion of the benefit base to the minimum wage and benefits applicable to the new target group, exceeding those of the previous categories. The public health product tax rate has risen by more than 20 percent on average.

In 2019, **revenues related to EU funding** amounted to HUF 1,586 billion in total, of which HUF 1,251 billion was related to the current cycle and HUF 211 billion to subsequent returns. Beneficiary repayments amounted to HUF 107 billion, and reimbursement of duty collection costs was HUF 16 billion. As a result, revenues substantially exceeded the statutory appropriation. The difference between accumulated revenues and expenses increased to close to HUF 3,900 billion by the end of 2019 (Chart 10), and the absorption rate totalled to 44 percent on 31 December.

Chart 10
Expenditures and revenues related to the EU budget funds of 2014-2020 (cumulative)



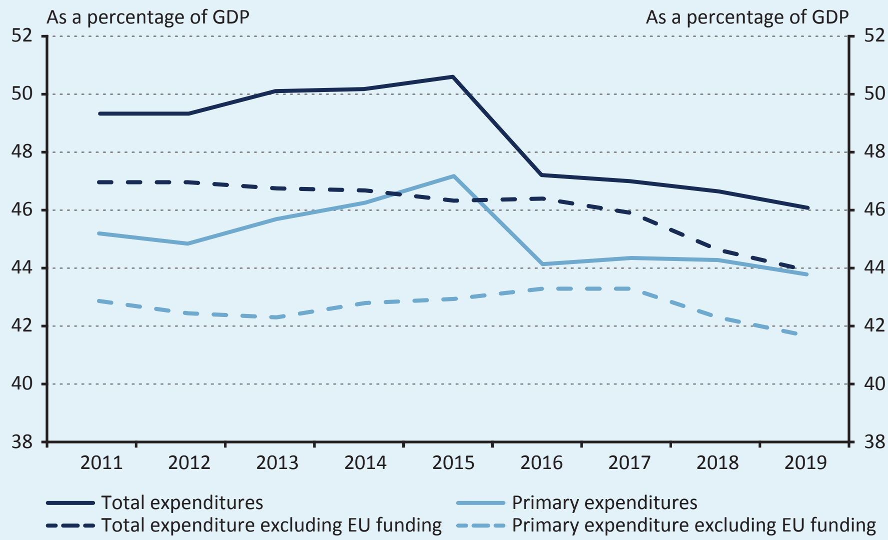
Source: Hungarian State Treasury, MNB calculation

The **budget revenues related to state property management** exceeded the statutory appropriations by HUF 85 billion in total. This amount is almost equal to the surplus realised in the previous year. Several factors contributed to the large amount of discrepancy, the budget generated HUF 32.5 billion revenue from the originally unplanned sale of frequencies concessions. The budget generated an additional HUF 20 billion revenue from the sale of emission allowances, the sale of real assets (real estate) exceeded the statutory appropriation by HUF 11 billion, and the revenue surplus from the sale of ownership shares also generated an unplanned revenue of HUF 20 billion. The dividend income of the budget recognised in cash flow was in line with the planned appropriation.

2.3 DEVELOPMENTS IN EXPENDITURE

General government ESA expenditures decreased by 0.6 percent of GDP in 2019 compared to 2018, excluding EU funding, the decline in expenditures was even greater (Chart 11). Primary spending fell from 44.3 percent of the GDP to 43.8 percent last year.

Chart 11
Expenditures and primary expenditures of the government sector (as a percentage of GDP)



Source: HCSO, MNB

The consolidated cash flow expenditures of the central sub-sector exceeded the amount planned in the appropriations by HUF 682 billion (*Table 4*)**.** The majority of the discrepancy was due to the over-performance of the expenditures of central budgetary institutions and chapters by more than HUF 1,000 billion, which was offset by the lower EU expenditures and the use of central reserves.

In the case of **special and normative subsidies and support to the public media**, the appropriations were exceeded by a total of HUF 53 billion, which together represented a 12 percent expenditure surplus. Within the titles, the appropriations for normative subsidies were exceeded by 12.3 percent, thus, compared to the base year, this type of expenditure increased by 10 percent in 2019. Among the extra expenditure exceeding the statutory appropriation by HUF 47 billion, an extra expenditure of HUF 32 billion was related to the financing of public transport services, the reason for the surplus support: primarily the additional resources provided for the replacement of the bus fleet. Of the higher-than-planned expenditure HUF 15 billion was due to the subsequent settlement of the public railway transport service in 2018. Subsidies spent on public service broadcasting were by HUF 7 billion higher than the statutory appropriation, as a result of additional needs that arose during the year. The amount paid for the social policy fare subsidy amounted to HUF 89 billion, which is essentially the same as the appropriation and the subsidy used in 2018.

Table 4
Partially consolidated cash expenditures of the central sub-sector in 2019 (HUF billions)

	2019		
	Statutory appropriation (original)	**Actual**	**Difference (Actual – Original appropriation)**
PRIMARY EXPENDITURE ITEMS	**17,482**	**18,274**	**791**
Special and normative subsidies and support to the public media	**448**	**501**	**53**
Social policy fare subsidy	**91**	**89**	**-1**
Housing grants	**242**	**191**	**-51**
Family allowances, social benefits	**551**	**562**	**11**
Early retirement benefits	**89**	**92**	**3**
Net own expenditures of central budgetary organisations and chapters	**5,861**	**6990**	**1,129**
Expenditures related to EU transfers	**1,956**	**1,566**	**-390**
Support to local governments	**729**	**779**	**50**
Contribution to the EU budget	**352**	**365**	**13**
Central reserves	**381**	**0**	**-381**
Other expenditures	**469**	**652**	**184**
Expenditures of extra-budgetary funds	**502**	**528**	**25**
NEF – Passive allowances	75	83	8
NEF – Active allowances	180	166	-14
Other expenditures	247	279	32
Expenditures of social security funds	**5,812**	**5,959**	**148**
PIF – Pensions	3,445	3,502	57
HIF – Disability and rehabilitation benefits	287	283	-4
HIF – Cash benefits	394	406	12
HIF – Medical and preventive care	1,274	1,341	67
HIF – Net expenditures of the drug budget	281	292	11
Other expenditures	132	135	3
NET INTEREST EXPENDITURES	**952**	**842**	**-110**
TOTAL EXPENDITURES	**18,434**	**19,116**	**682**

Source: Budget Act 2019, Budget Act 2019, Bill No. T/13089 on the implementation of Act L of 2018 on the central budget of Hungary for 2019, Hungarian State Treasury

Expenditure **on home construction subsidies** amounted to HUF 191 billion, which is almost the same as in the previous year. Expenditures fell short of the statutory appropriation by HUF 51 billion, and thus in 2019 only 79 percent of the planned amount was paid. Primarily, the expenditures related to the Home Purchase Subsidy for Families fell short of the statutory appropriation, which, also fell short of the 2018 subsidies by HUF 15 billion.

For the family support expenditures, social benefit and early retirement benefits, disbursed from the **National Family and Social Policy Fund,** an extra expenditure of nearly HUF 11 billion was realised compared to 2018. A significant part of the increase in income substitute and supplementary social benefits was related to the performance of district social tasks, which was due to the payment of child home care allowance and child care fee introduced in 2019. The expenditure of HUF 653 billion, disbursed from the Fund in 2019 (family allowances, social benefits and early retirement benefits line of Table 4) exceeded the statutory appropriation by HUF 12 billion, mainly due to higher expenditures linked to the fulfilment of district duties. In addition, family support payments (family allowance, child care allowance, etc.) fell slightly short of the appropriation, while early retirement benefits and miscellaneous allowances exceeded the appropriation.

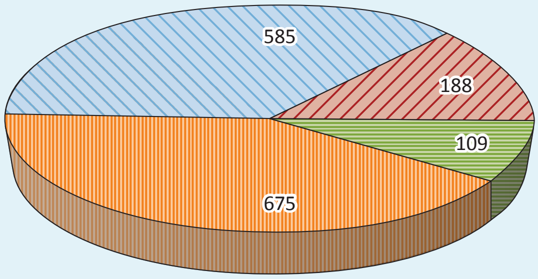
The net expenditures – calculated without the EU revenues and payments – of the budgetary institutions together with the central budgetary payments, according to the data included in the Final Accounts Bill, amounted to HUF 6,990 billion in 2019, by HUF 1,129 billion or 19.3 percent more than the net expenditure calculated from the appropriation included in the Budget Act. Net own expenditures of budgetary institutions and chapter-administered appropriations increased from 13.9 percent (as a percentage of GDP) in 2018 to 14.7 percent in 2019, while gross expenditures of budgetary institutions and chapter-administered appropriations rose from 19.9 percent (as a percentage of GDP) to 20.1 percent of GDP in the same period. Thus, it can be established that, the change on the revenue side (the decline in advance payments linked to EU programmes) determined the change in the net expenditure of budgetary institutions – excluding EU expenditures and revenues.

Gross expenditures of the budgetary institutions and chapter-administered appropriations exceeded those of the base period by HUF 1032 billion and gross expenditures exceeded the appropriations included in the Budget Act by HUF 2,297 billion. Since the realisation of the appropriations already contains the absorption of budget reserves, as well as the full payment to the Central Remainder Settlement Fund, considering also the expenditure of about HUF 600 billion related in total to these two factors, almost HUF 1,700 billion extra expenditure was spent over and above the legislator's original intent. In addition to the tax revenue surplus exceeding the revenue appropriations, the large extra expenditure was covered by the surplus revenue generated on the revenue lines of the budgetary institutions, and the re-use of the HUF 287 billion payment accumulated in the Central Remainder Settlement Fund. A total of HUF 1,195 billion surplus revenue was realised in excess of the appropriations included in the Budget Act in the case of the institutions, the chapter-administered appropriations, and the centralised revenues from budgetary institutions. As part of the mid-year expenditure-increasing measures, the government focused primarily on increasing the expenditures of budgetary institutions; the net expenditures of institutions exceeded the statutory appropriations by about HUF 1,061 billion, and the expenditure overrun for chapter-administered appropriations was HUF 464 billion.

The growth in the expenditures of budgetary institutions was dominated by the 8.1 percent rise in gross wage expenditures compared to the base of the previous year, the 6.4 percent growth rate of investment spending and the 13.6 percent increment in the payments for material expenditures.

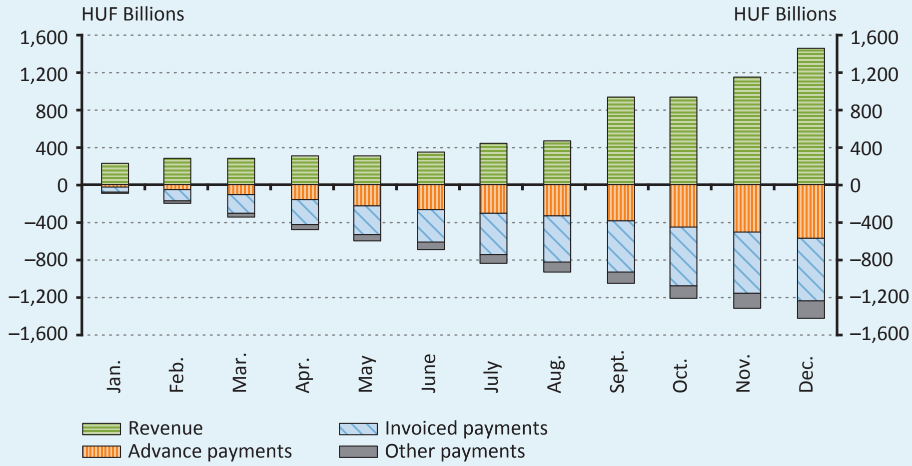
In 2019, on the budget heading of **the EU expenditures of the chapter-administered appropriation** HUF 1,566 billion was recognised, which fell short of the statutory appropriation by HUF 390 billion. At the same time, actual payments made to beneficiaries was slightly lower, according to our estimates at around HUF 1,450 billion, as there were technical transfers of more than HUF 100 billion between budget sub-accounts. Advance payments amounted to HUF 675 billion, which is about 47 percent of the actual payment. According to our estimates, the annual value of the absorption of advances, which is decisive in terms of effective utilisation, exceeded HUF 1,100 billion, which is 30 percent higher than in 2018. As the advance payment since 2016 showed concurrently a substantial slowdown in the year reporting year, the value of unused advance with beneficiaries decreased by more than HUF 400 billion to below HUF 2,800 billion by the end of the year.

Chart 12
Structure of EU disbursements in 2019 (HUF billions)



Source: Hungarian State Treasury, Ministry for Innovation and Technology, MNB calculation

Chart 13
Cumulative revenues and payments related to EU programmes in 2019



Note: "Other payments" denote the payments not directly linked to the Széchenyi 2020 programmes. The treasury data on its monthly profile may differ from the data included in the Final Accounts Bill.
Source: Hungarian State Treasury, Ministry for Innovation and Technology, MNB calculation

The value of tenders announced under **Széchenyi 2020 linked to the 2014-2020 EU programming period** increased by HUF 137 billion during 2019, while the value of tenders won, increased by HUF 336 billion and the value of tenders contracted, increased by HUF 574 billion. The payments related to the Széchenyi 2020 programmes amounted to HUF 1,260 billion at the end of the previous year. According to our estimate, roughly 42 percent of the funds disbursed in 2019 qualify as direct subsidies supporting the economy.

For the expenditure appropriation for **subsidies to local governments** expenditures exceeded the original budget appropriation by 6.8 percent, and previous year's fulfilment by 4.2 percent. The extra expenditure relative to the appropriation was caused by the usual absorption of part of the provisions (e.g. subsidy for wage compensation) and by the reallocations from other reserve funds. In the case of the latter, the government provided funds primarily for development and investment projects.

Expenditures related to state property were fulfilled by 152.2 percent of the adopted budget appropriation, the increase in expenditure amounted to 69.2 percentage points compared to the base year. Expenditures accelerated in the last quarter, when 54 percent of annual expenditure was met. Compared to the statutory appropriation, the support to companies subject to the exercise of shareholder rights of the Ministry without Portfolio for National Assets ("NVTNM") caused HUF 51 billion extra expenditure, the capital increase of the companies subject to the exercise of shareholder rights of the

NVTNM accounted for HUF 106 billion additional expenditure, the Eximbank's capital was increased by HUF 25 billion more than what was included in the statutory appropriation, and the establishment and capital increase of Adria Port Zrt. represented a new expenditure of HUF 10 billion. Capital increase of Paks II Atomerőmű Fejlesztő Zrt. was by HUF 31 billion less than the planned HUF 106 billion, due to the slower-than-planned pace of the investment.

For the **contribution to the budget of the European Union** expenditure heading an additional expenditure of HUF 13 billion was met compared to the original budget appropriation, as the HUF/EUR exchange rate deviated from the exchange rate assumed when adopting the Budget Bill.

Net accrual-based interest expenditure was 2.2 percent of the GDP in 2019, representing a decrease of 0.1 percentage point compared to 2018, and this was due to the continued re-pricing of government debt to low yield levels. **Net cash-based interest expenses** fell short of the budget appropriation by HUF 110 billion. This is due to the fact that gross interest expenditures and revenues exceeded those anticipated by the Act by HUF 111 billion and HUF 221 billion, respectively. The fact that revenues and expenditure exceed the appropriations each year is the result of debt management transactions during the year. The significantly higher-than-expected interest income is the result of an interest premium realised on government securities issued at market prices above par value in a low yield environment, while the higher expense is a consequence of the discount paid on repurchases above par value. In 2019, the net cash-based interest expenditure decreased further in nominal terms compared to the previous year. All this means that the extent of expenditures as percentage of GDP substantially decreased, i.e. the GDP-proportionate financing need continuted to decrease due to interest expenditure.

Consolidated **expenditures of extra-budgetary funds** exceeded the appropriation by HUF 25 billion; however, they fell short of the base year by HUF 25 billion. Major difference compared to the budgeted value occurred at the National Employment Fund and the Bethlen Gábor Fund, while at the other funds the difference from the statutory appropriation (and the previous year) amounted to merely a couple of billion forints.

The **expenditures of the National Employment Fund** fell short of the planned amount by HUF 33 billion. On the one hand, expenditures related to the Start Labour programme were realised in the amount of HUF 166 billion compared to the planned HUF 180 billion, i.e. fell short of the appropriation by HUF 14 billion. In addition, the co-financing of the EU employment programmes was HUF 9 billion lower than planned, while at the same time the expenditures on job seeker's allowance exceeded the appropriation by HUF 8 billion.

Expenditures related to the Start Labour programme were realised in the amount of HUF 166 billion compared to the planned HUF 180 billion, at the same time, if we take into account the budget reallocations implemented in the second half of last year, it can be stated that the utilisation for the labour program was almost HUF 35 billion lower than initially planned. With this, the process observed in the previous year – when the absorbed amount fell short of the appropriated expenditure by HUF 52 billion – repeated. Compared to the base period, payments from the budget for public employment decreased by HUF 25 billion. The decrease in expenditures is due to the fact that the average number of public employees decreased by more than 24,000 in 2019 compared to the average headcount in the previous year, because as a consequence of the tight labour market some public workers could be absorbed by the labour market, and this process was supported by measures taken by the government.

In the case of the **Bethlen Gábor Fund**, the expenditures exceeded the appropriation by HUF 36 billion as a result of the surplus expenditures of subsidies for national policy purposes, based on special government decisions. The average monthly expenditure of less than HUF 4 billion during the year was followed by an expenditure of some HUF 27 billion in December; however, expenditures fell short of those recorded in the previous year by HUF 17 billion.

In 2019, **pension** expenditures amounted to HUF 3,502 billion, which exceeded the statutory appropriation by HUF 57 billion. Compared to the 2018 actual figures, expenditures rose by HUF 156 billion in 2019, which represents a growth in expenditures of 4.6 percent.

- **In early 2019 pensions were increased by 2.7 percent**, based on the rate of the consumer price increase planned in the 2019 Budget Act. At the same time, in the first eight months of 2019, consumer prices rose by an average of

3.4 percent year-on-year, which led to a supplementary pension increase in November 2019. Considering that the difference between the increase at the beginning of the year (2.7 percent) and the expected rate of inflation for the reporting year (3.4 per cent) did not reach 1 percentage point, beneficiaries received the difference for the whole year in a lump sum in November. The average amount of the pension supplement per capita was around HUF 11,000, and the total budgetary impact exceeded HUF 20 billion.

- In addition to the pension increase at the beginning of the year, the **replacement effect** also acted towards the rise in expenditures, since the benefits paid to new pensioners follow the net average wage increase, thus its amount is typically higher than the benefits of those leaving the scheme.

- In 2019, the **increase of the age-limit for compulsory retirement** continued, corresponding to 64 years for those born in 1955, thus, in 2019, unlike in 2018, a new pension assessment was made in each month (Table 5).

Table 5
Retirement age in Hungary

Year of birth	Retirement age	Time of reaching retirement age
1951	62 years	2013
1952	62.5 years	2014 H2 – 2015 H1
1953	63 years	2016
1954	63.5 years	2017 H2 – 2018 H1
1955	64 years	2019
1956	64.5 years	2020 H2 – 2021 H1
1957	65 years	2022

Source: Act LXXXI of 1997 on Social Security Retirement Provision

Based on the performance of the economy, a pension premium was also paid to pensioners in 2019. Pursuant to the Pension Act,[1] the beneficiaries receive pension premium if the rate of GDP growth expected for the current year calculated at constant prices is above 3.5 percent and the general government's current year fiscal balance target is expected to be met. The amount of the pension premium is determined by the economic growth rate and the monthly benefit received by the pensioners. Based on the rule, in 2019 the maximum amount of the pension premium – considering the estimated value of the economic growth – was HUF 22,000, which was paid for pensions of HUF 80,000 per month or higher. The average amount of payment per capita amounted to HUF 20,000. As in previous years, the government decided in 2019 as well to extend the payment of the pension premium to those beneficiaries who have not reached the retirement age, for example to those women who receive pension after completing the 40-year eligibility period and those who receive pension-type benefits (e.g. those eligible for disability and rehabilitation benefits). **In November 2019, pension premium was paid from the budget in the total amount of HUF 52 billion.**[2]

Expenditures related to **disability and rehabilitation benefits** fell short of the statutory appropriation by HUF 4 billion. The decline in expenditures was due to the gradual decrease of the number of beneficiaries, because those who reach the retirement age are gradually transferred to the group of old-age pensioners, and the number of new beneficiaries is low on account of the tightened rules on eligibility.

The expenditures in 2019 exceeded the appropriation of HUF 394 billion for **cash benefits** disbursed by the **Health Insurance Fund** by HUF 12 billion. The increment was equally related (HUF 6-6 billion) to sickness benefits and child care benefits respectively, which was partially offset by the shortfall in other expenses. Sickness benefit expenditures were higher by HUF 16 billion, while the amount paid for child care benefits was HUF 21 billion higher than in the previous year.

[1] Act LXXXI of 1997 on Social Security Retirement Provision
[2] https://www.kormany.hu/hu/emberi-eroforrasok-miniszteriuma/csalad-es-ifjusagugyert-felelos-allamtitkarsag/hirek/a-nyugdijasok-mellett-a-nyugdijszeru-ellatasban-reszesulok-kapnak-nyugdijpremiumot

The 2019 statutory appropriation for **medical and preventive care** amounted to HUF 1,274 billion, while the expenditures incurred until the end of the year reached HUF 1,341 billion, thus, the cash-based expenditures exceeded the appropriations by HUF 67 billion. The stock of outstanding debt accumulated by hospitals increased by HUF 53 billion from HUF 15 billion at the end of 2018 to HUF 68 billion. Unlike in previous years, accounts payables were not settled in 2019.

Net expenditures of the drug budget in 2019 amounted to HUF 292 billion, and thus exceeded the statutory appropriation by HUF 11 billion. Drug reimbursement expenditures exceeded the appropriation by HUF 21 billion, which was partially offset by the fact that the payments by pharmaceutical companies exceeded the appropriation by HUF 10 billion. Within that, the contractual payments by the manufacturers and distributors of pharmaceutical products exceeded the statutory appropriation of HUF 24 billion by HUF 7 billion during 2019.

2.4 BUDGET MANAGEMENT OF LOCAL GOVERNMENTS

According to the EDP report published in early October, the local government subsystem closed 2019 with a cash-based deficit of HUF 76 billion. The revenues of the subsystem recognised in the cash flow increased by 3.4 percent compared to the base year, the amount of revenues approached HUF 3,100 billion, which corresponds to 6.5 percent of GDP. The expenses of the subsystem recognised in the cash flow increased by 15.6 percent compared to the base year exceeding HUF 3,150 billion, which corresponds to 6.6 percent of GDP. Among the expenditures, the increase in accumulation and capital-type expenditures was dynamic, the growth rate of such expenditures exceeded 30 percent, and the nominal increase approached HUF 220 billion. As a consequence of the different pace of expansion of the revenue and expenditure side, the HUF 249 billion surplus of the subsystem in 2018 turned into a HUF 76 billion deficit. The HUF 325 billion deterioration in the cash-based balance was mainly due to transactions related to EU advances and settlements related to transactions. The HCSO registered a change of HUF 249 billion (balance effect) in the local government subsystem in connection with the EU funding provided by the central budget as advances. While the statistical adjustment of advances reduced the cash-based surplus by HUF 200 billion in 2018, the adjustment reduced the reported cash-based deficit by HUF 49 billion in 2019 due to the use of part of the EU advances paid in previous years. According to the EDP report, the accrual-based deficit of the local government subsystem in 2019 amounted to HUF 43 billion, compared to the surplus of HUF 23 billion recognised in 2018. The change in the balance is related to the underlying processes, the accrual-based balance calculated without EU relations turned from a surplus of HUF 50 billion in 2018 to a deficit of HUF 27 billion, the main reason for which being the cyclical change in investment and material expenditures due to municipality elections.

2.5 STATISTICAL CORRECTION (ESA BRIDGE)

Reconciliation between the above explained cash-based revenues and expenditure and the resulting cash-based balance (GFS 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 2019 Budget Bill defined the balance of the accrual-based statistical adjustment (ESA bridge) as 0.9 percentage point of assumed GDP (HUF 400 billion). That is, the balance estimate related to the government sector contained a correspondingly more favourable ESA balance compared to the targeted cash balance applicable to the general government, approved in the Budget Act. According to the data of the EDP report of 30 September 2020, the ESA bridge was HUF 232 billion in 2019, i.e. 0.5 percent of GDP. The difference is attributable to the partially opposite effect of several factors.

A significant accrual-based discrepancy is related to the recognition of EU transfers, as their cash-based settlement and the utilisation of resources also developed differently from what was included in the plan figures. The ESA bridge pertaining to the Budget Bill calculated for EU settlements with an accrual-based balance improving adjustment of HUF

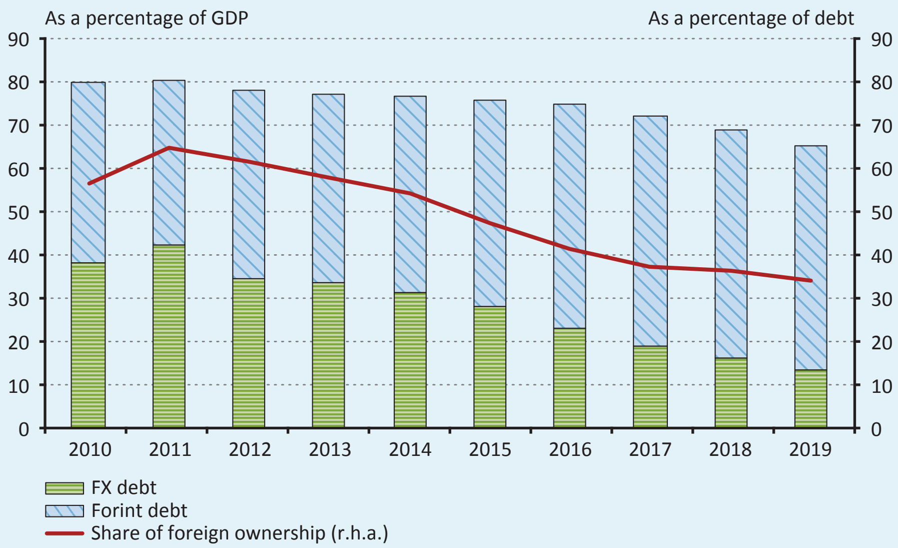
15 billion; according to the HCSO, the accrual-based balance was deteriorated by transactions and other settlements with the European Union by HUF 217 billion. In contrast, corporations, guarantee funds and non-profit institutions classified into the central government together improved the ESA balance of the general government sector by HUF 203 billion. In the case of capital income, the EDP report contains a HUF 160 billion adjustment with positive sign instead of the initially expected HUF 50 billion balance-improving adjustment. The balance-improving adjustments related to income-type revenues totalled HUF 191 billion, while balance-improving adjustment related to consumption amounted to HUF 114 billion. At the same time, the difference between the paid and accrued interests, and the balance of swap settlements decreased the surplus of the ESA bridge by HUF 144 billion compared to the accounting prepared for the Budget Bill.

In connection with the pre-natal baby supports and other standardized guarantees, the HCSO recognised a total of HUF 77 billion in balance-deteriorating statistical adjustments. When drafting the Budget Act, the adjustment for the pre-natal baby support was not yet taken into account in the ESA bridge, as it had been decided upon by the Parliament after the adoption of the Budget Bill. All other adjustments applied in the ESA bridge were in themselves deviated from the amount assumed when the budget was compiled to a less significant extent, and these differences had mostly opposite effect.

2.6 DEVELOPMENT OF PUBLIC DEBT

Last year, the gross government debt-to-GDP ratio declined outstandingly, by 3.8 percentage points, and by the end of 2019, it fell to 65.4 percent. The decline in the debt ratio was supported both by the dynamic economic growth and the low financing need. Nominal GDP increased significantly, by almost 10 percentage points, while net government securities issuance was more modest, amounting to about HUF 800 billion.

Chart 14
Developments in gross government debt, forint and FX debt within that and the share of foreign ownership



Source: MNB

The downward trend of the share of FX and in the proportion of foreign ownership within the debt observed since 2011 continued in 2019 as well (Chart 14). The key driver of the structural change in government debt in recent years was the growing demand for government securities by households and the domestic banking system. The stock of government securities held by households increased significantly in 2019, which was also supported by the renewal of the range of government securities offered to households, the Magyar Állampapír Plusz (MÁP +) introduced in June 2019, and the tax exemption on interest income on household government securities. As a result, the proportion of the non-residents' share within government debt decreased substantially, dropping from 65 percent at the end of 2011 to 33.9 percent by the end of 2019. Meanwhile, Hungary's FX debt also declined markedly. At the end of 2011, the foreign currency ratio of the central government debt amounted to approximately 50 percent, while this figure declined to 17.3 percent by the end of 2019. The diminishing FX and external debt contributed to the reduction of the Hungarian economy's vulnerability.

3 Expected general government developments in 2020

3.1 EXPECTED ESA BALANCE OF THE GOVERNMENT SECTOR IN 2020

According to our forecast, the accrual-based general government deficit in 2020 could be 7.0-7.5 percent of GDP. The budget deficit may be substantially higher than in previous years, and it may even significantly exceed the budget appropriation containing a deficit of 1.0 percent of GDP (Table 6). The discrepancy is a consequence of the coronavirus epidemic that emerged also in Hungary during this year, as well as the subsequent economic downturn, and the measures related to the epidemic and economy protection. Both the decrease in revenues and the significant rise in expenditures will contribute to the increase of the accrual-based budget deficit in 2020. The deficit of the central and local government subsystems may be also higher than the appropriations included in the Budget Act; however, the statistical adjustments may be somewhat more favourable than expected. As a consequence of the economic effects of the coronavirus epidemic, the Ministry of Finance adjusted its expectation of a general government deficit to 3.8 percent of GDP for the first time during the year, which it later raised to 7-9 per cent of GDP.

Table 6
Balance of the government sector in 2020

	Statutory appropriation	MNB forecast	Statutory appropriation	MNB forecast	Difference
	HUF billions		percentage of GDP		
1. Balance of the central subsector	-367	-3491	-0.8	-7.4	-6.6
2. Balance of local governments	-45	-250	-0.1	-0.5	-0.4
3. Cash-based (GFS) balance of the general government (1+2)	**-412**	**-3741**	**-0.8**	**-8.0**	**-7.1**
4. GFS-ESA difference	-73	342	-0.1	0.7	0.9
5. ESA balance of the general government sector (3+4)	**-485**	**-3399**	**-1.0**	**-7.2**	**-6.2**

Note: Due to rounding, differences may occur in the table. The point estimates in the table show the centre of the forecast bands.

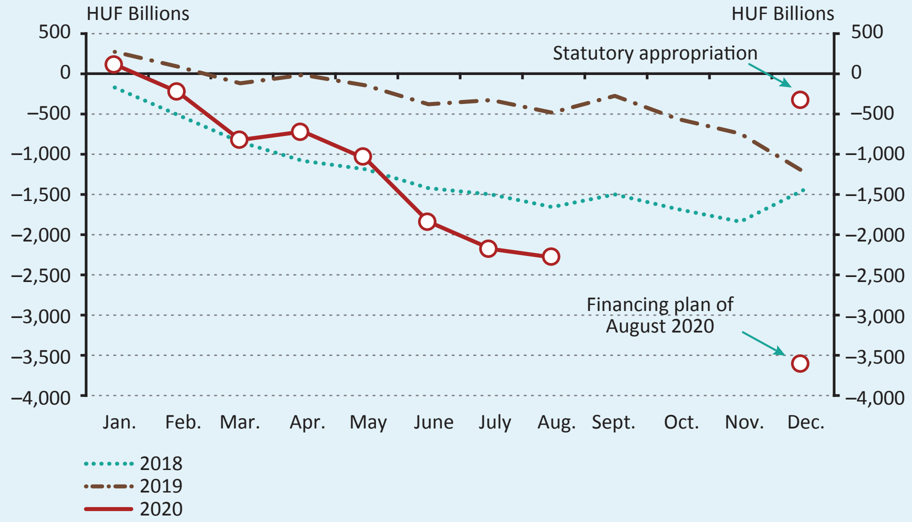
The 2020 Budget Act stipulated HUF 367 billion as the cash-based deficit of the general government's central subsector; our projection shows a deficit by over HUF 3,100 billion higher than that. According to our forecast, this year's cash-based deficit of the central subsystem may be higher than expected due to lower tax and contribution revenues and to expenditures rising as a result of epidemiological defence. The Hungarian Government Debt Management Agency expects, in the government debt financing plan amended at the end of August, a cash-based deficit of HUF 3,600 billion this year, which is almost in line with the MNB's expectations for the annual cash-based balance.

- The *central budget* deficit is expected to be higher than the statutory appropriation by some HUF 2,451 billion. Essentially, the larger deficit is the consequence of the revenue shortfall from all taxes and contributions, which is partly due to the adverse macroeconomic effects and partly to the result of revenue-reducing effect of targeted government measures taken to offset them. In contrast, the fact that revenues related to EU grants are expected to exceed the statutory appropriation, and central remainder payments will also technically increase revenues acts towards the increase in central budget revenues. Central expenditures may be higher than the appropriation especially for central budgetary institutions.

- Our projection for the balance of *extra-budgetary funds* is nearly in line with the balance included in the Budget Act; however, for the individual items significant discrepancies show. According to our forecast, the revenues and expenditures of extra-budgetary funds may also be approximately by HUF 75-95 billion higher than the statutory expectations. The surplus mainly lies in the National Employment Fund, where EU funds for part-time work increase the revenues and benefits provided during the implementation of the program increase the expenditures. In addition, the increase in jobseeker's allowance payments also causes the expenditures of extra-budgetary funds to increase.

- The Budget Act planned the balance of the *social security funds* with a balanced budget including the necessary central subsidies, while according to our projection the deficit of the social security funds may be approximately HUF 700 billion. The revenues of the funds may fall short of the appropriation by almost HUF 430 billion, which is due to the fact that significantly lower labour tax and contribution revenues are expected. According to our forecast, expenditures will exceed the appropriations included in the Budget Act by almost HUF 270 billion, mainly due to the additional expenditures of the Health Insurance Fund, which is explained in addition to the measures and asset purchases related to the epidemiological defence by the one-off benefits to health care workers involved in the defence.

Chart 15
Intra-year cumulative cash-based balance of the central sub-sector

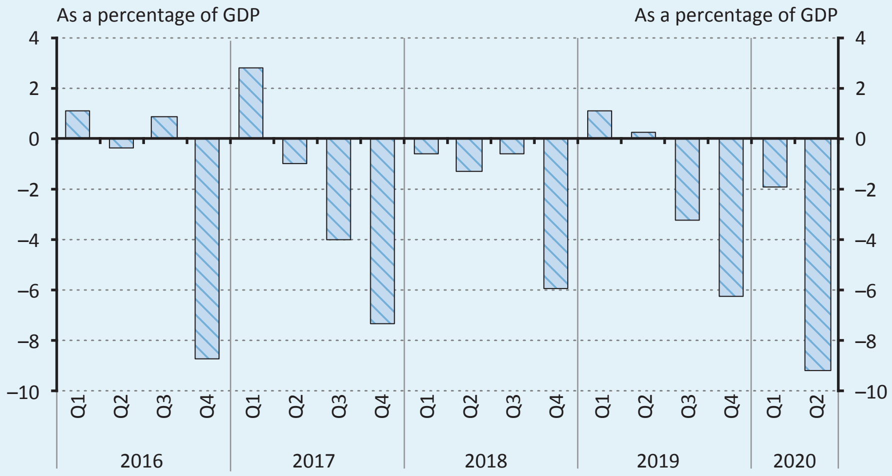


Source: Budget Act of 2020, ÁKK plan of August 2020, Hungarian State Treasury

The cumulative deficit of the central subsystem was HUF 2,261 billion until the end of August, which represents a deficit higher than in the first eight months of previous years (Chart 15). The tax and contribution revenues of the central subsystem were by HUF 42 billion lower than up to August last year, which was offset by the high revenues related to EU funding and the cash-based payment from the sale of mobile frequency concessions. Expenditures of the central subsystem were approximately by HUF 2,150 billion higher in the first eight months of this year than in the same period of the previous year. Most of the expenditures can be attributed to the central budgetary institutions, as well as to the expenditures related to EU funding, but the expenditures on curative and preventive benefits and net cash-based interest expenditures of the budget were also significantly higher than up to August 2019.

In the first six months of 2020, the accrual-based balance of the general government showed a deficit of 5.3 percent of GDP. Revenues fell by 1.4 percent in the first six months of the year, mainly due to a decline in social security contributions and consumption tax revenues in the second quarter. In the first six months of this year, expenditures rose by 12.6 percent year-on-year. In the first quarter of 2020, the general government deficit was only 1.9 percent of quarterly GDP, rising to 9.1 percent in the second quarter.

Chart 16
Accrual-based budget balance



Source: HCSO, MNB

Similarly to the previous year, the ESA balance of the local government subsystem may show a deficit in 2020. The deficit of the subsystem may be higher than in the Budget Act, which is due, in addition to the significant utilisation of EU advances, to the centralisation of motor vehicle tax revenue and the loss of fee income of municipally owned service institutions due to the temporary suspension of services.

In 2020, the statistical adjustments between cash-based and accrual-based accounting may exceed that of the Budget Act by nearly 1 percent of GDP. A significant part of the discrepancy is related to the adjustments to corporate tax settlements and local business tax revenues, i.e. the abolition of the year-end tax advance top-up rule, and the positive sign of adjustments related to EU settlements will also improve the general government balance. The dividend payment of the MNB's interest income also increases revenues that can be recognised under ESA methodology.

3.2 MACROECONOMIC PROJECTION UNDERLYING THE BUDGET

The outbreak of the coronavirus epidemic has fundamentally overridden growth prospects, including the macroeconomic path set out in the 2020 Budget Act. Due to the changed economic environment, the difference between the Budget Act and the MNB's forecast is significant in terms of the rate of growth and the key factors of growth with the exception of intermediate consumption. The MNB's September 2020 forecast expects a significant decline in GDP of between 6.8 and 5.1 percent. Household consumption expenditure is expected to decline this year due to more subdued dynamics in the gross wage bill and rising precautionary savings related to the epidemic. The measures taken to stop the spread of the coronavirus epidemic had a demand dampening consequences for the performance of most of our export market partners. As a result, the decline in net exports and investments, mainly due to the uncertain business environment, will primarily contribute to the economic downturn this year.

The economic effects of the epidemic are also felt in the labour market: a slower wage dynamic and a decline in employment is expected in 2020 compared to previous years. According to the MNB's September forecast, the growth of gross average wages may be between 8.7 percent and 9.2 percent. Wage dynamics seems to be less affected by the epidemic situation, but it is important to highlight that more than half of the increase in the second quarter could be explained by statistical effects. In addition to the redundancies, companies have adapted to the changing economic conditions on the intensive side by reducing the working hours of employees, which has been accompanied by a rapid increase in the proportion of part-time workers. Due to the slower recovery of the economy, the reorganisation of the labour market may be more prolonged, thus, according to the MNB's forecast, the number of employees is expected to decrease by almost 2 percent. The Budget Act includes an inflation of around 3 percent, while the MNB expects inflation to be around 3.5 percent this year.

Table 7
Comparison of the macroeconomic paths included in the 2020 Budget Act and in the MNB's September 2020 Inflation Report (percent)

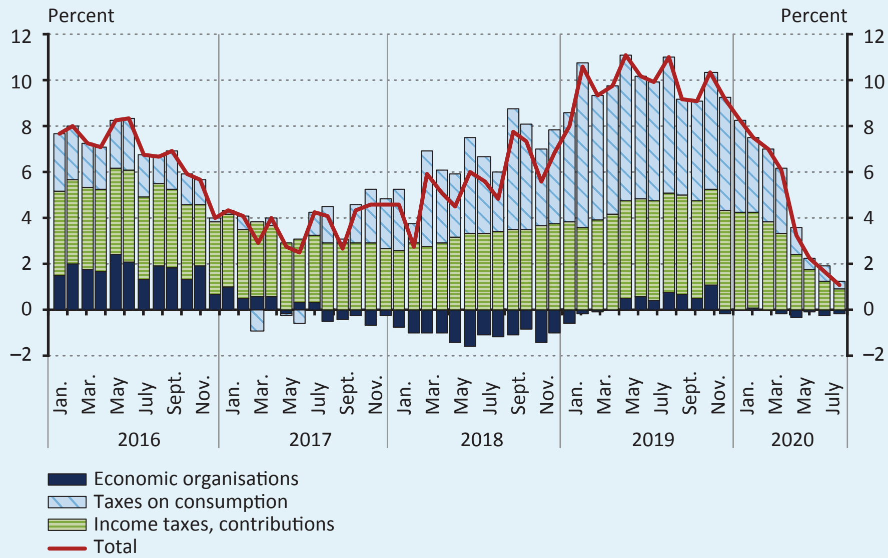
	2020		
	Budget Act	MNB	Difference
GDP	**4.0**	**(-6.8) – (-5.1)**	**(-10.8) – (-9.1)**
Consumption expenditure of households	4.8	(-4.0) – (-2.2)	(-8.8) – (-7.0)
Actual final government consumption	1.7	0.9 – 1.1	(-0.8) – (-0.6)
Gross fixed capital formation	3.8	(-11.2) – (-9.2)	(-15.0) – (-13.0)
Exports	5.2	(-13.3) – (-10.4)	(-18.5) – (-15.6)
Imports	5.4	(-10.4) – (-7.9)	(-15.8) – (-13.3)
Inflation	**2.8**	**3.5 – 3.6**	**0.7 – 0.8**
Gross wage bill	**9.6**	**1.3 – 2.2**	**(-8.3) – (-7.4)**
Gross average earnings	8.3	8.7 – 9.2	0.4 – 0.9
of which: private sector	8.9	7.8 – 8.5	(-1.1) – (-0.4)
Number of employees	1.3	(-2.1) – (-1.8)	(-3.4) – (-3.1)
of which: private sector	1.6	(-1.9) – (-1.5)	(-3.5) – (-3.1)

Source: Annex to the 2020 Budget Act, the MNB's September 2020 Inflation Report

3.3 CASH-BASED REVENUES OF THE CENTRAL SUB-SECTOR

Revenues from taxes and contributions of the central subsystem of the budget will be significantly lower than the appropriation included in the Budget Act this year, mainly due to the unfavourable macroeconomic effects of the coronavirus epidemic. Tax and contribution payments are expected to be by over HUF 1,200 billion lower than the appropriation. The most significant decline can be observed in the case of consumption taxes and labour taxes and contributions: the growth dynamics of taxes fell to a multi-year low already in the first six months of the year (Chart 17), which can be explained by the tax revenue decreasing effect of targeted measures aimed at mitigating the effects of economic downturn due to the epidemic. The subsystem's tax and contribution revenues in the first eight months amounted to only 60 percent of the appropriations. The substantial decline in tax payments is partly offset by the fact that revenues related to EU funding exceed appropriations, and the payment of budgetary institutions and other institutions to the central remainder fund also technically increases budget revenues compared to appropriations.

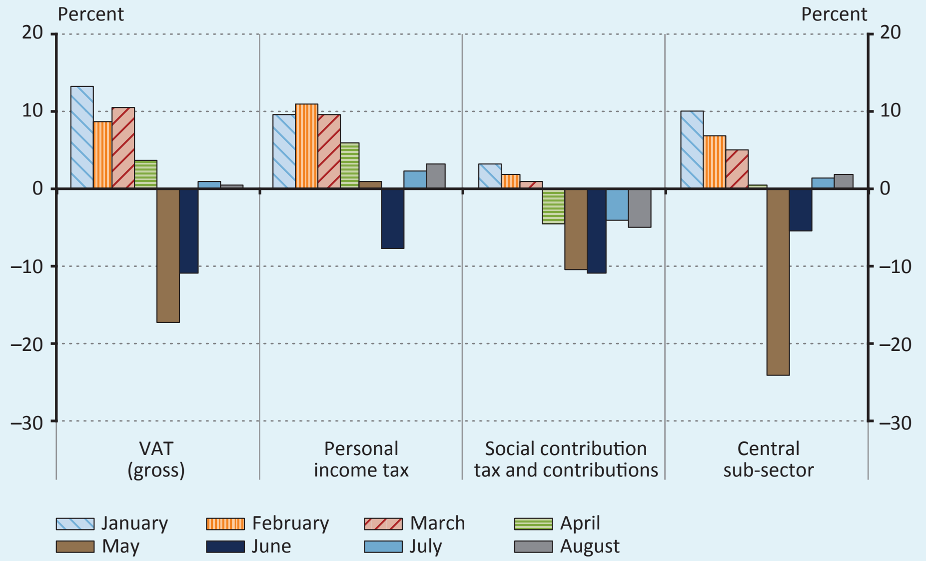
Chart 17
12-month moving average of changes in central sub-sector's tax and contribution revenues



Source: Hungarian State Treasury

Following the low point in May, tax revenues increased, showing a substantial adjustment; however, they stabilised at a lower pace than earlier. Tax and contribution revenues of the central sub-sector of the budget increased by 1.3 percent in July and by 2.1 percent in August compared to the same months of the previous year (Chart 18).

Chart 18
Change in revenues of certain major tax types and the overall central subsystem compared to the same month of the previous year in 2020



Source: Hungarian State Treasury

Corporate income tax revenues may be by HUF 83 billion lower than the appropriations included in the 2020 Budget Act. The discrepancy stems from the negative impact of the economic downturn caused by the coronavirus epidemic on companies' ability to pay taxes. However, corporate tax revenues may increase by HUF 114 billion compared to 2019 according to the cash-based approach. The increase is explained by the fact that in the last month of the base year, unlike in previous years, no significant corporate tax payments were made, as the spring tax package of 2019 abolished taxpayers' obligation to top-up corporate tax, income tax of energy suppliers and innovation contribution in December. In the first eight months of the year, corporate tax revenues exceeded by HUF 60 billion the payments made in the same period of the previous year. Of this, HUF 23 billion is explained by the fact that the payment of the December 2019 tax was postponed to January to a less extent than in the previous year, while the remaining HUF 37 billion increase signals the rising profits of companies in 2019.

Income tax on energy provieders fell by HUF 16 billion short of the value specified in the Budget Act. The difference may be attributed to the difference between the revenue expected by the Budget Act and the actual amount of revenue in 2019. Compared to the previous year, tax revenues may increase by HUF 31 billion due to the negative cash flow effect of the abolition of the year-end tax advance top-up in the base year. The receipt of cash-based revenues from corporate tax and income tax of energy suppliers within the year is strongly influenced by the government's measure, pursuant to which the deadline for most taxpayers to file tax returns changed from the end of May to the end of September. By the end of August, revenues from this type of tax exceeded by HUF 27 billion the payments in the first eight months of 2019.

The revenues expected from the **lump sum tax of small entrepreneurs** (KATA) may fall by HUF 38 billion short of the appropriation in the Budget Act. The shortfall is mainly due to government measures taken to address the economic effects of the coronavirus epidemic, in the framework of which a total amount of HUF 26 billion was waived to 151,000 taxpayers between April and July. As a result of the tax waiver, the annual expected KATA revenue will be by HUF 4 billion lower than the payments in 2019, which was essentially realised up until the end of August. Measures to address the coronavirus epidemic also affected the **small business tax (KIVA),** for which revenues are expected to be HUF 6 billion lower than the appropriation in the Budget Act. As part of the package of measures, in the case of certain specific sectors, the amount of staff payments up to and including 30 June did not have to be considered as tax base for the determination of the KIVA obligation. This year, payments under small business tax may substantially, by HUF 11 billion, exceed the 2019 revenues. In the first eight months, KIVA-revenues increased year-on-year by HUF 8 billion.

In order to fund protection against the coronavirus epidemic, the government introduced two special taxes in 2020. The special tax related to the epidemiological situation of credit institutions is recognised as part of the special tax of financial organisations. The basis of the tax is the part of the tax base of the special tax of financial organisations relevant to credit institutions over HUF 50 billion, and the rate is 0.19 percent. The special tax related to the epidemiological situation is to be paid by credit institutions in three increments, in June, September and December. In 2020, the amount paid in connection with the epidemiological situation may be deducted by credit institutions from their tax in equal instalments over the next five years. As a result of the measure, the revenues from the **special tax of financial organisations** may be by HUF 54 billion higher than the appropriations in the 2020 Budget Act, or they may exceed the payments of the previous year by HUF 62 billion, respectively. The other new type of tax is the **retail tax**, which was introduced as of May 1, 2020. Companies operating in the retail and wholesale sectors are subject to this tax, and their tax liability is determined in a progressive manner on the net sales revenue of their activities. The rates applicable for each bracket will increase in line with the increase of the tax base. Retail tax revenues could be as high as HUF 48 billion in 2020.

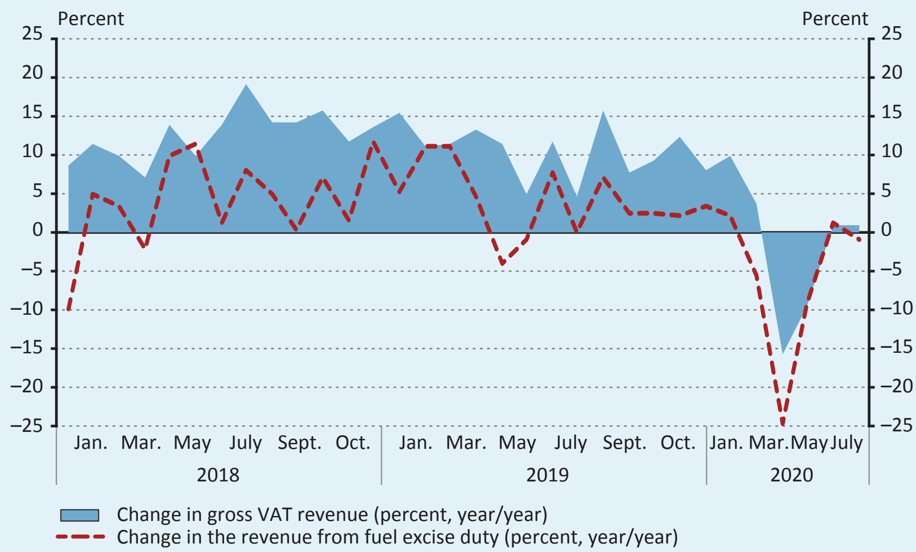
Revenues from e-road toll may fall short of the 2020 appropriation by HUF 22 billion. The difference is the balance of two opposite factors. Both the slowdown of the national economy and the spring restrictions affect the development of road toll revenues. This is slightly offset by another factor explaining the difference, i.e. the raising of the tolls from 15 March 2020 on average by 3.4 percent, the revenue increasing effect of which is not included in the appropriation enacted in summer 2019. Revenues from e-road tolls may be this year by HUF 3 billion lower than last year. By the end of August, HUF 139 billion had been paid by economic agents subject to pay road tolls, which is HUF 2 billion less than in the first eight months of 2019. The expected revenues from **mining royalties** may be by HUF 6 billion lower than the appropriation, as, according to the MNB’s forecast. The prices of energy carriers may be lower this year than the prices calculated when drafting the budget.

Other taxes and payments by economic organisations may be by HUF 11 billion lower than the appropriation. Penalty revenues may exceed the budget by HUF 21 billion, payments from environmental product fees may be by HUF 14 billion, time-based road tolls by HUF 10 billion, while revenues from rehabilitation contributions by HUF 5 billion lower than the appropriations in the Budget Act. The rehabilitation contribution and the water resource contribution were affected by the measures aimed at addressing the coronavirus epidemic, and some taxpayers were exempted from paying taxes during the state of emergency. Compared to the previous year, other taxes and payments may be by HUF 17 billion lower at the end of the year, and in the first eight months HUF 7 billion less payments were received by the state treasury.

Cash-based revenues from **value added tax** amounts to HUF 4,455 billion in 2020, falling by HUF 515 billion short of the statutory appropriation adopted last year. In the first eight months of the year, only 57 percent of the statutory appropriation was fulfilled due to the decline in turnover caused by the coronavirus and the shortening of the VAT refund deadline. The economy protection measure supporting small and medium-sized enterprises has reduced the deadline for VAT refunds from 30 days to 20 days for reliable taxpayers and from 75 days to 30 days for regular taxpayers, thus helping businesses' liquidity position. This reduces cash-based revenues by approximately HUF 100 billion this year. The fact that entities belonging to the municipal subsystem of the general government and subject to data reporting must submit their VAT returns next on 25 February 2021, i.e. must meet their VAT payment obligations on an annual basis reduces this year's cash-based revenues by additional HUF 60 billion. Gross VAT revenues accounted for 110 percent of last year's revenues in the first quarter, and they fell to 92.5 percent in the second quarter. In the subsequent months, revenues stagnated compared to the same period last year (Chart 19).

The **Online Invoice** system has been extended to transactions with a VAT content of less than HUF 100,000 as of 1 July. As a final step, from January 1, 2021, the tax authority will also oversee invoices issued to individuals, thus, it will account for all invoices in the economy, regardless of value limit, allowing the tax authority to prefill the online VAT return. As a result of the measure the Ministry of Finance expects a reduction in the shadow economy to the amount of tens of billions of forints. As of 1 January, the VAT rate payable on commercial accommodation decreased from 18 percent 5 percent; in parallel with this, the obligation to pay tourism development contribution was extended to this sector as well. However, the obligation to pay the tourism development contribution as part of the economy protection measures was waived from March to June and then this was extended until the end of the year. As of 1 January 2020, in line with previous plans, the normal, i.e. 27 percent, VAT rate is **applicable to the sales of new residential property**. Exceptions are those residential properties, for which the final construction permit was already available on 1 November 2018. In this case the VAT rate of 5 percent can be applied until 2024. An additional preferential VAT rate of 5 percent is expected in the case of sales of property within the framework of **brownfield investments**, the budgetary impact of which is expected to be felt from 2021.

Chart 19
Change in gross VAT revenue and excise tax revenue on fuel compared to the previous year



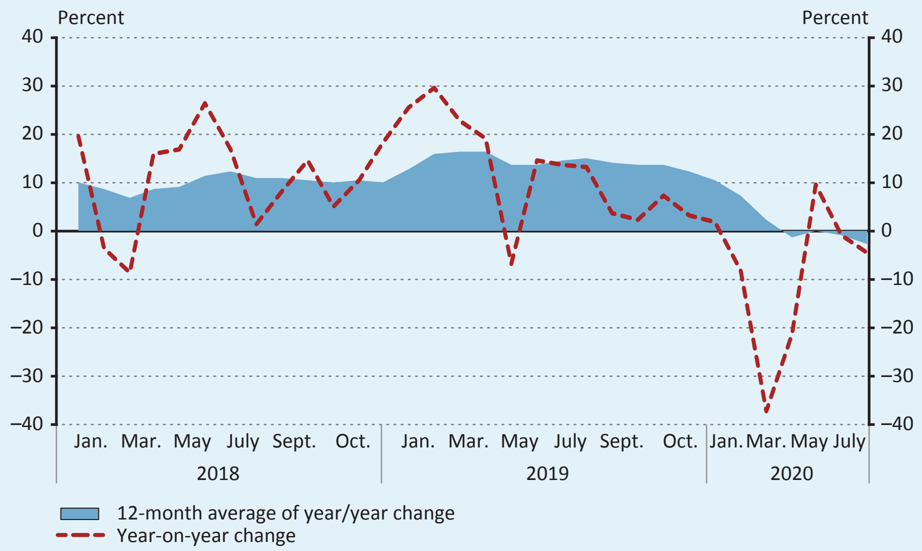
Source: Hungarian State Treasury

We forecast **excise duty revenues** to reach HUF 1183 billion this year, which is by HUF 43 billion lower than the appropriation included in the Budget Act. The loss of revenue due to the decline in consumption will be partially offset by the increase in the rate of excise duty on tobacco and fuel, but revenues are still expected to fall short of the planned level. In the first eight months of the year, revenues stagnated compared to the same period last year, due to a 14 percent decline in fuel excise tax revenues in the second quarter (Chart 19). **Excise duty on tobacco products** increased again on 1 January and 1 July to comply with EU regulations, which could be followed by further steps in addition to the previously planned January 2021 increase. According to the EU's minimum excise duty requirement the tax rate must be at least EUR 90 per 1,000 strands and reach 60 percent of the weighted average price, or a minimum of EUR 115 per 1,000 strands, regardless of its ratio to the price. In 2020, the budgetary impact of the two increases may be around HUF 25 billion, while the tax change in January 2021 will amount to HUF 15 billion. **Excise duty on fuels** has risen since July 1 as the price of Brent crude oil per barrel has been consistently below USD 50 in the relevant quarter. Excise duty per one litre of unleaded gasoline will increase from HUF 120 to HUF 125, while that of diesel will increase from HUF 110.35 to HUF 120.35. The budgetary impact of the measure could be around HUF 50 billion, which will partially offset the loss of revenue due to the coronavirus epidemic.

This year, revenues from **financial transaction levy** may reach HUF 217 billion, which may fall short of the appropriation in the Budget Act by HUF 9 billion. In the first eight months of the year 64 percent of the statutory appropriation was realised, while revenues fell by 10 percent year-on-year. The decrease in revenues is explained on the one hand by the tax reliefs introduced at the beginning of 2020: as of January no transaction tax must be paid on treasury operations and postal check payments below HUF 20,000, and on the other hand, by the lower number of transactions due to the economic slowdown as a consequence of the coronavirus and the moratorium on loan repayments.

The 2020 **revenues from duties** may amount to HUF 203 billion, which may be by HUF 26 billion lower than the appropriation in the Budget Act in light of the actual data for the first six months. Up until end of August, the budget received revenues from duties in the amount of HUF 133 billion, which amounts to 58 percent of the annual appropriation and is by 8 percent lower than the revenue of the first six months of last year. Although revenues in March, April, and May were significantly lower than last year's revenues, tax revenues had rebounded in June and were already higher than in June 2019 (Chart 20).

Chart 20
Change in revenues from duties year-on-year



Source: Hungarian State Treasury

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

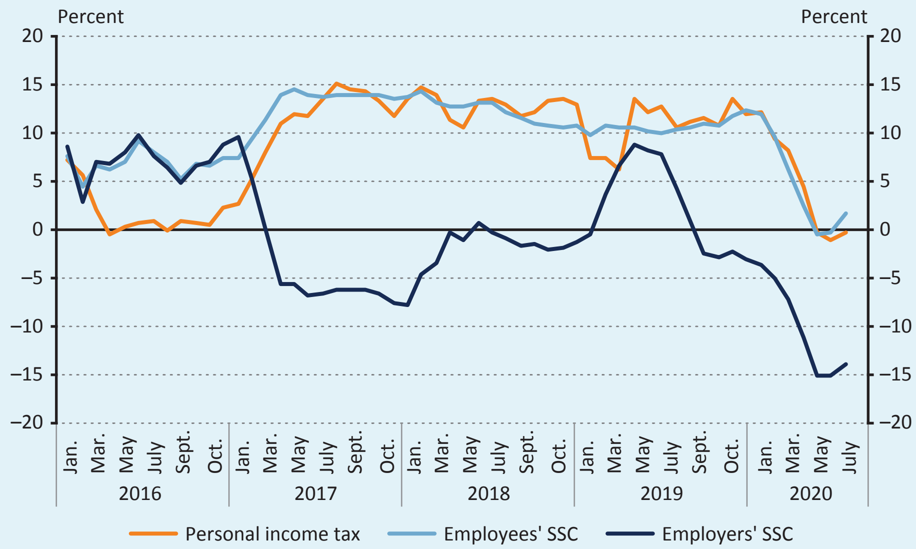
	2020				
	Statutory appropriation	January - August realisation	Percent of appropriation	MNB annual forecast	Difference: MNB – appropriation
TAX AND CONTRIBUTION REVENUES OF THE CENTRAL SUB-SECTOR	**17,192**	**10,365**	**60%**	**15,957**	**-1,235**
Payments by economic organisations	**1,690**	**961**	**57%**	**1,599**	**-91**
Corporate income tax	501	211	42%	418	-83
Special tax of financial institutions	65	52	80%	119	54
Retail tax	0	29	-	48	48
Mining royalty	38	21	56%	32	-6
Gambling tax	36	21	59%	33	-3
Income tax on energy providers	74	39	52%	58	-16
Lump sum tax of small entrepreneurs	193	98	51%	154	-38
Small enterprise tax	88	57	65%	81	-6
E-road toll	235	139	59%	213	-22
Utility tax	54	25	46%	48	-6
Other taxes and payments	406	270	66%	395	-11
Advertising tax	1	0	31%	1	0
Consumption taxes	**6,637**	**3,849**	**58%**	**6,049**	**-588**
Value added tax	4,970	2,813	57%	4,455	-515
Excise duties	1,226	761	62%	1,183	-43
Registration tax	27	13	49%	27	0
Telecommunication tax	54	37	69%	57	3
Financial transaction levy	226	146	64%	217	-9
Insurance tax	98	69	70%	101	3
Tourism development contribution	36	10	27%	10	-26
Payments by households	**2,899**	**1,835**	**63%**	**2,810**	**-88**
Personal income tax	2,609	1,649	63%	2,510	-99
Duties, other taxes	238	138	58%	211	-27
Motor vehicle tax	52	48	93%	90	38
Tax and contribution revenues of extra-budgetary funds	**451**	**290**	**64%**	**427**	**-24**
Tax and contribution revenues of social security funds	**5,516**	**3,430**	**62%**	**5,072**	**-444**
Social contribution tax and contributions	5,344	3,330	62%	4,918	-426
Other contributions and taxes	172	100	58%	154	-18
REVENUES RELATED TO EU FUNDS	**1,513**	**782**	**52%**	**1,601**	**88**
OTHER REVENUES	**350**	**397**	**114%**	**646**	**296**
Other revenues of the central budget	217	303	139%	392	174
Other revenues of social security funds	33	18	53%	39	5
Other revenues of extra-budgetary funds	99	77	78%	215	116
TOTAL REVENUES	**19,056**	**11,544**	**61%**	**18,204**	**-852**

Note: The point estimates in the table show the centre of the forecast bands.
Source: Budget Act of 2020, Hungarian State Treasury, MNB

Budget revenue from **motor vehicle tax** was as high as HUF 48 billion in the first eight months of the year, while our annual revenue forecast is HUF 89.5 billion. The original statutory appropriation was HUF 52 billion, but due to the health emergency, the part of the motor vehicle tax revenue due to local governments was also transferred to the Reserves of the Protection against the Epidemic, thus the amended revenue appropriation is HUF 86 billion.

Payments from **personal income tax** are expected to be almost by HUF 100 billion lower than the appropriation in the Budget Act adopted last year. The downturn in economic activity as a consequence of the coronavirus epidemic caused a substantial slowdown in revenues within the year. The decline in revenues is mostly due to rising unemployment and, to a lesser extent, to declining gross average wage dynamics. Up until August this year, the budget received HUF 1,649 billion personal income tax revenue, which is by 4.2 percent higher than in the first eight months of last year, mainly due to the high dynamics of the first months. The development of personal income tax in 2020 will be affected by the tax exemption for mothers with at least four children; however, the measures taken to mitigate the economic effects of the coronavirus epidemic did not affect this tax type.

Chart 21
3-month moving average of the development of labour taxes and contributions



Source: Hungarian State Treasury

This year, **the tax and contribution revenues of social security and extra-budgetary funds** may fall by about HUF 468 billion short of the appropriation in the Budget Act. The difference is mainly due to the unfavourable macroeconomic effects of the coronavirus epidemic; however, targeted sectoral contribution exemptions introduced in response to the crisis also contribute to the revenue shortfall. According to our estimates, the four-month allowance and partial relief gradually extended to several sub-sectors of the national economy, could have reduced this year's tax and contribution revenues by 0.2 percent of GDP. Additionally, the two percentage point reduction in the social contribution tax, already previously known and announced, will reduce tax revenues in 2020 by 0.3 percent of GDP. As a next stage of the tax cut that began in 2017, the social contribution tax rate fell to 15.5 percent in the second half of this year. From July 2020, not only those in employment, but all elderly pensioners will be entitled to be fully exempt from paying contributions, and social security contributions incumbent on employees will also be consolidated in the second half of this year. As a result, the minimum contribution base of entrepreneurs will be reduced, and the family tax allowance will be available from the total employee's social security contribution. In the first eight months of 2020, the tax and contribution revenues of social security and extra-budgetary funds decreased by 3.3 per cent year-on-year, to which employee contributions contributed 4.5 percent, while employer contributions by a decrease of 10.5 percent, the latter being mainly a consequence of the reduction in the social contribution tax in the second half of last year.

In the first eight months of the year, HUF 782 billion was recognised on the **revenues related to EU funding** lines, of which about HUF 210 billion was the annual advance received earlier than usual due to the epidemic. As in previous years, this year we expect to receive the significant share of revenue in the last quarter, especially in light of the fact that pursuant to the European Commission's decision, for invoices submitted between 1 July 2020 and 30 June 2021 instead of the previous 85 percent average financing an EU co-financing of 100 percent can be claimed. The **utilisation of advances** previously paid to beneficiaries exceeded HUF 600 billion up until August, which is almost by 20 percent higher than in August 2019.

By the end of August, the central budget realised HUF 41 billion revenues under the title **payments from local governments**, which is 95 percent of the annual revenue appropriation. Taking into account the prorated overperformance of the revenue, as well as the fact that the revenue plans were overperformed also in 2019, we expect that the payments will be around last year's revenue also this year; therefore, our annual revenue expectation is HUF 54 billion.

Revenues related to the **management of state assets** were realised in the amount of HUF 243 billion in the first eight months of the year. Revenues exceeded the total annual revenue appropriation by 49 percent. The high revenue in the first half of the year is due to the receipt of HUF 128 billion fee income from the mobile frequency concession sales not earmarked in the budget appropriation. Our annual revenue expectation is HUF 290 billion, which is higher than the revenue appropriation in the Budget Act by the amount of fee income from frequency sales. According to the ESA accounting rules, the revenue from the use of frequencies should be spread over the entire duration of the concession, thus, the cash-based surplus will increase the general government ESA revenues in 2020 only by a small amount.

3.4 CASH-BASED EXPENDITURES OF THE CENTRAL SUB-SECTOR

According to our forecast, the cash-based expenditures of the central subsystem of the general government may be substantially, by almost HUF 2,300 billion higher than the appropriations in the Budget Act. The increase in expenditures is mainly explained by the additional expenditures related to epidemiological defence, which is also reflected in the total expenditures of the central budgetary institutions and of the Health Insurance Fund. Additional expenditure in excess of the appropriation is the budgetary impact of measures offsetting the negative economic effects of the coronavirus epidemic, such as expenditure related to employment promotion and job retention programs. The additional expenditure is covered on the one hand by reallocations within the budget and the use of reserves, and on the other hand, part of the impact of measures directly increase the budget deficit.

Payments related to **special and normative subsidies, as well as support to the public media** were in total higher than 92 percent of the annual appropriation in the first eight months of the year. For the expenditure titles belonging to this category, we expect the legal appropriations to be exceeded by the end of the year, given that some of the government decisions on the use of the Economy Protection Fund are aimed at increasing the expenditures recognised for in individual and normative subsidies. The expected overperformance is also justified by the additional expenditure of HUF 15 billion due to the subsequent settlement of public transport services in the previous year, thus, we expect an overrun of the appropriation by HUF 147 billion as a consequence of the measures announced by the end of August.

For the **social policy fare subsidy** expenditure appropriation, due to the lower utilisation of the services of companies providing public transport services due to the health emergency, we expect HUF 27 billion annual expenditure savings compared to the appropriation. In the first eight months, subsidies in the value of HUF 40 billion were paid, which is 45 percent of the annual statutory appropriation.

According to our forecast, expenditures related to **housing grants** may fall short of the appropriation of HUF 297 billion by HUF 65 billion. Based on the data in the first eight months, the expenditures related to housing grants stand at 55 percent of the appropriation; however, interest has declined in the second half of the year due to the coronavirus epidemic and no substantial acceleration is expected due to limited access to HPS-related construction capacity. The anticipated annual amount of the state subsidy provided for the – already phased out – building society savings is continuously decreasing, and it may be HUF 70 billion in 2020. The expenditure on the tax refund programme may fall short of the appropriated expenditure of HUF 25 billion, since the expenditure realised in the first eight months of the year was HUF 10 billion.

The expenditure appropriations of the **National Family and Social Policy Fund** are mostly in line with our expectations. The Budget Act appropriated HUF 661 billion for the expenditures of the Fund (approximately half of that for the payment of family allowances). The expenditures had been prorated overperformed, since in the first eight months they amounted to 72 percent of the appropriations. This is due to the fact that, as in previous years, the amount of family allowance, child care allowance (gyes) and child raising support (gyet) due in September were previously paid to those entitled to it in order to alleviate the financial burden of school start, but this only affects the time-profile within the year.

In the first eight months of the year, **net own expenditures of budgetary institutions and chapters** were fulfilled to 83.3 percent of the annual statutory appropriation, which is by 29 percentage points higher than in the base period. The realisation of expenditures above the prorated level is closely linked to the outbreak of the epidemic in the spring months, during which the government decided on significant additional expenditures related to the fight against the health emergency and mitigation of the economic impacts of the pandemic.

Payments of budgetary organisations and payments from budgetary organisations due directly to the central budget increased by 24 percent year-on-year. The budgetary organisations must repay the remainders of the previous year's appropriation not burdened by commitments to the Treasury account of the central budget. By the end of August last year, HUF 266 billion had been realised in the Central Remainder Settlement Fund due to the required obligation, this year, HUF 325 billion had been paid for the same period. The Budget Act did not include any appropriation for the revenue of the Central Remainder Settlement Fund, accordingly, the gross expenditure of the budgetary organisations increased compared to the statutory appropriation by the amount of the payments made to the fund.

By the end of August, the gross **expenditures** of budgetary organisations and chapters together approached 95 percent of the statutory appropriation. Disregarding the amount paid into the Central Remainder Settlement Fund, gross expenditures have been realised to 90 percent of the original statutory appropriations. The high realisation in the first eight months is a consequence of the additional costs of the protection against health emergency, as well as government intervention due to the slowdown in economic growth in connection with the epidemic. At the expense of the resources reallocated to the newly created Economy Protection Fund, disregarding the usual prorated development of expenditures, the government provided additional resources to the economy. By the end of August, the funds used from the likewise newly created budget chapter "Central Reserve of the Protection against the Epidemic" exceeded HUF 685 billion; therefore, the additional expenditure in excess of the expenditure appropriations transferred to this chapter amounted to HUF 259 billion.

Among the gross expenditures of budgetary organisations, wages paid to employees were by 9 percent higher than in the same period of 2019, with payments approaching HUF 1,985 billion. Investment and renovation expenditure fell in the first eight months of the year as a result of expenditure reallocations in the budget, as payments for this purpose fell by 18 percent compared to the base period. Material expenditures of budgetary organisations expanded at an accelerating pace in the first two months of the third quarter, thus increasing by a total of 18 percent in the first eight months of the year. The so-called 'Other operating payments' also increased dynamically: an increase of 23 percent could be observed at the end of August, and such expenditures exceeded HUF 1,780 billion up until the end of August.

Our annual projection for the net own expenditures of budgetary organisations and chapters is by nearly HUF 2,200 billion higher than the net expenditure that can be derived from the original appropriation in the Budget Act. The large difference includes, on the one hand, the effect of the already realised additional expenditure increase and, on the other hand, in the remaining months of the year we expect additional expenditure for part of the provisioning appropriations and for several uncapped expenditure appropriations.

Subsidies to local governments amounted to HUF 483 billion up until the end of August, which is 65 percent of the original statutory appropriation. At the expense of the subsidies appropriation for local governments, HUF 47 billion was reallocated to the Central Reserve of the Protection against the Epidemic chapter created due to the health emergency. At the same time, the government has provided resources for a number of purposes to local governments from the central reserves and the Central Remainder Settlement Fund. Considering the measures, we expect to pay HUF 772 billion in subsidies by the end of the year, compared to the HUF 739 billion originally planned.

The **contribution to the budget of the European Union** expenditure heading was realised in the amount of HUF 282 billion in the first eight months, which is about 70 percent of the statutory appropriation. By the end of the year, we expect the appropriation to be exceeded by HUF 17 billion.

The **central reserves** statutory appropriation included a historic high amount for 2020. Out of the HUF 663 billion reserve amount, the Country Protection Fund and the reserve called extraordinary government measures together included a total of HUF 488 billion so called general purpose reserve. Due to the health emergency, the government transferred the HUF 378 billion reserve of the Country Protection Fund to the newly created Central Reserve of the Protection against the Epidemic chapter, and allowed the use of the reserves at a pace justified by the measures to protect against the state of emergency. Therefore, as a consequence of the deviation from the previous legislation, the full appropriation of the Country Protection Fund was spent in March and April. At the end of August, the unused appropriations of the central reserves amounted to HUF 60 billion, of which HUF 53 billion was still available to the government under title extraordinary government measures.

Expenditures related to the **management of state property** were realised in the amount of HUF 244 billion until the end of August. Compared to the seasonality of previous years, the realisation of expenditures of the first eight months may be deemed high despite the fact that only 53 percent of the appropriation was realised. Compared to the annual cash-based expenditure appropriation, we expect an additional expenditure of HUF 105 billion by the end of the year, based on the information published on the use of the Economy Protection Fund.

Table 9
Partially consolidated cash expenditures of the central sub-sector (HUF billions)

	2020				
	Statutory appropriation	January – August realisation	Percent of appropriation	MNB annual forecast	Difference: MNB – appropriation
PRIMARY EXPENDITURE ITEMS	**18,377**	**13,245**	**72%**	**20,694**	**2,316**
Special and normative subsidies and support to the public media	**487**	**449**	**92%**	**634**	**147**
Social policy fare subsidy	**91**	**40**	**44%**	**64**	**-27**
Housing grants	**297**	**164**	**55%**	**232**	**-65**
Family allowances, social benefits	**575**	**416**	**72%**	**578**	**4**
Early retirement benefits	**86**	**61**	**72%**	**90**	**4**
Net own expenditures of central budgetary organisations and chapters	**6,010**	**5,007**	**83%**	**8,203**	**2,193**
Support to local governments	**739**	**483**	**65%**	**772**	**33**
Contribution to the EU budget	**398**	**282**	**71%**	**415**	**17**
Central reserves	**663**	**0**	**0%**	**53**	**-610**
Other expenditures	**624**	**355**	**57%**	**743**	**119**
Expenditures of extra-budgetary funds	**549**	**370**	**67%**	**676**	**127**
NEF – Passive allowances	83	81	98%	103	20
NEF – Active allowances	140	85	60%	130	-10
Other expenditures	326	204	63%	443	117
Expenditures of social security funds	**6,178**	**4,242**	**69%**	**6,436**	**258**
PIF – Pensions	3,580	2,397	67%	3,631	50
HIF – Disability and rehabilitation benefits	282	183	65%	276	-6
HIF – Cash benefits	447	306	69%	449	2
HIF – Medical and preventive care	1,429	1,089	76%	1,634	204
HIF – Net expenditures of the drug budget	301	199	66%	309	8
Other expenditures	138	69	50%	138	0
Expenditures related to EU transfers	**1,682**	**1,374**	**82%**	**1,799**	**117**
NET INTEREST EXPENDITURES	**1,045**	**561**	**54%**	**1,002**	**-44**
TOTAL EXPENDITURES	**19,423**	**13,806**	**71%**	**21,695**	**2,273**

Note: The point estimates in the table show the centre of the forecast bands.
Source: Budget Act of 2020, Hungarian State Treasury, MNB

Until the end of August under expenditure appropriation title **subsidies to the extra-budgetary funds** payments amounting to HUF 35 billion were realised, which is 42 percent of the original annual appropriation. As a result of the government's economy protection measures, we raised our expectation for annual expenditures to HUF 88 billion, which is by HUF 5 billion higher than the appropriation in the Budget Act.

Within the **expenditures of the extra-budgetary funds**, we expect the expenditures to be about HUF 20 billion higher for the so-called passive expenditures of the National Employment Fund, as the jobs lost due to the coronavirus epidemic cause the jobseeker's allowance to significantly increase. In the first eight months over 98 percent of the jobseeker's allowance appropriation was paid. In the case of other expenditures, we expect a significant additional expense of about HUF 120 billion, which is mainly caused by the expected expenditures of short-time working arrangements and R&D support, as well as job creating wage subsidies. Expenditures on the **Start labour programme** amounted to HUF 85 billion by the end of August, which represent 60 percent of the annual statutory appropriation. At the same time, the government reallocated HUF 4 billion from the Start labour programme appropriation to other expenditures, thus, up until the end of August the expenditures directly used for public employment reached 58 percent of the annual appropriation. Expenditures decreased by HUF 20 billion compared to the base period; therefore, we expect total expenditures to be by HUF 10 billion lower by the end of the year than the planned expenditure appropriation of HUF 140 billion. The decreasing expenses are due to the decrease in utilisation, the average number of participants in the Start Work Programme decreased by almost 17,000 in the first half of the year compared to the base period.

In the first eight months of 2020, the **pensions** disbursed from the Pension Insurance Fund amounted to HUF 2,397 billion, which corresponds to 67 percent of the statutory appropriation. From January to August 2020, pension expenditures exceed the year-on-year value by HUF 122 billion, i.e. by 5.4 percent. In January 2020, pensions were increased by 2.8 percent at the beginning of the year, based on the inflation rate projected in the Budget Act. According to the HCSO data, consumer prices rose by an average of 3.5 percent in the first eight months of 2020, while the pensioner consumer price index rose by 4 percent compared to the same period in 2019; therefore, we forecast a 1.2 percent additional pension increase in November. Due to the supplementary pension increase, expenditures related to pensions are expected to exceed the statutory appropriation. In our forecast, we assume that the budgeted pension premium will not be paid this year, as it is due in the event of a GDP growth above 3.5 percent.

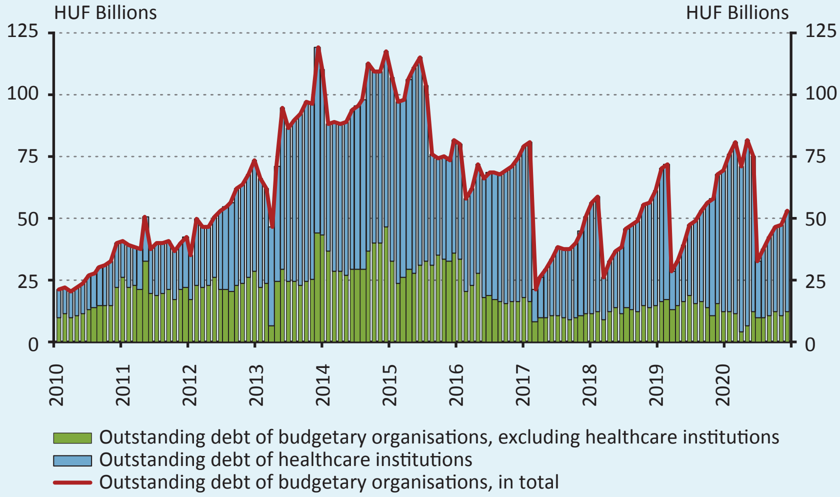
In the first eight months of the year expenditures spent on **medical and preventive care** were as high as 76 percent of the original appropriation. The original statutory appropriation was amended on the one hand due to the settlement of the debt of hospitals, and on the other hand due to the gross one-off benefit of HUF 500,000 paid to 170,000 healthcare workers for a for their commitment in the protection against the coronavirus epidemic. The amended appropriation amounted to HUF 1,573 billion, which is expected to be exceeded due to additional expenditures on the fight against the coronavirus epidemic.

Unlike in previous years, the **accumulated debt of healthcare institutions** was settled not at the end of the previous year, but at the beginning of this year. The outstanding debt of healthcare institutions decreased in total by about HUF 46 billion in two instalments, in February and March. At the end of August 2020, the outstanding debt stock of healthcare institutions amounted to HUF 41 billion (Chart 22).

69 percent of the appropriation for **health insurance cash benefits** were realised in the first eight months of 2020. Our forecast is slightly higher than the appropriation, as expenditures have been slightly higher than usual so far this year, mainly due to higher-than-expected expenditure on childcare benefits and adoption benefits, which is expected to be maintained also in the coming months.

In the first eight months of the year, 66 percent of **drug budget's net expenditures** was realised which corresponds to the prorated appropriation. On the whole, according to our forecast, net expenditures may exceed the statutory appropriation. Gross expenditures rose to a greater degree than expected this year as well – 68 percent of the annual appropriation was realised by the end of August–, which was offset by the higher payments by pharmaceutical companies. As in previous years, pharmaceutical manufacturers' payments may exceed the statutory appropriation in 2020, in the first eight months about HUF 68 billion was paid into the budget, representing 74 percent of the annual appropriation.

Chart 22
Outstanding debt of budgetary organisations, and within that, of healthcare institutions between January 2010 and August 2020



Note: The time series of healthcare institutions includes institutions for both outpatient and in-patient services, the background institutions of the healthcare sector, as well as universities with clinical centres. The time series contains an increasing number of institutions, and thus its comparability is limited.

Source: Hungarian State Treasury

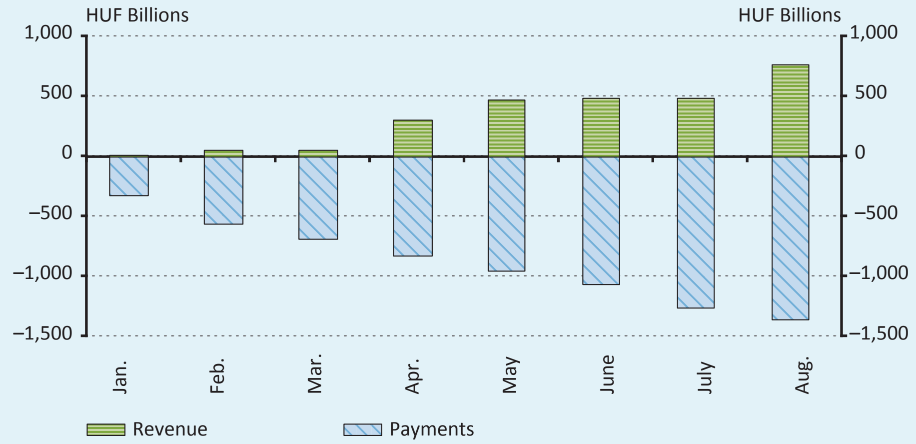
Other **expenditures of social security funds** amounted to 50 percent of the appropriation in the first eight months of the year. As a result of the emergency of the coronavirus epidemic, the most significant shortfall was in travel cost refund and subsidies for spa and other therapeutic provisions, but breast milk supply and postage costs were also lower than the prorated share. In parallel, expenditures of therapeutic equipment reimbursement and benefits from international conventions and healthcare abroad were realised on a pro rata basis.

In 2020, **the EU expenditures of the chapter-administered appropriation** amounted to HUF 1,374 billion in the first eight months of 2020, which is more than HUF 400 billion higher than in the first eight months of 2019 (Chart 23). Major part of the deviation is due to the transfers of the financial assets of the Economic Development and Innovation Operational Programme (EDIOP) priority 8 between the lines and the repayment to the EU. According to our estimates, the amount of advance payments was between HUF 550-600 billion, which is slightly higher than the year-on-year value.

During April and May, the amount of the **indicative financial envelope of Széchenyi 2020 related to the 2014-2020 EU programming period increased in two steps**, by a total of more than HUF 500 billion, **to HUF 9,715 billion**. The increase is mainly due to the revaluation with the HUF 350 exchange rate. According to the applicable Government Resolution 1264/2020. (V.28.), between June and December, Managing Authorities must make higher-than-planned commitments (tenders won) under the Economy Protection Action Plan, amounting to approximately HUF 1,377 billion. Based on the Economy Protection Action Plan, approximately HUF 400 billion of EDIOP funds are available, primarily to finance wage subsidies for short-time work arrangements, R&D wage subsidies, technological renewal, and to provide preferential corporate working capital loans.

The tenders **announced** under Széchenyi 2020 increased by about HUF 320 billion in the first eight months, thus exceeding HUF 10,350 billion (107 percent of the indicative envelope of HUF 9,715 billion). The **won** and **contracted** tenders also increased by more than HUF 300 billion, to 106 and 103 percent of the allocation. Due to the fact that the use of advances in the first eight months exceeded the advance payment, the value of unused advance held by the beneficiaries decreased to close to HUF 2,700 billion by the end of August.

Chart 23
Developments in revenues and expenditures related to EU programmes in 2020 (cumulative)



Note: Revenues show the amounts recognised in the budget for the reporting month, which may differ from the amounts received on the STA.
Source: Hungarian State Treasury, MNB calculation

Net cash-based interest expenditures amounted to roughly 54 percent of the annual appropriation in the first eight months of 2020. The higher-than-last-year prorated expenditure is due to the fact that gross interest expenditures exceeded that at the end of August last year, while revenues fell short of it. The reason for the higher expenditures is the additional expenditures due to the increased outstanding debt. Interest revenues in the first eight months are substantially, more than 3.5 times higher than the statutory appropriation, which is attributable primarily to the debt management transactions, and based on this, the annual interest revenue – as in previous years – is expected to be well over the appropriation.

Our forecast with regard to the annual **net cash-based interest expenditure** is lower than what is included in the statutory appropriation. This may be due to the fact that our revenue expectations are substantially higher than that included in the statutory appropriation. According to our forecast, **net accrual-based interest expenditure** may continue to decrease slightly, similar to previous year's decline dynamics.

3.5 BALANCE OF THE LOCAL GOVERNMENT SUB-SECTOR

Our projection in the September Inflation Report assumed that in 2020 the local government sub-sector would close the year with a cash-based deficit of approximately HUF 265 billion. Thus, our forecast assumes the generation of a cash-based deficit by more than HUF 210 billion higher than what the government reckoned with when compiling the 2020 Budget Act. The expected high cash-based deficit is on the one hand related to the use of advance revenues previously received under EU programmes on the one hand, and the significant cash-based deficit is due to revenue decrease because of the health emergency on the other hand. This year, according to our expectations, local governments will use HUF 240 billion of the EU advance paid by the central budget in previous years for various projects. This year's cash-based revenues of the local government subsystem will be reduced by local business tax revenues declining due to the epidemic, as well as the abolition of the obligation to top up the local business tax at the end of the year. Both the centralisation of motor vehicle tax revenue and the loss of fee income of municipally owned service institutions due to the temporary suspension of services cause a decrease in the own revenues of the local government subsystem.

Until the end of the first half of the year, the quarterly cash-based balances developed according to the seasonality typical for the subsystem's management. In the first quarter, a surplus of HUF 94 billion was generated, which, however, was by HUF 110 billion lower than the surplus in the same quarter of the previous year. The subsystem closed the second quarter with a cash-based deficit of HUF 196 billion, which was by HUF 18 billion higher than in the base period. The cash-based balance in the first half of the year indicated a cash-based deficit of HUF 101 billion, which represents an increase of HUF 128 billion compared to the first half of last year. The higher deficit is mainly due to the HUF 87 billion decrease in revenue, while expenditures were by HUF 41 billion higher than in the base period.

Similarly to the previous year, the ESA balance of the subsystem calculated according to the EU methodology may show a deficit also in 2020.

3.6 STATISTICAL CORRECTIONS

The 2020 Budget Act was adopted assuming an **ESA statistical adjustment** equivalent to HUF -73 billion. Our forecast, which is consistent with the September Inflation Report, calculates with a deficit-decreasing statistical adjustment of HUF 361 billion for 2020. Compared to the statistical adjustments assumed when the Budget Act was adopted, the adjustments of corporate tax settlements and local business tax revenues related to the abolition of the year-end tax advance top-up rule increased ESA state revenues by about HUF 170 billion. The dividend payment from the MNB's interest income increased the revenues that can be recognised under ESA methodology by almost HUF 50 billion, while the spreading of approximately HUF 128 billion of cash-based revenue from mobile frequency sales for the entire term of the concession reduced the revenues recognisable under ESA. The balance-improving adjustments related to settlements with the EU improve the ESA balance by a total of HUF 165 billion compared to the cash-based balance. They lead to a positive accrual-based adjustment of a significant amount: EU advances paid within the general government sector, advances paid to suppliers, settlement carry-overs; however, the use of EU advances previously received by companies classified into the general government sector reduces the size of the positive adjustment.

3.7 EXPECTED DEVELOPMENTS OF PUBLIC DEBT IN 2020

Based on the MNB's financial accounts data, gross government debt-to-GDP amounted to 70.3 percent at the end of the first half of 2020, which represents a substantial increase of 4.9 percentage points compared to 65.4 percent at the end of 2019. The debt ratio increased by 3.2 percentage points year-on-year. In the first half of the year, in addition to net debt issuance, the revaluation of exchange rates and the slowdown of economic growth also raised the value of the debt ratio. The foreign currency ratio of the central debt increased from 17.3 percent at the end of 2019 to 19 percent by the end of the first half of 2020 due to foreign currency issuances. The ratio of non-residents within total government debt fell from 33.9 percent recorded at the end of last year to 33.7 percent in the first half.

In 2020, the fact that the MNB paid a historically high dividend of HUF 250 billion to the budget supported the financing requirement and thus supports the reduction of public debt. Pursuant to the decision of the Board of Directors of the MNB on 1 April, the majority of the profit for 2019, HUF 250 billion, was paid into the budget as a dividend. The HUF 250 billion dividend (0.5 percent of GDP) will help with financing, and of this amount, HUF 48 billion (0.1 percent of GDP) will improve the ESA budget balance.

Consistent with our September Inflation Report, we forecast that gross government debt-to-GDP will temporarily increase to 76 in 2020 due to the economic environment becoming increasingly unfavourable as a consequence of the coronavirus epidemic and due to the measures and higher expenditures needed to mitigate the health and economic effects of the epidemic. The 10.6 percentage point increase in the rate is considered to be low by international standard, and the public debt-to-GDP ratio in the EU Member States may increase by an average of 16 percent in 2020 compared to the previous year.

According to our forecast, **as a result of the issuance of foreign currency bonds, by the end of 2020** the foreign currency ratio of the central government debt may increase to 18 percent (while within the total government debt the ratio of foreign currency debt may be somewhat higher, i.e. 21 percent). Subsequently, negative net foreign currency output over the forecast horizon of the September Inflation Report will result in the decrease of the ratio.

4 Compliance with the fiscal rules

There are a total of eight fiscal rules that pertain to the Hungarian general government between 2019 and 2020, with four Hungarian and four European Union requirements. There are two overlaps between the rules: the 3 percent 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 formula 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.

This year, Hungarian and international fiscal rules are subject to a number of escape clause in view of the emergency situation. Escape clauses provide a typically temporary deviation from fiscal rules. Fiscal rules often include such clauses, which ideally link the derogation from the rules to a well-defined, quantified condition or legal situation. Given that one of the essential functions of fiscal policy is economic stabilisation, it is important that fiscal rules do not force pro-cyclical economic policies. The role of clauses is appreciated in exceptional circumstances, such as the current one, when economic actors, and in particular economic policy makers are facing unprecedented challenges due to the coronavirus epidemic. In an event of a crisis, the flexibility built into the sets of rules ensures that fiscal adjustment and austerity is not an automatic expectation, as according to past experiences this would further exacerbate the economic downturn. Escape clauses permit a temporary increase in the general government deficit, and thus in debt, which allows for the implementation of counter-cyclical fiscal policies, partly through the operation of automatic stabilisers (e.g. declining tax revenues, increased unemployment allowances) and partly through crisis management measures.

The Hungarian fiscal developments will be in line with the requirements due to the application of the escape clauses. The 7.0-7.5 percent deficit expected for 2020 exceeds the 3 percent GDP-proportionate deficit criterion included in both the Hungarian and EU fiscal frameworks, but these rules will be temporarily suspended due to the epidemic situation and the economic downturn. The increase in public debt is also allowed by the escape clauses, according to which deviation from the provisions of debt rules included in the Fundamental Law may be permitted in the case of an enduring and significant national economic recession, and during special legal order. The structural budget balance does not reach the MTO, and developments concerning expenditures are expected not to comply with the adjustment path described by the expenditure benchmark; however, the EU institutions temporarily suspended the examination of these rules on the grounds of unusual economic circumstances.

As regards the **debt rule of the Fundamental Law**, Hungary's debt ratio is over 50 percent of GDP; therefore, in accordance with the rule, it has to be reduced.[3] Compliance with the debt rule is a condition for the adoption of the budget, which is verified by the Fiscal Council. This year's budget act was passed in 2019 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.[4] A decrease in the real value of gross domestic product for even one year should be considered as an enduring and significant national economy recession, while a state of national crisis, a state of emergency, a state of preventive defence, a state of terrorist threat, an unexpected attack or a state of danger are deemed as special legal orders.[5] The economic downturn as a consequence of the coronavirus epidemic, therefore, overrides the debt rule and puts in place the escape clause that will allow for a temporary increase in the debt ratio. Overall, therefore, the expected increase in Hungarian public debt this year is made possible by the flexibility of the set of rules.

The other Hungarian fiscal rule applicable to public debt is the **debt formula** of the Stability Act. Based on the amendment to the Stability Act that came into force this year, instead of the previous quantified debt reduction formula, the

[3] Fundamental Law of Hungary, Article 36(4)–(6), Article 37(2)–(3)
[4] Fundamental Law of Hungary, Article 36(6), Article 37(3)
[5] Fundamental Law of Hungary, Articles 48 to 54

requirement stipulates that, with the simultaneous enforcement of EU regulations, the debt-to-GDP ratio must decrease by at least 0.1 percentage point per year.[6] Last year, public debt fell by 3.8 percentage points, which is in line with the requirements of the rule. This year, on the contrary, the debt-to-GDP ratio will increase, which is, however, allowed by the escape clause that will come into force in the event of a one-year decline in the real value of gross domestic product.[7]

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 percent of GDP.[8] The Hungarian budget deficit in 2019 was 2.0 percent of GDP, which is in line with the relevant criterion. According to our forecast, the general government deficit is projected to be 7.0-7.5 percent of GDP in 2020, 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.[9] 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. In the Hungarian legal order, the decrease in the real value of gross domestic product exempts from the compliance with the 3 percent deficit rule.[10]

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 has to be determined in a way that it should be in line with achieving the medium-term budgetary objective.[11] 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) was -1.5 percent of GDP until 2019, which has changed to -1.0 percent of GDP from 2020. The structural balance of the Hungarian budget was estimated by the European Commission to be -3.8 percent of the GDP in 2019, which is significantly above the -1.5 percent requirement. According to the forecast of the European Commission, the structural balance-to-GDP may be -2.6 percent this year. 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 subject to a significant deviation procedure (SDP), including Hungary, 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 **European debt rule** states that the Member States' government debt ratio must not exceed 60 percent 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 percent 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.

In 2019, Hungary's gross government debt ratio was over 60 percent of GDP; however, the debt ratio ratio reduced more than the extent of the expected reduction, thus, the EU debt rule is met. This year's debt ratio is expected by both the MNB and the European Commission to increase, but it is expected to decrease again from 2021. The European Union's 1/20th debt rule is expected to be met if, following the temporary increase, the debt ratio declines accordingly in 2021 and 2022.

[6] Section 4(2a) of Act CXCIV of 2011 on the Economic Stability of Hungary
[7] Section 7(1)-(2) of Act CXCIV of 2011 on the Economic Stability of Hungary
[8] Section 3/A(2b) of Act CXCIV of 2011 on the Economic Stability of Hungary
[9] 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;
[10] Section 7(1)-(2) of Act CXCIV of 2011 on the Economic Stability of Hungary
[11] Section 3/A(2a) of Act CXCIV of 2011 on the Economic Stability of Hungary

5 Special topics

5.1 MAIN STEPS TAKEN TO REDUCE SALES TAX EVASION AND THEIR RESULTS

Reducing tax evasion has direct and indirect benefits for all compliant actors in the economy. In addition to the improvement of the budget balance and the reduction of the tax rate with an unchanged balance, through the reduction of tax evasion becomes competition fairer, which is more favourable for the whole economy. Capital and labour flow to really competitive businesses that operate effectively even while complying with the rules. In addition, non-payment of taxes is often accompanied by the violation of employees' rights: employees may not be entitled to sick leave, companies may not pay, or only partially pay health insurance and pension contributions while making use of public services. Finally, from a national economic point of view, it is also important that tax evasion distorts the statistics that underpin economic policy decisions.

Among the measures taken to reduce tax evasion after 2010, the introduction of online cash registers (OCRs) should be highlighted as a first and high-impact measure. Online cash registers have made innovative use of the potential of modern technology to reduce tax evasion. The structure of OCRs differs from the formerly used cash registers in that it contains a tax control unit (TCU), which records the content of the receipts issued by the cash registers and transmits all relevant information to the tax authority every 30 minutes via mobile internet, including in addition to the contents of invoices issued by cash registers, also the time of opening and closing the cash register and of power outages. The sales of the given cash register can be tracked by means of the TCU, and it is not possible to subsequently modify the log files.

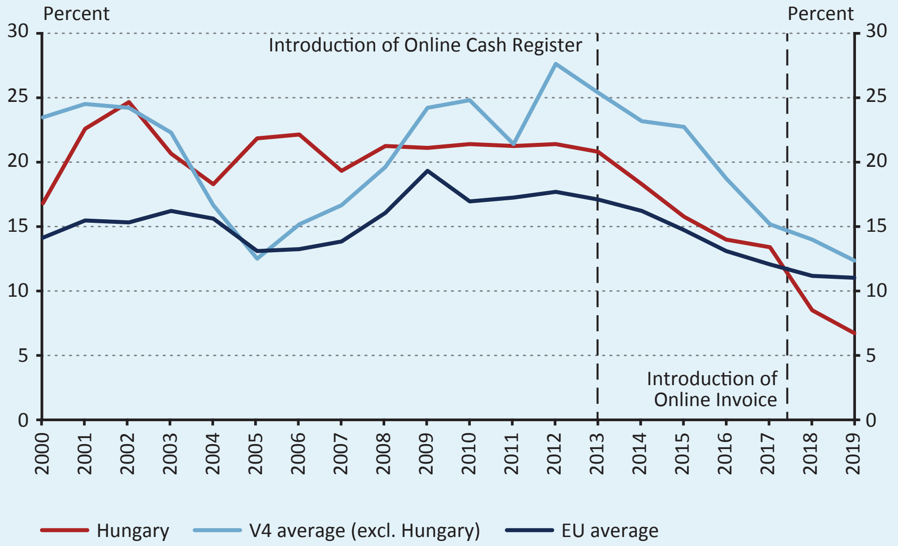
With the introduction of the OCR, the authorities aimed to reduce those actual sales that are lacking an invoice and to support the tax authority's control and selection process. In the first phase of the introduction, the devices were deployed between September 2013 and 2014, on a continuous basis. As a result of the measure, roughly 100,000 companies deployed almost 200,000 online cash registers. 70 percent of the companies purchased one online cash register, but there were more than 4,000 companies that replaced more than five of them. 83 percent of the turnover registered by the online cash registers can be linked to retail or accommodation and food services (AFS) sector. Based on the successes of the first wave, the mandatory use of online cash registers has been extended as of January 1, 2017 to the taxi passenger transportation, automotive parts retail, repair sectors and other service activities[12].

In addition to the introduction of online cash registers, the reduction of tax evasion was helped by the Electronic Public Road Trade Control System (EKÁER) introduced in early 2015, by means of which it become possible to trace the real journey of goods and thus prevent VAT fraud related to road traffic and trade in goods.

Similar to online cash registers, the introduction of the Online Invoice system in 2018 was aimed at reducing VAT evasion, which also brought about major results. The legislation made the provision of online data on invoices issued for transactions between resident taxpayers containing VAT of at least HUF 100,000 mandatory as of 1 July 2018. As of 1 July 2020, the Online Invoice system has been extended to transactions with a VAT content of less than HUF 100,000, and from 1 January 2021, NAV will also oversee invoices issued to individuals. As a result of the steps, from 2021, the tax authority will be able to electronically prefill – similarly to e-PIT – VAT returns, thus reducing the reporting burden of companies.

[12] Full scope of activities: vehicle repair, maintenance; retail trade of motor vehicle parts; motorcycle, parts trade, repair; taxi passenger transport; securities and commodity exchange brokerage exclusively currency exchange; from inpatient care activities exclusively plastic surgery; from other entertainment and leisure activities not elsewhere classified, exclusively dance halls, disco operation; from textile, fur washing, cleaning activities exclusively all kinds of clothing (including fur) and textile machinery, hand washing and dry cleaning, ironing; physical well-being services; taxable persons carrying out physical training services.

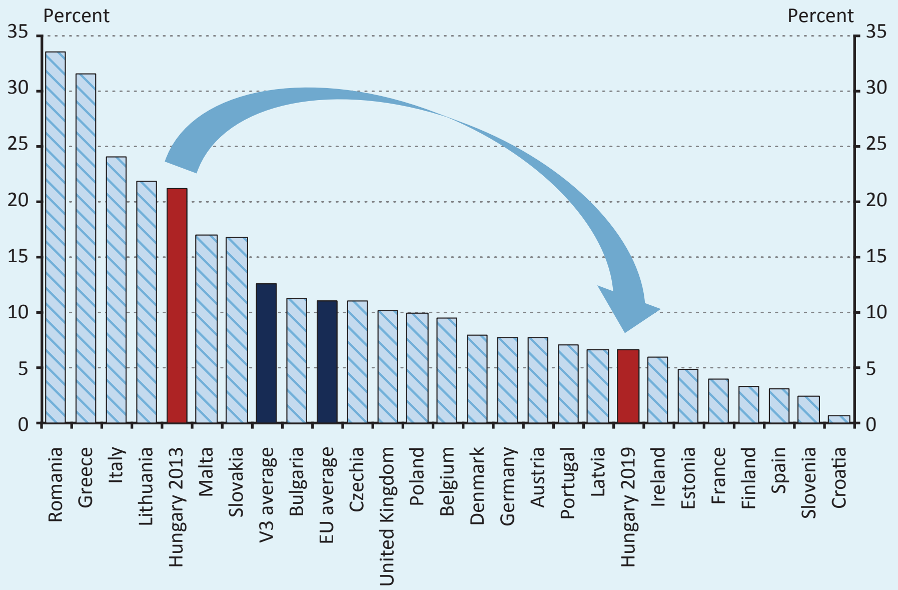
Chart 24
Development of VAT gap from the 2000's



Source: European Commission

As a result of the steps taken to reduce tax evasion, between 2013 and 2019 the VAT-gap fell in Hungary by 14.5 percentage points, to below the EU average (Chart 25). For the VAT, the most common measure of tax evasion shows the difference between the theoretical outstanding VAT liability based on economic developments and the VAT revenue actually collected. The most recent analysis published by the European Commission in September shows that in 2018 Hungary achieved the highest reduction in the shadow economy among the EU Member States compared to the previous year. According to preliminary estimates, the VAT gap decreased in Hungary to 6.6 percent by the end of 2019, making the indicator for Hungarian by 4 percentage points better than the EU average and by 6 percentage points better than the average of the Visegrád countries.

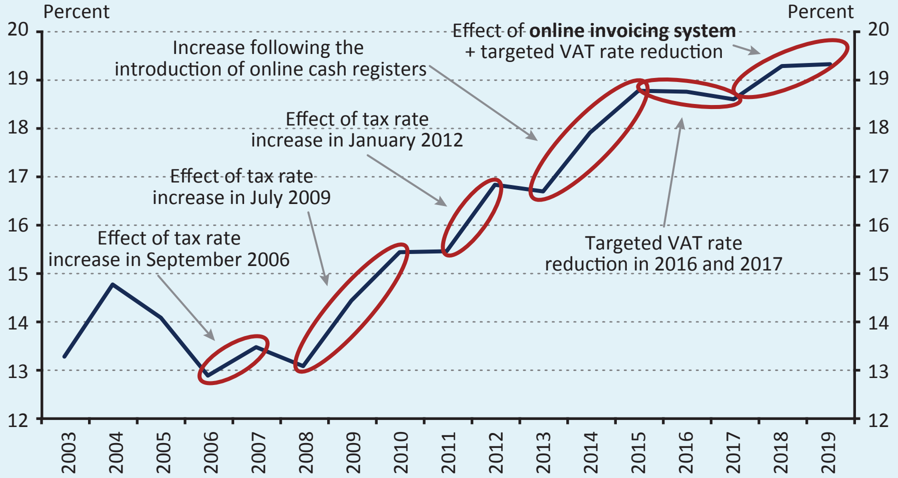
Chart 25
Estimated VAT gap in EU Member States (2019, preliminary estimate)



Source: European Commission

Another measure of VAT evasion is the effective VAT rate, which also indicates an increase in revenue (Chart 26). The effective VAT rate shows how the actually collected VAT relates to the theoretically available tax base. The indicator increases when the official VAT rate increases or when the efficiency of tax collection improves as a result of some measure. The substantial increase in the indicator between 2013 and 2015 took place without changing the VAT rate, i.e. it is basically related to the introduction of online cash registers. The effective rate decreased slightly in 2016-2017 as a result of targeted VAT reductions for new property, some basic food products and services. The introduction of the Online Invoice system may be behind the repeated increase in the effective VAT rate in 2018.

Chart 26
Development of the effective VAT rate in Hungary between 2003 and 2019



Source: MNB-calculation

In addition to macroeconomic figures, a company-level panel econometric study also confirms the effectiveness of the introduction of online cash registers[13]. Based on the research conducted by the experts of the MNB, the HCSO and the Ministry of Finance, the introduction of online cash registers increased the reported turnover in the scope of the examination, i.e. it resulted in a substantial reduction of the shadow economy in the retail – net of fuel sales – and AFS sectors. The effect is usually stronger in the AFS sector than in retail trade, and more significant among the smaller companies than at the larger ones. In the retail sector, the annual turnover of the smallest companies rose by 20-26 percent as a result of the introduction of the online cash registers, while that of the medium-sized companies was up by 3-7 percent. In the AFS sector, the annual turnover of the smallest companies rose by 30-40 percent as a result of the connection of the online cash registers.

5.2 GOVERNMENT MEASURES TAKEN TO MITIGATE THE ECONOMIC EFFECTS OF THE CORONAVIRUS

The budgetary impact of health defence efforts to control the coronavirus epidemic and measures to address the economic impact of the epidemic could be 7.3 percent of GDP in 2020. (Table 10). The measures are aimed at health defence, and the key objectives of the Economy Protection Action Plan are job preservation and job creation, targeted support for sectors adversely affected by the epidemic, and relaunch of the economy. Fund raising measures amount to 4.1 percent of GDP, thus, the net deficit-increasing effect could be 3.2 percent of GDP in 2020. The government intends to cover major part of the measures of the Economy Protection Action Plan from reallocations, the use of reserves, revenue-increasing measures (special retail tax, contributions from financial institutions) and reallocations of EU funds.

[13] Gábor Lovics, Katalin Szőke, Csaba G. Tóth, Bálint Ván: The effect of the introduction of online cash registers on reported turnover in Hungary https://www.mnb.hu/letoltes/mnb-op-137-final-1.pdf

Table 10
Summary of the estimated budgetary impact of measures taken to address coronavirus in 2020

Expenditures	HUF billions	GDP (%)
Health expenditure on the protection against the epidemic	801	1,7
Tax cuts and family support measures	409	0,9
Economy protection programmes	1,860	4,0
Job protection, job creation, developments	335	0,7
I. Total expenditures	**3,405**	**7,3**
Liabilities	**HUF billions**	**GDP (%)**
Budget reallocations in the 2020 budget	1,451	3,1
Revenue increasing and reallocation measures	125	0,3
Reallocation of EU funds	335	0,7
II. Total sources	**1,911**	**4,1**
III. Estimated effect on the budget balance (II-I)	**-1,494**	**-3,2**

Source: Amendment to the 2020 Budget Act, Magyar Közlöny (Hungarian Gazette), MNB

In 2020, the government can spend a total of HUF 801 billion on health defence, the purchase of medical equipment and the wage supplement for healthcare workers, which corresponds to 1.7 percent of GDP. At the beginning of July 2020, a gross one-off wage supplement of HUF 500,000 was paid to 170,000 healthcare workers, the budgetary impact of which, including contributions, totalled to HUF 101 billion. In addition, the previously decided increase of the salaries of healthcare workers represents an additional HUF 82 billion expenditure in the budget.

The total budgetary impact of the tax reduction measures provided under the Economy Protection Action Plan may add up to HUF 409 billion in total, representing 0.9 per cent of GDP. (Table 11). In the targeted industries[14], businesses are exempt **from employers' taxes** for the period between March-June and the rehabilitation contribution payment obligation was also suspended for the same period. Employees are exempt from the pension contribution and receive allowance from the health insurance contribution. The rental agreements concluded with the firms in these sectors were not allowed to be terminated until the end of June, and the rental price were not allowed to be raised. In addition, the lump sum tax of small entrepreneurs (**KATA**) was suspended until July for 151,000 entrepreneurs, and taxpayers received an allowance with respect to the small business tax (**KIVA**) liability until the end of July (for tax liabilities between March and June). The **tourism development contribution** and the **tourist tax** have also been suspended from March until the end of 2020. The limit on the **SZÉP Card'**s preferential tax rates rose to a base of HUF 800,000 benefits in the private sector and HUF 400,000 in the public administration, and no social contribution tax needs to be paid on the benefits on the card until the end of the year. In addition, most taxpayers were exempt from paying the water resource contribution in agriculture. The implementation of the previously announced **2 percentage point reduction in social contribution** tax as of July 2020 means a tax exemption of HUF 160 billion.

[14] Targeted sectors include, for example, tourism, catering, entertainment, film, travel arrangement, event management, public passenger transport by inland waterways, as well as sports, media and physical well-being services.

Table 11
Tax cuts and family support measures in 2020 (HUF billions)

Reduction of social contribution tax by an additional 2 percentage points	160
Annual VAT return of local governments	60
Rebate on employer and employee contribution for targeted sectors until 30 June	61
Tax exemption from KATA liabilities for certain selected services until June 30	26
Measures related to SZÉP card	44
Suspension of the tourism development contribution until 31 December	36
Exemption from vocational training contribution tax for targeted sectors until 30 June	4
Exemption from rehabilitation tax for targeted sectors until 30 June	3
Preferential KIVA obligation in certain sectors until June 30	2
Excise duty-free production of disinfectants	1
Extension of child care fee and child care allowance expiring during the state of emergency	11
Total tax cuts and family support measures	**409**

Source: Ministry of Finance, MNB

Protection of families and pensioners is also given high priority. In order to support families and pensioners, there is a moratorium on evictions, seizures, tax executions and outstanding KATA tax obligations. **Eligibility for childcare benefits** (child care fee, child care allowance, child raising support) has been extended until the end of the state of emergency. The **moratorium on loan repayments** lasting until the end of the year helps households as well as companies. The MNB estimates that the measure currently affects about 1.6 million retail and 60,000 corporate debtors and could leave up to HUF 2,000 billion in disposable income with the clients until the end of 2020. The government's decision in September 2020 extended the moratorium on loan repayments by an additional six months, until June 30, 2021, for those raising children, pensioners, the unemployed and public employees. In addition, companies can also take advantage of the loan repayment moratorium if their revenue has dropped by more than 25 percent. With the extension of the moratorium, in the first half of 2021, retail and corporate clients may be exempted from paying a total of approximately HUF 600 billion in downpayments.[15]

The income of pensioners will be significantly increased by the **gradual re-introduction of the 13th-month pension from 2021:** in February 2021, the beneficiaries will receive 25 percent of their January pension, then in 2022 50 percent of their monthly pension, in 2023 they will receive 75 percent of the pension amount, **while in 2024 and in subsequent years, pensioner will receive a full, one-month extra benefit**. The measure will have a budgetary impact first in 2021, about HUF 80 billion, which will gradually increase every year, thus, in 2024 the total impact could be 0.6 percent of GDP. These values also include the fact that, in addition to old-age pensioners, all beneficiaries of pension-like benefits will receive a 13th month extra benefit.

The government will provide a total of HUF 335 billion in funds for job protection, job creation and development by the reallocation of EU funds (Table 10). The job protection wage subsidy and the wage subsidy for those working in research and development, as well as the job creation wage subsidy, provided assistance for the employment of **280,000 employees in total**. Under the **wage subsidy** for employees employed under short-time working arrangements, 70 percent of lost wages are paid by the state for 3 months. About 18,000 enterprises applied for the job protection wage subsidy for the employment of 207,000 employees, representing about HUF 35 billion in expenditure in the budget. For those employed in **research and development jobs** a 40 percent wage subsidy (maximum HUF 319,000/person/month) is granted, for which an envelope of HUF 32 billion has been specified. A total of about 1,300 companies applied for the research and development wage subsidy, and it was used for 23,000 employees, representing a HUF 17 billion subsidy claim. **Under the job creation wage subsidy programme**, the state reimburses the employer monthly HUF 200,000 during the first six months, after which the employment of the coworker must be continued for another 3 months. The subsidy can be

[15] Tamás Nagy – Barnabás Virág (2020): Minden eddigi számításnál kedvezőbb lehet a moratórium meghosszabbításának hatása. (The effect of extending the moratorium may prove be more favourable than any previous calculation.) https://www.mnb.hu/letoltes/nagy-tamas-virag-barnabas-hitelmoratorium-meghosszabbitasa.pdf

claimed also by companies that laid off workers due to the crisis and are now recruiting workers again. A total of 37,000 companies applied for the job creation wage subsidy programme, and employers were able to hire 49,000 jobseekers as a result of the programme. In addition to job protection and job creation wage subsidies, the government, taking into account also other support elements of the Economy Protection Action Plan (e.g. contribution reductions, adult education), **provided support to a total of about 1 million people.**

The budget supports economy protection with substantial resources. The government initially allocated HUF 943 billion to the Economy Protection Fund through internal budget transfers, and the Fund's expenditures will be higher than previously planned. The use of the resources in the Fund started from the second half of April and the amount of the used resources exceeded the budgeted expenditures at the end of June. When the 2020 Budget Act was amended, a decision was adopted that the expenditures of the Economy Protection Fund may exceed the planned budget. By September 21, 2020, the government has decided on the payment in total of HUF 1,860 billion to the expenses of the Economy Protection Fund, which corresponds to 4 percent of GDP. The Fund's expenditures also support the relaunch of the economy, as **public investments** may be financed from this envelope in a considerable amount. **Subsidies to improve competitiveness** amounting to HUF 199 billion are also included in the expenditures of the Economy Protection Fund. The first round of applications for the subsidy closed at the end of May; however, on 1 September the possibility to submit applications was reopened up to the unused amount. In the first round, by the end of May, a total of 806 applications were received, the amount of support claimed totalled to HUF 179 billion, and the total value of investments under the programme may amount to HUF 377 billion. Subsidies to improve competitiveness will protect a total of 155,000 jobs in 30 industries and enable the realisation of new investments in the value of HUF 425 billion. **The financing of companies is also supported by capital and guarantee schemes**, the total amount of which is HUF 2,100 billion.

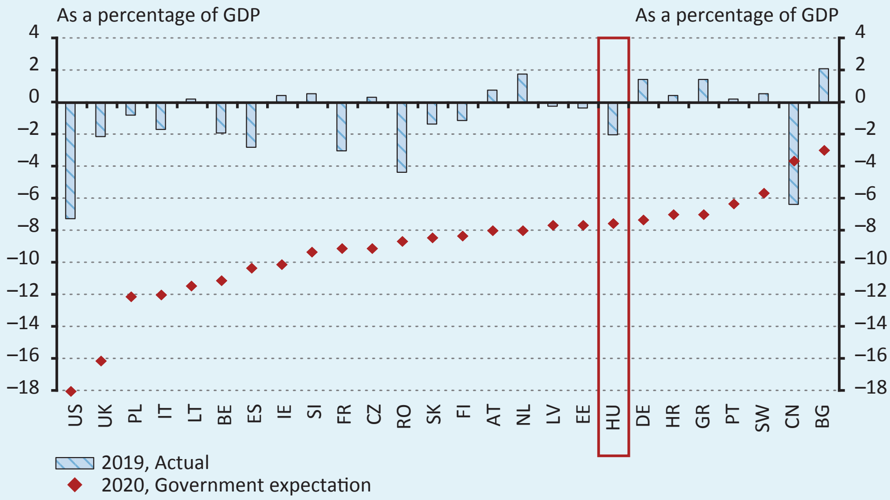
The government may cover a significant part of the measures from reallocations, the use of reserves, revenue-increasing measures and reallocations of EU funds. In 2020, revenue-raising measures may amount to HUF 125 billion. The tax on credit institutions will be increased by HUF 55 billion, which banks can deduct from their tax in the next five years. A special retail tax will be introduced until the end of the state of emergency. The subjects of the tax are shop merchants, as well as car and fuel retailers. The tax is to be paid on the basis of net sales revenue, and the tax rate increases with the sales revenue. The tax is expected to generate HUF 36 billion in revenue for the budget. The part of the motor vehicle tax due to local governments will be redirected to the central budget, which means an additional revenue of HUF 34 billion to the central budget.

The intra budget transfers and the use of the Country Protection Fund together represent a measure raising HUF 1,451 billion funds. Within this, the savings of the central institutions and programmes amount to HUF 943 billion, the use of the Country Protection Fund to control the epidemic amounts to HUF 378 billion, while the previously decided increase of the salaries of healthcare professionals and maternity nurses amounts to HUF 82 billion. In addition, HUF 1.3 billion was reallocated from the support of political parties and HUF 47 billion from local government expenditures to control the epidemic. Another fundraising measure is the reallocation of HUF 397 billion in EU funds to programmes aimed at mitigating the economic effects of the epidemic. This means that EU funds already planned to be called will be used for other purposes (this is not an additional call for funds).

5.3 INTERNATIONAL OVERVIEW OF THE DEVELOPMENT OF THE DEFICIT AND PUBLIC DEBT IN 2020

Governments themselves expect the general government deficit to rise on average to 8.4 percent of GDP in the EU and to 9.8 percent of GDP in the V3 countries in 2020. Member States have embarked on a major fiscal stimulus to address the crisis, which, together with the automatic effects of economic downturn, will lead to a significant deficit increase this year. Among the countries examined, the United States stands out, where a deficit of 18 percent is expected this year, according to the European Commission's May forecast. There, a significant deficit-increasing package was adopted with a deficit increase already dragged on for several years (the budget deficit as a percentage of GDP was 7 percent in 2019). In the United Kingdom, the general government deficit could be as high as 16 percent of GDP, where in addition to the pandemic, Brexit is also worsening the economic outlook. In the case of Hungary, the 7-9 percent government deficit expectation can be said to be average in EU comparison (Chart 27).

Chart 27
Government expectations for the general government balance-to-GDP

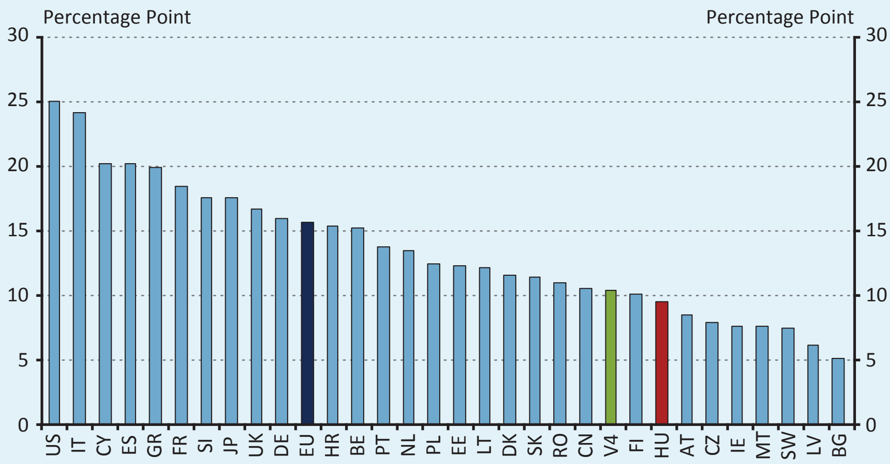


Note: For the US, the European Commission's May forecast is shown
Source: European Commission (2019), MNB collection (2020)

In parallel with the recovery from the crisis and according to government expectations, the general government deficit in 2021 may reach 3.1 percent of GDP in the European Union and 5.6 percent of GDP in the Visegrád countries. According to the forecasts, EU Member States' budget balances may improve significantly in 2021 compared to the previous year; however, they are not expected to reach pre-crisis levels that year.

In 2020, gross public debt as a proportion of GDP may increase by an average of 16 percentage points for the European Union and by 10 percentage points in the V4 countries compared to the previous year (Chart 28)**.** Among the countries examined, the most significant growth may take place in the US (25 percentage points) and Italy (24 percentage points), but even in Greece and Italy and increase of 20 percentage points is expected in 2020. The level of the debt ratio, in contrast to the deficit, may increase for a protracted period and may adjust only to a limited extent over the forecast horizon. The debt-increasing effect of the temporarily high deficit is not expected to be reversed by the budget surplus in the coming years; therefore, a permanently higher debt level is expected.

Chart 28
Change in gross government debt-to-GDP between 2019 and 2020



Source: European Commission, International Monetary Fund, Inflation Report (September)

The response of fiscal policy to the recession caused by the coronavirus epidemic has been comprehensive worldwide and has resulted in many similar sets of measures. The sets of measures covered almost all areas of public activity, from taxation to direct government expenditure to the impact of government regulation on the economy. In the countries examined, fiscal decision-makers mostly responded to the crisis with a similar set of tools: a measure introduced almost everywhere was the temporary reduction of labour and/or corporate taxes, postponing the payment of the same taxes within the year, launching government wage substitute or support programmes, corporate loan programs and direct support to certain groups involved (such as families, the unemployed, small and medium-sized businesses). To a lesser extent, the composition of fiscal policy included government investment and capital injections, as well as the introduction of various moratoriums (loans, utilities, rents, etc.) in the analysed countries. After the curfews were lifted, with the end of the first wave, governments shifted their focus to economic recovery, with more and more countries announcing investment stimulus programmes. It is important to note that although these elements are included in the fiscal policy response of many states, their weight and the structure of measures vary from country to country.

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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IN 2019–2020

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