PUBLIC FINANCE REPORT

2021
SEPTEMBER

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

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

PUBLIC FINANCE REPORT

Semi-annual analysis
of public finance developments

2021
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To support the fulfilment of its fundamental duties set forth in Act CXXXIX of 2013 on the Magyar Nemzeti Bank, in particular the tasks related to the determination and implementation of monetary policy, the Magyar Nemzeti Bank analyses developments in the budget deficit and debt, monitors the financing of the general government, analyses the impact of financing on monetary developments, capital markets and liquidity, and researches fiscal policy issues.

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

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

The analysis is based on information available for the period ending on 28 July 2021.

Contents

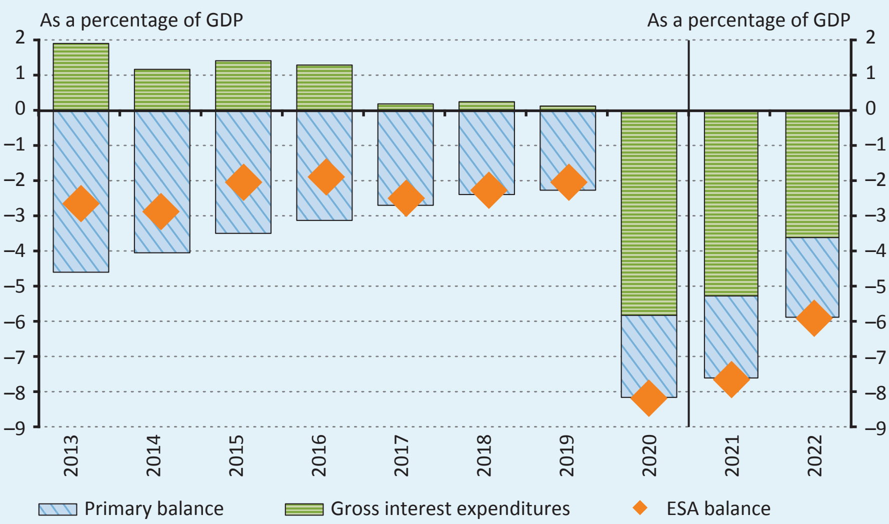
1 Summary

The purpose of this analysis is to present the developments in public finance in 2020 and the expected fiscal developments for 2021, on the basis of budget figures available for the first half of the year and the MNB's forecast prepared for its June Inflation Report. The analysis also intends to provide an overview of the realisation of the targets in the 2022 Budget Act adopted in June 2021. In view of the above, the actual compliance with the national and European Union's fiscal rules related to the budget balance and government debt for 2020, as well as the expected compliance for 2021 and 2022 are assessed.

GDP data of the first quarter of 2021 were more favourable than expected. According to the projection in the MNB's June Inflation Report the output of the Hungarian economy may increase to a larger degree in the remaining part of this year and also next year than the expectations underlying the budgets. Economic performance may grow by 6.2 per cent in 2021 and by 5.5 per cent in 2022, underpinned by the early opening, the economic policy providing strong support for the restart and accelerating public investments. Growth in corporate investments is equally supported by several large-scale development projects, the potential restart and continuation of the investments postponed in 2020, increasing corporate lending, favourable financing environment as well as by the government and central bank programmes. Household investments are stimulated by – in addition to the re-introduction of the preferential VAT on new housing and the Home Improvement Scheme – several family support schemes. Despite the pandemic, wage dynamics remained buoyant, while unemployment rate is still low in an international comparison. After the fading of the new waves of the pandemic, the recovery of the labour market and repeatedly coming closer to full employment may be realized faster than expected earlier. Household demand is recovering in parallel with the gradual lifting of the restrictions, also contributed to by a fall in the high savings rate and vigorous rise in incomes.

As a result of the measures taken to contain the coronavirus pandemic and the declining tax revenues, the budget deficit rose to 8.1 per cent of GDP in 2020 (Chart 1). This broke the multi-year trend of the accrual-based deficit being below 3 per cent of GDP. While the slowdown of economic growth resulted in a shortfall in tax revenues, through the government measures to mitigate the negative economic impacts of the pandemic, funds equivalent to 12.1 per cent of GDP flowed into the economy. The government covered almost one third of the measures with a direct budgetary impact by the reallocation of budgetary and EU funds as well as by imposing surtaxes on certain sectors (retail surtax, financial organisations' contribution), and thus the net cash-based balance effect of these measures amounts to 8.3 per cent of GDP. The temporary suspension of the 3 per cent Maastricht deficit criterion by the European Union supported the economic policy fostering recovery.

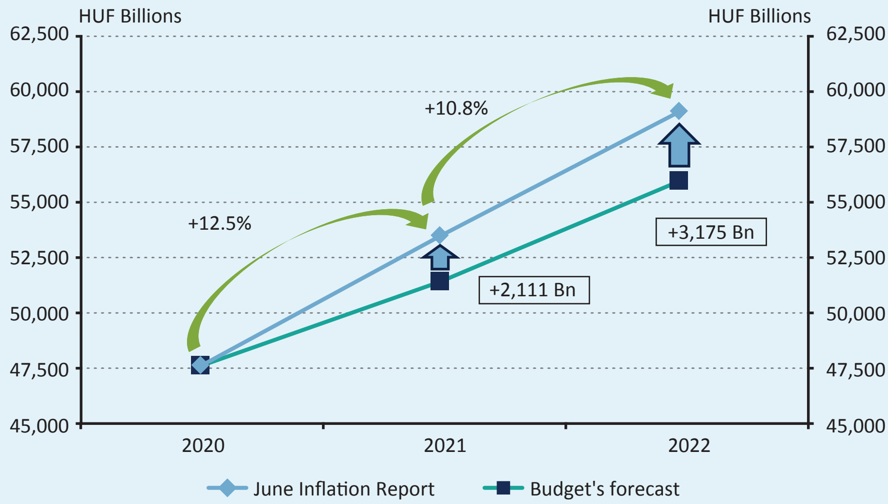
Chart 1
Balance of the general government sector (as a percentage of GDP), 2013–2022



Source: HCSO, MNB

According to the government's plans, the budget deficit target in 2021 and 2022 is 7.5 per cent and 5.9 per cent, respectively, and it would reach the Maastricht criterion of 3 per cent only in 2024. The decline in the deficit is caused primarily by the rise in revenues resulting from the acceleration of economic growth and the decrease in the pandemic prevention costs, which rose to a high level in 2020-2021. According to our forecast, the performance of the Hungarian economy may develop more favourably compared to the expectations of the budget, which may create the basis for a larger decline in the government deficit even in the short run. The fall in the deficit remains moderate in 2022 despite the fact that nominal GDP growth may exceed 10 per cent both this year and the next (Chart 2). Based on the favourable macroeconomic expectations, more ambitious reduction of the deficit and debt than currently envisaged may be a realistic target, and thus in 2022 it is worth saving the surplus funds generated by the economic growth. The more favourable prospects improve the budget balance and reduce the debt ratio through the growth in tax bases and the denominator effect resulting from the higher expected output. On the other hand, based on the extra-budgetary spending plans, the budget utilises the leeway resulting from the growth in excess of the expectations and the surplus revenues will be spent, and thus we forecast a deficit path consistent with the deficit target.

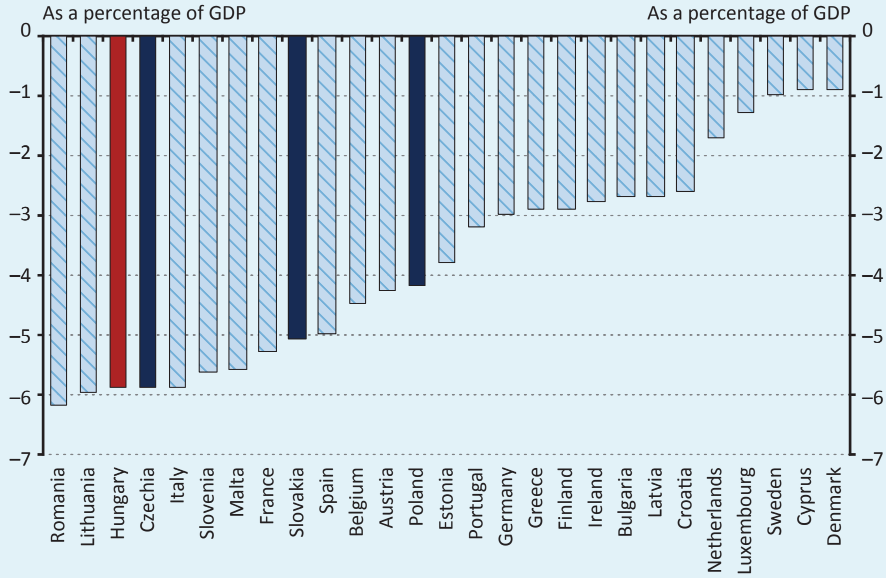
Chart 2
Expected nominal GDP according to the budget bill and forecast in the June Inflation Report



Source: 2022 Budget Acts, Convergence Programme, MNB forecast

The Hungarian budget deficit of 5.9 per cent as a percentage of GDP may be the third highest one in the European Union in 2022 (Chart 3). Based on the Stability and Convergence Programmes submitted by the Member States, the Hungarian government deficit – amounting to 5.9 per cent of GDP – would finish in the first three (tie) in an EU comparison, and it may also exceed the level of the countries in the region.

Chart 3
EU Member States' expected budget balance as a percentage of GDP in 2022



Source: Stability and Convergence Programmes

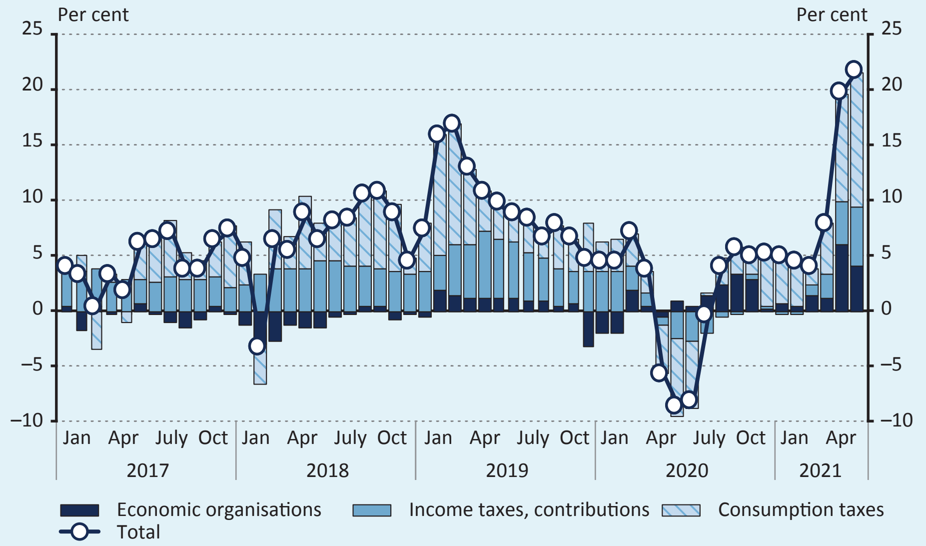
By the end of 2020, the gross government debt as a percentage of GDP rose from 65.5 per cent registered at the end of 2019 by roughly 15 percentage points to 80.4 per cent. According to our forecast, following a temporary rise, the gross government debt-to-GDP ratio will decline to 76.8 per cent by end-2021. By the end of 2022 it will decline further, to 75.4 per cent (Chart 4). The expectations in the Budget Acts anticipate a government debt of 79.9 per cent and 79.3 per cent, as a percentage of GDP, for 2021 and 2022, respectively. The delay in the inflow of EU funds may result in a change in the debt ratio's time profile, i.e. this year it causes the debt level to decline more slowly than expected and then, upon the actual receipt of the funds, it will reduce the debt. The reduction of the debt is supported by the partial absorption of the government deposits, that were significantly increased in 2020, as well as by the persistently low level of government interest expenses, offset by the high primary balance deficit. The faster debt reduction anticipated in our forecast compared to the budget bill is caused by the dynamic economic growth. The foreign currency ratio of the central budget debt is expected to decline to around 18 per cent in 2021-2022 from 19.9 per cent registered at the end of 2020.

Chart 4
Expected development in gross government debt as a percentage of GDP

Source: Government Debt Management Agency, MNB

The level of the budget's tax and contribution revenues as a percentage of GDP fell by 0.1 percentage point in 2020. Following this, tax centralisation is likely to decline in 2021 due to the rising output and in 2022 due to the reduction of labour tax and contribution revenues. Owing to the fast opening and the dynamic restart of the economic processes tax revenues showed a double-digit growth in the second quarter of 2021 year-on-year (Chart 5) and they are expected to exceed the amended appropriation by roughly HUF 500 billion (by 1 per cent of GDP). It projects a future increase in tax revenues that part of the tax allowances introduced for the period of the state of emergency remained in force also in the first half of this year. On the other hand, based on the government's announcements related to 2022, the exemption of young employees, below the age of 25, from the personal income tax represents a permanent tax cut of larger effect than those of the measures introduced in the past few years – amounting to roughly 0.3 per cent of GDP, while the one-off tax refund to parents with children may generate a shortfall of roughly 1 per cent, as percentage of GDP, in revenues.

Chart 5
3-month moving average of annual change in central subsector's tax and contribution revenues



Note: In addition to the restart of the economy, the restrictions introduced in view of the crisis last year as well as the tax policy measures fostering employment and supporting the liquidity of enterprises also contributed to the outstanding dynamics in 2021.
Source: Hungarian State Treasury

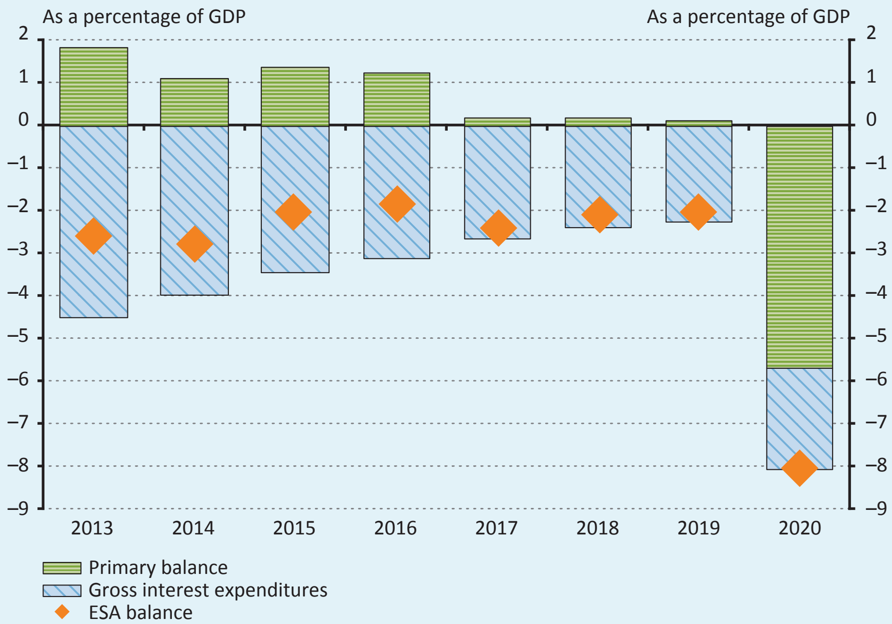
Public sector spending is expected to exceed by roughly HUF 2,200 billion (4.1 per cent of GDP) the amount of the amended appropriation in 2021, and this excess is primarily linked to the expenditure related to the prevention of the pandemic and certain measures aimed at the restart of the economy. The revision affected only the appropriations meant to be amended by the Parliament, while the appropriations implemented within the competence of the government and those deviating without separate amendment due to changes in demographic and other trends were not modified. In 2022 the wage review of healthcare workers and the reinstatement of the 13th month pension will continue, and major public funds will continue to be allocated to infrastructural and employment creation developments and to the fostering of investments. According to the Convergence Programme, with a view to supporting the restart of the economy, government investments will rise to a historic high of 7.1 per cent from that of 6.5 per cent of GDP registered in 2021. On the other hand, it is reasonable to extend the implementation of public investments due to the global increase in raw material prices and the high utilisation of construction capacities.

The budgetary processes expected for 2021, subject to applying the exemption clauses, will be in line with the requirements pertaining to the general government balance and the government debt. The Maastricht deficit criterion, included in both the Hungarian and the EU fiscal framework, specifies that the accrual-based deficit of the general government may not exceed 3 per cent of GDP. The Hungarian budget deficit in 2020 was 8.1 per cent of GDP, 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. According to the latest notification by the EU organisations, the general exemption clause will continue to apply in 2022 as well, while in the Hungarian legislation the 3 per cent debt criterion and the rules related to attaining the medium-term budgetary objective have been suspended in the 2021-2023 fiscal years.

2. Balance of the general government sector in 2020

The government sector's ESA deficit of 2020 was 8.1 per cent of GDP. In 2020, the growth in expenditures and the shortfall in tax revenues caused by the coronavirus crisis, broke the multi-year trend of the accrual-based deficit being below 3 per cent of GDP (Chart 6). The economy protection measures mitigating the economic impacts of the pandemic amounted to 8.3 per cent of GDP: the focus was on the job protection and economy protection programmes in addition to the tax cuts and family support measures (Table 1). The economic policy fostering recovery was facilitated by the fact that the European Union temporarily suspended the 3 per cent Maastricht deficit criterion. **As a result of the outstanding deficit, the declining trend in the gross government debt to GDP ratio, lasting since 2011, also faltered** and by the end of 2020 it rose by roughly 15 percentage points to 80.4 per cent from 65.5 per cent registered at the end of 2019.

Chart 6
Balance of the general government sector (as a percentage of GDP), 2013–2020



Source: HCSO, MNB, 2020 Budget Act

Table 1
Budgetary implications of government measures in 2020 (as a percentage of GDP)

Measures with a direct budgetary impact	**12.1**
1. Tax cuts and family support measures	0.9
2. Job protection	0.6
3. Economy protection programmes	8.5
4. Expenditure on disease control	2.2
Fund raising measures	**3.8**
1. Revenue increasing measures	0.3
2. Budget reallocations	3.0
3. Reallocation of EU funds	0.5
Impact on the budget balance	**-8.3**

Source: Ministry of Finance, MNB

The ESA deficit of HUF 3,870 billion reflects the balance of the central subsector's (balance of the central government and the social security funds) deficit in the amount of HUF 3,923 billion and the local government subsector's surplus of HUF 53 billion. Following the 2019 deficit, the accrual-based balance of local governments once again turned into a moderate surplus, amounting to 0.1 per cent of GDP. (Table 2).

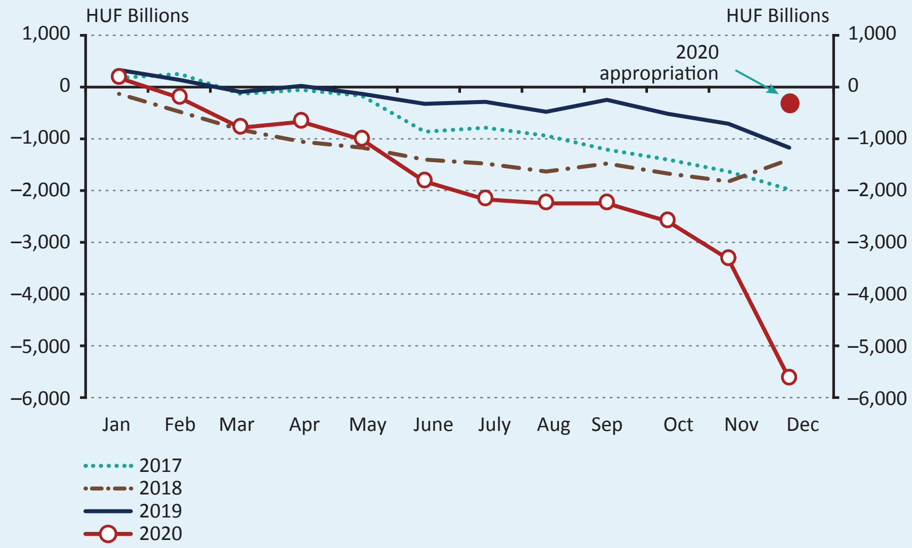
Table 2
Budget balance indicators in 2020

	Cash-based balance	**ESA-bridge**	**ESA balance**
	HUF Billions		
Central subsector	-5,552	1,630	-3,923
Local governments	-101	154	53
Total general government	**-5,653**	**1,783**	**-3,870**
	As a percentage of GDP		
Central subsector	-11.6	3.4	-8.2
Local governments	-0.2	0.3	0.1
Total general government	**-11.8**	**3.7**	**-8.1**

Source: EDP Report, April 2021

The 2020 **cash-based deficit of the general government** (the central and local government subsector) amounted to HUF **5,653** billion at year end. **Based on Hungary's EDP report, the cash-based deficit of the central subsector was HUF 5,552 billion in 2020.** The annual cash-based deficit exceeded the HUF 367 billion deficit target specified in the Budget Act by almost HUF 5,180 billion (Chart 7).

Chart 7
Intra-year developments of cash-based deficit of the central subsector (year-to-date cumulative value)



Note: The cash-based data of the Hungarian State Treasury (HUF 5,549 billion) differs by roughly HUF 3 billion of that stated in the EDP report (HUF 5,552 billion)

Source: 2020 Budget Act, Hungarian State Treasury

2.1. REALISATION OF THE MACROECONOMIC PROJECTIONS UNDERLYING THE BUDGET

As a result of the coronavirus pandemic, the performance of the Hungarian economy shrank by 5.0 per cent in 2020. This substantially fell short of the expectations reflecting the appropriation. The 2020 Budget Act calculated with a real economic growth of 4.0 per cent, which, on the whole, was in line with the analysts' expectations and did not deviate significantly from the central bank's projection. The crisis caused by the COVID pandemic significantly diverted the Hungarian economy from the formerly expected path, which – however – was not foreseeable when the budget was prepared.

As a result of the COVID pandemic, total **employment** declined by 0.9 per cent in 2020. Despite the crisis, the growth rate of the gross average wage was 9.7 per cent in 2020, which represents only a minor deceleration compared to the double-digit wage dynamics observed in previous years. The high wage dynamics also exceeded the projection in the Budget Act. The dynamic wage growth was supported – in addition to the technical effects (impact of part-timers, impact of change in headcount) – by the 8 per cent increase of the minimum wage and guaranteed wage minimum, the wage reviews at the beginning of the year (before the pandemic) and the substantial resilience of the labour market.

The budget calculated with a 4.8 per cent **growth in the consumption of the households**, whereas consumption expenditures fell by 2.5 per cent due to the pandemic and the restrictive measures introduced to contain it. Contrary to the previous crisis, demand for services significantly declined, while the consumption of durable goods continued to rise dynamically.

Table 3
Comparison of the macroeconomic projection in the 2020 Budget Act and the actual figures

	Government's forecast	Actual
GDP	**4.0**	**-5.0**
Exports	5.2	-6.8
Imports	5.4	-4.4
Gross fixed capital formation	3.8	-7.3
Consumption expenditure of households	4.8	-2.5
Public consumption	1.7	-0.8
Consumer prices index	**2.8**	**3.3**
Average gross earnings	**8.3**	**9.7**

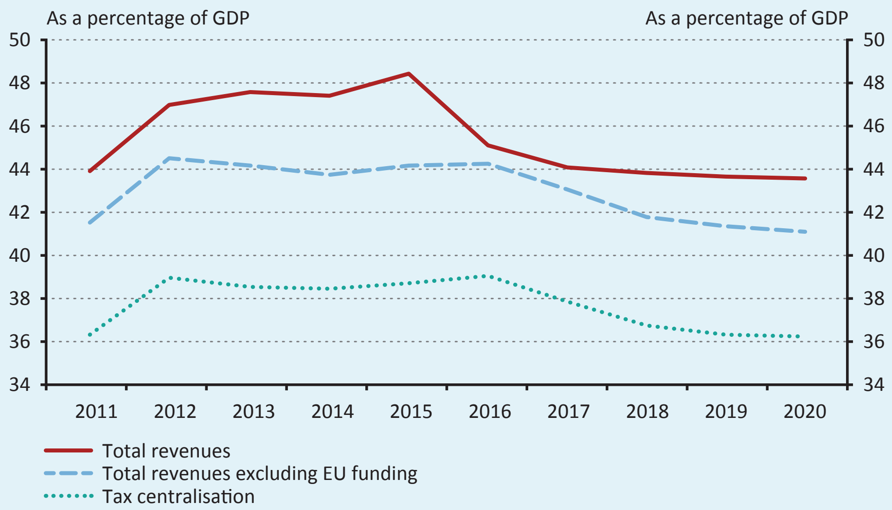
Source: HCSO, 2020 Budget Act

The consumer price index was 3.3 per cent instead of 2.8 per cent anticipated by the Act. The change in commodity prices and the global coronavirus pandemic exerted significant effect on the annual inflation developments, causing material volatility. In the summer months price dynamics exceeded the usual pattern, which may have been attributable to the repricing resulting from the sudden shift in demand and supply conditions, connected to the restart of the economy. In addition to this, the excise duty increases (tobacco products and fuels) also pointed to a growth in inflation.

2.2. BUDGET REVENUES

By 2020 the accrual-based revenues of the general government decreased to 43.5 per cent of GDP compared to 43.6 per cent of previous year, while the decline without the EU grants was 0.3 percentage point (Chart 8). The tax centralisation's rate of decline slowed down, with the decline amounting to merely 0.1 percentage point.

Chart 8
Accrual-based revenues of the government sector and degree of tax-to-GDP ratio



Source: HCSO, MNB

Consolidated cash revenues of the central subsector amounted to HUF 18,559 billion, of which HUF 16,248 billion was linked to tax and contribution revenues (Table 4). Due to the economic crisis caused by the pandemic tax revenues considerably fell short of the statutory appropriations.

Table 4
Partially consolidated revenues of the central subsector in 2020 (HUF billions)

	2019	2020		
	Actual	Statutory appropriation (original)	Actual	Difference (actual – appropriation)
TAX AND CONTRIBUTION REVENUES OF THE CENTRAL SUBSECTOR	**15,936**	**17,192**	**16,248**	**-944**
Payments by economic organisations	**1,414**	**1,690**	**1,611**	**-79**
Corporate income tax	303	501	407	-95
Surtaxes payable by financial institutions	57	65	120	55
Retail tax	0	0	48	48
Simplified corporation tax	43	0	2	2
Mining royalty	46	38	31	-7
Gambling tax	28	36	35	-1
Income tax on energy providers	27	74	64	-11
Itemised tax of small taxpayers	159	193	158	-34
Tax of small enterprises	70	88	83	-4
E-road toll	216	235	217	-18
Tax of utility system	55	54	53	-1
Other taxes and payments	405	406	394	-12
Advertising tax	6	1	0	-1
Consumption taxes	**6,140**	**6,637**	**6,268**	**-369**
Value added tax	4,532	4,970	4,669	-301
Excise duties	1,176	1,226	1,196	-30
Motor vehicle registration tax	25	27	20	-7
Telecommunication tax	54	54	57	3
Financial transaction levy	243	226	218	-9
Insurance tax	82	98	99	1
Tourism development contribution	27	36	10	-26
Payments by households	**2,698**	**2,899**	**2,827**	**-72**
Personal income tax	2,425	2,609	2,528	-81
Duties, other taxes	223	238	214	-24
Motor vehicle tax	50	52	85	34
Tax and contribution revenues of extra-budgetary funds	**466**	**451**	**436**	**-15**
Tax and contribution revenues of social security funds	**5,217**	**5,516**	**5,107**	**-409**
Social contribution tax and contributions	5,027	5,344	4,953	-391
Other contributions and taxes	190	172	154	-18
REVENUES RELATED TO EU FUNDS	**1,586**	**1,513**	**1,700**	**187**
OTHER REVENUES	**466**	**350**	**610**	**260**
Other revenues of the central budget	312	217	406	189
Other revenues of social security funds	39	33	40	7
Other revenues of extra-budgetary funds	115	99	164	65
TOTAL REVENUES	**17,988**	**19,056**	**18,559**	**-497**

Source: Hungarian State Treasury, 2020 Budget Act, MNB

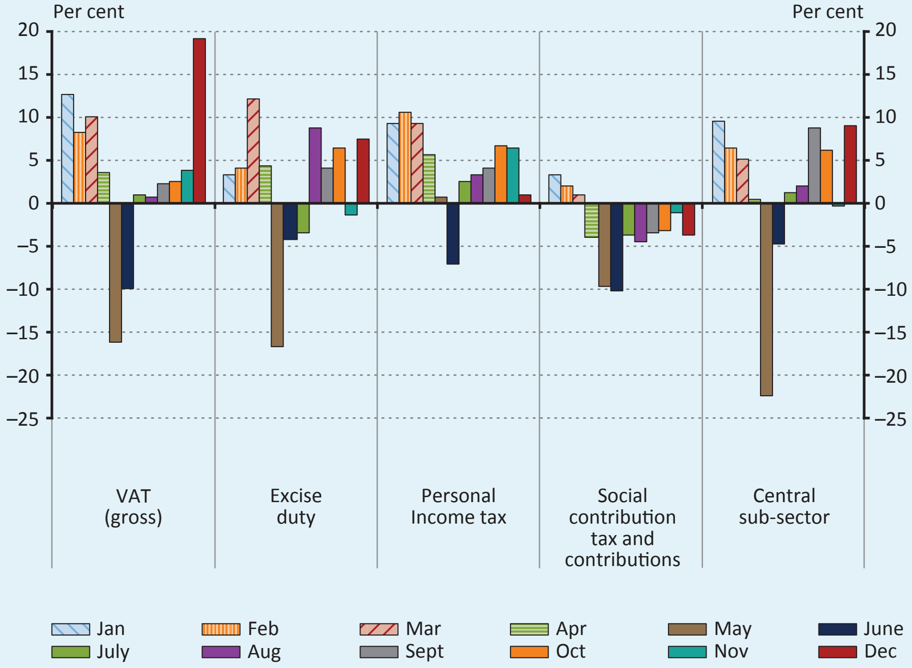
In 2020 payments by enterprises fell short of the appropriation included in the Budget Act by HUF 79 billion. The effects of the coronavirus pandemic and the related economic downturn mostly influenced revenue trends through two threads: directly and through the crisis management measures. The decline in economic activity mostly explains the major revenue shortfall compared to the appropriation in the case of the following tax types: **corporate income tax** (HUF - 95 billion), **energy suppliers' income tax** (HUF -11 billion), **electronic road toll** (HUF -18 billion), and within other payments **time-based road toll** (HUF -14 billion) and **environmental product levies** (HUF -9 billion). Revenues from **mining royalties** fell short of the statutory appropriation by HUF 7 billion, since the major decline in fuel prices led to lower tax payments.

In the following tax type categories the shortfall in payments compared to the appropriation is also attributable – in addition to the economic downturn – to the fiscal policy measure supporting the survival of enterprises, but at the same time reducing budget revenues. In the case of the **itemised tax of small taxpayers** (KATA), payments fell short of the appropriation by HUF 34 billion. In order to mitigate the economic losses caused by the restrictions implemented in connection with the spring phase of the pandemic, the Government cancelled KATA payment in March, April, May and June of 151,000 taxpayers in 26 subsectors. Revenues from **small enterprise tax** fell short of the appropriation by HUF 4 billion. In addition to the aforementioned spring months, a group of small enterprise taxpayers hardest hit by the crisis also benefited from a tax allowance in November and December 2020; however, in cash terms this resulted in a tax loss of only one more month in 2020, since the tax for December was paid by the taxpayers to the Treasury only in January 2021. The tax allowance supporting enterprises affected, within other payments by economic organisations, the **rehabilitation contribution** (HUF -5 billion) and the other centralised revenues (HUF -5 billion).

In the third group of the taxes of economic organisations the government measures led to a rise in revenues compared to the appropriation, since certain tax increases helped partially finance the crisis management. Revenues from the **surtaxes payable by financial institutions** exceeded the relevant appropriation in the Budget Act by HUF 55 billion. In this case, the measure prescribed for credit institutions an additional tax payment at the rate of 0.19 per cent for their tax base over HUF 50 billion. Taxpayers may write off the excess tax paid in 2020 in 5 equal instalments between 2021 and 2025. Payments of **retail tax** amounted to HUF 48 billion by the end of 2020. The Government introduced the tax type in April 2020, after that in March 2020 the European Court of Justice declared the tax structures of sectoral surtax applicable to telecommunication and retail companies between 2010 and 2013 to be compatible with the EU legislation. The tax type broadly corresponds to the former sectoral surtax applicable to retail companies. Retail trade taxpayers are required to pay to the Treasury a tax increasing on a tiered basis depending on their net sales. The first HUF 500 million of the tax base is exempted from tax. The rate of the tax payable between HUF 500 million and HUF 30 billion is 0.1 per cent, between 30 and 100 billion 0.4 per cent and over HUF 100 billion 2.5 per cent.

Compared to 2019, payments by enterprises increased by HUF 196 billion. The HUF 103 billion growth in corporate income tax is attributable to the cancellation of the year-end tax advance top-up obligation in 2019. Revenues from the income tax of energy providers rose by HUF 37 billion due to the cancellation of the tax advance top-up obligation in the base year. Tax of small enterprises revenues rose by HUF 13 billion, mostly due to the fact that the number of taxpayers increased by 28 per cent between 2019 and 2020. Mostly due to the tax increases introduced to finance the crisis management, payments from the surtaxes payable by financial institutions and retail tax revenues exceeded previous year's figure by HUF 64 billion and HUF 48 billion, respectively. Revenues from the simplified business tax fell short of those of previous year by HUF 42 billion due to the phase-out of the tax type in early 2020. Revenues from mining royalties fell short of previous year's figure by HUF 15 billion due to the major decline in fuel prices.

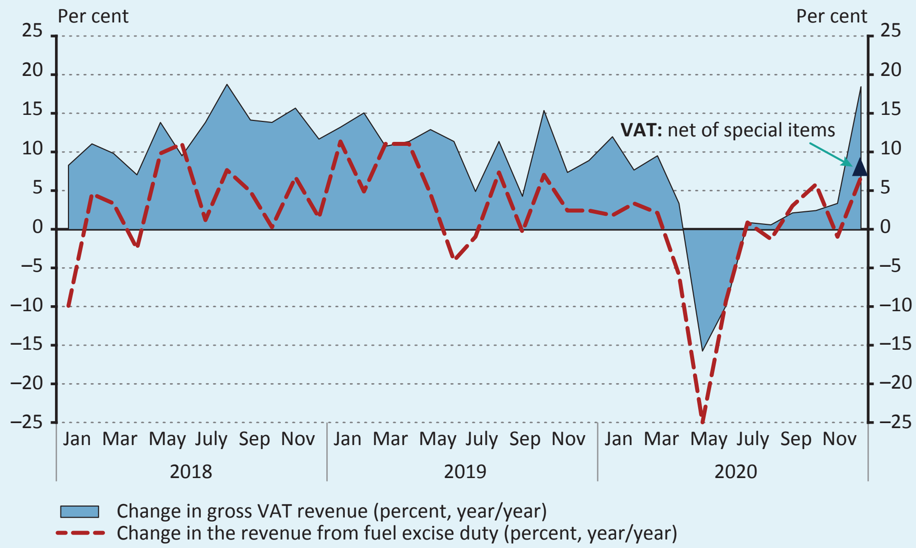
Chart 9
Change in major tax and contribution types year-on-year



Source: Hungarian State Treasury, MNB calculation

Net revenues from **value added tax** amounted to HUF 4,669 billion in 2020, exceeding last year's revenues by HUF 137 billion. Due to the major decline in consumption, caused by the pandemic, 94 per cent of the 2020 statutory appropriation was realised. In the second quarter the decline was 7.5 per cent on average, followed by a slow growth from the second half of the year (Chart 10). In addition, the change in the deadline for reclaiming VAT reduced the 2020 cash receipts by roughly HUF 100 billion. The economy protection measure helping small and medium-sized enterprises reduced the deadline for VAT reimbursement from 30 to 20 days in the case of reliable taxpayers and from 75 to 30 days in the case of normal taxpayers, thereby supporting the liquidity of enterprises. In addition, the fact that the deadline for the VAT return of reporting agents belonging to the local government subsector of the general government was postponed to 25 February 2021 – i.e. postponing their VAT payment obligation to this year with annual frequency – also contributed to the fall in cash revenues.

Chart 10
Change in gross VAT revenue and revenue on fuel compared to the previous year



Source: Hungarian State Treasury

From 1 July 2020 the **Online Invoice** system has been extended also to transactions with VAT content below HUF 100,000. As a last step, from 1 January 2021 the NTCA also sees the invoices issued to private individuals, and thus – irrespective of the value – it has a clear view of all invoices, thereby supporting the tax authority in making online proposals for the VAT return. As a result of the measure, the Ministry of Finance calculates with an effect of several tens of billion forint due to the reduction of the shadow economy. From 1 January last year the VAT rate for commercial accommodation services was lowered from 18 per cent to 5 per cent, and in parallel with this the tourism development contribution payment obligation has been extended to this sector as well. However, as part of the economy protection measures, the **tourism development contribution** payment obligation has been cancelled between March and June, and then – after several prolongations – until the end of 2021.

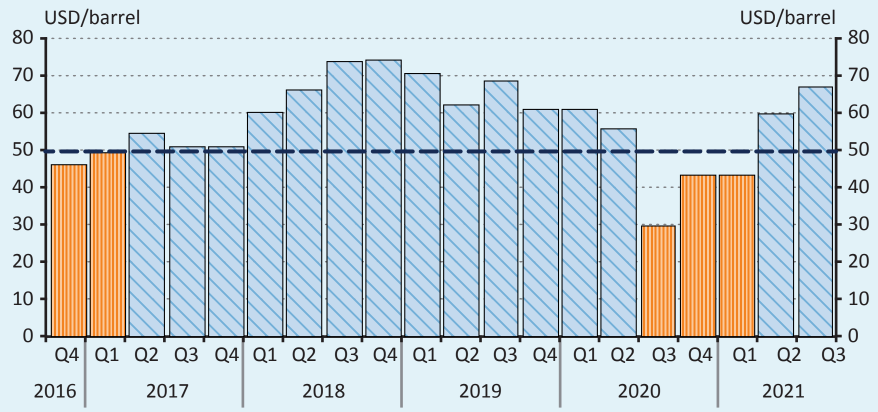
In 2020 the VAT rate applicable to the **sales of new residential properties** was 27 per cent. In fact, the higher VAT rate impacted only a few housing projects as the residential properties for which the final construction permit necessary for the construction was available already on 1 November 2018 could be sold at 5 per cent VAT. The VAT rate applicable to the sales of new residential properties was once again reduced to 5 per cent from 2021.

In 2020 excise duty revenues amounted to HUF 1,196 billion, exceeding those of 2019 by HUF 20 billion. As a result of the moderately declining fuel and other excise duty revenues compared to previous year, 97.5 per cent of the annual appropriation as realised. Only the excise duty revenues paid on tobacco products increased, by roughly 10 per cent, compared to 2019. **The excise duty on tobacco products** rose on 1 January and 1 July last year again in order to comply with EU legislation, which was followed – in addition to the previously planned increase in January 2021 – by an increase also in April. According to the EU requirement regarding the minimum excise duty, the excise duty must be at least EUR 90 per 1,000 cigarettes and reach 60 per cent of the weighted average retail selling price, or should be at least EUR 115 per 1,000 cigarettes, irrespective of its ratio to the price. The budget effect of the two increases in 2020 was HUF 20-25 billion, while the increase of roughly 20 per cent to be implemented in two steps in 2021 may improve the budget balance by HUF 35-40 billion. **The excise duty to be paid on fuel consumption was higher between 1 July 2020 and 31 March 2021 as a result of the lower world market price of crude oil** (Chart 11). Pursuant to the Act on Excise Duties adopted by the National Assembly in June 2016, the tax rate on fuels is linked to the world market price of crude oil, and the tax may be adjusted every quarter. Pursuant to the Act on Excise Duties[1], if the world market price of Brent falls below USD 50 on average, a higher tax is applied in order to offset the ensuing lower revenues. In this period the price of unleaded fuel and diesel fuel per thousand litre

[1] Act LXVIII of 2016 on Excise Duties

rose from HUF 120,000 to HUF 125,000 and from HUF 110,000 to HUF 120,000, respectively. In 2020, it increased budget revenues by almost HUF 25 billion, which moderately offset the revenue shortfall caused by the coronavirus.

Chart 11
Average price determined on the daily Brent quotes necessary for establishing the tax rate on crude oil



Note: Tax rates in a given quarter are set according to the average price between the first day of the first month and the 15th day of the last month of the quarter preceding the reference quarter.

Source: NTCA, S&P Global Inc. (Platts) 2016-2021

Revenues from financial transaction levy amounted to HUF 218 billion in 2020, which falls short of the statutory appropriation by HUF 9 billion, i.e. by roughly 4 per cent. Revenues fell by HUF 26 billion compared to 2019 due to the tax reliefs introduced at the beginning of 2020. Namely, from January no transaction levy applied to treasury operations and to postal money orders below HUF 20,000; in addition, the fall is also attributable to the economic slowdown resulting from the coronavirus and to the declining number of transactions due to the moratorium on loan instalments.

Last year revenues from **duties** amounted to HUF 207 billion, falling short of the statutory appropriation by 10 per cent. In annual terms revenues from duties declined by 4 per cent compared to 2019. A shortfall in revenues compared to previous year was registered in e-procedure duties, vehicle property duties and the NTCA duty income account, with the latter also containing the duties payable on the purchase of housing.

In 2020, **personal income tax** payments amounted to HUF 2,528 billion, representing a growth of HUF 103 billion compared to previous year. The 4.3 per cent growth in revenues lags behind the dynamic growth rate of previous year, which is primarily attributable to the unfavourable economic effects of the coronavirus pandemic. Although gross average earnings in the national economy rose significantly, by 9.7 per cent, in 2020, employment declined by almost 1 per cent, and thus revenues from personal income taxes fell short of the appropriation by HUF 81 billion in total. Revenues were reduced by the tax exemption of mothers with at least four children, while the measures adopted to offset the economic impacts of the coronavirus pandemic did not affect this tax type.

Last year the **social insurance and tax and contribution revenues of extra-budgetary funds** substantially fell short of the appropriation in the Budget Act. The difference of over HUF 420 billion is mostly the consequence of the economic downturn resulting from the coronavirus pandemic and the temporary government measures adopted to offset that. Certain national economy sectors affected by the lockdowns in spring were temporarily exempted, in a targeted manner, from the payment of certain employee and employer burdens, while from the year-end the employer tax burdens were partially cancelled. In line with the trilateral wage agreement concluded in previous years, in the second half of 2020 the social contribution tax rate was reduced by an additional 2 percentage points to 15.5 per cent. According to our estimate, the sectoral allowances and the reduction of employer taxes for half a year decreased the budget revenues by 0.2 per cent and 0.3 per cent of GDP, respectively. From the second half of the year full exemption from contributions is provided to all old-age pensioners in their own right, not only those employed in an employment relationship, and also from July 2020 the social insurance contribution of 18.5 per cent was merged, and thus the family contribution allowance is now available for the total social security contribution.

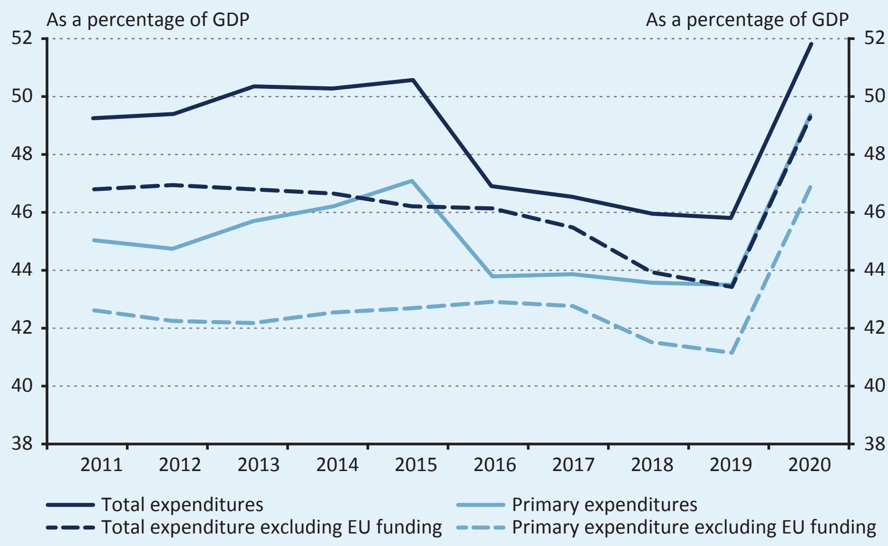
In the last month of 2020, almost HUF 670 billion was recognised in **the revenues related to EU grants**, and thus the annual revenue was HUF 1,700 billion, being the highest amount in the past 5 years and exceeding the appropriation by almost HUF 190 billion. As a result, Hungary's absorption rate rose to 62 per cent by the end of 2020, i.e. of the 2014-2020 cohesion funds amounting to HUF 25 billion, net of co-financing, Hungary drew down slightly more than EUR 15.5 billion.

Other revenues of the central budget together exceeded the appropriation in the Budget Act by HUF 189 billion. Within the combined appropriations **the budget revenues related to state property management** exceeded the statutory appropriations by HUF 129 billion in total. The difference is mostly attributable to the concession revenues from the sales of frequency utilisation. Cash receipts from telecommunication concessions amounted to HUF 128.5 billion last year, of the revenues from other asset management revenues from land sales fell short of the statutory appropriation by HUF 12 billion, while the budget realised HUF 16 billion instead of the planned HUF 3 billion on the sales of residential properties within the framework of the National Asset Management Programme. **Other revenues** directly accruing to the central budget amounted to HUF 46 billion in total, exceeding the statutory appropriation by HUF 34 billion. **Payments by local governments** were realised in the amount of HUF 68 billion instead of the planned HUF 43 billion. HUF 20 billion of the almost HUF 25 billion surplus revenue arose as a result of the additional payment obligation due to the coronavirus pandemic.

2.3. DEVELOPMENTS IN EXPENDITURE

In 2020, as a result of the crisis management, the accrual-based expenditures of the general government rose by almost 6 percentage points, to 51.6 per cent of GDP, compared to previous year (Chart 12). Primary expenditures net of EU grants also sharply increased, by roughly 5 percentage points, to 46.8 per cent of GDP.

Chart 12
Total and primary expenditures of the government sector (as a percentage of GDP)



Source: HCSO, MNB

The consolidated cash expenditures of the central subsector amounted to HUF 24,107 billion, of which HUF 23,127 billion was linked to primary expenditure items (Table 5**).** Primary expenditures exceeded the appropriation by almost HUF 4,750 billion, which was primarily the consequence of the costs of managing the economic crisis caused by the pandemic, and mostly appeared at the expenditures of the central budgetary organisations.

Table 5
Partially consolidated cash expenditures of the central subsector in 2020 (HUF billions)

	2019	2020		
	Actual	Statutory appropriation (original)	Actual	Difference (actual – original appropriation)
PRIMARY EXPENDITURE ITEMS	**18,274**	**18,377**	**23,127**	**4,749**
Special and normative subsidies and support to the public media	**501**	**487**	**748**	**262**
Social policy fare subsidy	**89**	**91**	**65**	**-25**
Housing subsidy	**191**	**297**	**251**	**-45**
Family allowances, social benefits	**562**	**575**	**564**	**-10**
Early retirement benefits	**92**	**86**	**93**	**7**
Net non-EU related expenditures of central budgetary organisations and chapters	**6,990**	**6,010**	**9,405**	**3,395**
Expenditures related to EU transfers	**1,566**	**1,682**	**2,025**	**343**
Support to local governments	**779**	**739**	**821**	**82**
Contribution to the EU budget	**365**	**398**	**450**	**52**
Central reserves	**0**	**663**	**0**	**-663**
Other expenditures	**652**	**624**	**1,500**	**876**
Expenditures of extra-budgetary funds	**528**	**549**	**763**	**213**
NEF – Passive allowances	83	83	123	40
NEF – Active allowances	166	140	125	-15
Other expenditures	279	326	515	189
Expenditures of social security funds	**5,959**	**6,178**	**6,441**	**263**
PIF - Pensions	3,502	3,580	3,646	65
HIF - Disability and rehabilitation benefits	283	282	276	-6
HIF - Cash benefits	406	447	472	26
HIF - Medical and preventive care	1,341	1,429	1,612	183
HIF - Net pharmaceutical expenditures	292	301	306	5
Other expenditures	135	138	128	-10
NET INTEREST EXPENDITURES	**842**	**1,045**	**980**	**-65**
TOTAL EXPENDITURES	**19,116**	**19,423**	**24,107**	**4,685**
BALANCE	**-1,128**	**-367**	**-5,549**	**-5,182**

Source: Hungarian State Treasury, 2020 Budget Act, MNB

The combined statutory appropriation for the **special, normative subsidies and support for the public media** was HUF 487 billion, while payments exceeded HUF 748 billion, and thus the excess expenditure was almost HUF 262 billion in total. The Government received extraordinary authorisation from the Parliament for the high overrun of the appropriation for the prevention of the coronavirus pandemic. Based on the authorisation, the budget spent HUF 255 billion in excess on special and normative corporate subsidies. The budget paid a total of HUF 658 billion in subsidies to companies providing public transport and other public services to compensate for the pandemic-related revenue shortfall of the respective companies. A subsidy of HUF 5 billion was paid to reduce the additional costs of the postal services. The government granted an additional subsidy of HUF 6 billion to cover the additional costs of public media.

Expenditures on housing subsidies reached HUF 251 billion, and thus they exceeded the subsidy paid in 2019 by HUF 60 billion. Expenditures fell short of the statutory appropriation by HUF 45 billion, and thus in 2020 only 85 per cent of the planned amount was disbursed. Primarily the expenditures related to the Home Purchase Subsidy for Families fell short of the statutory appropriation.

At the social benefit expenses of the family support expenditures, disbursed from the **National Family and Social Policy Fund**, a surplus expenditure of roughly HUF 2 billion was realised compared to 2019. The disbursed expenditure of HUF 564 billion fell short of the statutory appropriation by HUF 10 billion, primarily due to the lower expenses related to the fulfilment of the districts' duties. In addition, the child-care benefit and the disability aid slightly fell short of the appropriation, while the family allowance expenditures exceeded the appropriation.

Consolidated **expenditures of extra-budgetary funds** exceeded the appropriation by HUF 213 billion; however, they increased to the base year by HUF 235 billion. The difference compared to the budgeted value occurred at the National Employment Fund, the Bethlen Gábor Fund and at the National Research, Development and Innovation Fund, while at the other funds the departure from the statutory appropriation (and from the previous year) amounted to merely a couple of billion forints.

The **expenditures of the Employment Fund** exceeded the planned amount by HUF 23 billion. On the one hand, due to the unfavourable labour market trends resulting from the coronavirus pandemic the expenditures for jobseekers' allowance (passive expenditures) exceeded the appropriation of HUF 83 billion by HUF 43 billion (by 48 per cent). On the other hand, the expenditures related to the **Start Labour Scheme** were realised in the amount of HUF 125 billion instead of the estimated HUF 140 billion. The lower realisation is attributable to the lower than planned number of participants. According to the HCSO's statement, in 2020 the annual average headcount of public workers was 88,700, which fell short of the 100,000 persons assumed upon planning. Compared to the base period, if the impact of the expenditure reallocation in 2019 is taken into consideration, the budget's expenditure on public employment decreased by HUF 3 billion. HUF 113 billion of the total expenditure was used for wage costs and material expenditures, while HUF 12 billion was used for capital formation.

In the case of the **Bethlen Gábor Fund**, the expenditures exceeded the appropriation by HUF 93 billion as a result of the surplus expenditures of subsidies for national policy purposes, based on special government decisions, and thus the actual expenditure was three times higher than the appropriation. The average monthly expenditure of less than HUF 4 billion during the year was followed by an expenditure of HUF 99 billion in December, and thus expenditures exceeded those recorded in the previous year by HUF 70 billion.

The **National Research, Development and Innovation Fund** incurred HUF 39 billion higher expenditure than planned, due to the expenditure of the Innovation Fund part in the amount of HUF 54 billion in December (essentially corresponding to the amount incurred in the previous 11 months). Due to this, the average monthly expenditure below HUF 10 billion was followed by an expenditure of HUF 70 billion in the last month, and thus the expenditures exceeding the appropriation by 28 per cent outstripped previous year's expenses by HUF 105 billion.

The **net expenditures of budgetary organisations, calculated without the EU transfers and disbursements** together with the payments to the central budget amounted to HUF 9,405 billion in 2020, according to the preliminary data of the Hungarian State Treasury, exceeding those of 2019 by HUF 2,415 billion or 34.6 per cent. The net expenditure calculated from the appropriations of the Budget Act is HUF 6,010 billion, by HUF 3,395 billion lower than the realisation according to the preliminary data, and thus the over-realisation of the statutory appropriations reached 56.5 per cent. Revenues of the budgetary organisation were realised in the amount of HUF 2,647 billion instead of the planned HUF 1,416 billion; the greater part of the large difference is the consequence of the accumulation due to the reallocation of the statutory appropriations between chapters. Payments by the budgetary organisations to the central budget were realised in the amount of HUF 374 billion instead of the anticipated HUF 26 billion. The difference between the appropriation and the realisation was primarily caused by the revenues of the Central Residue Settlement Fund, i.e. the revenues arising from the centrally ordered payment obligation related to previous year's appropriation residues. On the whole, on the revenue side of the central budget, the statutory appropriations for the payments by budgetary organisations and centralised payments were realised in the amount of HUF 3,020 billion instead of the anticipated HUF 1,442 billion.

Gross expenditures of the budgetary organisation and chapter-administered appropriations exceeded by HUF 2,868, billion those of the base period by 30 per cent, while they exceeded the appropriations in the Budget Act by HUF 4,974 billion, i.e. 66.7 per cent. Since the realisation of the appropriations already includes the absorption of the fiscal reserves as well as the payments to the Central Residue Settlement Fund, together with the absorption of the surplus revenues realised over the statutory appropriations on the expenditure side, when also taking into consideration the expenditures belonging to these item in total in the amount of HUF 2,230 billion, the excess spending of budgetary organisations over the original appropriation was almost HUF 2,750 billion. The growth in the excess expenditure compared to the statutory appropriations arose primarily from the professional chapter-administered expenditure appropriations. Gross excess expenditures exceeded the statutory appropriation by HUF 2,319 (85.1 per cent), while the excess spending of budgetary organisations became higher by HUF 2,654 billion (by 56.2 per cent).

The extra costs of the pandemic prevention increased the expenditures of budgetary organisations through the expenses of the *Central Reserve for Pandemic Control appropriation* and the *Economy Protection Fund* (both had been established during the year), as well as through the sectoral provision expenditures. According to the available preliminary data of the Hungarian State Treasury, the total expenditure of the Central Reserve for Pandemic Control exceeded HUF 945 billion last year. The utilisation of the amount was fully realised through the expenditures of the budgetary organisations. According to the available preliminary data of the Hungarian State Treasury, the utilisation of more than HUF 2,840 billion of the expenditures used for economy protection programmes financed from the *Economy Protection Fund* was realised through budgetary organisations. As a result of the government's mid-year decisions and the extra costs of the minimum wage increase affecting the budget, the sectoral provision's global amount of HUF 152 billion was exceeded by HUF 73 billion.

The wage costs of budgetary organisations rose by 6 per cent compared to the base year due to the pandemic prevention, while the material expenditures of the public budgetary organisations – primarily due to the growth in the costs of healthcare institutions – increased by HUF 457 billion (29 per cent) compared to the base period. Other operational expenditures of such organisations rose by HUF 71 billion (25 per cent) compared to the base year. HUF 33 billion of the increment resulted in an excess expenditure for civil organisations and households, while the budgetary organisations' expenditures of this type rose by HUF 30 billion. The investment and renovation expenses of government organisations grew by merely HUF 12 billion (1.6 per cent) in 2020 compared to previous year. Other expenditures rose by more than three and a half times in 2020, with subsidies paid outside the general government and funding for capital formation purposes being determinant factors.

Based on the Hungarian State Treasury's preliminary data, gross expenditures of the ***professional chapter-administered appropriations*** were realised in the amount of HUF 5,045 billion, exceeding the gross expenditure determined by the Act of 2019 on Final Accounts by HUF 1,715 billion. Of the excess expenditure, the budget increased its expenditure for operating subsidies by HUF 536 billion (36 per cent). The increment of the capital expenditure was HUF 1,161 billion (84 per cent), the budget chapters and the expenditures of this type, disbursed from the Economy Protection Fund reached HUF 2,548 billion. Capital formation subsidies were disbursed in the total amount of HUF 1,070 to churches, non-profit enterprises and civil organisations. The amount of the subsidies disbursed to corporations with majority state interest and to other non-financial corporations was broadly the same. The total amount of the subsidies paid exceeded the 2019 expenditure level by roughly HUF 305 billion.

In 2020, **pension** expenditures amounted to HUF 3,646 billion, which exceeded the statutory appropriation by HUF 65 billion. Compared to the 2019 actual figures, expenditures rose by HUF 134 billion in 2020, which represents a growth in expenditures of 4 per cent.

- **At the beginning 2020 there were two types of pension increases.** On the one hand, the pension of those pensioners who received a lump sum payment in November 2019 was increased by 0.7 per cent from January 2020. This is because the difference for the whole year based on the additional pension increase in November 2019 was paid to the beneficiaries in a lump sum, and the amount of the pension for December 2019 corresponded to the amount of the pension for October 2019. On the other hand, in January 2020 in the case of pensions assessed before 1 January 2020, **there was an increase of 2.8 per cent**, based on the rate of the consumer price increase planned in the 2020 Budget Act. Since in the first eight months of 2020 the pensioner inflation rate measured by HCSO (4 per cent) exceeded the rate of the start-of-year pension increase defined in the 2020 Budget Act (2.8 per cent), in November 2020 there was a supplementary pension increase of 1.2 per cent in the case of pensions assessed before 1 January 2020. Roughly 2.5 million persons benefited from the November supplementary pension increase.

- 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 2020 the **rise in the pensionable age continued**, which is now 64.5 years for those born in 1956, and thus in 2020 new pension was assessed only in the second half of the year. (Table 6).

Table 6
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

The 2020 Budget Act calculates with the payment of pension premium in the amount of HUF 20 billion, based on the 4 per cent economic growth anticipated for 2020. Pursuant to the Pension Act[2], the beneficiaries receive pension premium if the rate of GDP growth expected for the current year calculated at constant prices is above 3.5 per cent and the general government's fiscal balance target for the current year is expected to be met. In 2020 the volume of GDP fell short of that of last year by 5 per cent due to the coronavirus pandemic, and thus no pension premium was paid.

Expenditures related to **disability and rehabilitation benefits** fell short of the statutory appropriation and the 2019 actual data by HUF 6 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.

In 2020, HUF 1,612 billion was spent on the funding of **medical and preventive care**, which exceeds the statutory appropriation of HUF 1,429 billion by HUF 183 billion. The difference is primarily attributable to the settlement of hospitals' debt and the one-off benefit of gross HUF 500,000 paid to healthcare workers for their efforts in fighting the coronavirus pandemic. In 2020, a total of HUF 90 billion debt, accumulated by hospitals, was settled in three tranches, and thus the outstanding debt fell from HUF 68 billion registered at the end of 2019 to HUF 8 billion. The one-off benefit to healthcare workers represented an expenditure of roughly HUF 100 billion for the budget.

The expenditures in 2020 exceeded the appropriation of HUF 447 billion for **cash benefits** disbursed by the **Health Insurance Fund** by HUF 26 billion. More than 80 per cent of the increment – partly due to the eligibility period extended between March and June in view of the state of emergency – was linked to the maternity benefits, and the sickness benefit payments also exceeded the quota. When comparing it to 2019, the amount paid for child-care benefit rose by HUF 31 billion, while payments related to infant-care benefit and sickness benefit expenditure rose by HUF 12 billion and HUF 24 billion, respectively.

At the end of 2020, **net pharmaceutical expenditures** amounted to HUF 306 billion, and thus exceeded the statutory appropriation by HUF 5 billion. Drug reimbursement expenditures exceeded the appropriation by HUF 15 billion, which was partially offset by the fact that the payments by pharmaceutical companies exceeded the appropriation by almost HUF 10 billion.

The **net accrual-based interest expenditure** amounted to 2.4 per cent of GDP in 2020, representing a growth of 0.2 percentage point compared to 2019. After seven years of steady decline, the government interest expenditure temporarily rose due to the increasing debt and the decline in economic growth. **Net cash-based interest expenses** exceeded the

[2] Act LXXXI of 1997 on Social Security Retirement Provision

budgetary appropriation by HUF 65 billion. This is due to the fact that gross interest expenditures and revenues exceeded those anticipated by the Act by HUF 149 billion and HUF 212 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 partly a consequence of the discount paid on repurchases above par value. In 2020, net cash-based interest expenditure rose by roughly HUF 140 billion in nominal terms, which is mostly attributable to the increase in the interest settlement of bonds.

Expenditures related to EU grants amounted to HUF 2,025 billion in 2020, which exceeds the original appropriation by HUF 343 billion and the 2019 figure by almost HUF 460 billion. Almost half of the disbursements were advances to the beneficiaries. Of the Széchenyi 2020 Programmes the largest payments, in the total amount of over HUF 900 billion, were connected to the Economic Development and Innovation Operational Programme (EDIOP/GINOP) and the Integrated Transport Development Operational Programme (ITDOP/IKOP). The volume of advances absorbed during the year substantially exceeded the disbursement of advances, and thus the unutilised advances held by the beneficiaries fell below HUF 2,400 billion by the end of December 2020.

Exceeding the approved appropriation by HUF 843 billion, **expenditures related to state property** were realised in the amount of HUF 1,305 billion, coming to 282.7 per cent of the statutory appropriation. Expenditures accelerated in the last quarter, when 73 per cent of the annual expenditure was realised. In total, more than HUF 720 billion was used from the Economy Protection Fund to support and increase the capital of companies falling with the ownership competence of the Minister Without Portfolio in charge of National Property Management. The budget also allocated additional, significant amount – i.e. HUF 293 billion – to support companies falling within the ownership competence of ministries. The operating and investment expenditure of the Hungarian National Asset Management Inc. exceeded HUF 191 billion, while spending on priority government building construction projects reached HUF 70 billion. The capital increase of the Paks II Nuclear Power Plant Development Ltd. was slightly below the HUF 77 billion target, since the capital was raised by HUF 73 billion. The total expenditure of HUF 28 billion for other asset management tasks was in line with the usual level of expenditure in previous years.

The **contribution to the budget of the European Union** expenditure item exceeded the initial appropriation by HUF 52 billion, due to an increase in Hungary's GNI-based contribution quota following a higher-than-expected economic growth of the Hungarian economy in previous years.

Expenditure on **subsidies to local governments** exceeded the original budgetary appropriation by 11.1 per cent, representing a growth of 5.5 per cent relative to the previous year. The excess expenditure compared to the appropriation was generated by using part of the provisions for the usual purposes (e.g. wage compensation subsidy) and the surplus subsidies granted from the Economy Protection Fund; in the latter case the general government provided surplus funds primarily for development and investment projects.

2.4. BUDGET MANAGEMENT OF LOCAL GOVERNMENTS

Based on the EDP report published at the end of March, the local government subsector closed 2020 with a cash-based deficit of HUF 101 billion. Based on the available preliminary data, the cash revenues of the subsector declined by 2.2 per cent compared to the base year, and revenues amounted to around HUF 2,920 billion, corresponding to 6.1 per cent of GDP. Local government expenditures declined by 0.5 per cent compared to 2019, and were around HUF 3,030 billion at the end of the year, corresponding to 6.3 per cent of GDP. Of the expenditures, wage payments rose by 5.2 per cent. The amount of operating subsidies paid within the general government sector rose dynamically, by almost 12 per cent, and the funds transferred outside the general government (to local government-owned enterprises) grew by 37 per cent compared to the base year. Expenditures for investments and purchased consumption both fell by 5.6 per cent compared to the disbursements in 2019. According to the spring EDP report, the closing ESA balance of the local government subsector was a surplus of HUF 53 billion. The sum of the statistical corrections performed by the HCSO is HUF 154 billion; two-thirds of the corrections with positive sign are related to the recognition of EU grants. Apart from this, accrual-based corrections of larger amount relate to local business tax revenue and investment expenditures. According to the preliminary data, the ESA balance of the local government subsector improved by HUF 96 billion compared to the 2019 balance, and thus the deficit of previous year turned into a surplus. The improved balance is attributable to the higher subsidy amount received from the central budget and the expenditure (investments and intermediate consumption) cuts.

2.5. STATISTICAL CORRECTION (ESA BRIDGE)

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

The 2020 Budget Bill defined the balance of the accrual-based statistical adjustment (ESA bridge) as 0.2 percentage point of planned GDP (HUF -73 billion). That is, the balance estimate related to the government sector contained a correspondingly less 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 preliminary EDP report of 31 March 2021, the ESA bridge was HUF 1,783 billion in 2020, i.e. 3.7 per cent of GDP. The high amount is attributable to the deviation in several factors, some of which relate to the coronavirus pandemic control measures.

The financial operations carried out in the central subsector resulted in a total correction of HUF 669 billion, improving the cash balance. Net lending of the central budget and budgetary organisations to the corporate sector realised in cash transactions was HUF 195 billion in total in 2020, and since loan operations are not to be recognised in the ESA balance, the HCSO recognised a statistical correction in the EDP balance corresponding to the amount of net lending. The equity transactions carried out by the central government contributed to the positive balance of financial operations by further HUF 342 billion, with the purchase of MVM Zrt's shares for HUF 229 billion being the most significant transaction.

Corporations, guarantee funds and non-profit institutions classified into the central government sector together improved the ESA balance of the general government sector by HUF 1,087 billion. The high surplus reflects the advances – received from the central budget – related to the restart of the economy and the capital increases. The aggregate amount of the corrections belonging to the expenditure accounts of the government sector improved the cash expenditures by HUF 199 billion, since the fulfilments fell short of the payments under the accounts in this amount on the whole.

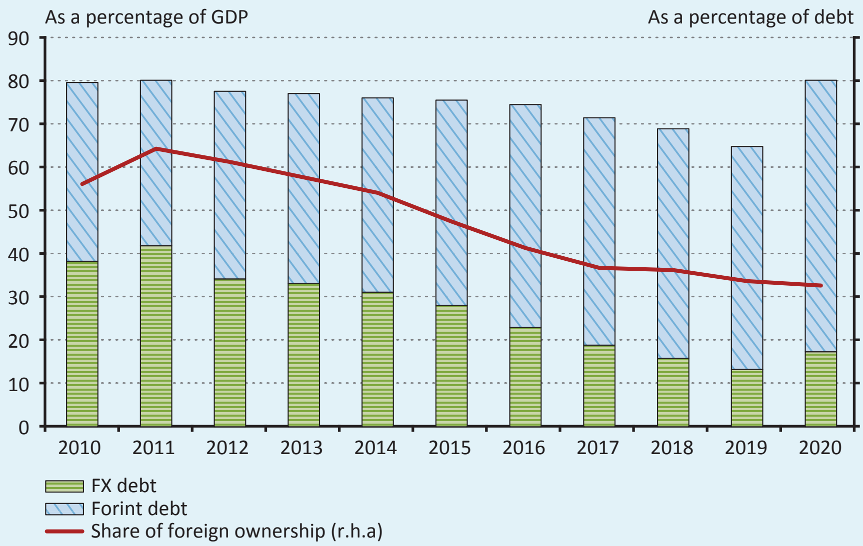
Furthermore, the corrections related to the tax and tax-type revenues and other revenues reduced the ESA bridge surplus by HUF 93 billion. In connection with the pre-natal baby supports and other standardized guarantees, the HCSO recognised a total of HUF 102 billion in balance-deteriorating statistical adjustments. The statistical correction of the settlements related to EU transfers, increasing ESA expenditures, was a much smaller amount than those recognised in previous year, merely HUF 48 billion.

The consolidated amount of the other statistical corrections between subsectors increased the surplus of the ESA bridge by HUF 46 billion, while the difference between paid and accrued interest contributed to the high balance of the ESA bridge by further HUF 27 billion.

2.6. DEVELOPMENTS OF GOVERNMENT DEBT

The downtrend in the gross government debt-to-GDP ratio seen since 2011 halted temporarily in 2020 (Chart 13). By the end of 2020, the government debt as a percentage of GDP rose by roughly 15 percentage points to 80.4 per cent from 65.5 per cent registered at the end of 2019. In addition to the rise in the budget deficit and the growth in liquid reserves (Single Treasury account and foreign currency deposits), the revaluation of foreign currency debt also contributed to the higher government debt. Nominal GDP grew merely by 0.5 per cent, while net issuance of government securities amounted to HUF 5,950 billion in 2020. The financing of the state was supported by the MNB's paying dividends to the budget in the amount of HUF 250 billion.

Chart 13
Developments in gross government debt, forint and FX debt within that and the share of foreign ownership



Source: MNB

As a result of the foreign currency bond issuances, the foreign currency ratio of the government debt increased somewhat by end-2020, while the ratio of non-resident holdings in government debt continued to decline. In 2020, the net foreign currency issuance by the Government Debt Management Agency amounted to HUF 1,650 billion, raising the foreign currency ratio of central government debt to 19.9 per cent from 17.3 per cent registered in 2019. One of the key objectives of the government's debt management strategy is to strengthen domestic financing, owing to which the ratio of non-resident holdings within government debt declined to 33.2 per cent by the end of 2020, continuing the trend seen since 2011. The debt management agency specified increasing the maturity of the government debt as a new objective from 2020, which – as a result of the growth in the portfolio of longer bonds and the Hungarian Government Securities Plus (MÁP+) – rose by more than 1 year in 2020. The moderate non-resident holdings and the foreign currency ratio are key to the decrease in external vulnerability and to Hungary's continuing favourable credit rating, while the rise in the average term-to-maturity also contributes to the fall in gross financing need through the decline in the maturing debt.

3. Expected general government developments in 2021

3.1. EXPECTED ESA BALANCE OF THE GOVERNMENT SECTOR IN 2021

According to our forecast, the accrual-based general government deficit in 2021 could be 7.5 per cent of GDP. The budget deficit is expected to be slightly lower than the 8.1 per cent deficit of 2020. On the other hand, it may be in line with the 7.5 per cent deficit target, increased from the previously expected 2.9 per cent in the Budget Act amendment of 2021 (Table 7). The rise in the deficit target is attributable to the measures aimed at mitigating the healthcare and economic effects of the new waves of the pandemic, which appeared after the approval of the 2021 Budget Act in July 2020, as well as by the fiscal measures supporting the restart of the economy after the coronavirus crisis. According to our forecast, domestic economic performance will be more favourable than the assumption used for the budget, and thus tax revenues may be higher than the appropriations. Based on the off-budget expenditure plans, we presume that the fiscal leeway will be exploited by spending the additional revenues, and thus in our projection we expect a deficit path that corresponds to the budget's deficit target.

Table 7
Balance of the general government sector in 2021

	Statutory appropriation	Expected based on the amendment of the budget	MNB forecast	Statutory appropriation	Expected based on the amendment of the budget	MNB forecast	Difference
	HUF Billions			percentage of GDP			
1. Balance of the central subsector	-1,491	-3,990	-3,944	-2.9	-7.7	-7.4	0.4
2. Balance of local governments	-198	-32	-7	-0.4	-0.1	0.0	0.0
3. Cash-based (GFS) balance of the general government (1+2)	**-1,689**	**-4,022**	**-3,951**	**-3.3**	**-7.8**	**-7.4**	**0.4**
4. GFS-ESA difference	213	162	-72	0.4	0.3	-0.1	-0.4
5. ESA balance of the general government sector (3+4)	**-1,476**	**-3,860**	**-4,023**	**-2.9**	**-7.5**	**-7.5**	**0.0**

Note: Due to rounding, differences may occur in the table.
Source: 2021 Budget Act, 2022 Budget Act, MNB's June 2021 Inflation Report

The amendment of the 2021 Budget Act defined the cash-based deficit of the general government's central subsector in the amount of HUF 2,288 billion, which may be substantially exceeded by the expected cash-based deficit stated in the Act, amounting to HUF 3,990 billion, consistent with the 7.5 per cent deficit target under the ESA methodology. The difference between the two is caused by the fact that the revision affected only the appropriations meant to be amended by the Parliament, while the appropriations implemented within the competence of the government and those deviating without separate amendment due to changes in demographic and other trends were not modified. At the recommendation of the Fiscal Council the budget bill submitted to the Parliament presented in the general justification the connection between the expected cash-based and ESA deficit and the amendment of the Budget Act.

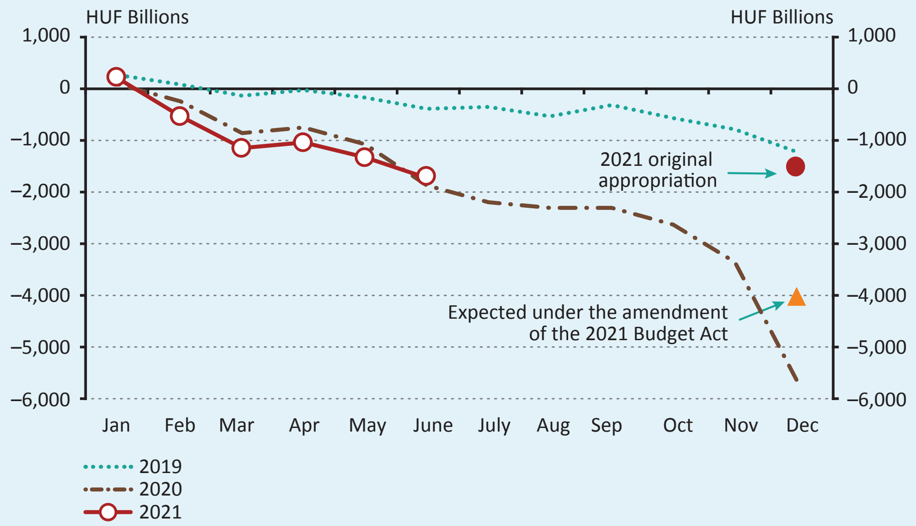
Our projection calculates with higher economic growth than that anticipated by the Act, due to which the tax and contribution revenues may exceed the appropriation. On the other hand, the expenditures related to the restart of the economy may also exceed the appropriation, which – due to the absorption of the higher-than-expected tax revenues – may lead to a deficit corresponding to the deficit target in 2021.

- According to our expectations, the central budget deficit may exceed the HUF 2,288 estimate of the Budget Act by roughly HUF 1,650 billion, i.e. essentially it may be in line with the expected deficit of HUF 3,990 billion. The deficit over the appropriation is caused by the significantly higher expenditures, which is offset only partially by the materially increasing tax and contribution revenues resulting from the favourable economic growth.

- Our forecast with regard to the balance of extra-budgetary funds is almost in line with the balance stated in the Budget Act, while there are differences in the individual items. The differences mostly appear on the expenditure side, since due to the soar in the utilisation of the job protection and employment creation subsidies the expenditures of the Economy Restart Employment Fund may exceed the appropriation, while in the case of the Start labour programme expenditures may fall short of the appropriation.

- Revenues of the social security funds may exceed the appropriation by roughly HUF 150 billion, caused by the anticipated realisation of labour tax and contribution revenues over the appropriation. On the other hand, according to our forecast, expenditures may exceed the appropriation in the Budget Act by almost HUF 430 billion, mainly due to the excess expenditure of the Health Insurance Fund, which is attributable to the fact that the appropriation has not changed, and thus it does not contain the impact of the wage increases in the healthcare sector.

Chart 14
Intra-year cumulative cash-based balance of the central subsector

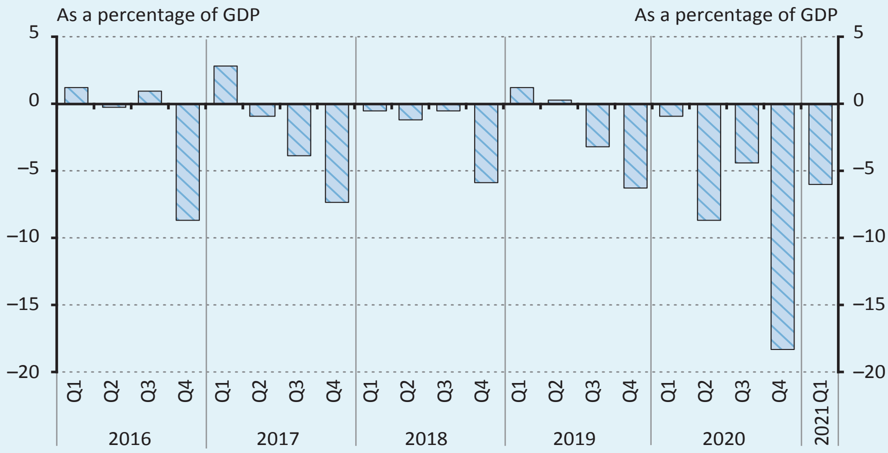


Source: 2021 Budget Act, EDP Report, April 2021, Hungarian State Treasury

The cumulative deficit of the central subsector was HUF 1,705 billion until the end of June, which represents a lower deficit than the balance of the first six months of 2020 (Chart 14). The tax and contribution revenues of the central subsector exceeded those registered last June by HUF 935 billion, which was partly offset by the shortfall of HUF 240 billion in revenues related to EU grants. Expenditures of the central subsector in the first half of this year exceeded the year-on-year figure by more than HUF 460 billion. The larger part of the increase in expenditures is linked to the reinstatement of the 13th month pension, the usual pension increase at the beginning of the year and the supplementary one in June, the growth in the support to local governments and the high expenditures related to state assets.

In the first quarter of 2021, the accrual-based balance of the general government showed a deficit reaching 6.1 per cent of GDP, exceeding the year-on-year figure by 5.1 percentage points. The growth is attributable to the economic impacts of the coronavirus pandemic and the measures taken to mitigate those. In the first quarter of 2021, revenues of the government sector rose by HUF 150 billion or 3.1 per cent year-on-year, while expenditure grew by HUF 814 billion, or 16.5 per cent.

Chart 15
Accrual-based budget balance



Source: HCSO

3.2. MACROECONOMIC PROJECTION UNDERLYING THE BUDGET

Following the coronavirus pandemic, both the macroeconomic projection underlying the 2021 Budget Act and the MNB's expectations project economic growth after the temporary decline; however, the MNB's projection anticipates faster economic growth. The latest macroeconomic expectations of the budget project slightly less favourable macroeconomic path than the projection assumed when the 2021 Act was planned. The MNB's June 2021 forecast anticipates major, 6.2 per cent GDP growth this year, while the latest projection of the budget calculates with a more moderate, 4.3 per cent growth. According to the central bank's forecast, household consumption expenditure will grow by 4.6 per cent this year. In line with expected gross wage bill developments, the budget calculated with a lower growth. According to the MNB's forecast, performance of Hungarian exports may show double-digit growth this year, and as a result of the dynamic growth in domestic demand items and exports, imports may also rise significantly.

After the fade-out of the additional waves of the pandemic, the labour market correction and recovery may take place faster than expected, and thus employment is expected to increase. Upon the planning of the 2021 Act, the budget still calculated with higher growth in employment; however, based on the latest macroeconomic expectations it already anticipates protracted labour market correction. According to the MNB's forecast, in parallel with the recovery of the labour market, full employment may be approached again in the second half of 2021, while in parallel with the rise in employment, unemployment rate will fall below 4 per cent. According to the MNB's June projection, the growth in whole-economy gross average wage may exceed the projection in the budget bill and reach 9.6 per cent in 2021. Incoming data for the beginning of 2021 still project high wage dynamics, the persistence of which is supported by the increasing labour demand and tightening labour market resulting from the recovery of the economy. The latest budget expectation assumes 3.6 per cent inflation, which slightly exceeds the appropriation, while in its June Inflation Report the MNB calculates with 4.1 per cent inflation for this year.

Table 8
Comparison of the macroeconomic paths included in the 2021 Budget Act and in the MNB's June 2021 Inflation Report

	2021			
	Budget Act	**Expected based on the budget**	**MNB**	**Difference between the MNB's and the expected figure**
GDP	**4.8**	**4.3**	**6.2**	**1.9**
Consumption expenditure of households	3.8	3.4	4.6	1.2
Public consumption	1.0	0.8	3.8	3.0
Gross fixed capital formation	5.5	4.2	4.7	0.5
Exports	10.5	6.4	11.5	5.1
Imports	8.9	5.2	8.9	3.7
Inflation	**3.0**	**3.6**	**4.1**	**0.5**
Gross wage bill	**8.5**	**8.0**	**9.6**	**1.6**
Gross average earnings	6.9	7.0	8.0	1.0
of which: private sector	7.0	6.9	7.4	0.5
Number of employees	1.6	0.0	0.4	0.4
of which: private sector	2.0	0.1	0.0	-0.1

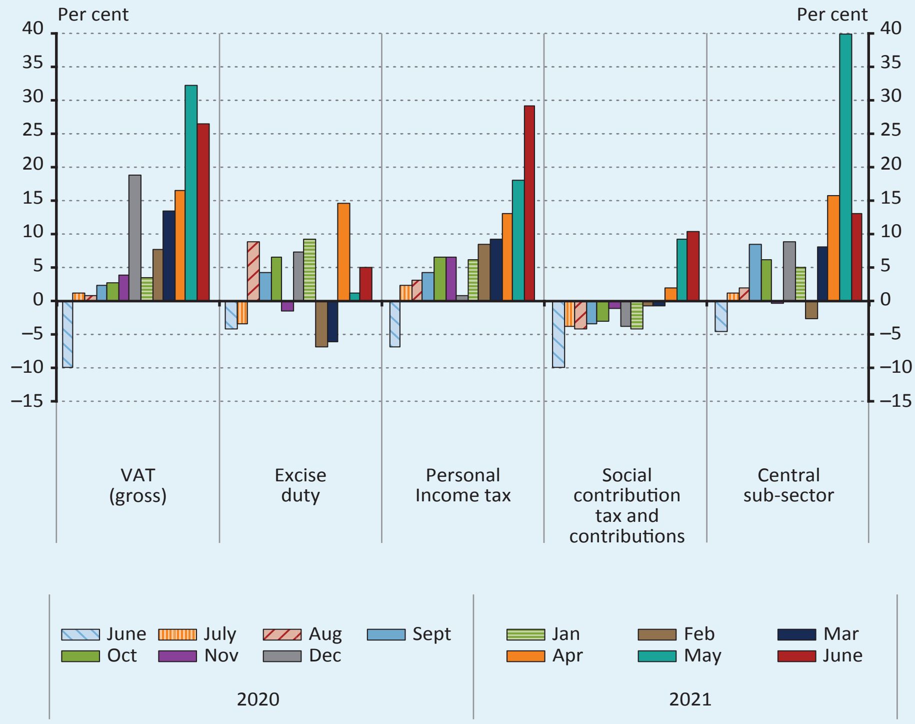
Source: Annexes to the 2021 Budget Act and 2022 Budget Act, MNB's June 2021 Inflation Report

3.3. CASH-BASED REVENUES OF THE CENTRAL SUBSECTOR

According to our forecast, the primary revenues of the central subsector may exceed the statutory appropriations due to the more favourable economic performance. Tax and contributions payments are expected to exceed the original and the amended statutory appropriation by HUF 250 billion and HUF 500 billion, respectively. The greatest increase appears in labour taxes and contribution as well as in consumption taxes: in the second half of the first half of this year, tax revenues showed significant growth dynamics (Chart 5).

From May onwards tax revenues have significantly increased, which is attributable – in addition to the low base of last year – to the recovery of the economy. Namely, last year as a result of the restrictions and the temporary economy protection measures revenues declined, compared to which the tax and contribution revenues of the central subsector showed double-digit growth in the second quarter of 2021 year-on-year (Chart 16).

Chart 16
Year-on-year change in some major tax revenues and total revenue of the central subsector in 2021



Source: Hungarian State Treasury

Corporate tax revenues may exceed the amended appropriation in the 2021 Budget Act by HUF 31 billion. The difference is attributable to the more favourable macroeconomic developments. On the other hand, corporate income tax revenues may increase by HUF 71 billion compared to 2020 on a cash basis. The increment is attributable to the dynamic growth in the tax base in line with the economic recovery. In the first six months of the year corporate income tax revenues exceeded the year-on-year payments by HUF 160 billion. The major growth is attributable to the fact that the 2020 measures related to the coronavirus crisis included the postponement of the deadline for the submission of corporate tax return from May to September, while in 2021 this measure was not repeated.

Revenues from the **surtaxes payable by financial institutions** may correspond to the appropriation in the 2021 Budget Act, but may fall short of the payments of last year by HUF 59 billion. The latter is mostly attributable to the fact that the special tax of credit institutions related to the pandemic was recognised in 2020 as the surtaxes payable by financial institutions. Credit institutions may deduct the roughly HUF 55 billion paid in 2020 in connection with the pandemic situation from their tax in the next five years in equal instalments. In the first half-year revenues from special taxes declined by HUF 20 billion compared to the year-on-year amount. The respective institutions had to pay the first instalment of the credit institutions' special tax connected to the pandemic situation in June 2020, which justifies the decline.

Due to the more favourable recovery of the national economy revenues from **retail taxes** may slightly exceed the amended appropriation in the Budget Act. Compared to 2020, revenues may increase by HUF 22 billion. The tax type was introduced on 1 May 2020 and the payments in 2020 apply only to the last eight months of the year. In the first half-year taxpayers paid by HUF 5 billion less to the Treasury compared to the first six months of last year, since the rules applicable to the payment of this tax type within the year were determined differently by the law from 2021 compared to 2020 (in 2020 the three payment deadlines were the end of June, August and October, while from 2021 taxpayers are required to pay the advance to the Treasury by the end of July and October).

Revenues from the **income tax of energy providers** may essentially be in line with the amount stated in the Budget Act, while they may slightly fall short of those registered in previous year. Until the end of June revenues from this tax type exceeded payments in the first six months of 2020 by HUF 11 billion; the measure related to the deadline for submitting the tax returns, already mentioned at the corporate income tax, also applied to this tax type.

The revenues expected from the **itemised tax of small taxpayers** (KATA) may fall short of the appropriation in the Budget Act by HUF 15 billion. The lower expected tax revenue is primarily attributable to the targeted tax reliefs repeatedly introduced in connection with the third wave of the coronavirus pandemic. Compared to previous year KATA revenues may increase by HUF 64 billion. This is attributable to three factors. On the one hand, the targeted tax reliefs affected more months in 2020 than they presumably will affect in 2021, and on the other hand dynamic growth in the number of taxpayers continues this year as well. The third factor of the increment is the measure hindering the spread of hidden employment, according to which from 1 January 2021 legal entities paying more than HUF 3 million to a specific small taxpayer in one year are obliged to pay 40 per cent of the amount over 3 million to the Treasury. As a result of the measure roughly HUF 30 billion surplus revenue may arise this year. In the first half-year revenues from itemised tax of small taxpayers exceeded the year-on-year figure by HUF 17 billion.

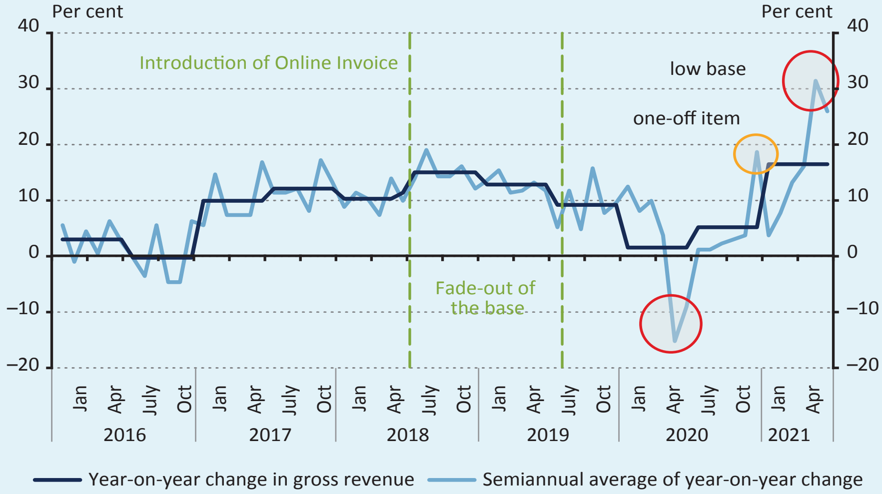
According to our expectations revenues from **tax of small enterprises** (KIVA) may exceed the appropriation in the Budget Act by HUF 7 billion, which is also attributable to the more favourable macroeconomic conditions. Revenues may increase by HUF 21 billion compared to previous year. During the first half-year, revenues from tax of small enterprises rose by HUF 11 billion year-on-year. At this tax type as well the targeted tax allowance to mitigate the impacts of the coronavirus crisis impacted more months in the first half of 2020 than in the first six months of this year.

Revenues from electronic road toll may exceed the 2021 appropriation and the 2020 revenues by HUF 24 billion and HUF 32 billion, respectively, due to the more favourable developments in the economic environment. Revenues from road tolls in the first six months exceeded the year-on-year figure by HUF 17 billion.

Other taxes and payments by economic organisations may exceed the amended appropriation by HUF 31 billion. Revenues from penalties and rehabilitation contribution may exceed those stated in the budget by HUF 20 billion and HUF 7 billion, respectively. The difference here as well is attributable to the more favourable macroeconomic expectations. Compared to the previous year, other taxes and payments may be higher by HUF 38 billion at the end of the year. In addition to the fast economic growth, the difference is also attributable to the fact that the temporary tax cut at certain tax types (rehabilitation contribution, water reserve contribution) was in force for a longer period in 2020 than in 2021. In the first six months of the year, the Treasury received HUF 1 billion more in payments from the revenues recognised in this group.

According to our expectations, net cash revenues from **value added tax** may amount to HUF 5,138 billion in 2021, exceeding the amended appropriation by HUF 102 billion. In the first half of the year, 49 per cent of the appropriation was realised, gross VAT revenues rose by 17 per cent on average year-on-year due to the low base of last year and the restart of economic growth (Chart 17). The economy protection measure helping small and medium-sized enterprises, reducing the deadline for VAT reimbursement from 30 to 20 days in the case of reliable taxpayers and from 75 to 30 days in the case of normal taxpayers, thereby supporting the liquidity of enterprises, continues this year as well. Temporarily the VAT rate on **take-away food** was reduced from 27 per cent to 5 per cent between 14 November 2020 and 31 July 2021, and the VAT rate applicable to the **sales of new residential properties** was reduced again to 5 per cent from 2021.

Chart 17
Change in gross VAT revenues compared to the same period of the previous year



Source: Hungarian State Treasury, Ministry of Finance

In line with the appropriation, in 2021 **revenues from excise duties** are expected to amount to roughly HUF 1,250 billion, almost 45 per cent of which was realised in the first six months. As a result of the higher consumption expected in the second half of the year, we anticipate higher revenues compared to the first half of the year, when the third wave of the coronavirus still decelerated consumption. **Excise duty on tobacco products** rose in January and April 2021 to ensure compliance with the EU regulation. The two-step tax increase of roughly 20 per cent may improve the balance of the budget by some HUF 35–40 billion. From 1 April the rate of the **excise duty on fuel consumption** declined, since the Brent price per barrel was steadily over USD 50 in the first quarter. From this year no excise duty applies to brandy distillation below 86 litres, which causes a revenue shortfall of around HUF 5-10 billion to the budget.

Revenues from **financial transaction levy** may amount to around HUF 230 billion in 2021, exceeding the statutory appropriation and last year's revenues by roughly HUF 10 billion. In the first half of the year 51 per cent of the appropriation has been realised. In the second half-year, due to the economic recovery and the increasing rate of suspending the moratorium on loan instalments we anticipate a moderate rise in revenues.

This year the revenues from **tourism development contribution** may be merely around HUF 1 billion, since the obligation to pay this contribution has been suspended until the end of the year with a view to providing tax relief during the state of emergency. The basis of the 4 per cent contribution, applicable to catering and commercial accommodation providers is the consideration for the service subject to the contribution net of VAT. This contribution has been extended to the commercial accommodation sector from 2020 and simultaneously with this the VAT rate was reduced from 18 to 5 per cent.

Table 9
Partially consolidated cash revenues of the central subsector (HUF billions)

	2021					
	Statutory appropriation	Statutory appropriation (amended)	January – June realisation	Percent of appropriation	MNB-forecast	Difference: MNB – amended appropriation
TAX AND CONTRIBUTION REVENUES OF THE CENTRAL SUBSECTOR	**17,401**	**17,153**	**8,624**	**50%**	**17,654**	**501**
Payments by economic organisations	**1,824**	**1,727**	**948**	**55%**	**1,799**	**72**
Corporate income tax	539	447	349	78%	478	31
Surtaxes payable by financial institutions	61	61	31	50%	61	0
Retail tax	54	65	6	9%	69	4
Mining royalty	44	44	19	43%	39	-5
Gambling tax	35	35	15	42%	28	-7
Income tax on energy providers	61	61	47	77%	62	1
Itemised tax of small taxpayers	237	237	92	39%	223	-15
Tax of small enterprises	97	97	51	52%	104	7
E-road toll	225	225	118	52%	249	24
Tax of utility system	53	53	28	52%	54	1
Other taxes and payments	417	401	195	48%	432	31
Consumption taxes	**6,705**	**6,689**	**3,256**	**49%**	**6,807**	**117**
Value added tax	5,015	5,036	2,490	49%	5,138	102
Excise duties	1,263	1,249	561	45%	1,251	2
Motor vehicle registration tax	20	20	9	45%	20	0
Telecommunication tax	53	53	30	57%	59	6
Financial transaction levy	219	219	111	51%	230	11
Insurance tax	106	106	54	51%	108	3
Tourism development contribution	30	8	0	4%	1	-7
Payments by households	**2,997**	**3,007**	**1,536**	**51%**	**3,156**	**149**
Personal income tax	2,684	2,718	1,372	50%	2,854	136
Duties, other taxes	227	202	109	54%	215	13
Motor vehicle tax	87	87	55	63%	87	0
Tax and contribution revenues of extra-budgetary funds	**453**	**453**	**245**	**54%**	**467**	**14**
Tax and contribution revenues of social security funds	**5,421**	**5,277**	**2,639**	**50%**	**5,425**	**149**
Social contribution tax and contributions	5,262	5,118	2,561	50%	5,258	140
Other contributions and taxes	159	159	78	49%	168	8
REVENUES RELATED TO EU FUNDS	**1,145**	**2,050**	**257**	**13%**	**2,039**	**-11**
OTHER REVENUES	**474**	**467**	**388**	**83%**	**524**	**56**
Other revenues of the central budget	334	327	277	85%	326	0
Other revenues of social security funds	39	39	16	42%	31	-8
Other revenues of extra-budgetary funds	102	102	95	93%	166	64
TOTAL REVENUES	**19,021**	**19,670**	**9,269**	**47%**	**20,216**	**546**

Source: 2021 Budget Act, amended 2021 Budget Act, Hungarian State Treasury, MNB's June 2021 Inflation Report

The amended appropriation for the **personal income tax** in 2021 includes revenues of HUF 2,718 billion, exceeding the original fiscal target approved last year by HUF 34 billion. According to our forecast the actually expected revenue may exceed even the amended appropriation by more than HUF 130 billion. In the first half-year revenues from personal income tax exceeded those of the first six months of last year by 13.3 per cent, which is mostly attributable to the low base resulting from declining payments due to the coronavirus pandemic. This year gross whole-economy average earnings may increase by roughly 8 per cent as a whole, while – based on the forecast in the June Inflation Report – employment is expected to rise by 0.4 per cent in 2021 compared to last year.

This year revenues from **the payment of duties** may amount to HUF 207 billion, exceeding current year's appropriation by HUF 12 billion. In the first six months of this year 55 per cent of the appropriation was realised, exceeding the year-on-year revenues by 9 per cent. Although the tax reliefs adopted at the beginning of the year, such as exempting from the duty those who purchase with HPS and the duty exemption connected to first instance public administration proceeding, reduce the revenues, this is offset by the growth in revenues resulting from the soar in the number of homes built in the first quarter. The number of homes built in the first quarter of 2021 exceeded the year-on-year figure by 29 per cent.

In the first six months budget revenue from **motor vehicle tax** reached HUF 55 billion, which corresponds to 63 per cent of the statutory appropriation. The revenue received until the end of the first half-year exceeds the year-on-year revenues by HUF 10 billion. The annual appropriation is HUF 87 billion, which may be realised according to our expectations.

The total amended appropriation of **tax and contribution revenues of social security and extra-budgetary funds** is HUF 5,730 billion, which is HUF 145 billion lower than the original appropriation. According to our forecast, the revenue anticipated in 2021 may exceed the expectation in the amended appropriation to almost the same degree, by roughly HUF 161 billion. The employee and employer tax and contribution revenues may substantially exceed the appropriation, while other revenues may broadly correspond to it. In the first half of 2021 employee contribution revenues rose by 10.8 per cent compared to the first six months of last year, while employers' burdens declined by 6.7 per cent. In the first half of this year, certain national economy sectors were exempted from the payment of employers' burdens, and the social contribution tax payable on fringe benefits paid on SZÉP cards, entertainment and business gifts was cancelled until the end of the year.

In the first half of this year, merely HUF 257 billion was recognised in **revenues related to EU grants**. On a pro rata basis this substantially falls short of the amended appropriation over HUF 2,000 billion; however, based on the experience of previous years, the revenues moving in parallel with the submission of invoices are mostly received in the last two quarters. The realisation of our revenue projection and the amended appropriation is surrounded by higher than usual risks due to the uncertainties linked to the plans related to the funds under the new cycle. Our revenue projection of HUF 2,039 billion also includes – in addition to the cohesion revenues – the 13 per cent advance (HUF 326 billion) belonging to the HUF 2,511 billion requested from the Recovery and Resilience Facility, which Hungary may receive after the approval of the plan.

Of the other revenues of the central budget under the title of payments by local governments the central budget received HUF 86 billion in the first half-year, which corresponds to 52 per cent of the annual revenue estimate. In our forecast to the June Inflation Report we calculated with the realisation of the HUF 165 billion statutory appropriation for the whole year. In the knowledge of the revenue trends in the first half-year, the appropriation is expected to be met in 2021.

Revenues related to **state asset management** amounted to HUF 111 billion at the end of June, and thus 78 per cent of the HUF 143 billion statutory appropriation was realised by the end of the first half-year. The realisation of other asset utilisation revenues and the revenue estimate of the Hungarian State Holding Company fell short of the pro rata estimate.

3.4. CASH-BASED EXPENDITURES OF THE CENTRAL SUBSECTOR

According to our forecast, the cash-based expenditures of the central subsystem of the general government may be substantially, by almost HUF 2,200 billion higher than the amended appropriations in the Budget Act. The increase in expenditures is primarily caused by the excess costs related to the pandemic prevention necessary due to the extension of the state of emergency, and new measures were also announced. The measures aim at reopening the economy following the containment and economic protection measures.

In the first six months of the year, payments related to **special and normative subsidies and support to the public media** amounted to HUF 297 billion, which corresponds to 53 per cent of the appropriation of HUF 562 billion. We expect that the statutory appropriations of the expenditures belonging to this category will be realised by the end of the year.

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 18 billion annual expenditure savings compared to the appropriation. In the first half-year, merely HUF 35 billion was paid, which is 25 per cent of the annual statutory appropriation. The method of recognising the social policy fare subsidy has changed from 2021, and thus in the second half-year we anticipate much higher payment obligation than the expenditures in the first half-year.

According to our forecast, expenditures related to **housing subsidies** may be slightly lower than the appropriation of HUF 370 billion. The amendment of the 2021 budget raised the appropriation for housing subsidy expenditures by HUF 120 billion, which corresponds to the anticipated expenditures of the Home Improvement Programme announced after the approval of the original budget. Based on the data received in respect of the first six months, the expenditures related to housing subsidy stand at 33 per cent of the appropriation. The expected annual volume of the state subsidy granted for home savings (LTP), which cannot be concluded any more, is gradually decreasing, and it may be around HUF 60 billion in 2021. The mortgage loan write-off for parents with three or more children is increasing year by year, and in 2021 it may exceed HUF 25 billion.

The expenditure appropriation of the **National Family and Social Policy Fund** is in line with our expectations at most of the items. The Budget Act appropriated HUF 579 billion for the expenditures of the Fund, with the payment of family allowance accounting for more than half of it.

At the end of the first half-year **net non-EU related expenditures of budgetary organisations and professional chapters** was HUF 3,630 billion, representing almost 54 per cent of the amended statutory appropriation. The over-realisation of the expenditure on a pro rata basis is connected with the coronavirus pandemic which continued in the spring months, during which the costs related to the healthcare emergency increased the expenses of the public budgetary organisations and the chapter-administered appropriations related to the healthcare and communication expenditures.

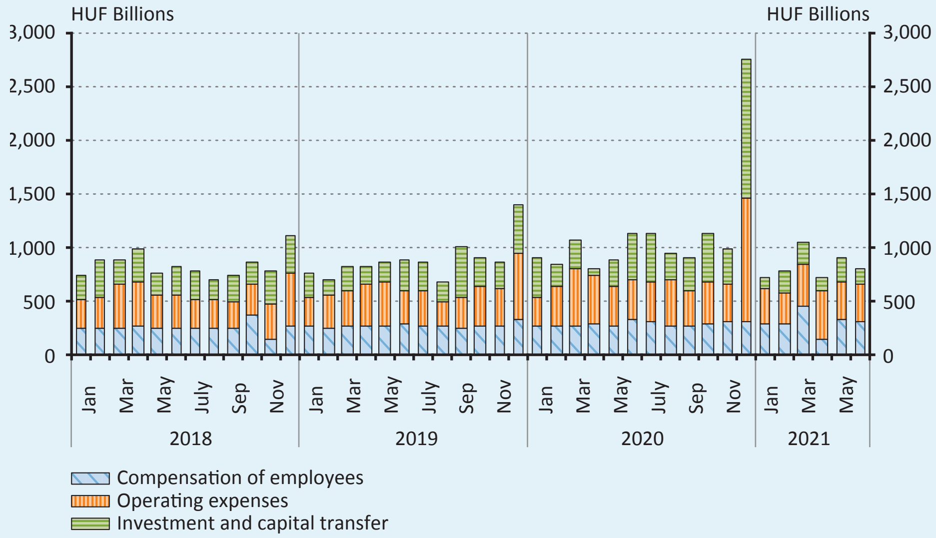
Revenues by budgetary organisations and **payments** directly accruing to the central budget by budgetary organisations are broadly in line with those observed in the same period of the previous year. The budgetary organisations must repay the remainders of the previous year's appropriation not burdened by commitments to the Treasury account of the central budget. The Budget Act contained no appropriation for the revenues of the Central Residue Settlement Fund; accordingly, the amounts paid to the Fund increased the gross expenditure of budgetary organisations compared to the original statutory appropriation.

By the end of the first half-year **gross expenditures** of the budgetary organisations and chapters together reached 64.5 per cent of the amended statutory appropriation. Net of the amount paid to the Central Residue Settlement Fund, gross expenditures amounted to 60.4 per cent of the statutory appropriation. The high realisation in the first half-year is the excess expenditure resulting from the health state of emergency and the consequences of the state measures related to the restart of the economy connected to the pandemic. The government injected additional resources into the economy in the second quarter – disregarding the usual pro rata developments in expenditures – from the appropriations in the newly created Economy Restart Fund. At the end of June, the funds used from the appropriation entitled "Central Pandemic Control Reserve" exceeded HUF 466 billion, and thus the excess expenditure over the expenditure appropriation reallocated to the chapter reached HUF 286 billion.

Of the gross expenditures of budgetary organisations, the wages paid to employees exceeded those paid in the first half of 2020 by 8.6 per cent, with the payments exceeding HUF 1,614 billion. The investment and renovation expenses rose by 4 per cent in the first six months of the year, reaching HUF 240 billion. Intermediate consumption of budgetary organisations came close to HUF 970 billion by the end of the first half-year, representing a 6.1 per cent growth in expenditures. Payments for other operating purposes dynamically rose; by the end of June expenditures grew by 10.6 per cent, exceeding HUF 1,196 billion by the end of the period. Capital expenditures of budgetary organisation were close to HUF 780 billion in the first half of 2021; the growth rate of expenditure exceeded 22 per cent year-on-year. On the other hand, other expenditures significantly declined compared to the base period. In the first six months of this year these types of expenditures amounted to HUF 241 billion, being merely 35.4 per cent of the payments in the first half of 2020.

Our annual projection for the net non-EU related expenditures of budgetary organisations and chapters is by nearly HUF 1,800 billion higher than the net expenditure that can be derived from the amended appropriation in the Budget Act. The large difference includes, on the one hand, the effect of the already realised additional expenditure increasing measures 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.

Chart 18
Structure of the expenditures of central budgetary organisations and chapters



Note: The time series also contains the expenditures related to EU programmes, including the expenditures related to the pre-financing of EU programmes.
Source: Hungarian State Treasury

Subsidies to local governments amounted to HUF 475 billion in the first half-year, representing 52 per cent of the amended statutory appropriation, increased by HUF 44 billion mid-year. As a result of the amendment of the Act, capital formation funds provided to local governments increased. Based on the decisions included in the government resolutions disclosed meanwhile, we expect that by the end of the year the expenditure appropriation, raised to HUF 909 billion, will be exceeded by HUF 34 billion.

The **contribution to the EU budget** expenditure appropriation was realised in the first half of the year in the total amount of HUF 309 billion, which corresponds to 50 per cent of the expenditure appropriation increased by HUF 165 billion upon the amendment of the Budget Act. The raising of the payment obligation by a large amount is attributable to the fact that due to the Hungarian economy's high growth rate Hungary's share increased in the European Union under the GNI-based accounting, and the exit of Great Britain from the EU also increased the quota. Our latest forecast calculates with the realisation of the amended appropriation.

The original statutory appropriation of **central reserves** was HUF 396 billion, which was raised by the Parliament by HUF 50 billion upon the amendment of the 2021 Budget Act. On 1 July, an envelope of roughly HUF 110 billion was available from the central reserve, raised to HUF 446 billion by the amendment of the Act. Of the reserve budgets that the Government may exceed within its own competence, only HUF 27 billion of the "Provisions" appropriation has not been realised in the first half-year. At this appropriation we expect an overspending of HUF 30 billion by the year-end, without further measures. The expenditures of the "Central Reserves for Pandemic Control" appropriation reached HUF 466 billion in the first half-year. As the government has in the meantime made a transfer of HUF 155 billion to other institutional expenditures, the resources of the reserve increased to HUF 180 billion, resulting in an overrun of HUF 286 billion at the end of the first half-year. Upon the amendment of the Budget Act the central reserve of the Economy Restart Fund rose from the original HUF 68 billion to HUF 108 billion. The utilisation of the reserve exceeded HUF 145 billion until 30 June, inclusive. Our forecast calculates with the further exceeding of the so called uncapped reserve appropriations only among the risks, and the greatest risk factor is the development of the pandemic situation in the second half of the year.

Expenditures related to the **management of state property** were realised in the amount of HUF 314 billion in the first half of the year. Compared to the seasonality of previous years, the realisation of expenditures in the first six months may be deemed particularly high, as more than 61 per cent of the annual appropriation has been realised. Compared to the annual cash expenditure appropriation we anticipate excess expenditures in the amount of HUF 164 billion until the end of the year, based on the decisions made to date on the absorption of central reserves and the government measures adopted on the utilisation of the revenues of the Central Residue Settlement Fund.

Table 10
Partially consolidated cash expenditures of the central subsector (HUF billions)

	2021					
	Statutory appropriation	Statutory appropriation (amended)	January – June realisation	Percent of appropriation	MNB forecast	Difference (MNB – amended appropriation)
PRIMARY EXPENDITURE ITEMS	**19,574**	**21,021**	**10,502**	**50%**	**23,122**	**2,101**
Special and normative subsidies and support to the public media	**562**	**562**	**297**	**53%**	**562**	**0**
Social policy fare subsidy	**138**	**138**	**35**	**25%**	**120**	**-18**
Housing subsidy	**250**	**370**	**123**	**33%**	**365**	**-5**
Family allowances, social benefits	**579**	**579**	**291**	**50%**	**579**	**0**
Early retirement benefits	**93**	**93**	**49**	**53%**	**96**	**4**
Net non-EU related expenditures of central budgetary organisations and chapters	**6,574**	**6,738**	**3,630**	**54%**	**8,516**	**1,779**
Expenditures related to EU transfers	**1,601**	**2,515**	**987**	**39%**	**2,510**	**-5**
Support to local governments	**865**	**909**	**475**	**52%**	**943**	**34**
Contribution to the EU budget	**450**	**615**	**309**	**50%**	**615**	**0**
Central reserves	**396**	**446**	**111**	**25%**	**111**	**-334**
Other expenditures	**740**	**730**	**411**	**56%**	**917**	**186**
Expenditures of extra-budgetary funds	**591**	**591**	**321**	**54%**	**625**	**33**
EREF – Passive allowances	109	109	43	40%	90	-19
EREF – Active allowances	165	165	76	46%	118	-47
Other expenditures	318	318	201	63%	416	98
Expenditures of social security funds	**6,736**	**6,736**	**3,464**	**51%**	**7,164**	**428**
PIF - Pensions	3,907	3,907	1,987	51%	4,019	112
HIF - Disability and rehabilitation benefits	284	284	144	51%	295	12
HIF - Cash benefits	496	496	251	51%	523	27
HIF - Medical and preventive care	1,567	1,567	877	56%	1,874	307
HIF - Net pharmaceutical expenditures	333	333	149	45%	303	-30
Other expenditures	149	149	54	37%	149	0
NET INTEREST EXPENDITURES	**937**	**937**	**472**	**50%**	**1,037**	**101**
TOTAL EXPENDITURES	**20,511**	**21,958**	**10,974**	**50%**	**24,160**	**2,202**
BALANCE	**-1,491**	**-2,288**	**-1,705**	**75%**	**-3,944**	**-1,656**

Source: 2021 Budget Act, amended 2021 Budget Act, Hungarian State Treasury, MNB.

Within the expenditures of the **extra-budgetary funds** the expenditures under the passive expenses of the Economy Restart Employment Fund may fall short of the appropriation by roughly HUF 20 billion. Due to the favourable labour market trends in the first half-year, expenditures reached merely 40 per cent of the appropriation. In the case of other expenditures we calculate with major, some HUF 100 billion, excess expenditure, caused primarily by the job protection and employment creation measures. In the first half of 2021 **the Start Labour Programme expenditures** of the central budget exceeded the year-on-year payments by HUF 11 billion. Until the end of the first half-year, subsidies and subsidy advances were disbursed in the amount of HUF 76 billion. Last year the effective expenditures of public employment amounted to roughly HUF 120 billion, and this year similar expenditures are expected.

In the first six months of 2021 **retirement benefits** disbursed from the Pension Insurance Fund amounted to HUF 1,987 billion, corresponding to 51 per cent of the statutory appropriation. In the first half of 2021, pension expenditures exceed the year-on-year value by HUF 186 billion, i.e. about 10 per cent.

- The increase in expenditures compared to previous year is partly attributable to the fact that in February 2021 **the gradual reinstatement of the 13th month pension** has commenced, as in February the beneficiaries received 25 per cent of their January pension as an additional benefit. The budget impact of the measure, in the case of benefits financed from the Pension Insurance Fund, was HUF 78 billion. In addition to the old-age pensioners, all beneficiaries receiving pension-type benefits (disability and rehabilitation benefits, early retirement benefits) also received the 13th month pension, and thus in total 2.56 million beneficiaries received extra benefit.

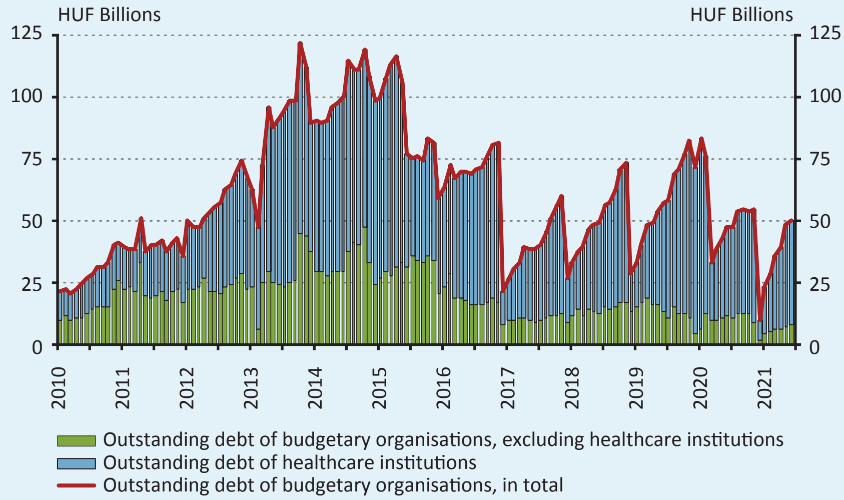
- In January 2021 a 3 per cent **start-of-the-year pension increase** was implemented based on the inflation rate projected in the current year's Budget Act. According to the government's revised macroeconomic expectations, in 2021 the consumer price index is likely to increase by more than 3 per cent, and thus the government decided to increase pensions and other pension-like benefits by an additional amount in June 2021. Based on this, benefits covered by the increase on 1 January 2021 were increased by further 0.6 per cent retrospectively to 1 January 2021. The supplementary pension increase in June had a budget impact of HUF 18 billion. Based on the Pension Act, the supplementary pension increase is due in November, but this year the government decided to pay earlier.

- The MNB's June 2021 Inflation Report forecasts an inflation of 4.1 per cent for 2021, and thus in our projection we anticipate a 0.5 per cent supplementary pension increase to be implemented in November 2021.

The 2021 Budget Act calculates with the payment of **pension premium** in 2021 in the amount of HUF 53 billion, based on the 4.8 per cent real GDP growth included in the macroeconomic path. The MNB's macroeconomic forecast prepared for its June Inflation Report projects a 6.2 per cent GDP growth for 2021. Accordingly, the amount of the pension premium paid from the Pension Insurance Fund is expected to be higher, close to HUF 110 billion in 2021.

Expenditures for medical and preventive care reached 56 per cent of the appropriation of HUF 1,567 billion in the first half of 2021. The original statutory appropriation has not been modified in the reference year; however, the Act on Hungary's central budget for 2022 includes the projection prevailing at the time of the submission (notification of expected for 2021), which calculates with an expenditure of HUF 1,871 billion for this year. Accordingly, our forecast exceeds the original appropriation by HUF 307 billion, while it calculates with broadly the same expenditure as that shown in the latest available projection of the Ministry of Finance. Healthcare institutions' outstanding debt was HUF 42 billion at the end of June 2021 (Chart 19).

Chart 19
Outstanding debt of budgetary organisations, and within that, of healthcare institutions (January 2010 – June 2021)



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.
Source: Hungarian State Treasury

In the first half of 2021, **51 per cent** of the **appropriation for cash benefits** disbursed from the Health Insurance Fund was realised. Our annual forecast exceeds the appropriation by HUF 27 billion. The difference appears primarily at the maternity benefits. The amount of the payments related to child-care benefit projected by us exceeds the appropriation by roughly HUF 15 billion.

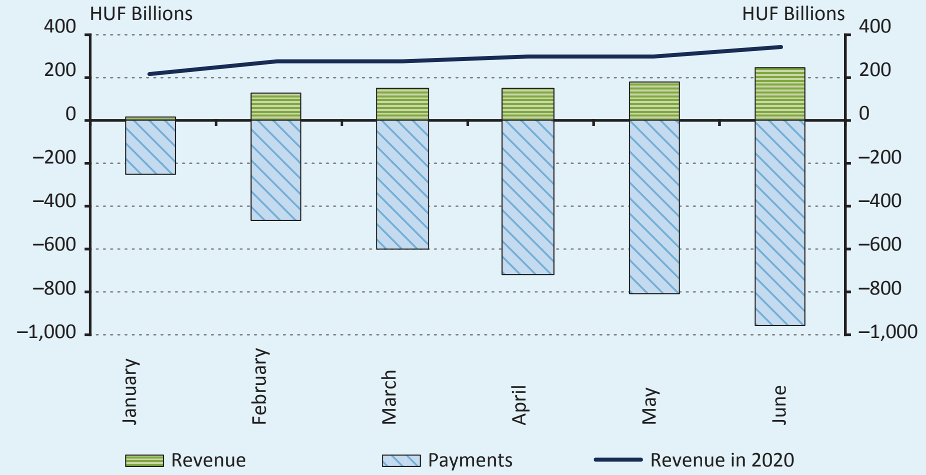
Net pharmaceutical expenditures reached 45 per cent of the appropriation at the end of June, which – under relatively steady time profile – assumes payments below the appropriation at the end of 2021. According to our forecast, net expenditures may fall short of the appropriation by HUF 30 billion, with the difference appearing primarily in gross expenditures.

The **expenditures related to EU grants** amounted to HUF 987 billion in the first half of 2021, which is almost 40 per cent of the amended appropriation of HUF 2,515 billion (Chart 20). According to our estimate, in line with the practice of previous years, the ratio of advance payments within the payments may have been around 50 per cent. Based on our expectations consistent with the June Inflation Report, the amended appropriation related to the 2021 EU expenditures may be realised.

Roughly one third of the rural development envelope of the 2021-2027 programming cycle will be connected to the 2014-2020 cycle due to the financing of the transitional years to ensure that the beneficiaries can draw down part of the new envelope, supported by higher domestic co-financing, under the previous, more lenient regulation. In the 2014-2020 cycle the total rural development envelope was HUF 1,413 billion, 17.5 per cent of which was the national co-financing, which was raised by the government to 80 per cent in the new cycle. Of the total new rural development envelope of HUF 4,265 billion, including the increased co-financing, some HUF 1,530 billion was added to the 2014-2020 envelope for the transitional years. As a result of the reallocation, the total envelope for 2014-2020 increased from HUF 9,713 billion to HUF 11,379 billion, and the envelope for the 2014-2022 Rural Development Programme including the transitional years increased to HUF 2,943 billion.

In the case of the **Széchenyi 2020 programmes related to the 2014-2020 EU budget cycle** and the Rural Development Programme, the value of the tenders announced for the transitional years of 2021 and 2022 increased by more than HUF 700 billion in June, reaching more than HUF 12,000 billion by the end of the half-year. The significant rise is primarily the result of announcing the tenders related to the envelope reallocated to the Rural Development Programme. In June, the first tenders under the 2021-2027 Széchenyi Plan Plus framework programme were announced within the framework of GINOP Plus (Economic Development and Innovation Operational Programme), in the total amount of HUF 270 billion. However, the European Commission has not yet approved the Partnership Agreement setting out the national operational programmes for 2021-2027.

Chart 20
Expenditures and revenues related to the EU funds in 2021



Source: Hungarian State Treasury

According to our projection, **net accrual-based interest expenditure** may slightly decrease following the temporary growth last year and, in line with the statutory appropriation, may be 2.3 per cent at the end of 2021. The decreasing government debt and the persistently low yield environment acts towards a decline in interest expenditure. **Net cash-based interest expenditures** amounted to roughly 50 per cent of the annual appropriation in the first half of 2021. On the other hand, due to the higher interest payment anticipated in the second half of the year, at the end of the year the cumulative interest expenditure may exceed the appropriation, while it may fall short of the latest expectation of the budget (notification of expected for 2021). The higher expenditures compared to the original appropriation is presumably attributable to the excess expenditure resulting from the debt outstanding at the end of 2020 higher than expected at the time of approving the Budget Act. Our projection further on calculates with the debt management transactions considering last year's data, and thus our revenue expectations materially exceeds the value stated in the statutory appropriation.

3.5. BALANCE OF THE LOCAL GOVERNMENT SUBSYSTEM

Our forecast assumes a more favourable cash balance of around HUF 210 billion compared to the HUF 198 billion deficit in the 2021 Budget Act, but the balance is only slightly better compared to the amended appropriation.

Revenues of the subsector increased by HUF 92 billion year-on-year; of the increment HUF 85 billion surplus revenue was received from the general government (central budget, Health Insurance Fund, National Employment Fund). Funds received under the EU programmes generated an additional HUF 22 billion surplus revenue for local governments, while their own current revenues slightly declined on the whole in the first quarter year-on-year.

Expenditures of the subsector rose by HUF 75 billion in the first quarter year-on-year. Current operating expenses rose by 8.2 per cent in total; within that wage costs and other personnel expenditures grew by 10.3 per cent, while the growth rate of intermediate consumption was 9.1 per cent. The subsector's capital formation and equity expenditure stagnated on the whole; within that local governments' direct investments fell by 3.1 percentage points in nominal terms. Subsidies paid by local governments dynamically rose compared to the base period; disbursements of this type grew by HUF 46 billion, or 52 per cent, in the first quarter of 2021.

The surplus of the local government subsector rose by HUF 18 billion compared to the first quarter of 2020 as result of the developments in cash revenues and expenses. According to our expectations, the subsector's ESA balance may close 2021 with a surplus of roughly HUF 170 billion, subject to the realisation of the expected inflow of EU funds.

3.6. STATISTICAL CORRECTIONS (ESA BRIDGE)

The 2021 Budget Act was approved by assuming an **ESA statistical correction** of HUF 213 billion, reducing the cash deficit with this amount. The forecast in the spring EDP report for 2021 contained a cash balance improving statistical correction of only HUF 162 billion. On the other hand, our forecast, which is consistent with the June Inflation Report, calculates with a deficit increasing statistical correction of HUF 72 billion for 2021. According to our expectations, the statistical corrections belonging to the EU programmes are close to HUF 210 billion, exceeding the government's expectations by roughly HUF 120 billion. The statistical corrections linked to the advance payments in 2021 may improve the expenditures under ESA by roughly HUF 380 billion. Other corrections (e.g. prenatal baby support loan) together may increase the statistical corrections of negative sign by further HUF 43 billion.

3.7. EXPECTED DEVELOPMENTS OF GOVERNMENT DEBT IN 2021

According to the MNB's financial account data, at the end of the first quarter of 2021, the gross public debt ratio stood at 81 per cent of GDP, representing a growth of 0.6 percentage point compared to 80.4 per cent at the end of 2020. By the end of the first quarter of 2021, the debt ratio rose by 15.3 percentage points year-on-year. The high net issue of debt, concentrated at the beginning of the year, acted toward a rise in government debt, which was slightly mitigated by the expiry of the reverse repo transaction concluded by the Government Debt Management Agency at the end of last year. The foreign currency ratio of the central government debt declined from 19.9 per cent registered at the end of 2020 to 18.5 per cent by the end of the first half-year of 2021. The ratio of non-residents within the total government debt declined to 31.8 per cent in the first half-year from 33.2 per cent registered at the end of last year.

According to our forecast, consistent with our June Inflation Report, following a temporary rise, the gross government debt-to-GDP ratio will decline to 76.8 per cent by the end of 2021. According to our forecast, the government debt ratio will decline more dynamically than anticipated by the Budget Act, which is explained by the MNB forecast related to higher economic growth. The reduction of the debt is supported by the partial absorption of the government deposits, significantly increased in 2020, as well as by the persistently low level of government interest expenses. The delay in the inflow of EU funds may result in a change in the debt ratio's time profile, i.e. this year it causes the debt level to decline slower than expected and then, upon the actual receipt of the funds, it will reduce the debt.

According to our forecast, within the central government debt the foreign currency ratio will decline to 17.8 per cent by the end of 2021. As a result of the buoyant demand for retail government securities and increasing ratio of longer-term government securities, we expect that the average term-to-maturity of the Hungarian government debt will increase further.

4. Expected general government developments in 2022

The MNB published its analysis of the submitted 2022 budget bill[3], adopted by the Parliament on 15 June 2021 with minor amendments during parliamentary debate. We update our revised forecast, prepared for the June Inflation Report, with the amendments of the Budget Act's appropriations. Below we compare the MNB's forecast and anticipation with the adopted Budget Act, and the key figures therein.

4.1. EXPECTED ESA BALANCE OF THE GOVERNMENT SECTOR IN 2022

According to the adopted Act, the ESA-based budget deficit target in 2022 is 5.9 per cent of GDP (Table 11). The set deficit target corresponds to the 5.9 deficit path stipulated in the Convergence Programme and 1.6 percentage points lower than the 2021 ESA-based deficit of 7.5 per cent, published in the spring EDP report. When reviewing the details of the Budget Act we estimate that the key tax and contribution revenues exceed the statutory appropriations; however, this surplus revenue will be offset by the measures already announced after the adoption of the Act and by additional expected measures, the most significant of which is the reimbursement of the 2021 personal income tax to families with children up to the whole-economy average wage. The implementation of conditionally promised reimbursement may represent a one-off tax relief of around 1 per cent of GDP next year.

Table 11
Balance of the general government sector in 2022 (as a percentage of GDP)

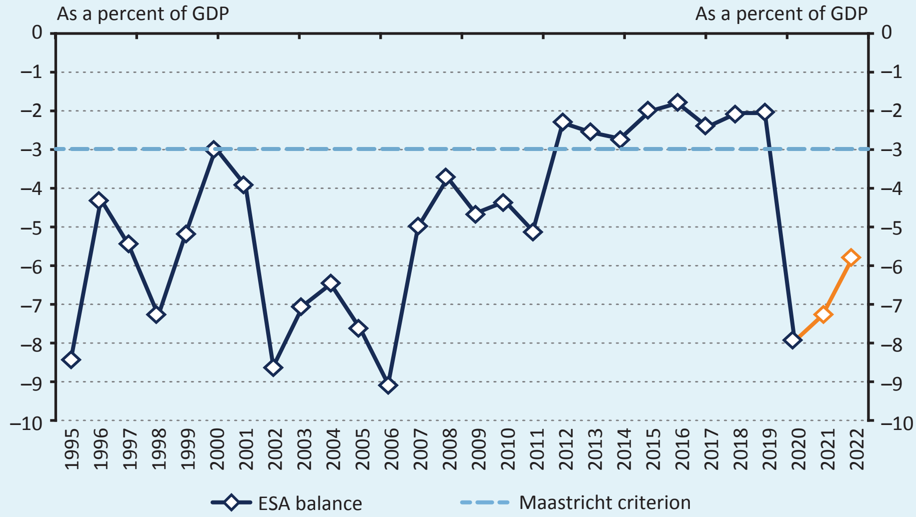
	2022		
	Statutory appropriation	MNB forecast	Difference
1. Balance of the central subsector	-5.6	-5.9	-0.3
2. Balance of local governments	-0.3	-0.3	0.0
3. Cash flow balance of central-subsector and local governments (1+2)	**-5.9**	**-6.2**	**-0.3**
4. GFS-ESA difference	0.0	0.3	0.3
5. ESA balance of the general government sector (3+4)	**-5.9**	**-5.9**	**0.0**

Note: The forecast of the MNB presents the fiscal projection included in the June 2021 Inflation Report.
Source: 2022 Budget Act, MNB

In 2022 the budget deficit may exceed the Maastricht criterion, while the economic growth would justify a larger deficit reduction (Chart 21). The reduction of the deficit remains moderate despite the fact that the nominal GDP growth may be exceed 10 per cent both this year and next year. The decline in the deficit is also supported by the fact that in the period of 2013-2020 the interest expenditures decreased to the second largest degree in Hungary of the EU Member States. The Hungarian budget deficit of 5.9 per cent as a percentage of GDP could be the third highest in the European Union.

[3] https://www.mnb.hu/kiadvanyok/jelentesek/koltsegvetesi-jelentes

Chart 21
Budget balance in 1995 – 2022



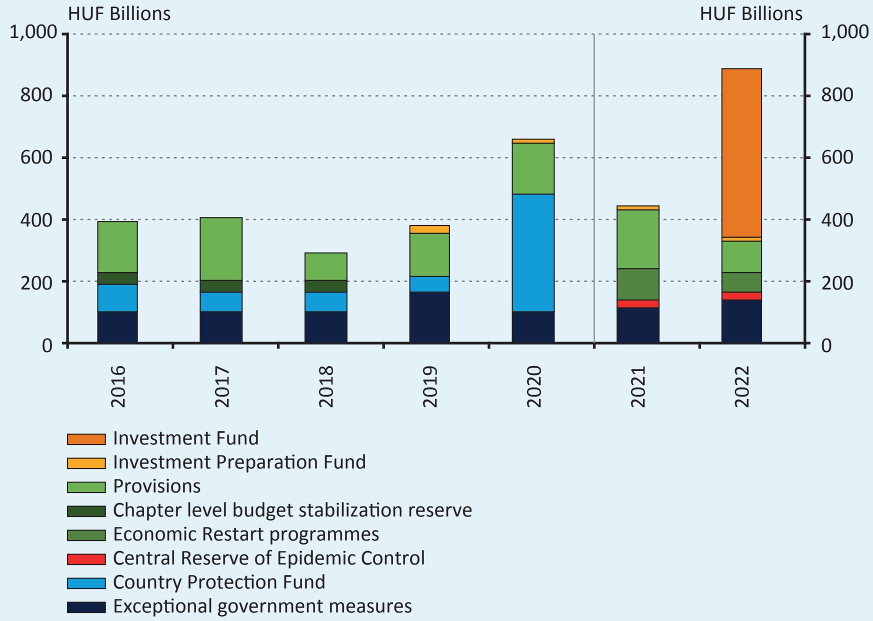
Source: Eurostat, MNB forecast for 2021–2022

According to our forecast based on the macroeconomic assumptions of the June Inflation Report, the 5.9 per cent deficit target set in the budget bill is realisable. Our current projection assumes that tax and contribution revenues of the budget may fall short of the appropriation in the Budget Act by less than 0.2 percentage points of GDP, due to the reimbursement of personal income tax to families with children, announced since the adoption of the Act. The MNB's current projection assumes higher growth than the macroeconomic path of the budget.

In 2022, free central reserves in the central subsector amount to HUF 233 billion, i.e. 0.4 per cent of nominal GDP indicated in the bill. It consists of the appropriation of HUF 145 billion of the reserves of extraordinary government measures, the envelope of HUF 68 billion of the Economic Restart Fund and the HUF 20 billion appropriation of the central reserves for epidemic control. Further reserves are available to provide funds for future investment decisions: investment funds contain an expenditure appropriation of HUF 555 billion in total. Provisions for wages and wage-type payments amount to HUF 93 billion, which is almost half of the appropriation with the same purpose for 2021.

Accordingly, including the Investment Fund, the planned amount of all the central reserves and reserve type appropriations for 2022 is HUF 894 billion, i.e. some 1.6 per cent of GDP. It is favourable that their sum may be sufficient to safely achieve the deficit target if next year the containment of the pandemic will not result in additional fiscal expenditures. Under the subtitle Crucial Overground Construction Projects of the Government in the Economic Restart Fund chapter there is an additional investment reserve of HUF 40 billion, whose function in an economic sense is similar to that of the investment funds of central reserves, further expanding next year's fiscal room for manoeuvre.

Chart 22
Fiscal reserves between 2016 and 2022



Source: 2016 – 2022 Budget Acts

The adopted Budget Act includes a further reduction of labour taxes. In line with the 6-year wage agreement the 1.5 per cent vocational training contribution will be abolished from next year and the social contribution tax rate will decline by 0.5 percentage point. According to the legislator's intention both measures will enter into force from the second half of 2022. The bill includes a partial income tax exemption of people under the age of 25 years, which, according to the annex to the bill, may reduce budget revenues by some HUF 140 billion, i.e. 0.25 per cent of GDP. Pursuant to the measure, the consolidated tax base of people who have not reached the age of 25 will be exempt from paying the personal income tax up to the degree of the whole-economy gross average earnings in July of the previous year. The personal income tax revenue appropriation of the Budget Act does not yet contain the effect of the subsequent and conditional announcement by the government, according to which, if in 2021 Hungary's economic growth reaches or exceeds 5.5 per cent, the personal income tax paid in 2021 will be reimbursed to parents with children up to the amount of the whole-economy average wage. Since according to the MNB's latest macroeconomic forecast the condition related to the growth rate will be met in 2021, we assumed in our projection that parents with children will get back their personal income tax paid this year up to maximum HUF 800,000. According to our estimate the first-round effect of the measure may be around 1 per cent of GDP. A further tax measure is the earlier decision to lower the minimum threshold for investments eligible for development tax allowance from HUF 500 million to HUF 50 million for small companies and to HUF 100 million for medium-sized companies in 2022

In 2022, the decline in budget deficit compared to 2021 will be attained through expenditure restraint. The decline in expenditures is largely supported by a reduction in the cost of pandemic control, which rose to a high level in 2020-2021, a reduction in capital and operating transfers outside the general government sectors as a percentage of GDP, and the fall in personnel expenditures and financial transfers as a percentage of GDP. According to the plans, the appropriations including intermediate consumption will also rise to a lesser degree than the growth in GDP, thereby supporting the deficit reducing budget path. By 2022 the government sector's investment expenditure will rise to historic high both in nominal terms and as a percentage of GDP, reaching 7.1 per cent as a percentage of GDP, subject to realising the government's plans.

4.2. EVALUATION OF THE MACROECONOMIC PROJECTION UNDERLYING THE BUDGET

In 2022 there are differences both in the growth rate and the factors underlying the growth between the Budget Act and the MNB's current forecast. According to the MNB's June 2021 forecast, growth is expected to reach 5.5 per cent in 2022, compared to the more moderate growth projected in the budget forecast for 2022. According to the central bank's forecast, household consumption expenditure will grow by 5.6 per cent in 2022, while the Budget Act calculates with a higher growth, in line with the expected gross wage bill developments. There is no significant difference in the expectations for investments in 2022. According to the MNB's forecast, performance of Hungarian exports may increase by 7.4 per cent this year, and because of dynamic growth in domestic demand items and exports, imports may also rise. The Budget Act expects a more significant increase in external trade in 2022.

The MNB forecasts an increase in employment (+0.7 percent) next year. According to the MNB's June forecast, the growth in average gross national income may be below the projection in the budget bill and reach 8.7 per cent in 2022. Incoming data for the beginning of 2021 still project high wage dynamics, albeit lower than last year, the persistence of which is supported by the increasing labour demand and tightening labour market resulting from the recovery of the economy. The Budget Act projects 3 per cent inflation for 2022, which is broadly in line with the central bank's forecast published in the June Inflation Report.

Table 12
Comparison of the macroeconomic forecasts

	2020	2021			2022		
	Actual	Budget	MNB	Difference	Budget	MNB	Difference
GDP	**-5.0**	**4.3**	**6.2**	**1.9**	**5.2**	**5.5**	**0.3**
Consumption expenditure of households	-2.5	3.4	4.6	1.2	6.0	5.6	-0.4
Public consumption	2.8	0.8	3.8	3.0	-1.9	1.6	3.5
Gross fixed capital formation	-7.3	4.2	4.7	0.5	7.2	7.5	0.3
Exports	-6.8	6.4	11.5	5.1	10.5	7.4	-3.1
Imports	-4.4	5.2	8.9	3.7	10.0	7.2	-2.8
GDP deflator	5.7	3.7	5.8	2.1	3.8	5.0	1.2
Inflation	**3.3**	**3.6**	**4.1**	**0.5**	**3.0**	**3.1**	**0.1**
Gross wage bill	**6.0**	**8.0**	**9.6**	**1.6**	**9.8**	**8.7**	**-1.1**
Gross average earnings	9.7	7.0	8.0	1.0	7.7	7.8	0.1
Of which: private sector	9.8	6.9	7.4	0.5	7.6	7.6	0.0
Number of employees	-0.9	0.0	0.4	0.4	1.1	0.7	-0.4
Of which: private sector	-0.5	0.1	0.0	-0.1	1.3	1.1	-0.2

Source: 2021 Budget Act and 2022 Budget Act, HCSO, MNB's June Inflation Report

4.3. CASH-BASED REVENUES OF THE CENTRAL SUBSECTOR

According to our forecast, in 2022 the **primary revenues of the central subsector of the budget** may be lower than the appropriations in the approved Budget Act by HUF 239 billion in total (Table 13). Within this, tax and contribution revenues could be lower by HUF 90 billion, or just 0.2 percentage point of GDP. As a result of a higher growth path than assumed when the Budget Act was compiled, the central subsector would realise by HUF 466 billion higher tax and contribution revenues. However, the new government measure announced following the adoption of the Budget Act on the refund of personal income tax for families with children, would reduce net tax and contribution revenues of the budget by HUF 556 billion in 2022, according to the central bank's forecast prepared for the June Inflation Report. The government measures to refund personal income tax is conditional, i.e. it will be implemented if economic growth in 2021 will be at least 5.5 per cent. Since the MNB's latest macroeconomic forecast assumes that the economic growth condition for 2021 is met, our baseline forecast includes the impact of the reimbursement on net personal income tax revenue. In addition to the tax reimbursement, our current forecast assumes that cash revenues from EU grants will be by around HUF 160 billion lower than the appropriation in the adopted Budget Act.

Our forecast for **payments by enterprises** exceeds the appropriation by HUF 83 billion. The difference is explained by the more favourable MNB forecast for macroeconomic conditions compared to the forecast in the Budget Act for most tax items. Of the more significant differences, this explains the difference in **corporate income tax** (+ HUF 5 billion), **income tax on energy suppliers** (+ HUF 13 billion), **tax of small enterprises** (+ HUF 8 billion), and among other payments by economic organisations, the difference in **rehabilitation contribution** (+ HUF 9 billion) and **time-based road-toll** (+ HUF 5 billion)

In the case of the revenues from **itemised tax of small taxpayers**, our forecast is by HUF 10 billion higher than the appropriation, which may be attributable to the different assumptions with regard to the number of active small taxpayers. In the case of the **surtaxes payable by financial institutions**, our forecast exceeds the appropriation by HUF 15 billion. Our forecast differs from the projected tax base estimate for this tax type. Within the other payments appropriation, the statutory appropriation for **revenues from fines** fall short of the MNB forecast by HUF 12 billion. At this item the difference may be attributable to the base effect of the difference between the projections related to the revenues in 2021.

Overall, we expect a revenue surplus of HUF 62 billion **from consumption and sales taxes** in 2022, based on the macroeconomic forecast consistent with the June Inflation Report. Primarily VAT revenues and financial transaction levy payments are expected to be higher than the corresponding appropriations in the Budget Act. However, in the case of tourism development contribution, we anticipate lower revenues than those stated in the Budget Act.

The budget calculates with **value added tax** of HUF 5,487 billion on an accrual basis in 2022, which falls short of our forecast by HUF 44 billion and exceeds the revised 2021 appropriation by 9 per cent. Our projection exceeding the appropriation in the Budget Act is primarily attributable to the base effect. In 2022, the VAT on newly purchased or built homes, reduced from 27 per cent to 5 per cent, will decrease revenues by approximately HUF 45 billion. The measure is applicable from 1 January 2021 to 31 December 2022 (until 31 December 2026 with transitional provisions), facilitating the acquiring of flats smaller than 150 m^2 and houses with an area of less than 300 m2.

In line with our forecast, the appropriation for revenues from **excise duties** will amount to HUF 1,296 billion next year, exceeding the revised 2021 estimate by 3.8 per cent. A higher revenue risk is posed by a possible further increase in tobacco excise duty to comply with the EU requirements.

The appropriation for **financial transaction levy** for next year is HUF 233 billion in the adopted Budget Act, which falls short of our forecast by HUF 10 billion. The difference is due to the base effect of the 2021 appropriation, explained by different macroeconomic assumptions for 2021.

Next year's appropriation of **revenues from duties** amounts to HUF 199 billion, which is HUF 19 billion lower than our forecast. Firstly, the difference may be explained by the different macroeconomic assumptions, and secondly, our forecast expects a lower decline in revenues as a result of a government measure introduced as of this year, i.e. the exemption from duty of the homes purchased using the Home Purchase Subsidy Scheme for Families (HPS).

Following the revenue of HUF 108 billion from **insurance tax** this year, for next year we calculate with HUF 121 billion, which exceeds the statutory appropriation by HUF 6 billion.

According to the appropriation in the Budget Act, next year revenues from **telecommunication tax** may amount to HUF 53 billion. Our expectation includes HUF 8 billion higher revenue, mainly due to the base effect.

The revenue appropriation for **tourism development contribution** for next year is HUF 34 billion, while the MNB forecast is lower by HUF 9 billion. The deviation is mainly explained by the difference in the projections for the recovery of catering and international tourism.

Tax revenues from **labour taxes** – other than the tax revenue from the itemised tax of small taxpayers – are expected to fall short of the tax revenue derived from the statutory appropriations by HUF 233 billion in total. The lower revenue compared to the Budget Act's appropriations is due to the expected reimbursement of part of the personal income tax revenue of 2021 in 2022.

Table 13
Partially consolidated revenues of the central subsector in 2022 (HUF billions)

	2022		
	Statutory appropriation	**MNB forecast**	**Difference: MNB – appropriation**
TAX AND CONTRIBUTION REVENUES OF THE CENTRAL SUBSECTOR	**18,496**	**18,407**	**-90**
Payments by economic organisations	**1,960**	**2,043**	**83**
Corporate income tax	589	593	5
Surtaxes payable by financial institutions	61	76	15
Retail tax	76	75	-1
Mining royalty	38	38	0
Gambling tax	34	31	-3
Income tax on energy providers	55	67	12
Itemised tax of small taxpayers	237	246	9
Tax of small enterprises	121	129	8
E-road toll	263	263	0
Tax of utility system	53	54	1
Other taxes and payments	433	469	37
Consumption taxes	**7,243**	**7,305**	**62**
Value added tax	5,487	5,531	44
Excise duties	1,296	1,299	3
Motor vehicle registration tax	25	25	0
Telecommunication tax	53	61	8
Financial transaction levy	233	243	10
Insurance tax	115	121	6
Tourism development contribution	34	25	-9
Payments by households	**3,156**	**2,704**	**-451**
Personal income tax	2,867	2,398	-468
Duties, other taxes	199	217	19
Motor vehicle tax	91	89	-2
Tax and contribution revenues of extra-budgetary funds	**441**	**449**	**8**
Tax and contribution revenues of social security funds	**5,697**	**5,906**	**208**
Social contribution tax and contributions	5,537	5,727	190
Other contributions and taxes	160	179	18
REVENUES RELATED TO EU FUNDS	**2,386**	**2,226**	**-160**
OTHER REVENUES	**573**	**584**	**11**
Other revenues of the central budget	425	434	10
Other revenues of social security funds	35	37	1
Other revenues of extra-budgetary funds	113	113	0
TOTAL REVENUES	**21,455**	**21,216**	**-239**

Note: The difference between the revenue totals shown in the table and those indicated in the Budget Act, resulting from the consolidation, is due to the fact that, based on the data available, we excluded the effect of cash transfers within the central subsector, and recognised certain expenditure items in net terms, i.e. reduced them by the related direct revenues.

Source: 2022 Budget Act, MNB

The budget appropriation of the **personal income tax** is HUF 2,867 billion in 2022, which significantly exceeds the amount in our projection. Although the Budget Act adopted for last year includes the partial exemption of those below 25 years from personal income tax, the announced tax reimbursement to those with children is not included in the Act. The government made the introduction of the measure conditional upon a 5.5 percent increase in gross domestic product this year, which – based on the latest forecast in the MNB's June Inflation Report – will be achieved, and thus the fiscal impact of the tax reimbursement was incorporated in the forecast. The tax exemption up to the average wage for young people under 25 may reduce revenues by 0.25 per cent of GDP, while the tax reimbursement to those with children may reduce revenues by a further 1 percentage point of GDP, and thus the net personal income tax revenues of the budget may fall by about 16 per cent in total next year, compared to the actual expected revenues this year.

According to our forecast, next year, **the tax and contribution revenues of social security and extra-budgetary funds** may significantly exceed the total appropriation of HUF 6,138 billion. The difference of almost HUF 220 billion appears at the labour tax and contribution revenues, primarily due to the expected significantly higher base than that in this year's Budget Act and to the presumably lower utilisation of the benefits under the Job Protection Action Plan. In the second half of next year, the employers' tax rate will be reduced again by 2 percentage points, but in a different structure from previous rate cuts, this time in the form of abolition the 1.5 per cent vocational training contribution and a further 0.5 percentage point reduction of the social contribution tax.

The 2022 Budget Act calculates with **revenues from EU grants** in the amount of HUF 2,386 billion. Of this, around HUF 1,500 billion is related to the 2014-2020 programmes, HUF 500 billion would come from the 2021-2027 Cohesion Policy envelope and around HUF 350 billion related to the mobilisation of the Recovery and Resilience Facility (RRF). We expect that revenues in 2022 may be lower than the plan assumed when the Budget Act was compiled, due to the longer than previously expected time needed to implement the 2021-2027 cohesion programmes and send out the invoices.

4.4. CASH-BASED EXPENDITURES OF THE CENTRAL SUBSECTOR

According to our projection, **the cash-based expenditures of the central subsector** may exceed the statutory appropriation, also including reserves, by HUF 128 billion in 2022. (Table 14). Net expenditures of budgetary organisations and pension expenditures may exceed the appropriations in the Budget Act by HUF 170 billion and HUF 57 billion, respectively, in total. We anticipate higher savings at the housing subsidy expenditures and the drug reimbursement appropriation, expecting lower expenditure by HUF 23 billion and HUF 29 billion, respectively. The net cash-based interest expenditure is lower by HUF 36 billion than the net expenditure calculated from the relevant appropriations of the Budget Act.

At the **special and normative subsidies and support to the public media** and the **social policy fare subsidy** our projection assumes the realisation of the statutory appropriation.

The **appropriation of housing subsidy** for 2022 is HUF 382 billion, which exceeds the 2021 budget plan by HUF 12 billion. In 2022 we anticipate savings of HUF 23 billion in subsidies. Due to the absence of new entrants and the continuous expiry of existing contracts, home saving expenditures decline further. Data on the utilisation of the home improvement programme launched at the beginning of 2021 are only available for a short period, and thus the cost of the programme, which will run until the end of 2022, can only be estimated within broad limits, with the appropriation foreseeing more than HUF 150 billion. With the focus on home improvement subsidy, the support for the construction and purchase of new and used home will slightly decline. The cost of interest rate subsidies for related preferential loans will rise and higher expenditure is also expected on mortgage remission for families with 3 or more children.

Among the key items of the **National Family and Social Policy Fund,** at the family benefits the 2022 appropriation for family allowance is consistent with our projection, expected to be around HUF 307 billion. Similar to the income substitute and supplementary social benefits and reimbursements disbursed under various titles, the appropriations for the other items of the family benefits are also expected to be realised. The HUF 9 billion higher appropriation compared to earlier years is mainly attributable to the surplus disbursements connected to the performance of social tasks in the country districts.

The appropriation calculated for the **budgetary organisations' net own expenditures** is HUF 6,937 billion, or 11.7 per cent of next year's GDP. Our projection consistent with the June Inflation Report, anticipates that the appropriation will be overrun by HUF 170 billion, i.e. we expect that the net self-financed expenditures, excluding the reserve appropriations absorbed, will be close to 12 per cent of GDP. If we take into account the appropriation for the Investment Fund included in the reserves and the utilisation of the provision envelope by the budgetary organisations, the estimates for net budgetary expenditure next year show a decline of 3.5 per cent as a percentage of GDP compared to the base period. The expenditures of budgetary organisations may be increased by raising the minimum wage to a larger degree. If the steep rise in the construction price index persists, it may make government investment projects more expensive.

The amount planned by 2022 Budget Act for the **expenditures related to EU grants** is an all-time high HUF 3,001 billion. The plan representing a historic peak is based on the fact that the 2014-2020 funds can be used by the end of 2023, while advance payments for the 2021-2027 cohesion programmes can start in 2022. In addition, Hungary has requested non-reimbursable funds in the amount of HUF 2,511 from the Recovery and Resilience Facility (RRF), in respect of which the Budget Act foresees a payment of HUF 450 billion in 2022. We expect that if agreement is reached on the adoption of the plans related to the funds in the new cycle by the end of this year, the payment appropriation of HUF 3,000 billion could be realised.

At the **appropriation for local government expenditures,** we expect that the statutory appropriation will be realised. Expenditures may increase as the planned global subsidy amount for next year is HUF 36 billion lower than the revised subsidy appropriation for 2021 and nearly HUF 70 billion lower than the expected realisation in 2021. A possible overrun of the statutory appropriation next year does not automatically imply the overrun of the global expenditure amount, as the subsidies for the subsector were previously covered by the available reserves.

Pursuant to the 2022 Budget Act, the appropriations belonging to the expenditures of the **pensions and pension-like benefits** amount to a total HUF 4,561 billion. According to our estimation, in 2022 the budget may spend a total HUF 4,613 billion on pensions and pension-like benefits, equalling 7.8 per cent of GDP.

Our projection for financial **retirement provision** disbursed from the Pension Insurance Fund is HUF 4,220 billion, HUF 57 billion higher than the statutory appropriation. The difference is attributable to differences in the base year projections, in headcount assumptions and in macroeconomic paths. For 2022, the Budget Act presumes inflation to be 3 per cent, whereas the MNB's June Inflation Report presumes a 3.1 per cent inflation. In the case of the pension premiums, we anticipate HUF 12 billion higher disbursements due to the projection of higher growth.

The 2022 appropriation for the largest pension expenditure item, **old-age pensions over the retirement age**, amounts to HUF 3,189 billion, whereas our forecast includes HUF 43 billion higher expenditure. The difference may partly be attributable to the difference in headcount estimates and partly to the different base due to the higher 2021 inflation projection. The macroeconomic path prepared for the MNB's June Inflation report expects inflation to be 4.1 per cent in 2021, and thus according to our projection the pension increase in June 2021 may be followed by an additional increase of 0.5 per cent in November. The measure may increase the expenditures by some HUF 19 billion in the case of expenditures disbursed from the Pension Insurance Fund. New old-age pensions are expected to be determined throughout 2022, as for those born in 1957 the retirement age corresponds to 65 years, and thus the raising of the retirement age that had started in 2014 comes to an end.

Table 14
Partially consolidated cash expenditures of the central subsector in 2022 (HUF billions)

	2022		
	Statutory appropriation	MNB forecast	Difference (MNB – appropriation)
PRIMARY EXPENDITURE ITEMS	**24,237**	**24,401**	**164**
Special and normative subsidies and support to the public media	**590**	**590**	**0**
Social policy fare subsidy	**120**	**120**	**0**
Housing subsidy	**382**	**359**	**-23**
Family allowances, social benefits	**588**	**588**	**0**
Early retirement benefits	**97**	**99**	**2**
Net non-EU related expenditures of central budgetary organisations and chapters	**6,937**	**7,107**	**170**
Expenditures related to EU transfers	**3,001**	**3,000**	**-1**
Support to local governments	**873**	**873**	**0**
Contribution to the EU budget	**565**	**565**	**0**
Central reserves	**894**	**894**	**0**
Other expenditures	**1,074**	**1,074**	**0**
Expenditures of extra-budgetary funds	**557**	**556**	**-1**
EREF – Passive allowances	105	105	0
EPEF – Active allowances	120	120	-1
Other expenditures	332	332	0
Expenditures of social security funds	**7,665**	**7,681**	**17**
PIF - Pensions	4,163	4,220	57
HIF - Disability and rehabilitation benefits	301	293	-9
HIF - Cash benefits	586	578	-8
HIF - Medical and preventive care	2,123	2,126	3
HIF - Net pharmaceutical expenditures	344	315	-29
Other expenditures	148	150	2
NET INTEREST EXPENDITURES	**1,265**	**1,229**	**-36**
TOTAL EXPENDITURES	**24,607**	**24,735**	**128**

Note: The difference between the expenditure totals shown in the table and those indicated in the Budget Act is due to the fact that, based on the data available, we excluded the effect of cash-transfers within the central subsector, and recognised certain expenditure items in net terms, i.e. reduced them by the related direct revenues.

Source: 2022 Budget Act, Hungarian State Treasury, MNB

Women are entitled to receive pension below the age limit after a 40-year eligibility period. In the case of these provisions, the appropriation practically corresponds to our forecast; expenditures in 2022 may amount to some HUF 335 billion. As regards the early retirement benefit of women, we continue to expect increasing utilisation, considering the fact that an increasing number of women complete the 40-year eligibility period necessary for early retirement as the retirement age of old-age pension gradually rises.

Table 15
Comparison of the 2022 statutory appropriation and our projection for pension and pension-type benefits (HUF billions)

	2022 Budgetary appropriation	2022 Forecast	Difference (forecast - appropriation)
I. Pension Fund	**4,163**	**4,220**	**57**
1. Old-age pensions	3,521	3,564	43
1.1 Old-age pensions over the retirement age	3,189	3,229	40
1.2 Early retirement benefit for women	332	335	3
2. Retirement provision to relatives	413	411	-2
3. One-time subsidy	1	1	0
4. Provision for pension premium	68	81	12
5. 13th-month pension	160	164	4
II. Early retirement benefits	**97**	**99**	**2**
III. Disability and rehabilitation benefits	**301**	**293**	**-8**
Total pensions and pension-like benefits	**4,561**	**4,613**	**52**

Source: 2022 Budget Act, MNB

A new measure in the case of **retirement provision to relatives** is that the monthly minimum amount of orphan allowance will increase from the current HUF 24,500 to HUF 50,000 as of 1 January 2022. The increase applies to the orphan allowances that are already being paid and to the newly granted ones as well. As a result of the measure, the amount of allowances paid to the beneficiaries may increase by HUF 8 billion next year.

The 2022 Budget Act calculates with the payment of **pension premium** in 2022 in the amount of HUF 68 billion, based on the 5.2 per cent real GDP growth included in the macroeconomic path. The MNB's macroeconomic forecast prepared for its June Inflation Report projects a 5.5 per cent growth in GDP in 2022. Thus, according to our forecast the amount of the pension premium exceeds the amount planned in the Budget Act by HUF 12 billion.

The gradual reintroduction of the **13th month pension**, which started in 2021, will continue in 2022. In February 2022, pensioners will receive an additional amount equivalent to two weeks' pension. According to the 2022 Budget act, in the case of the provisions paid from the Pension Fund, the disbursement of the second phase of the 13th month pension may amount to HUF 160 billion in 2022, which practically corresponds to our projection.

The 2022 Budget Act calculates with expenditures of HUF 2,123 billion for medical and preventive care, which broadly corresponds to our expectations. Of the expected increase compared to 2021, the budget will contribute HUF 120 billion to the second phase of the wage increase for doctors working in specialised care, and HUF 47 billion to further strengthening the practice subsidies for general practitioners and dentists. The salaries of healthcare ancillary workers will be increased by a further 21 per cent from January 2022, covered by a total earmarked appropriation of HUF 92 billion. Our expectations for next year, consistent with the June Inflation Report, are broadly in line with the expenditure appropriations in the category of medical and preventive care.

For cash benefits disbursed from the Health Insurance Fund, the budget foresees an expenditure of HUF 586 billion in 2022, which is more than HUF 60 billion higher than our expectation for 2021. Of the total difference, HUF 16 billion is related to sickness benefit expenditure, HUF 18 billion to childcare allowance and HUF 28 billion to infant care allowance. The increased expenditure is mainly due to favourable labour market expectations, i.e. the high wage dynamics. In addition to the general growth rate, the amount of the infant care allowance was raised to 100 per cent of the previous gross salary as of 1 July 2021, the impact of which will be felt in the first half of 2022 due to the lower base. The targets in the budget are broadly identical with our expectations for next year, consistent with the 2021 Inflation Report.

Gross expenditure on drug subsidies is projected in the amount of HUF 450 billion in the 2022 budget, which is HUF 19 billion higher than our forecast prepared in line with the June Inflation Report. In the light of the target figure – contrary to the practice of previous years – we do not anticipate any mid-year increase of the budget in 2022. Net drug reimbursement expenditure adjusted for contributions by pharmaceutical manufacturers is forecast to be around HUF 315 billion, HUF 29 billion lower than the corresponding net expenditure in the Budget Act. The difference in the gross drug reimbursement expenditures is caused by the higher payment obligation resulting from higher economic growth.

With respect to the expenditures of the **extra-budgetary funds**, our forecast related to the passive expenditures of the Economy Restart and Employment Fund (EREF) is almost identical with the appropriation, while in the case of active expenditures we also anticipate almost the same expenditure as the appropriation. At the expenditures of the Start Labour Programme we assume a slight decrease in the number of public workers compared to 2021 and wages increased by inflation targeting wage index and – in line with the appropriation – a total cost of HUF 120 billion. In addition to EREF, in the case of other extra-budgetary funds we assume that the 2022 expenditure appropriation will be realised, and thus the total expenditure of the funds may reach around HUF 560 billion next year.

The sum of the appropriations for **central reserves** practically doubled compared to the reserves of 2021 and rose from HUF 446 billion of 2021 to HUF 894 billion. Of the reserve appropriations the newly created Investment Fund with an envelope of HUF 550 billion should be highlighted. The Investment Fund provides funds for the government's investment decisions The Parliament has set aside HUF 145 billion for the reserve for extraordinary government measures, while the central reserve appropriation for Economy Restart programmes contains HUF 68 billion. The Central Reserve for Pandemic Control appropriation is HUF 20 billion. The HUF 106 billion set aside for wage measures is likely to be exceeded next year, based on expected wage increases, which we have taken into consideration in our forecast in the net expenditure of budgetary organisations.

Our forecast for **net cash-based interest expenses** falls short of the appropriation in the Budget Act by HUF 36 billion. According to our forecast, gross interest expenditures may slightly exceed the statutory appropriation, while – in line with the data of previous year – we estimate interest revenues to become materially higher, since at the mid-year debt management transactions generating revenues, our projection calculates with higher volume than assumed upon the planning of the appropriation.

According to our projection, **net accrual-based interest expenditure** may be lower than the statutory estimate of 2.4 per cent. In 2022, interest expenditure may amount to 2.3 per cent of GDP, representing a minimal decline in the ratio as a percentage of GDP compared to our expectations in previous year. According to our forecast the rate of the decline in interest expenditure may slow down from 2022, driven by historically low yield levels stagnating at low levels rather than declining significantly further. Accordingly, a major part of the government debt will be repriced to a lower yield level by the end of next year.

4.5. BALANCE OF LOCAL GOVERNMENTS

According to the plans in the budget, **cash-based balance of local governments** may be a deficit of HUF 156 billion in 2022. Our forecast for the June Inflation Report assumed for next year a cash-based deficit of HUF 181 billion in the subsector. The more than HUF 190 billion deterioration in the balance in the base year compared to the expected one is mainly linked to the accelerated absorption of EU advances previously disbursed to local governments. As the small surplus in the subsector expected in 2021 is caused by the acceleration of investment projects co-financed by the EU, the accrual-based deficit of the subsector is not expected to change materially compared to 2021.

4.6. APPLIED STATISTICAL CORRECTIONS (ESA BRIDGE)

According to the Budget Act **the ESA bridge, containing the statistical corrections, as a percentage of GDP** increases the ESA-based deficit of the general government only by HUF 16 billion. Our forecast is consistent with the June Inflation Report assumes a cash balance improving statistical correction of HUF 173 billion. According to our projection, the statistical correction related to the cash settlements with the European Union may reduce the cash-based deficit by HUF 265 billion in total. According to our expectations, the statistical corrections belonging to the prenatal baby subsidies increase ESA expenditures by HUF 62 billion. Dividend revenues from entities classified into the government sector (e.g. public foundations) and other asset management-related settlements may improve the government sector balance by HUF 49 billion, while the proceeds from the sale of telecommunication frequencies will be reduced by HUF 129 billion by spreading the revenues over the entire maturity. Other adjustments increase the ESA-bridge surplus by an additional HUF 50 billion in total.

4.7. EXPECTED DEVELOPMENTS OF GOVERNMENT DEBT IN 2022

According to our forecast, following a temporary rise, **general government gross debt-to-GDP ratio** will decline in 2021 to 76.8 per cent from 80.4 per cent registered at the end of 2020, and then to 75.4 per cent by the end of 2022. The decrease in the debt ratio is supported by the declining budget deficit and dynamic economic growth.

The foreign currency ratio of the central government debt will remain essentially unchanged in 2022. The share of foreign ownership in public debt may further decline in parallel with the increasing participation of households. Improved sales of retail securities is expected to continue in 2022 as well, and thus the medium-term debt management target can be met, according to which by the end of 2023 the stock of outstanding government securities held by households will reach HUF 11,000 billion.

5. Compliance with the fiscal rules

There are a total of eight fiscal rules that pertain to the Hungarian general government between 2020 and 2022, with four Hungarian and four European Union requirements. There are two overlaps between the rules: the 3 per cent Maastricht deficit criterion and the regulations regarding the medium-term budgetary objective. The other two Hungarian rules include the debt rule in the Fundamental Law and the debt 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.

As regards **the debt rule of the Fundamental Law**, Hungary's debt ratio remains over 50 per cent of GDP; therefore, in accordance with the rule, it has to be reduced.[4] Compliance with the debt rule is a condition for the adoption of the budget, which is verified by the Fiscal Council. The 2020 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.[5] A decrease in the real value of gross domestic product for even one year should be interpreted as permanent and significant economic downturn, while special legal order means state of national crisis, state of emergency, state of preventive defence, state of terrorist threat, unexpected attack and state of danger.[6] Thus the economic downturn in the wake of the coronavirus pandemic overrode the debt rule in 2020 and triggered the escape clause, which allowed a temporary increase in the debt ratio of around 15 percentage points last year. The debt ratio is expected to decline both this year and in 2022, and thus the rule is fulfilled in all three years.

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 in 2020, instead of the previous quantified debt reduction formula, the requirement stipulates that, parallel with the enforcement of EU regulations, the debt-to-GDP ratio must decrease by at least 0.1 percentage point per year.[7] In 2020, the debt-to-GDP ratio increased, which was, however, allowed by the escape clause that comes into force in the event of a one-year decline in the real value of gross domestic product.[8] The decline in the debt ratio this year and next year complies with the provisions of the debt rule in the Stability Act.

The **Maastricht deficit criterion**, included in both the Hungarian and the EU fiscal framework, specifies that the accrual-based deficit of the general government may not exceed 3 per cent of GDP.[9] The general government deficit was 8.1 per cent 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.[10] Subject to the escape clause, by not complying with the rules in the corrective arm of the Stability and Growth Pact, thus, with the deficit criterion, according to the discretionary decision, EU institutions will not initiate an excessive deficit procedure. However, their activities are limited to formulating revised country-specific economic policy recommendations. Based on the latest notification of the EU organisations, the application of the general exemption clause will continue in 2022.[11] In the Hungarian legal order, the decrease in the real value of gross domestic product

[4] Fundamental Law of Hungary, Article 36(4)–(6), Article 37(2)–(3)
[5] Fundamental Law of Hungary, Article 36(6), Article 37(3)
[6] Fundamental Law of Hungary, Articles 48 to 54
[7] Section 4(20) of Act CXCIV of 2011 on the Economic Stability of Hungary
[8] Section 7(1)-(2) of Act CXCIV of 2011 on the Economic Stability of Hungary
[9] Section 3/A(2b) of Act CXCIV of 2011 on the Economic Stability of Hungary
[10] 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;
[11] Economic policy coordination in 2021: overcoming COVID-19, supporting the recovery and modernising our economy, European Commission, page 6

exempts from the compliance with the 3 per cent deficit rule.[12] The government deficit-to-GDP ratio of 7.5 per cent this year and 5.9 per cent next year also exceeds the threshold value; however the relevant provision of the Stability Act has been amended, and according to the amendment between 2021 and 2023 the rule related to the budget deficit and medium-term budgetary objective shall not be applied.[13]

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.[14] The objective is measured by the structural balance, which refers to the cyclically adjusted balance net of one-off and other temporary items. For Hungary, the medium-term budgetary objective (MTO) is -1 per cent of GDP between 2020 and 2022. Following the entry into force of the general escape clause in the European Union, during the period of its effect, the Commission will not sanction or examine compliance with the rules of the preventive arm of the Stability and Growth Pact. Thus, Member States will be temporarily exempted from the medium-term budgetary objective or, in the event of non-compliance, from the **expenditure benchmark** designating the adjustment path. According to the notification by the Commission, the specific qualitative target related to the structural adjustment necessary for the correction path leading the medium-term objective may be set in 2022 at the earliest.[15] The rule in the Hungarian legislation applicable to MTO has been modified, and thus it is not necessary to comply with this requirement between 2021 and 2023.

The **European debt rule** states that the Member States' government debt ratio must not exceed 60 per cent of GDP, or if it does, the debt ratio must be reduced at a satisfactory pace. The appropriate decrease in the debt is quantified by the one-twentieth rule, according to which the debt ratio should be reduced by one twentieth of the part that exceeds 60 per cent on average over three years. Based on its own forecast, the European Commission calculates the extent of the change of the debt ratio using three different methodologies (forward-looking, backward-looking and cyclically adjusted), and if the one-twentieth drop is satisfied based on any of them, the rule is deemed to have been complied with.

Hungary's gross government debt ratio is over 60 per cent of GDP in all three years under review. The debt ratio for 2020 increased by 15 percentage points compared to the end of the previous year, which did not trigger an excessive deficit procedure due to the general escape clause. The clause is expected to remain in force until 2022, but the European Commission forecasts that nevertheless, the Hungarian debt-to-GDP ratio will develop in line with the temporarily suspended debt rule, looking ahead [16]

[12] Section 7(1)-(2) of Act CXCIV of 2011 on the Economic Stability of Hungary

[13] Section 1 of Government Decree 196/2021. (IV. 28)

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

[15] Recommendation for a COUNCIL RECOMMENDATION delivering a Council opinion on the 2021 Convergence Programme of Hungary, European Commission, paragraph (17)

[16] Report from the Commission – Report prepared in accordance with Article 126(3) of the Treaty on the Functioning of the European Union, European Commission, 2 June 2021, Table 4

6. Special topics

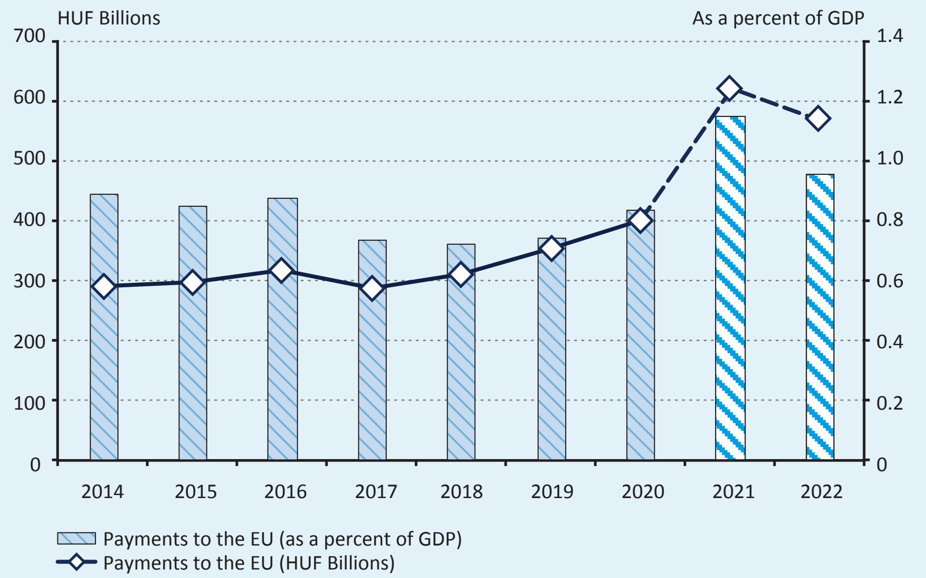
6.1. HUNGARY'S CONTRIBUTION TO THE EU BUDGET

The European Union's budget is mainly financed through the system of own resources, with the largest revenue item being the GNI-based contribution paid by the Member States on the basis of their maturity level. This is supplemented by VAT-based resources, corrections linked to the GNI-based contributions and customs duties, which are traditional own resources. The European Commission plans a gradual reform and expansion of the own resources system, as the current forms of revenue in the EU budget only cover the expenditure planned for the usual 7-year budget cycle. In order to cover the total NextGen EU programmes (of which RRF loans and grants are also a part) of more than EUR 800 billion at current prices, the Commission therefore plans to increase its own revenues in addition to the common bond issue.

Firstly, a plastic packaging waste-based contribution has been introduced from 1 January 2021, based on the amount of non-recycled plastic packaging waste. The uniform rate of contribution is EUR 0.80 per kilogram, but Member States with a per capita GNI below the EU average will see their contributions reduced by a flat rate of 3.8 kg/person of plastic waste per year, which – according to our estimate – could mean an allowance of around 20-25 per cent for Hungary. The Commission expects that the revenue from the plastic source could account for 4 per cent of the EU budget.

Including the new plastic-based resource, Hungary's national contribution could amount to EUR 11 billion, or nearly HUF 4,000 billion, excluding duties, in the new 2021-2027 cycle. As a result, the average annual contribution of HUF 320 billion in the 2014-2020 cycle could exceed HUF 500 billion from 2021. The HUF 615 billion in the amended 2021 appropriation is a particularly significant increase compared to the previous year, but it also includes transitional items related to the previous cycle. This is confirmed by the fact that the estimate for the 2022 contribution is already lower, at HUF 564 billion, around 0.9 per cent of the expected GDP.

Chart 23
Payment by Hungary to the EU budget (2014-2022)



Source: Hungarian State Treasury, Ministry of Finance

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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