PUBLIC FINANCE REPORT

2020

JULY

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

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

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Analysis of the 2021 Budget Act

2020

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

Pursuant to Act CXCIV of 2011 on the Economic Stability of Hungary, the Governor of the MNB is a member of the Fiscal Council (FC), and thus the professional expertise and accumulated information available in the MNB can indirectly support the work of the FC. The MNB prepares background analyses for the duties of the FC stipulated in the Stability Act and provides them to the FC.

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

The analysis is based on information available for the period ending on 3 July 2020.

Contents

1 Summary

The subject of this analysis is the Act on Hungary's 2021 Central Budget (Budget Act), adopted by the Parliament on 3 July, which we assess in the light of the MNB's fiscal forecast. As part of this analysis, the MNB prepared its own projection for the 2021 budget balance based on the available information, and this projection is compared with the appropriation in the Budget Act. We update our revised forecast, prepared for the June Inflation Report, with the amendments of the Budget Act's original appropriations.

The coronavirus pandemic and its impacts on the economy significantly affect the 2021 fiscal developments as well. Economic growth in 2020 as well as the degree of the 'rebound' expected following that determine how the main tax bases (wage bill, consumption) change, which has an effect on the budget as well through the tax revenues. Nevertheless, it is still uncertain how long the pandemic will last and how the economic difficulties evolving in connection with the pandemic will change over time. This analysis takes into account the macroeconomic projection included in the June Inflation Report of the Magyar Nemzeti Bank, and the budget forecast based on that is compared to the appropriations in the Act. In addition, the direct expenditures related to the health emergency and the measures of the Economy Protection Action Plan also affect the 2021 budget.

According to the Budget Act, in 2021 the ESA budget deficit target will be 2.9 percent of GDP. The 2021 deficit target significantly exceeds the 0.7 percent target shown in the projection of the 2020 Budget Act, which, according to the Act, is justified by the negative effects of the pandemic as well as by the measures necessary for restarting the economy and restoring the growth momentum. At the same time, the planned deficit represents a 0.9 percentage point decline compared to the 3.8 percent deficit foreseen for 2020 in the Convergence Programme.

According to our forecast, the deficit target in the Budget Act can be achieved. In view of the different macroeconomic paths, our forecast suggests that the tax and contribution revenues of the budget may be slightly higher than the appropriations. The difference is primarily attributable to the higher revenues expected from taxes on income, while the revenues from consumption taxes may fall short of the plan. At the same time, the higher tax revenues are offset by the fact that up to the deficit target we expect the tax revenue surplus to be used for investment next year within the framework of the economy protection measures.

In 2021 the amount of the central reserves of the budget will be HUF 210 billion, i.e. 0.4 percent of GDP, according to the Budget Act. The amount of the reserves of extraordinary government measures may be HUF 118 billion, the central reserves of the economy protection programmes may amount to HUF 68 billion, while the central reserves for epidemic control may correspond to HUF 25 billion, according to the Budget Act. Compared to the significant reserves of nearly HUF 500 billion in 2020, the amount of reserves will decline, but can still be considered high.

The Economy Protection Fund (EPF) contains total expenditures of HUF 2610 billion in the 2021 Budget Act. The Fund provides cover for the continuation of the programmes related to the protection and restarting of the economy, crucial development and investment projects (e.g. road and railway construction, Hungarian Village Programme, Modern Cities, Healthy Budapest, overground construction projects of the Government) as well as for measures in connection with the promotion of employment. Parts of the Fund are the Economy Protection Employment Fund (EPEF), which comes into being from the National Employment Fund, and the 13th month pension, whose cover going into the Pension Fund is provided as expenditure by the Economy Protection Fund. The Fund also contains free reserves amounting to HUF 68 billion, about the spending of which the Government may decide during the year.

The 2021 budget contains the funds required for the defence against the pandemic and for operating the healthcare system in a renewed structure, a money fund called Fund for Health Insurance and Defence Against Epidemics (FHIDAE). The combining of the resources results in a money fund of some HUF 3000 billion, whose expenditures and revenues are primarily accounted for by the Health Insurance Fund, which supplied the cover for health insurance provisions earlier as well. Revenues of the FHIDAE also include all the revenues from the retail tax and the motor vehicle tax.

According to the Budget Act, the debt-to-GDP ratio is expected to decline considerably, by 3.3 percentage points in 2021, whereas our forecast expects a decrease of some 2 percentage points. As per the Budget Act, the gross general government debt-to-GDP ratio according to the EDP methodology will increase from 66.3 percent at end-2019 to 72.6 percent in 2020, before declining to 69.3 percent by end-2021. Our forecast suggests that the decline in the general government debt-to-GDP ratio may be lower than anticipated, i.e. some 2 percentage points.

The forecast for economic growth in 2021 in the macro path of the Budget Act (4.8 percent) is in line with the central bank's projection prepared for the June Inflation Report (3.8–5.1 percent). At the same time, in view of the economic crisis that evolved due to the coronavirus pandemic, the budget foresees a 3 percent fall in real GDP in 2020, which is much lower than the 0.3–2 percent growth expected in the MNB's June Inflation Report. According to the Budget Act, the economic downturn will be limited to this year, which may be followed by persistently high growth dynamics. The budget forecasts a 3 percent inflation for 2021, which is slightly lower than the 3.2–3.3 percent expected by the MNB.

The Budget Act takes account of the impact of previously announced tax measures. The Act takes into account the introduction of the retail tax, the deductibility of the one-off contribution related to the bank tax in equal parts for five years as of 2021 as well as the reduction of the small enterprise tax. In addition, the Act considers the whole-year impact of the 2 percentage point reduction of the social contribution tax in July 2020.

The adopted Budget Act complies with the debt rule outlined in the Fundamental Law, as the expected decline in the debt-to-GDP ratio is well above the prescribed rate of 0.1 percentage point. The Budget Act is also in line with the requirement of the European Union regarding the change in government debt. The anticipated change in the accrual-based balance is in line with the relevant rules of the EU and Hungary.

The 2.2 percent structural deficit in the 2021 Budget Act is higher than the medium-term objective. The medium-term objective (MTO) framework stipulates that all Member States should reach the structural balance determined jointly with the European Commission, or approximate it to a sufficient degree. The medium-term objective required of Hungary for 2021 is -1.0 percent of GDP.

2 General government balance

The adopted Budget Act determines the ESA deficit of the general government in 2021 as 2.9 percent of GDP, representing a 0.9 percentage point decline compared to the 3.8 percent deficit expected in the Convergence Programme for 2020. According to our forecast, in 2021 the cash-based deficit of the central budget and the ESA bridge containing statistical corrections may be lower than the appropriation. At the same time, the balance of local governments may be very similar to the one foreseen in the Budget Act (Table 1).

Table 1
ESA balance of the general government sector in 2021 (as a percentage of GDP)

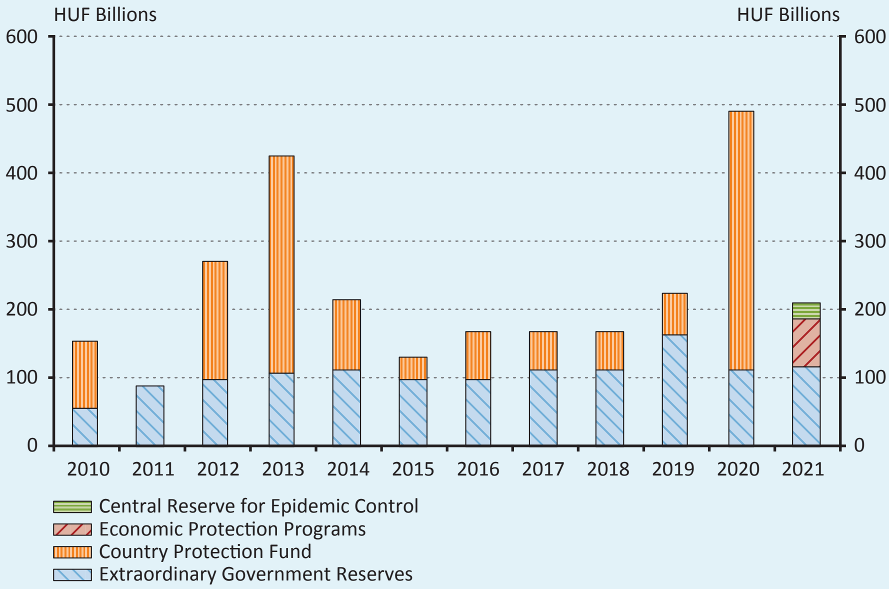
	2021		
	Statutory appropriation	**MNB forecast**	**Difference**
1. Balance of the central sub-sector	-2.9	-2.5	0.4
2. Balance of local governments	-0.4	-0.5	-0.1
3. Cash-based (GFS) balance of the central-sub sector and local governments (1+2)	**-3.3**	**-3.0**	**0.3**
4. GFS-ESA difference	0.4	0.0	-0.4
5. ESA balance of the general government sector (3+4)	**-2.9**	**-2.9**	**0.0**

Source: Budget Act of 2021, MNB.

According to our forecast, the accrual-based deficit target of 2.9 percent foreseen in the Budget Act can be achieved. In view of the different macroeconomic paths, according to our forecast the tax and contribution revenues of the budget may be 0.1 percent of GDP higher than the appropriations in the Budget Act. The difference is primarily attributable to the higher revenues expected from taxes on income, while the revenues from consumption taxes may fall short of the plan. At the same time, the higher tax revenues are offset by our expectation that the tax revenue surplus will be used for investment next year within the framework of the economy protection measures.

According to the Budget Act, in 2021 the amount of the central reserves of the budget will be HUF 210 billion, i.e. 0.4 percent of GDP. The amount of the reserves of extraordinary government measures may be HUF 118 billion, the central reserves of the economy protection programmes may amount to HUF 68 billion, while the central reserves for epidemic control may correspond to HUF 25 billion, according to the Budget Act. Compared to the significant reserves of nearly HUF 500 billion in 2020, the amount of reserves will decline, but can still be considered high (Chart 1).

Chart 1
Central budget reserves between 2010 and 2021



Source: Budget Acts of 2010-2021.

The cash-based deficit of the local government sub-sector is planned by the Government to amount to HUF 198 billion in the Budget Act. The central bank's projection expects a slightly higher deficit of HUF 257 billion for the sub-sector. The higher deficit is attributable to various reasons: our forecast is based on the assumption that local governments, which were more capable of imposing taxes until now, will not yet be able next year to completely adjust themselves to the major reallocation of the local business tax, and thus an increased use of deposits is expected in their case to partly offset the decline in revenues. In addition, our expectation is presumably also different from the Government's projection regarding the absorption of advance payments previously disbursed for EU programmes.

For 2021, the so-called ESA bridge, which contains **accrual-based ESA corrections**, comprises corrections amounting to HUF 213 billion that improve the cash-based balance. The ESA bridge calculated and applied by us takes account of a cash-based balance improving correction of HUF 21 billion. The difference is primarily attributable to the accrual-based adjustments of EU settlements, as our forecast disregards the carrying forward of EU funding from one year to another. At the same time, in the case of cash-based revenues it means additional revenue in our forecast compared to the budget, and thus, on the whole, it does not result in any difference in the accrual-based balance.

Box 1
Amendments between the submission and approval of the 2021 budget bill

Compared to the provisions of the bill, submitted under No T/10710, the amended appropriations approved by the Parliament increased the grand total of revenues by HUF 91.8 billion, while the restructuring of the expenditure-side appropriations raised the grand total of expenditures with the same amount; thus, as a result of the amendments, the cash-based deficit of the central sub-sector did not change. Furthermore, there was no change in the general government deficit calculated according to the EU methodology and in the planned amount of the government debt either.

In total, the proposed amendments added around HUF 214 billion to certain expenditures, while other expenditures declined by HUF 122 billion. Most of the additional assistance is granted to the Hungarian Village Programme, the public service media service providers, the Eötvös Loránd Research Network, the Fund for Health Insurance and

Defence Against Epidemics, local governments, public prosecutor's offices, churches, universities, colleges, the Ministry of Foreign Affairs and Trade as well as child, youth and family policy tasks.

The sources of expenditure appropriations are provided mainly by regroupings of expenditure and reserve appropriations and, to a lesser degree, by additional revenue appropriations. Compared to the submitted bill, declining by HUF 2 billion, the amount of reserves for extraordinary government measures may be HUF 118 billion, the central reserves of economy protection programmes may be lower by HUF 52 billion, amounting to HUF 68 billion, whereas the central reserves for epidemic control may decrease by HUF 5 billion to HUF 25 billion according to the Budget Act. The revenue appropriation expected from the lump sum tax of small entrepreneurs rose by HUF 40 billion, which is attributable to an amendment in the tax. The VAT appropriation increased by nearly HUF 33 billion.

3 Expected developments of government debt

According to our forecast, in view of the deteriorating economic environment due to the coronavirus pandemic as well as the measures and higher expenditures necessary in order to mitigate the economic effects of the pandemic, in 2020 **the gross general government debt-to-GDP ratio** will temporarily increase from the 66.3 percent observed at end-2019. In 2021, however, as result of the recovery in economic growth and the decrease in the expected deficit, the government debt ratio will return to a declining path once again. According to our forecast, in 2021 the government debt-to-GDP ratio will decline by 1.9 percentage points to 66.5 percent.

Table 2
Developments in government debt (in HUF billions and as a percentage of GDP)

	Budget Act	MNB	Budget Act	MNB
	HUF billions		As a percentage of GDP*	
1. 2020 initial government debt	34,147	33,576	72.6	68.3
2. 2021 cash-based deficit of the central budget	1,491	1,293	2.9	2.6
3. Other effects	-366	281	-0.7	0.6
4. 2021 expected public debt (1+2+3)	35,273	35,150	69.3	66.5
5. Change in public debt-to-GDP ratio in 2021 (4-1)			**-3.3**	**-1.9**

*Note: * The MNB and the Budget Act calculate with different nominal GDP. The sum of the items may differ from the aggregate values because of rounding.*
Source: Budget Act of 2021, MNB forecast

The MNB's projections for nominal debt at end-2020 and end-2021 are lower than the ones in the Budget Act. The lower year-end values are partly explained by the fact that according to our forecast the cash-based deficit of the central budget will be lower in both years than the values presented in the Budget Act.

According to the Budget Act, the debt-to-GDP ratio is expected to decline by 3.3 percentage points in 2021, whereas our forecast expects a decrease of some 2 percentage points. The Act foresees an increase from 66.3 percent at end-2019 to 72.6 percent in 2020 in the gross debt-to-GDP ratio of the general government according to the EDP methodology, followed by a decline to 69.3 percent by end-2021. The decline in debt forecast in the budget is greater in 2021 because the Budget Act foresees higher net issuance than the net financing need for 2020 and a lower one for 2021. Compared to the impact of the budget deficit, this increases the government debt in 2021 and reduces it in 2020.

The foreign currency ratio of the central government debt declined considerably in the past years: from around 50 percent in 2011 to 17.3 percent by end-2019. According to our forecast, by end-2020 this ratio may temporarily increase as a result of the foreign currency bond issuance but may already decrease to below 17 percent in 2021. In 2021, the retail government securities introduced with favourable conditions last year may ensure a high demand for retail government securities, which may result in a rise in the share of domestic financing once again.

Chart 2
Expected developments of government debt

Source: MNB, ÁKK (Government Debt Management Agency).

4 Evaluation of the macroeconomic assumptions underlying the Budget Act

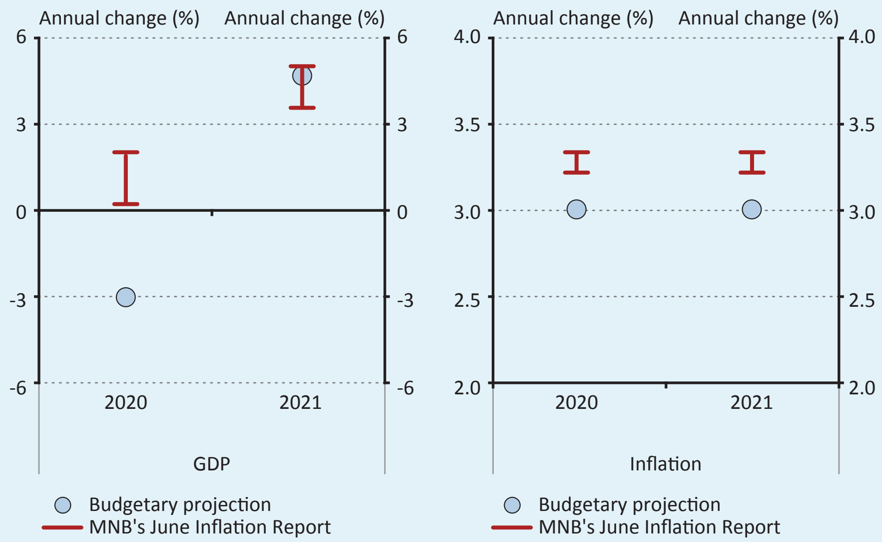
Due to the coronavirus pandemic economic outlook has become much more uncertain than previously anticipated. Due to the current situation, the Magyar Nemzeti Bank temporarily broke with the practice of building its projection around a favoured baseline scenario; instead of that, it gives a range for the main variables in its forecast.

The forecast for economic growth in 2021 in the macro path of the Budget Act (4.8 percent) is in line with the central bank's projection prepared for the June Inflation Report (3.8–5.1 percent). At the same time, the budget foresees a 3 percent fall in real GDP in 2020, which is well below the projection in the MNB's June Inflation Report (Chart 3). According to the Budget Act, the economic downturn will be limited to this year, which may be followed by persistently high growth dynamics. High uncertainty surrounding the growth outlook is indicated by the greater dispersion of market analysts' growth expectations for both this year and next year.

For this year, household consumption and public consumption developments are concurrent overall, in the two forecasts**.** A difference **is mainly seen in gross fixed capital formation, but also in the forecasts related to foreign trade.** The central bank expects lesser downturns in exports and imports than the budget. **According to the MNB's forecast, the FGS Go!, the expansion in corporate lending contribute to the upturn in investment activity, and the upswing in government investment in H2 also supports the rapid economic recovery.** In line with the slight, positive increase in households' consumption expenditure, the growth dynamics of the gross wage bill and wages is subdued. The moratorium on loan repayments, however, frees up a significant amount of funds in the household sector, which supports consumption. In the past years, households' savings rate and net financial worth rose to a high level, which is also an important contributor to consumption this year. **Compared to the central bank forecast, the consumer price index is slightly lower, while the GDP deflator is slightly higher in the Budget Act.**

Only a smaller difference is observed in the GDP dynamics for 2021: the projection in the Budget Act is at the upper bound of the central bank's forecast band, which may be attributable to the different expectations regarding foreign trade as well as to the different degrees in the downturn in 2020 (base effect). **The Budget Act's picture of export dynamics is significantly, while its import projection is slightly above the central bank's forecast band. The macro path of the budget forecasts a somewhat greater growth in household consumptio**n, which may be explained by the lower 2020 base as well. For next year, however, **the Budget Act forecasts an increase in gross fixed capital formation that falls slightly short of the MNB's projection**. According to the central bank's forecast, the expansion in corporate lending supported by the FGS Go! as well as by the BGS will continue next year as well, which may result in higher corporate investment activity. **In the case of the labour market, the Budget Act's wage bill forecast projects a smaller expansion than the central bank for 2021.** The difference reflected in the wage bill is primarily explained by the wage index of the private sector: the central bank projection exceeds the forecast of the budget, and this year's temporarily lower wage increase will be followed by an adjustment next year. Meanwhile, the estimates regarding employment are nearly similar in the two forecasts for both the economy as a whole and the private sector. **In 2021, the consumer price index is slightly lower, while the GDP deflator is slightly higher in the Budget Act compared to the central bank forecast.**

Chart 3
Comparison of GDP and inflation forecasts



Source: 2021 Budget Act, Inflation Report (June 2020).

Table 3
Comparison of macroeconomic forecasts (percentage change compared to the previous year)

	2019	2020			2021		
	Actual	Convergence Programme	MNB	Difference	Budget	MNB	Difference
GDP	**4.9**	**-3.0**	**0.3 – 2.0**	**3.3 – 5.0**	**4.8**	**3.8 – 5.1**	**(-1.0) – 0.3**
Consumption expenditure of households	5.0	0.9	0.3 – 1.8	(-0.6) – 0.9	3.8	2.8 – 3.8	(-1.0) – 0.0
Public consumption	2.0	1.5	1.3 – 1.8	(-0.2) – 0.3	1.0	1.0 – 1.4	0.0 – 0.4
Gross fixed capital formation	15.3	-8.8	1.7 – 2.9	10.5 – 11.7	5.5	6.2 – 7.2	0.7 – 1.7
Exports	6.0	-8.3	(-8.1) – (-5.1)	0.2 – 3.2	10.5	5.8 – 8.4	(-4.7) – (-2.1)
Imports	6.9	-6.8	(-5.4) – (-3.0)	1.4 – 3.8	8.9	5.2 – 6.9	(-3.7) – (-2.0)
GDP deflator	4.7	3.7	3.5 – 3.6	(-0.2) – (-0.1)	3.2	3.0	(-0.2)
Inflation	**3.4**	**3.0**	**3.2 – 3.3**	**0.2 – 0.3**	**3.0**	**3.2 – 3.3**	**0.2 – 0.3**
Gross wage bill	**12.1**	**3.9**	**2.0 – 4.4**	**(-1.9) – 0.5**	**8.5**	**10.4 – 12.0**	**1.9 – 3.5**
Gross average earnings	11.4	5.7	6.5 – 7.5	0.8 – 1.8	6.9	7.9 – 8.6	1.0 – 1.7
of which: private sector	11.6	5.5	5.3 – 6.4	(-0.2) – 0.9	7.0	9.1 – 9.7	2.1 – 2.7
Number of employees	1.0	-1.8	(-2.5) – (-1.7)	(-0.7) – 0.1	1.6	1.6 – 1.9	0.0 – 0.3
of which: private sector*	1.4 [2.0]	-2.3	(-2.5) – (-1.5) [(-2.8) – (-1.9)]	(-0.5) – 0.4	2.0	2.1 – 2.5 [2.0 – 2.3]	0.0 – 0.3

*Note: * The Budget Act defines the private sector differently from the central bank's terminology; due to this, the headcount projection comparable with the budget's macro path is shown in square brackets, and the difference is also calculated from that.*

Source: 2021 Budget Act, Inflation Report (June 2020)

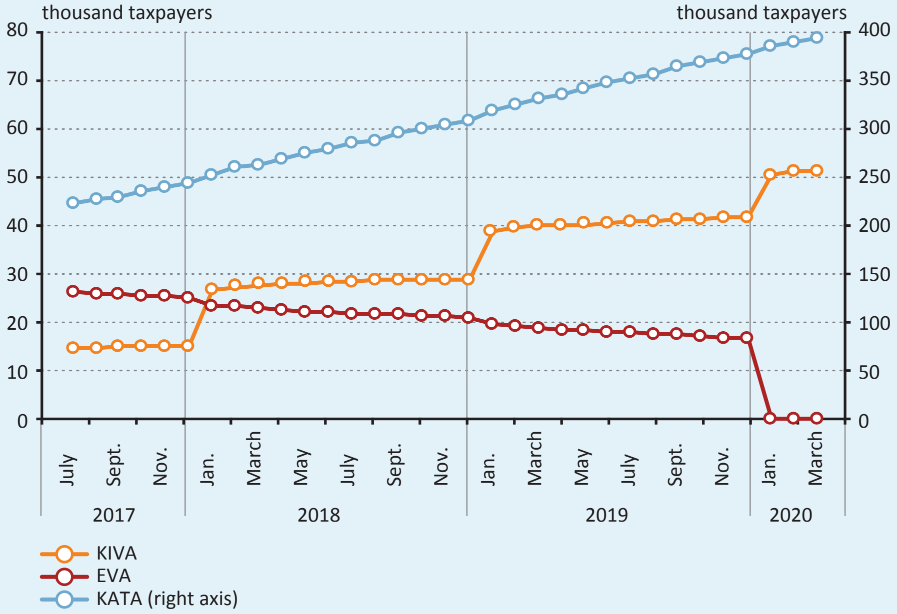
5 Detailed evaluation of the Budget Act

5.1 PRIMARY REVENUES

According to our forecast, the **primary revenues of the central subsector of the budget** may be higher than the appropriations in the Budget Act for 2021 by HUF 301 billion in total (Table 4). Within that, tax and contribution revenues may be HUF 69 billion, i.e. slightly more than 0.1 percent of GDP, higher than the appropriations, the major part of which is reflected in taxes on labour, which is mainly attributable to the difference in the macro paths. Namely, in its June Inflation Report the Magyar Nemzeti Bank expects higher wage and employment dynamics in 2021. Moreover, according to our forecast, the cash-based revenues related to EU funds may come in higher than the appropriation in the Act.

Payments by economic organisations may practically equal the appropriation, although there may be significant differences in the structure of payments. Revenues from the corporate income tax may be HUF 10 billion lower than the appropriation, which may be explained by the different assumptions concerning the changes in revenues in 2020. Revenues from mining royalty may be HUF 13 billion less than the appropriation. Compared to the appropriation, the MNB's projection expects a lower growth in mineral raw material production and geothermal energy production, which determine this tax payment obligation. In the case of the retail tax, the MNB's projection expects that the revenue will exceed the appropriation by HUF 6 billion. The difference is attributable to the fact that the MNB forecasts more favourable developments in macroeconomic conditions. Our forecasts are practically the same as the appropriations in the case of the lump sum tax of small entrepreneurs (KATA) and the small business tax (KIVA). The number of those who opted for the small business tax increased further in the past period. The number of those choosing the KATA and the KIVA grew to 400,000 and more than 50,000, respectively (Chart 4). In line with the budget, the amendment to the rules concerning the lump sum tax of small entrepreneurs requires additional payment in certain cases. If the value of transactions between an entrepreneur who chose the lump sum tax of small entrepreneurs and one of his business partners exceeds HUF 3 million within a year, the business partner concerned will have to pay a 40 percent tax on the portion above the HUF 3 million. In the case of the e-road toll, as a result of different assumptions concerning the macroeconomic environment, the MNB expects HUF 16 billion higher revenues than the Budget Act. Penalty revenues may exceed the appropriation by HUF 19 billion; here the difference is explained by the base effect stemming from the difference in the forecasts regarding the payments in 2020. Environmental product levies may fall short of the appropriation by HUF 8 billion, also as a result of a base effect.

Chart 4
Number of taxpayers choosing the small business taxes



Source: Ministry of Finance.

On a cash basis, the budget expects to receive HUF 5,015 billion **from the value added tax** in 2021, exceeding our projection by HUF 157 billion. The difference is mainly attributable to the difference in macroeconomic expectations. The budget presumes a 3.8 percent increase in household consumption expenditures in 2021, whereas according to the MNB's June Inflation Report the growth rate may be between 2.8–3.8 percent. It concerns the value added tax forecast that as of 1 January 2021, the retailers that use online cash registers will be obliged to provide the possibility of electronic payment, which will allow an even wider use of instant payment. Our projections suggests that this year's economy protection measures according to which the VAT refund to the small and medium-sized enterprises of the sectors concerned declines from 30 days to 20 days and from 75 days to 30 days, respectively, will not be carried over to 2021.

The 2021 appropriation of revenues **from excise duties** is HUF 1,263 billion, which is in line with our forecast. The excise duty on tobacco products will increase in January as well in order to comply with the required EU level. Revenues from the excise tax on fuels are also expected to increase, because pursuant to the relevant regulation, if the per barrel price is permanently below USD 50, the amount of the tax rises from HUF 120,000 to HUF 125,000 on unleaded petrol, while the excise tax on diesel fuel grows from HUF 110,350 to HUF 120,350 as of 2020 H2.

According to the Budget Act, next year's appropriation of **the financial transaction levy** is HUF 219 billion, which is HUF 16 billion lower than our forecast. It is explained by the differences between the macroeconomic assumptions that determine the expected revenues in 2020.

The Budget Act foresees revenues of HUF 2,684 billion **from the personal income tax**, i.e. 2.9 percent more than the statutory appropriation for this year. Nevertheless, growth dynamics is expected to be higher than that, considering that in view of the coronavirus pandemic, due to a downturn in employment, the gross wage bill will decline considerably, and thus this year's base may be much lower compared to the 2020 appropriation. According to our forecast, the expected revenue may be HUF 68 billion higher than that, the reason for which is the difference between the wage bill growth assumptions. The Budget Act does not contain any new measure concerning the personal income tax.

The total appropriation of **tax and contribution revenues of social security and extra-budgetary funds** for 2021 is HUF 5,869 billion, which is almost HUF 120 billion lower than our forecast. The difference is mostly attributable to the different macroeconomic assumptions, mainly related to the increase in the gross wage and salary bill. At the same time, however, in the case of the revenues from the vocational training contribution, the difference is somewhat greater than what is justified by real economy assumptions. The 2020 base will presumably be much lower than this year's statutory appropriation, but next year's increase in revenues is consistent with the macroeconomic projection enclosed to the 2021 Budget Act. Of the other revenues of social security funds, mainly the ones from the public health product tax may be higher than the appropriation. In line with our projection, for 2021 the Budget Act does not contain a further 2 percentage point reduction of the social contribution tax rate, and the Act does not name any new measures unknown to date.

According to the Budget Act, the appropriation of **duty revenues** for next year is HUF 219 billion, which is very close to our forecast, while being 4.7 percent lower than the base year appropriation. The decline in this revenue is attributable to the base year effect of the coronavirus, which was taken into account in both the appropriation and our forecast.

The appropriation of **motor vehicle tax** revenues is HUF 87 billion, although our assumption is HUF 1 billion lower. The difference is due to a base effect, as in 2020 we do not expect the taxable stock of motor vehicles to expand. In 2021, the total revenue from the motor vehicle tax will be allocated to the Fund for Health Insurance and Defence Against Epidemics.

The appropriation concerning the **revenues of EU programmes** amounts to a total HUF 1,145 billion, of which some HUF 1,017 billion is related to cohesion policy and rural development programmes. The statutory appropriation for 2021 is nearly HUF 360 billion lower than the 2020 appropriation. According to our forecast, taking into account the increase in invoiced payments and in the absorption of previously disbursed advances, there is a positive risk in the case of the revenues of EU programmes. The Budget Act does not provide any details of its expectations regarding invoiced payments and the expected absorption of advances, which fundamentally determine the level of cash-based revenues. We expect the sum of the invoiced payments and the absorption of advances, i.e. actual utilisation to exceed HUF 1,600 billion in 2021. The level of cash-based revenues is considerably affected by the fact that in the case of the invoices submitted between 1 July 2020 and 30 June 2021 the European Commission provides 100 percent co-financing, which is higher than usual. Consequently, if the invoices that confirm performance are sent out and approved in the year under review, according to our calculations the revenues related to EU programmes may exceed HUF 1,370 billion.

Table 4
Revenues of the central subsector – comparison of the forecasts (HUF billion)

	2021		
	Statutory appropriation	MNB forecast	Difference
TAX AND CONTRIBUTION REVENUES OF THE CENTRAL SUB-SECTOR	**17,396**	**17,465**	**69**
Payments by economic organisations	**1,824**	**1,833**	**9**
Corporate income tax	539	529	-10
Special tax of financial institutions	61	63	2
Retail tax	54	60	6
Mining royalty	44	31	-13
Gambling tax	35	32	-2
Income tax on energy providers	61	66	5
Lump sum tax of small entrepreneurs	237	235	-3
Small business tax	97	98	1
E-road toll	225	241	16
Utility tax	53	50	-3
Other taxes and payments	417	428	10
Consumption taxes	**6,705**	**6,580**	**-126**
Value added tax	5,015	4,858	-157
Excise duties	1,263	1,260	-3
Registration tax	20	27	7
Telecommunication tax	53	54	1
Financial transaction levy	219	235	16
Insurance tax	106	110	5
Tourism development contribution	30	36	6
Payments by households	**2,997**	**3,064**	**67**
Personal income tax	2,684	2,751	68
Duties, other taxes	227	226	0
Motor vehicle tax	87	86	-1
Tax and contribution revenues of extra-budgetary funds	**448**	**469**	**21**
Tax and contribution revenues of social security funds	**5,421**	**5,519**	**98**
Social contribution tax and contributions	5,262	5,354	92
Other contributions and taxes	159	166	6
REVENUES RELATED TO EU FUNDS	**1,145**	**1,377**	**232**
OTHER REVENUES	**467**	**467**	**0**
Other revenues of the central budget	**327**	**327**	**0**
Other revenues of social security funds	**39**	**39**	**0**
Other revenues of extra-budgetary funds	**102**	**102**	**0**
TOTAL REVENUES	**19,008**	**19,309**	**301**

Note: Partly consolidated data. The MNB forecast shows the midpoint of the revenue forecast band based on the banded macroeconomic forecast.

5.2 PRIMARY EXPENDITURES

According to our forecast, the **primary expenditures of the central subsector** may be higher than the appropriations in the Budget Act for 2021 by HUF 78 billion in total (Table 5). Within that, net own expenditures of budgetary institutions may exceed the appropriations by HUF 199 billion, which is mostly related to investment expenditures. This is partly offset by our assumption concerning the expenditures related to EU transfers, which is HUF 81 billion lower than the appropriation.

The appropriation of **special and normative subsidies** increases by HUF 75 billion compared to the appropriation for 2020. Of the appropriation of HUF 464 billion, the budget foresees the spending of HUF 434 billion on subsidising the companies that provide public transport services. Within that, the expenditures on operating the railway network increase by 19 percent, and the state expenditures spent on the refunding of the costs of passenger transport public services by railway and bus expand by more than 10 percent.

The appropriation of the **social policy fare subsidy** increases by HUF 47 billion compared to the 2020 appropriation. The increase in the appropriation is a result of the fact that as of 2021 the total amount of the lost income due to the reduced inter-town fares will be reimbursed to the inter-town public transport providers within this appropriation. This measure does not result in any additional expenditure for the budget, as only a rearrangement took place among the budgetary appropriations.

The appropriation of **housing grants** is HUF 250 billion, which is HUF 47 billion lower than the 2020 appropriation. The considerable decline is caused by lower than expected base year developments in the programmes related to the Family Housing Allowance and the decline in expenditures due to the ending of the subsidies of home savings. As in the previous years, the expenditures related to the Family Housing Allowance may reach HUF 190–200 billion in 2020 as well, whereas a higher expenditure of around HUF 225 billion is expected for 2021, which means savings compared to the appropriation, similarly to previous years. The saving of some HUF 25 billion compared to the Budget Act is much lower than the saving of around HUF 95 billion expected for 2020, as the housing developments and investment projects postponed due to the coronavirus pandemic may be implemented next year.

The appropriation of the **National Family and Social Policy Fund** corresponds to the expenditures planned for the previous year. Among the key items of the Fund, the 2021 appropriation for family allowance is consistent with our projection, expected to be around HUF 305 billion. We also consider the appropriations well-established in the case of other items of family allowances as well as income substitute and supplementary social benefits and reimbursements given for various reasons.

On the basis of the appropriations of the Budget Act, excluding the revenues and expenditures of EU programmes, **net expenditures of budgetary institutions** amount to HUF 6,516 billion, corresponding to an 8.4 percent increase in expenditure compared to the 2020 appropriations. Based on the appropriations of the Budget Act it can be established that the 2020 wage measures were carried over in the personal allowances items of the chapters. Expenditures on public education and social human services are expanding at a higher rate than the average. Our expenditure projection, which is higher than that in the Budget Act, is partly attributable to the increasing of government investment on the basis of the Convergence Programme. This was allowed by the fact that as a result of the more favourable 2020 base, our tax revenue forecast is higher than the appropriations.

The appropriation of the **support to local governments** increases by HUF 126 billion compared to the 2020 appropriation. Some HUF 122 billion of the increase supports settlements with lower ability to impose taxes and originates from the centralisation of some of the local business tax revenue.

Table 5
Expenditures of the central subsector – comparison of the forecasts (HUF billion)

	2021		
	Statutory appropriation	MNB forecast	Difference
PRIMARY EXPENDITURE ITEMS	**19,562**	**19,631**	**69**
Special and normative subsidies and support to the public media	**562**	**562**	**0**
Social policy fare subsidy	**138**	**138**	**0**
Housing grants	**250**	**225**	**-24**
Family allowances, social benefits	**579**	**580**	**1**
Early retirement benefits	**93**	**92**	**-1**
Net expenditures of central budgetary institutions and chapters	**8,117**	**8,235**	**118**
Net own expenditures	6,516	6,715	199
Expenditures related to EU transfers	1,601	1,520	-81
Support to local governments	**865**	**865**	**0**
Contribution to the EU budget	**450**	**450**	**0**
Central reserves	**406**	**406**	**0**
Other expenditures	**787**	**787**	**0**
Expenditures of extra-budgetary funds	**586**	**561**	**-25**
NEF – Passive allowances	109	109	0
NEF – Active allowances	165	140	-25
Other expenditures	313	313	0
Expenditures of social security funds	**6,731**	**6,731**	**0**
PIF - Pensions	3,907	3,907	0
HIF - Disability and rehabilitation benefits	284	280	-3
HIF - Cash benefits	491	494	3
HIF - Medical and preventive care	1,567	1,571	4
HIF - Net expenditures of the drug budget	333	331	-2
Other expenditures	149	149	0
NET INTEREST EXPENDITURES	**937**	**970**	**33**
TOTAL EXPENDITURES	**20,499**	**20,602**	**103**

Note: Partly consolidated data. The MNB forecast shows the midpoint of the revenue forecast band based on the banded macroeconomic forecast.

The Budget Act foresees a payment obligation of HUF 450 billion as **contribution to the EU budget**. For calculating the payment obligation, as technical assumption, the Budget Act assumes an exchange rate of EUR/HUF 353.8 and the growth path expected by the Government when determining the GNI based contribution.

The appropriation of **central reserves** amounts to HUF 406 billion, which is some HUF 260 billion lower than the amount of the 2020 central reserves. On the basis of previous years' practice, of the central reserves of HUF 406 billion, the total amount of the Investment Preparation Fund and the central provisions is expected to be used, and thus of the amount placed in the central reserves the amount of so-called free reserves, which expand the leeway of the Government, is estimated to be HUF 210 billion in 2021. The Budget Act does not contain the expenditure structure of the central provisions expenditure appropriation unlike previous years.

The Budget Act foresees HUF 510 billion as **expenditures related to state property**. On the whole, the expenditures of state property management rise by HUF 49 billion in 2021, corresponding to a nearly 11 percent expenditure increase. The Government is planning to spend HUF 116 billion on the development of the Paks Nuclear Power Plant.

The appropriation of expenditures planned for the **enforcement of guarantees** is related to the measures of the Economy Protection Action Plan, within the framework of which the amount of the guarantees provided to the corporate sector was raised, and the number of credit schemes with state guarantees was increased. The appropriation exceeds the 2020 statutory appropriation by HUF 14 billion.

With respect to the **expenditures of the extra-budgetary funds**, our forecast related to the job seeking allowances of the **Economy Protection Employment Fund** corresponds to the appropriation. The expenditure may reach HUF 108 billion, which is HUF 25 billion higher than the 2020 appropriation (depending on labour market developments, the actual expenditure is expected to exceed the appropriation in 2020). The Budget Act foresees to spend HUF 165 billion on the expenditures of the START public work scheme, i.e. HUF 30 billion more than the amended 2020 appropriation (following reallocation). The central bank forecast indicates a lower expenditure of HUF 140 billion, as the path of economic growth expected by us projects a higher labour demand. Regarding other items of the funds our forecast corresponds to the appropriations.

The expenditures planned for **medical and preventive care** amount to HUF 1,567 billion in 2021, which practically corresponds to our projection and is some HUF 140 billion higher than the previous year's appropriation. The purpose of the additional funding is to follow the pay rises of ancillary workers in healthcare as well as to supply and purchase high-value medicines and devices. In line with the Government's family support programmes, the additional funding for institutions that provide infertility treatment support childbearing. After HUF 40 billion in 2020, in 2021 the budget plans to spend HUF 45 billion on the renewal of the financing system, on determining the real costs of the provisions and thus on a lower indebtedness of hospitals.

The 2021 appropriation of **gross expenditures on drug budget** amounts to HUF 432 billion, which is some HUF 40 billion more than the 2020 appropriation, and corresponds to our projection prepared for the June Inflation Report. This year, due to the coronavirus situation the budget may spend around HUF 20 billion more on drug reimbursements compared to the appropriation, but it is not expected to be carried forward to next year.

According to the 2021 Budget Act, **cash benefit** expenditures will reach HUF 161 billion in the case of the sick pay and HUF 237 billion in the case of the childcare fee. The expenditure on infant care allowance (CSED) is expected to rise to HUF 93 billion, as starting from 1 July 2021, instead of 70 percent, 100 percent of the gross average earnings will be the basis of the CSED. Accordingly, while the CSED is being paid, the income of the parent may exceed the previous earnings as there is no upper limit in the case of the CSED, and it is only levied by personal income tax. Our projection, which is consistent with the June Inflation Report, expects the expenditure to be some HUF 3 billion higher in total, which is explained by a higher gross salary and wage bill compared to the 2021 Budget Act.

The 2021 Budget Act foresees accrual-based expenditures to amount to a total HUF 107 billion in the case of the **prenatal baby support** (Table 6). The expenditures indicated in the Act are only slightly lower than our forecast.

Table 6
Expected developments in cash-based and accrual-based expenditures related to the prenatal baby support in the Budget Act and our forecast for 2021 (HUF billion)

	Budgetary appropriation	MNB forecast	Difference (forecast-appropriation)
1. Total cash-based expenditures	68	72	4
of which: interest rate subsidy	41	46	5
2. Cash-based revenues	0	6	6
3. Accrual-based adjustment (methodological item)	60	66	6
4. Credit waiver	-21	-20	1
ESA deficit effect of prenatal baby support (1.-2.+3.+4.)	**107**	**112**	**5**

Source: Budget Act of 2021, MNB.

In total, the **cash-based expenditures** related to the prenatal baby support amount to some HUF 68 billion in the Budget Act, and within that the interest rate subsidy of the prenatal baby support may be HUF 41 billion in 2021. Our forecast expects a HUF 5 billion higher interest rate subsidy, i.e. HUF 46 billion for 2021. The difference may result from two factors: the different estimates for the increase in loans outstanding and for the degree of the interest rate subsidy. Our 2021 forecast foresees the disbursement of prenatal baby support to amount to HUF 387 billion.

The Budget Act does not indicate separately the cash-based revenue related to the prenatal baby support, i.e. the **guarantee fee**. The supported people have to pay the guarantee fee on the outstanding amount of the loan to the budget simultaneously with the monthly instalment. The fee corresponds to 0.5 percent of the outstanding principal debt. We estimate this amount to be HUF 6 billion in 2021.

When quantifying the total budgetary effect of the prenatal baby support, not only cash-based expenditure needs to be taken into account but also that **the estimated amount of the waiver of the principal upon the birth of the second and third child should be recognised in the ESA deficit at the time of lending**. According to the rules of European Union statistics, if the future debt write-off is certain, its anticipated amount should be recognised in the accrual-based deficit upon the disbursement of the loan. Although in the case of the prenatal baby support the actual debt write-off occurs when the child is born, this has to be taken into account in the ESA statistics upon the disbursement of the loan in the form of an estimate. As methodological item, waiver of principal amounting to HUF 60 billion is shown in the Budget Act in the ESA adjustments. Due to our slightly higher estimate of new lending, for 2021 our forecast expects a greater amount of debt write-off of a total HUF 66 billion. In addition, in the case of the prenatal baby support, after the second or third child born in the year under review, the amount of the child-raising subsidy (which may amount to some HUF 20 billion in 2021) actually disbursed in the cash transactions has to be deducted from the amount of the ESA adjustments (Table 6).

Pursuant to the 2021 Budget Act, the appropriations belonging to the expenditures of the **pensions and pension-like benefits** amount to a total HUF 4,284 billion. Our forecast broadly corresponds to the amount in the Act; according to our estimation, in 2021 the budget may spend a total HUF 4,279 billion on pensions and pension-like benefits (Table 7), equalling 8.1 percent of GDP.

The 2021 appropriation for **retirement provision** paid from the Pension Fund amounts to HUF 3,907 billion in total. The amount in our forecast corresponds to the appropriation, but with a different structure of pension expenditures. The difference is attributable to the differences in the base year projections and in macroeconomic paths. The Budget Act foresees a 3 percent inflation, whereas the MNB's June Inflation Report expects a consumer price index of 3.2–3.3 percent in 2021, as a result of which we presume an additional rise in pensions in November 2021.

The 2021 appropriation of **old-age pensions over the retirement age** and the disbursement of the **13th month pension** is HUF 3,158 billion in total, compared to which our forecast is HUF 18 billion higher. The difference may be explained by the different base year forecasts and the higher inflation forecast. In 2021, new old-age pensions will be assessed only in the first half of the year, since those born in 1956 retire after reaching the age of 64.5.

The 2021 Budget Act also takes account of the fiscal impacts of the gradual reintroduction of the **13th month pension**. In February 2021, pensioners will receive an additional amount corresponding to one week's pension, for which the Pension Fund contains an appropriation of HUF 77 billion. This additional allocation will also be received by those entitled to pension-type benefits, including disability pensions and early retirement benefits; the related additional expenditures are included in the expenditure items.

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 2021 may amount to some HUF 300 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.

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 percent real GDP growth included in the macroeconomic path. The MNB's macroeconomic forecast prepared for its June Inflation Report projects GDP growth to be between 3.8 and 5.1 percent in 2021. Accordingly, the amount of the pension premium paid from the Pension Fund is expected to be in a range between HUF 12 and 65 billion in 2021.

Table 7
Comparison of the 2021 appropriation of the expenditures on pensions and pension-like benefits and the MNB forecast (HUF billion)

	Budgetary appropriation	MNB forecast	Difference (forecast-appropriation)
I. Pension Fund	**3,907**	**3,907**	**0**
1. Old-age pensions (13th-month pension included)	3,460	3,478	17
2. Retirement provision to relatives	393	390	-3
3. One-time subsidy	1	1	0
4. Provision for pension premium	53	38	-15
II. Early retirement benefits	**93**	**92**	**-1**
III. Disability and rehabilitation benefits	**284**	**280**	**-3**
Total pensions and pension-like benefits	**4,284**	**4,279**	**-4**

Source: Budget Act of 2021, MNB.

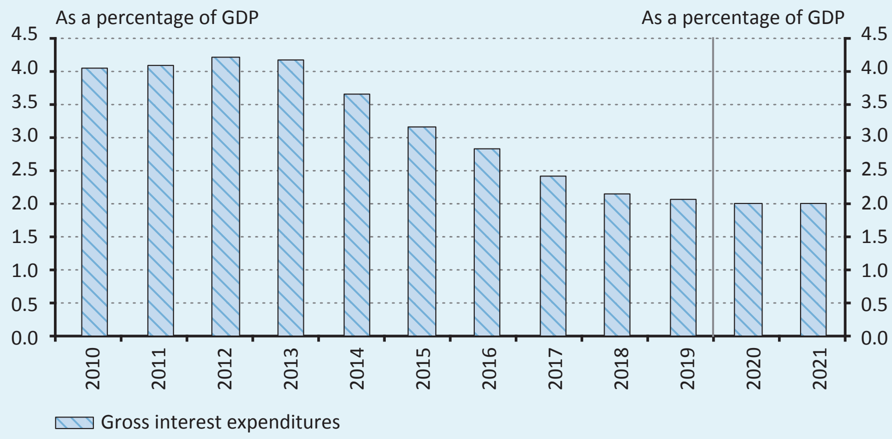
The 2021 Budget Act plans the **expenditures of EU programmes** to amount to HUF 1,601 billion, falling HUF 81 billion short of the 2020 appropriation. The expenditures related to cohesion policy, rural development and other programmes belonging to the 2014–2020 programming period may amount to HUF 1,341 billion according to the Budget Act. Taking into account the approximate level of HUF 260 billion of the expenditures planned for the 2021–2027 EU budget as well as the revenue appropriation, considerable advance payment is presumed for 2021 as well, although the Budget Act does not specify its planned amount.

We expect the expenditures of EU programmes to be HUF 81 billion lower than the appropriation in 2021. Of the expenditures, primarily the HUF 260 billion target for the 2021–2027 programming period is surrounded by negative risks. Namely, for significant disbursements to take place in 2021 in relation to the new programming period, the EU Member States have to agree on the total EU budget, the European Commission has to approve the domestic operational programmes, tenders must be announced and evaluated, and contracts have to be signed with the beneficiaries. The risks are offset by the fact that the indicative limit amount of the 2014–2020 programming period was raised to HUF 9,420 billion by Government Resolution 1152/2020. (IV.14.), and then to HUF 9,715 billion by Government Resolution 1264/2020. (V. 28.). Pursuant to Point 3 of Resolution 1152/2020. (IV.14.), managing authorities have to arrange for the possibility of recognising the disbursements related to tenders evaluated in 2020 to the account of the funds of the 2021–2027 programming period as well if necessary.

5.3 INTEREST BALANCE

According to our forecast, net accrual-based interest expenditures may be in line with the appropriation, i.e. decline to close to 2 percent of GDP, meaning a continuous decrease in expenditures similarly to the previous years. The expenditure level as a percentage of GDP foreseen in the appropriation exceeds our expectation by less than 0.1 percentage point, as a result of a lower GDP in 2021 presumed in the budget, while in nominal terms the MNB's expectation concerning interest expenditures nearly corresponds to the appropriation. Compared to the previous years, we expect the decline in expenditures to continue, although our forecast suggests that the pace of the decrease may decelerate. The underlying reason is that a major portion of the government debt was repriced, and the yield level of a smaller and smaller part of the debt is decreasing.

Chart 5
Developments in interest expenditure (as a percentage of GDP)



Note: Excluding the imputed interests arising due to the transformation of the pension scheme.

6 Legal compliance of the Budget Act

6.1 THE DEBT RULE OF THE FUNDAMENTAL LAW

According to the Budget Act and the MNB's forecast, the gross government debt-to-GDP ratio will decline in 2021, which is in line with the debt rule in the Fundamental Law. Based on the Fundamental Law, the public debt rate should decrease by 0.1 percentage point, which is safely met according to both forecasts (Budget Act: -3.3 percentage points; MNB: -1.9 percentage points). The projected substantial decrease also means that the decline in debt required by the Fundamental Law is guaranteed even if the external or internal economic developments turn out slightly less favourably than expected at present.

6.2 THE 3-PERCENT DEFICIT RULE OF THE STABILITY ACT

The budget balance expected for 2021 satisfies the deficit rule of the Stability Act. Article 3/A (2) b) of Act CXCIV of 2011 on the Economic Stability of Hungary provides that the general government deficit shall not exceed 3 percent. Pursuant to the Budget Act, the deficit will be 2.9 percent of GDP in 2021, which, according to the MNB's forecast, can be achieved, i.e. the balance meets the deficit target set forth in the Stability Act.

6.3 DEBT INCREMENT PERMITTED ON THE BASIS OF THE DEBT FORMULA SPECIFIED IN THE STABILITY ACT

The Budget Act is in line with the debt formula of the Stability Act, according to which the year-end value of the government debt indicator has to be determined in a way that the annual decline in the government debt indicator must reach at least 0.1 percentage point, while the EU rules regarding the reduction of public debt are complied with. The European debt rule states that the Member States' government debt ratio must not exceed 60 percent of GDP, or if it does, the debt ratio must be reduced by a satisfactory pace. The appropriate decrease in the debt is quantified by the so-called "one-twentieth rule", according to which the debt ratio should be reduced by around one twentieth of the part that exceeds 60 percent on average over three years. Calculating the degree of the change in the government debt ratio using three types of methodologies (forward-looking, backward-looking, cyclically adjusted) on the basis of the European Commission's own forecast and the forecast of the Convergence Programme it can be established that in 2021 the decline in government debt ratio will be satisfied based on two methodologies (forward-looking and cyclically adjusted), and thus the rule can be considered as complied with.

6.4 REQUIREMENT PERTAINING TO THE STRUCTURAL BALANCE OF THE GENERAL GOVERNMENT

The 2.2-percent structural deficit in the Budget Act does not fullfil the medium-term budgetary objective. Article 3/A (2) a) of Act CXCIV of 2011 on the Economic Stability of Hungary provides that the balance of the government sector must be determined in a way that is in line with the achievement of the medium-term budgetary objective (MTO). The Hungarian MTO in 2021 represents a structural balance equalling -1.0 percent of GDP. The structural balance is the cyclically adjusted government balance net of one-off and other temporary items. The 2021 Budget Act projects a structural balance of -2.2 percent to the accrual-based deficit of -2.9 percent of GDP, and thus it does not reach the medium-term budgetary objective.

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

The Budget Act is expected to satisfy the requirements of the corrective arm of the EU fiscal framework. The corrective arm includes the 3-percent deficit target, which is also specified in the Hungarian legislation, and the requirements of the European Union's debt rule.

The criterion related to **the 3-percent deficit** prescribes that the accrual-based deficit of the Member States must not exceed 3 percent of GDP. The 2.9 percent deficit target in the Budget Act and the deficit expected by the MNB comply with the rule.

The **EU debt rule** states that the Member States' gross, consolidated government debt ratio calculated at face value must not exceed 60 percent of GDP, and in case it does, the debt ratio must be diminishing at a satisfactory pace. The appropriate decrease in the debt is quantified by the one-twentieth rule, according to which the debt ratio should be reduced by one twentieth of the part that exceeds 60 percent on average over three years. Pursuant to the Budget Act, the GDP-proportionate government debt will decrease by 3.3 percentage points in 2021 (MNB expects a decrease of 1.9 percentage points, while according to the latest 2020 spring forecast of the European Commission, the ratio will decline by 1.5 percentage points). Based on all forecasts, the changes in the debt ratio are in line with the forward-looking and cyclically adjusted methodologies of the one-twentieth rule.

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

The structural deficit target in the Budget Act does not comply with the requirements of the preventive arm of the EU rules. The structural balance is not in line with the medium-term budgetary objective, and according to the European Commission's forecast it is not even approaching the objective at a satisfactory pace.

The framework related to the **medium-term budgetary objective** (MTO) provides that Member States should achieve the structural balance designated jointly with the European Commission, or converge towards it on the designated adjustment path to a sufficient degree. Hungary's MTO for the coming year was set at -1.0 percent of GDP. Based on the Budget Act, the 2021 structural balance will be -2.2 percent of GDP, i.e. higher than the medium-term objective, and even departing from it compared to 2020. In its latest, spring 2020 forecast, the European Commission projected a 3.1 percent structural deficit in Hungary for next year, which is also higher than the structural deficit of 2.6 percent expected for this year. The target set by the Budget Act is that as of 2021, returning to its high growth rate path, the structural balance should considerably approach the MTO.

Upon deviation from the MTO, the **expenditure benchmark** needs to be applied, the purpose of which is to ensure the convergence on the recommended adjustment path to the medium-term budgetary objective. According to the benchmark, compared to the previous year, the general government's net primary expenditures may increase by no more than the potential long term GDP growth rate, unless the increasing expenditures are offset by other, discretionary revenue measures. Considering that neither the expected value of the structural balance, nor the shift compared to the previous year comply with the requirements concerning the medium-term objective, compliance with the rules of the preventive arm depends on the changes in the expenditure benchmark. As within the framework of the significant deviation procedure (SDP) against the Hungarian fiscal management EU institutions have not yet decided on the recommendations concerning 2021, it is uncertain what adjustment path will set forth the dynamics that Hungarian budgetary expenditures will have to comply with next year. It is important to emphasise, however, that if the application of the general escape clause put into force as a result of the pandemic remains in effect in 2021 as well, that will grant temporary exemption from the compliance with the preventive arm of budgetary rules.

7 Special topics

7.1 ESTIMATED FISCAL IMPACTS OF REBUILDING THE 13TH MONTH PENSION

One of the elements of the Economy Protection Action Plan announced on 6 April 2020 is the Family and Pensioner Protection Programme, based on which the 13th month pension will be gradually reintroduced in several steps between 2021 and 2024. In February 2021, pensioners will receive 25 percent of the amount of their January pension, 50 percent of the monthly pension in 2022, 75 percent of the monthly pension in 2023, and every year starting from 2024, in the form of additional benefit, they will receive an amount corresponding to the pension of a whole month.

According to our estimate, 2.6 million people will be eligible to receive the one-week pension disbursement in 2021. Every year, those will be eligible to receive the 13th month pension who were also pensioners in the calendar year preceding the payment. In addition to old-age pensioners, the additional 13th month benefit will also be granted to those receiving pension-like provisions and allowances.

Pursuant to the 2021 Budget Act, in 2021 this measure results in an additional expenditure of HUF 77 billion in the Pension Fund. Accordingly, in 2021 the fiscal effect of the gradual reintroduction of the 13th month pension may amount to 0.15 percent of GDP and may rise to 0.6 percent of GDP by 2024 (Chart 6).

Chart 6
Estimated fiscal impacts of reintroducing the 13th month pension (as a percentage of GDP)

Source: MNB forecast.

The amount of the 13th month additional benefit is determined by the monthly amount of the pension. Across all the beneficiaries, the average pension may be around HUF 134 000 in 2021, entailing some HUF 34 000 additional benefit at the beginning of 2021. In the case of old-age pensions, the average amount of the benefit corresponding to one-week pension may be around HUF 36 800 in 2021. Taking into account the effect of the indexation to inflation, the average old-age pension may increase to HUF 160 000 by 2024, and thus the average disbursement per person in February 2024 may correspond to this amount.

Pursuant to the Budget Act, in addition to the gradual rebuilding of the 13th month pension, pension premium may also be paid in 2021. As stated in the Pension Act, the beneficiaries receive pension premium if the rate of GDP growth expected for the current year calculated at constant prices is above 3.5 percent. The 2021 Budget Act foresees real growth of 4.8 percent, and thus according to the appropriation of the Budget Act the pension premium may amount to HUF 53 billion in 2021.

7.2 ESCAPE CLAUSES OF THE FISCAL RULES

In the past decades the importance of fiscal frameworks appreciated both at national and international levels. The measures and initiatives related to the formulation of fiscal frameworks comprise fiscal rules as well as independent budgetary institutions watching over responsible general government management. Fiscal rules comprise all the requirements that represent some kind of – usually quantifiable – constraint for fiscal policy, thus ensuring the prudent, sustainable, and transparent functioning of fiscal policy. Fiscal rules usually relate to an aggregate indicator that captures general government developments, and in connection with that they usually contain requirements that entail accountability. A requirement concerning the proper functioning of fiscal rules is that they should comply with various aspects of evaluation. One of these important aspects is that the rules – primarily in view of the macroeconomic situation – must be sufficiently flexible, which, inter alia, may be guaranteed by the so-called escape clauses.

Escape clauses allow typically temporary deviations from the fiscal rules. Clauses like this often belong to the fiscal rules, and in an ideal case they tie the deviation from the rules to a well-defined quantified condition or legal situation. The role of the clauses appreciates under extraordinary circumstances, like now, when the coronavirus pandemic posed an unprecedented challenge to economic agents, including economic policy decision makers.

In the Hungarian legal system, the provision with the highest-level of legal authorisation is the debt rule of the Fundamental Law; two escape clauses relate to it. Pursuant to the provision, the domestic general government debt ratio may not exceed half of the gross domestic product, and while it is exceeded, the Parliament may only adopt a Budget Act that foresees a decline in the government debt-to-GDP ratio. In addition, according to the rule, no borrowing that would result in an annual growth in the debt ratio is allowed.[1] On the basis of the escape clauses it is possible to deviate from the provisions of the rule only in the case of a permanent and significant downturn in the national economy and at the times of special legal order.[2] Economic downturn should be interpreted as permanent and significant if the real value of the gross domestic product declines for a year or more, while special legal order means state of national crisis, state of emergency, state of preventive defence, state of terrorist threat, unexpected attack and state of danger.[3]

Three further important provisions concerning the domestic general government developments are included in the Stability Act. Two of them are automatically suspended when there is a downturn in the economy. Pursuant to the debt formula, which changed as of this year, the government debt ratio in the Budget Act needs to be determined in a way that it should decline by at least 0.1 percentage point in the year under review, while complying with the EU rules concerning debt reduction.[4] In addition, the Stability Act provides that the balance of the government sector has to be determined in a way that its deficit should not exceed 3 percent of the gross domestic product, while being in compliance with the achievement of the medium-term objective.[5] The escape clause in the Act refers to the debt ratio and the deficit target, and it is allowed to be applied at the time of a permanent and significant downturn in the national economy. It is important to emphasise that the Stability Act applies the permanent and significant downturn in the economy to any case when the real value of the annual gross domestic product declines, i.e. already a downturn of one year in the economy triggers the application of the escape clause.[6]

The escape clause of the fiscal rules of the European Union comes into force upon the occurrence of an extraordinary event that has a major impact on Member States' fiscal positions (Table 8). The application of the escape clause is not automatic, but the institutional system of the European Union decides on its introduction on an ad hoc basis. Two types of the clause are distinguished: the unusual events clause and the general escape clause. While the former escape clause

[1] Fundamental Law of Hungary, Article 36(4)–(5), Article 37(2)–(3)
[2] Fundamental Law of Hungary, Article 36(6), Article 37(3)
[3] Fundamental Law of Hungary, Articles 48 to 54
[4] Section 4(2a) of Act CXCIV of 2011 on the Economic Stability of Hungary
[5] Section 3/A(2a-b) of Act CXCIV of 2011 on the Economic Stability of Hungary
[6] Section 7(1)-(2) of Act CXCIV of 2011 on the Economic Stability of Hungary

is often applied by the EU at member state level in crisis situations and mainly in times of local disasters, the general escape clause has not been activated until now. The general escape clause was included in the EU's fiscal framework through the Six-Pack reform that drew the lessons of the crisis.

Responding to the economic crisis that evolved in parallel with the spreading of the coronavirus pandemic, the EU institutions put into force the general escape clause. At the proposal of the European Commission, on the basis of the opinion of the Economic and Financial Affairs Council (ECOFIN) the conditions of applying the clause are met, according to which severe economic downturn will take place in the euro area or the EU as a whole. According to the latest, spring 2020 forecast of the European Commission, this year the euro area economy and the output of the EU as a whole may decline by 7.7 percent and 7.4 percent, respectively. The general escape clause does not aim at a complete suspension of the rules, but allows temporary deviation primarily from the reference value concerning the budget balance as well as from the medium-term objective and the adjustment path that leads to it, provided that this does not endanger fiscal sustainability in the medium term.[7] Accordingly, it is ensured for the governments of the Member States that the additional fiscal expenditures incurred in connection with the coronavirus as well as the funds spent on the protection of the economy do not contrast the provisions of the fiscal framework of the European Union.

Table 8
Summary of the main rules concerning Hungarian fiscal developments and their escape clauses

<table>
<tr><th colspan="2">Hungarian national rules</th><th>Description</th><th>Escape clause</th></tr>
<tr><td colspan="2">Debt rule of the Fundamental Law</td><td>As long as the government debt ratio exceeds 50 percent of GDP, only such and Act on the central budget can be adopted that foresees the reduction of the ratio.</td><td>During special legal order or in the event of a decline in the gross domestic product.</td></tr>
<tr><td colspan="2">Debt formula of the Stability Act</td><td>Government debt-to-GDP ratio should decline by at least 0.1 percentage point annually.</td><td>Decline in gross domestic product.</td></tr>
<tr><td colspan="2">Deficit criterion</td><td>General government deficit must not exceed 3 percent of GDP.</td><td>Decline in gross domestic product.</td></tr>
<tr><td colspan="2">Medium-term budgetary objective</td><td>The balance of the government sector should be in line with achieving the medium-term budgetary objective.</td><td>–</td></tr>
<tr><th colspan="2">EU fiscal framework rules</th><th>Description</th><th>Escape clause</th></tr>
<tr><td rowspan="2">Corrective arm</td><td>Maastricht deficit criterion</td><td>The planned or actual budget deficit should not exceed 3 percent of GDP.</td><td>Unexpected adverse economic events with major unfavourable consequences for government finances and / or a severe economic downturn in the euro area or in the Union as a whole.</td></tr>
<tr><td>Maastricht debt criterion</td><td>Government debt should not exceed 60 percent of GDP, or should approach the reference value at a satisfactory pace.</td><td>–</td></tr>
<tr><td rowspan="2">Preventive arm</td><td>Medium-term budgetary objective</td><td>The budget balance should be in line with achieving the medium-term budgetary objective.</td><td rowspan="2">Unusual event outside the control of the Member State concerned which has a major impact on the financial position of the general government or in periods of severe economic downturn for the euro area or the Union as a whole.</td></tr>
<tr><td>Expenditure benchmark</td><td>The developments in net primary fiscal expenditures should be in line with the requirements of the adjustment path leading to the medium-term objective.</td></tr>
</table>

[7] 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;

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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