PUBLIC FINANCE REPORT

2017
MAY

"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

Analysis of the 2018 Budget Bill

2017

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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 definition 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 makes them available for the FC. The general public can learn about the most important results of these expert analyses from the publication entitled 'Public Finance Report'.

This report was prepared by the staff of the Directorate for Fiscal and Competitiveness Analysis with the contribution of the staff of the Directorate Economic Forecast and Analysis. The analysis was approved by Dániel Palotai, Executive Director.

The analysis is based on information available for the period ending on 5 May 2017.

Contents

1 Summary

The subject of this analysis is the 2018 budget bill submitted to the Parliament on 2 May, and assessed in the light of the MNB's fiscal forecast. Based on the information available, as part of this analysis, the MNB prepared its own projection for the 2018 budget balance, and this projection is compared to the appropriations in the bill.

According to the budget bill, the ESA budget deficit in 2018 is projected at 2.4 per cent of GDP. This deficit target corresponds to the target for 2017, but is higher than the deficit path anticipated in the 2016 Convergence Programme and the March Inflation Report. After reviewing the details of the bill, we believe that certain revenue and expenditure items may fall short of the estimate, and thus, on the whole, **the specified deficit target can only be achieved with cancellation of the Country Protection Fund**.

According to our projection, in 2017 the budget deficit may remain below the statutory target. Hence, as we know the semi-annual fiscal figures, it may be worth examining whether it would be feasible to bring forward certain expenditures in 2017, provided that the 2017 budgetary processes permit this, with a view to fulfilling them safely and facilitating achievement of the 2018 deficit target.

According to the bill – at a constant exchange rate – the debt ratio as a percentage of GDP will fall by roughly 1.9 percentage points in 2018. According to our forecast, however, a decrease of 0.7-0.8 percentage point can be expected, in an environment of more moderate economic growth. Using the end-2016 exchange rate of EUR/HUF 311.0, the gross general government debt-to-GDP ratio according to the EDP methodology is forecast to decline from 74.1 per cent at end-2016 to around 73.1 per cent in 2017, and then to decrease further to 72.4 per cent by end-2018. The substantial, i.e. 0.7-0.8 percentage point, annual decrease in the debt ratio is supported by the low budget deficit and dynamic economic growth. Accordingly, the debt rule of the Fundamental Law, which will be the focus of the Fiscal Council's future decision, is expected to be satisfied.

In the macro path of the bill, **the economic growth projection (4.3 per cent) substantially exceeds the projection in the central bank's March Inflation Report (3.7 per cent) and exceeds the range of economists' expectations**. Compared to the MNB's forecast, this GDP growth is primarily explained by the more buoyant expansion in household consumption over the forecast horizon, and a difference can be observed in the projections in respect of developments in gross fixed capital formation over the years. In addition, compared to the MNB's forecast, the budget forecast projects more active growth in the wage bill, which is attributable to the increase in headcount and wages. As a result of the higher consumption and the rising wage bill, the budget forecast for labour and consumption taxes exceeds the MNB's projection by 0.7 per cent of GDP. This is partially offset by the fact that the bill projects a higher headcount and pension premium in the area of pension expenses as compared to the MNB's forecast.

According to our forecast, in 2018 the effective absorption of EU funds may fall short of what is anticipated in the bill. According to our forecast used for the March Inflation report, the estimate of HUF 2,418 billion for the disbursement of funds may materialise, but due to the different expectations related to the structure of disbursements the effective absorption of funds may fall short of the value indicated in the budget act. The lower effective absorption of funds is attributable to the presumption that, compared to the government's expectations, the acceleration in the absorption of advances and invoice-based disbursements will be slower, which reduces the deficit calculated on an accrual basis by roughly 0.3 per cent of GDP by way of the lower own contribution requirement.

In respect of the major measures and items **of the budget bill**, those worth noting include the reduction of the social contribution tax by 2 percentage points, the targeted reduction of the value added tax (for fish, restaurant catering and internet utilisation), the increase in the tax allowance for families with two children, cancellation of the healthcare contribution on income from property letting, the expansion of public investments (public road construction, Modern Cities Programme, healthcare improvements, developments in Pest County), and the continuation and expansion of the career path models (teachers, healthcare employees, national defence and law enforcement employees, civil servants, tax authority).

The budget bill complies with the debt rule outlined in the Fundamental Law, the debt rule specified in the Stability Act, the 3 per cent deficit requirement, and with the rules of the corrective arm of the Stability and Growth Pact of the European Union.

The 2.4 per cent structural deficit indicated in the bill does not comply with the medium-term budgetary objective determined for 2018 in Hungary's Convergence Programme. The bill explains this by stating that in 2018 the structural deficit of 2.4 per cent corresponds to budget deficit of 2.4 per cent calculated in accordance with EU methodology. On the other hand, the EU's structural deficit criterion and the requirements based on such in Section 3/A (2) a) of the Stability Act prescribe that the balance of the government sector must be determined in such a manner that it is in line with the attainment of the medium-term budgetary objective, which at present in the case of Hungary is 1.5 per cent of GDP. According to the bill, the temporarily higher structural deficit supports economic growth, facilitates the enforcement of economic and social policy priorities, while at the same time meeting the medium-term budgetary objective, which will be reached in 2020 and exceeded in 2021.

2 General government balance

The bill defines the general government deficit on an ESA basis at 2.4 per cent of GDP for 2018, which corresponds to the target for 2017. According to our forecast, the cash balance of the central budget may be slightly lower, while the balance of the local governments may be higher than the target. According to the MNB's estimate, the ESA bridge containing statistical corrections may be more favourable than that in the budget act, which is mostly related to the accrual-based accounting of EU funds and net interest expenditures, and thus can basically be regarded as a technical item.

Table 1
ESA balance of the government sector in 2018
(as a percentage of GDP)

	Statutory appropriation	MNB forecast	Difference
1. Balance of the central subsystem	–3.4	–3.8	–0.4
2. Balance of local governments	0.5	0.6	0.1
3. Cash-based (GFS) balance of the general government (1+2)	**–2.9**	**–3.3**	**–0.4**
4. GFS–ESA difference	0.4	0.7	0.2
5. ESA balance of the government sector (3+4)	**–2.4**	**–2.6**	**–0.2**
6. ESA balance with cancellation of central free reserves	**–2.4**	**–2.4**	**0.0**

According to our forecast, the deficit target set in the bill may be achieved if the Country Protection Fund is not used. According to our forecast, the primary revenues of the budget may fall short of the appropriations specified in the bill by 0.7 per cent of GDP. The difference is mostly attributable to the lower revenue expected from income and consumption taxes. The difference between the appropriation and our projection is primarily attributable to the difference between the macro paths. The budget bill forecasts GDP growth of 4.1 and 4.3 per cent for 2017 and 2018, respectively, in contrast to the MNB's expectations of 3.6 and 3.7 per cent, as stated in the March Inflation Report. The tax bases are substantially influenced by the fact that the bill anticipates an annual increase in the wage bill, the rate of which exceeds the MNB's projection by roughly 2-2.5 percentage points. In addition, in the case of the value added tax, the Ministry of National Economy presumably took into account a stronger effect from combating the hidden economy and assumed the absorption of more EU funding (of which there is a VAT payment obligation related to funding used by the government, but the VAT may be reclaimed in respect of funds used by the private sector).

On the other hand, the lower-than-estimated revenues are offset by our forecast suggesting that budgetary institutions will be able to absorb EU funds to a lesser extent in 2018 than planned in the budget, and thus the savings on own contributions related to EU funding may reach 0.3 per cent of GDP. In addition, our projection related to pension expenses falls short of the statutory appropriation by 0.2 per cent of GDP, which is partly attributable to the fact that in contrast to the budget's GDP growth forecast of 4.3 per cent, the MNB's March Inflation Report projects growth of 3.7 per cent for next year, which is accompanied by the payment of a lower pension premium. In addition, in the case of the pensions payable to women after a 40-year eligibility period and dependants' benefits, we project a smaller increase in the number of beneficiaries (and presumably there is a difference in the estimated degree of the replacement effect as well).

Our projection related to the balance of the local government sub-sector is more favourable than that assumed in the budget bill by 0.1 per cent of GDP. This difference can be ascribed to the difference in the 2017 bases: the central bank's projection also assumes a more favourable underlying process of a similar magnitude in the base year, compared to the government's projection related to 2017. In addition, partial cancellation of the Country Protection Fund alone would improve the balance by 0.2 per cent of GDP (Table 2).

Our projection for the 2018 deficit has increased compared to the forecast in the March Inflation Report. In addition to the new tax cuts included in the bill (targeted reduction of the value added tax on fish and on the internet, and cancellation of the healthcare contribution on income from property letting), according to the bill, the degree of public investments and public sector wages may also be higher than previously expected.

Table 2
Difference between the MNB forecast and the budget bill
(on ESA basis, as a percentage of GDP)

	Deviation from appropriation
I. Central government revenues	**–0.7**
Consumption taxes	–0.4
Labour taxes	–0.3
II. Central government expenditures	**0.6**
Net expenditures of budgetary institutions	0.3
Pensions	0.2
III. Other effects	**0.0 – 0.2**
Local governments	0.04
Blocking of the Country Protection Fund	0.0 – 0.2
Total (I.+II.+III.)	**(–0.2) – 0.0**

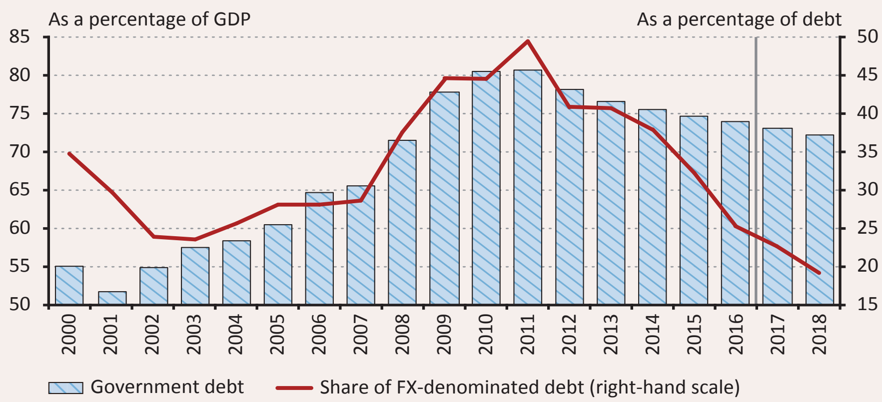
Note: The positive and negative signs indicate deficit-reducing and deficit-increasing effects, respectively, compared to the appropriations.

3 Expected developments in government debt

Using the end-2016 exchange rate of EUR/HUF 311.0, **the gross general government debt-to-GDP ratio according to the EDP methodology** is forecast to decline from 74.1 per cent at end-2016 to around 73.1 per cent in 2017, and then to decrease further to 72.4 per cent by end-2018. The substantial, i.e. almost 1 percentage point, annual decrease in the debt ratio is supported by the low budget deficit and dynamic economic growth. Due to the low yield environment and the fall in government debt ratio, interest expenditures fall year by year, providing the budget with increasing room for manoeuvre.

The substantial surplus of local governments represents a positive risk for the developments in the Maastricht public debt. The balance of the local governments may record a surplus both in 2017 and 2018, which, in addition to the favourable underlying processes, is attributable to the EU advances granted by the central budget. Last year a trend was observed, according to which the local governments invested part of their free funds in government securities. This government securities holding reduces the Maastricht debt, as during the calculation thereof this holding must be consolidated. In the underlying path we ignore this effect, as it is the competence of the local governments to decide how they manage their liquid monetary assets, and thus the amount of their end-2018 government securities holding is uncertain.

Chart 1
Public debt forecast – calculated with unchanged (end-2016) exchange rate over the forecast horizon



Source: MNB, Government Debt Management Agency.

As a result of negative net foreign currency issuance, the ratio of foreign currency within government debt is expected to continue to decline, contributing to a decrease in the external vulnerability of the economy. According to our forecast, the foreign currency ratio of the central government's debt will decrease to below 20 per cent by end-2018 from 25 per cent recorded at end-2016.

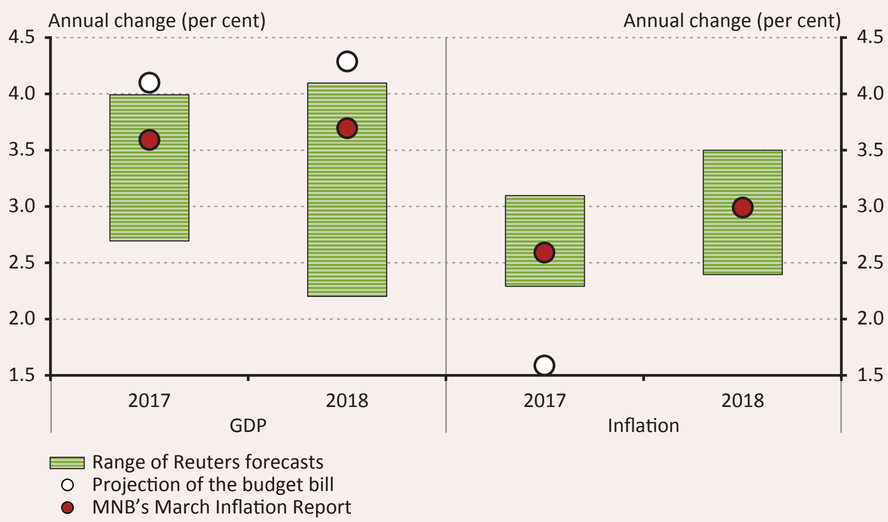
Table 3
Government debt calculated using EDP methodology

	HUF billion	As a percentage of GDP
1. End-2017 EDP government debt	27,173	73.1
2. 2018 cash-based deficit of the central budget	1,444	3.7
3. Other effect	–8	0.0
4. 2018 expected EDP government debt (1+2+3)	28,610	72.4
5. Change in government debt-to-GDP ratio in 2018 (4-1)		–0.7

4 Evaluation of the macroeconomic assumptions underlying the bill

In the macro path of the bill, **the forecast related to economic growth exceeds the projection in the central bank's March Inflation Report and is above the range of market analysts' expectations** (Chart 2). Compared to the MNB's forecast, this GDP growth is primarily explained by the more buoyant expansion in household consumption over the forecast horizon, and a difference can also be observed in the projections for developments in gross fixed capital formation over the years (Table 4).

Chart 2
Comparison of GDP and inflation forecasts
(percentage change compared to the previous year)



Source: 2018 budget bill, Inflation Report (March 2017), Reuters (April 2017).

As **regards households' consumption expenditure**, the budget expects substantially **stronger expansion** both in 2017 and 2018. The difference can be explained by the wage bill increase exceeding the MNB's forecast and the substantially lower inflation. The increase in consumption at current prices adjusted for inflation is the same in the budget forecast for this year and higher for next year. According to the macro path of the bill – in line with the Inflation Report – **gross fixed capital formation will provide major support for GDP growth this year and next year as well**, also contributed to by the public projects, along with the rise in the investment activity of corporations and households. The difference in the outcome of the volatile whole-economy fixed investments between the years may be related to the different perception of the effective absorption of EU funds. The budget's macro path assumes a **slightly higher increase in exports, while imports are slightly lower this year and significantly higher next year** as compared to the projection in the Inflation Report, in line with the scheduling of the investments. **According to the forecasts, net exports may make a negative contribution to GDP growth in both years.**

The bill's **inflation projection for this year is much lower than that of the MNB and falls outside the range of economists' expectations**, while it is 3 per cent for 2018, in line with the central bank's projection. The dynamics of the GDP deflator included in the budget bill exceeds the MNB's expectations, which is presumably attributable to the different structure of economic growth.

In line with the Inflation Report, the budget forecast projects a further increase in employment and strong growth in wages. Relative to the MNB's forecast, the larger increase in the wage bill is attributable to the stronger rise in headcounts and the wage growth, and substantially expands the tax bases.

Table 4
Comparison of the macroeconomic forecasts
(percentage change compared to the previous year)

		2017			2018		
	2016*	**Budget**	**MNB**	**Difference**	**Budget**	**MNB**	**Difference**
GDP	2.2 (2.0)	4.1	3.6	–0.5	4.3	3.7	–0.6
Household consumption expenditure	4.9	6.1	5.1	–1.0	5.4	4.0	–1.4
Public consumption	0.6	0.8	1.0	0.2	0.9	1.0	0.1
Gross fixed capital formation	–12.6 (–15.5)	10.2	13.2	3.0	12.9	8.7	–4.2
Exports	5.8	5.4	5.1	–0.3	6.5	6.2	–0.3
Imports	5.8 (5.7)	6.8	7.2	0.4	8.2	7.0	–1.2
GDP deflator	1.0	2.9	2.4	–0.5	3.2	2.5	–0.7
Inflation	0.4	1.6	2.6	1.0	3.0	3.0	0.0
Gross wage bill	9.2	13.2	11	–2.2	10.4	8.2	–2.2
Gross average earning	6.2	11.0	9.1	–1.9	8.8	7.0	–1.8
of which: private sector	5.4	10.2	8.5	–1.7	8.9	6.9	–2
Number of employed	3.4	2.5	1.9	–0.6	1.8	1.1	–0.7
of which: private sector	4.1	3.8	2.3	–1.5	2.6	1.4	–1.2

*Note: *Considering the expected routine revisions in respect of 2016 (eliminating the impacts of methodological changes). The data in brackets are those published by HCSO during its March 2017 data release. In the case of the labour market data, the different methodology (in the case of the MNB: full-time equivalent headcount) may also cause minor differences in the forecasts.*

Source: 2018 budget bill, Inflation Report (March 2017).

5 Detailed evaluation of the budget bill

5.1 PRIMARY REVENUES

According to our forecast, the **primary revenues of the central sub-sector of the budget** may fall short of the appropriations in the bill by 0.7 per cent of GDP, i.e. HUF 304 billion in total (Table 5). A good part of the difference appears in the labour and consumption taxes, which is attributable to the different bases and the projection of higher consumption and wage bill increase in the bill.

In the case of **revenues from corporate income tax**, the appropriation exceeds our forecast by HUF 8 billion, which may be attributable to the difference in expectations with regard to pre-tax profit. Tax revenues fall significantly compared to 2016 due to two reasons. The Growth Tax Credit introduced in 2015 permits that if a company's pre-tax profit increases significantly from one year to another, the additional tax arising as a result of the growth can be paid to the budget over 2 years, in 8 equal instalments. The deadline for the payment of the surplus tax reported in 2015 expires at end of 2017 for companies that enrolled in 2015. Through the Growth Tax Credit scheme the affected companies paid HUF 268 billion to the budget in 2016 and the same revenue can be expected in 2017 as well. In 2018, however, only a minimum amount can be expected under this title. Another reason for the decrease is the uniform reduction of the corporation tax rates to 9 per cent, as 2018 will be first year when the tax advance payable in both half-years will have to be assessed at the uniform tax rate of 9 per cent, instead of the previous rates of 10 and 19 per cent.

In the case of the **special tax of financial institutions**, our forecast exceeds the appropriation by roughly HUF 14 billion. The difference is primarily attributable to the fact that the appropriation incorporates lost tax of HUF 18-19 billion, as a result of the tax allowance related to the support of spectacular team sports, also available in respect of the special tax of financial institutions. Pursuant to the amendment of the Act on Special Tax, submitted by the Government, taxpayers may also utilise the tax allowance related to the support of spectacular team sports, upon supporting amateur organisations and the education of juniors, in the special tax of financial institutions up to 50 per cent of the tax payable, subject to complying with certain conditions.

In the case of the **small taxpayers' itemised lump sum tax (KATA)**, our projection falls short of the appropriation by roughly HUF 10 billion. The difference is explained by the fact that the Ministry of National Economy estimates the willingness to enrol for this tax type higher than the MNB's assumption. The major increase in the revenues from this tax type, compared to 2016, is justified by the measure taken at end of 2016, pursuant to which the annual threshold above which the sales revenue is burdened by tax at a rate of 40 per cent is raised from HUF 6 million to HUF 12 million. As a result of this, the number taxpayers opting for this tax type may increase significantly.

In the case of **small business tax (KIVA)**, the budget appropriation exceeds our projection by almost HUF 11 billion. At the end of 2016, measures that reduce the tax base and the tax rate were introduced, as a result of which the Ministry of National Economy expects higher willingness to opt for this tax type in 2017 than the central bank, and this also appears as a base effect in relation to the 2018 bill.

For the **simplified entrepreneurial tax**, our projection falls short of the bill by roughly HUF 9 billion. Similarly to KIVA, the assumptions with regard to the willingness to enrol, related to the 2017 forecast, differ here as well: in line with the changes in the rules related to KATA, the MNB anticipates a larger decrease in the tax revenues from the simplified entrepreneurial tax in respect of this year, and the effect of this will spill over to 2018 as well.

The **value added tax** estimate in the bill is HUF 3,839 billion, which exceeds our projection by HUF 156 billion. The larger part of the difference is attributable to the base effect. Part of the remaining difference is explained by the differences in the macroeconomic forecasts. A smaller part of the higher estimate may be explained by the presumed revenue-increasing effect of certain measures aimed at combating the hidden economy (e.g. introduction of online invoicing, the Strategic Renewal Programme of the National Tax and Customs Administration). Our forecast for next year includes the expected impact of the tax cuts indicated in the bill (fish, restaurant services, internet subscription), which is estimated to reduce revenues from this tax type by HUF 49 billion. In assessing the bill, we took into consideration that, similarly to 2017, the rules of refunding will change next year as well, and thus the cash-flow revenues will fall short of the tax revenue calculated on an accrual basis by more than HUF 100 billion in 2018 as well.

For next year, the bill projects revenue of HUF 1,099 billion from **excise tax**, which essentially corresponds to the MNB's forecast.

Our forecast for **personal income tax** falls short of the estimate included in the 2018 budget bill by HUF 64 billion. The higher revenue estimate in the bill is almost fully attributable to the different macroeconomic paths. The Ministry of National Economy projects growth in gross wages and the wage bill which exceeds the MNB's estimate by 2-2.5 percentage points both in 2017 and 2018. The expectations included in the bill with regard to the use of tax allowances differ from the MNB's forecast only slightly, and here again the difference is primarily caused by the assumptions related to the wage bill (e.g. utilisation of the family tax allowance). Apart from the extension of the allowance for families with two children, which was already known before, the bill and the related tax law mostly contain changes that ease tax administration and have a minor effect on the budget. The anticipated measures include several administrative changes (cancellation of tax equalisation, technical legislative clarifications, recognition of per diem), and property letting and the transfer of medical practice will become more favourable.

According to our forecast, **the tax and contribution revenues of social security funds** may be lower than the estimate by roughly HUF 60 billion. The 2018 estimate contains a figure for the revenues from social contribution tax and other contributions of the insured that exceeds the MNB's expectations by more than HUF 70 billion. The difference is fully attributable to the fact that the Ministry of National Economy projects a substantially higher increase in the wage bill than our forecast. Our forecast related to the use of the allowances provided by the Job Protection action plan corresponds to the estimate of roughly HUF 100 billion included in the bill. In the relevant period of 2017, the increase in the gross average wage of the private sector is unlikely to reach 11 per cent, and thus the conditional reduction of the social contribution tax by a further 0.5 percentage point will not enter into force in 2018 according to the forecast of the MNB and the Ministry of National Economy.

The budget appropriations of the **tax and contribution revenues of the extra-budgetary funds** are in line with our forecast for 2018. As regards the tax and contribution revenues of the Labour Market Fund, the budget bill projects a revenue figure that exceeds the MNB's expectations by roughly HUF 7 billion. Despite the substantial difference between the forecasts related to the increase in the gross wage bill, the difference in the revenue figures is relatively low, as in 2018, in contrast to the previous years, the Labour Market Fund will not benefit at all from the social contribution tax revenues. The difference of HUF 7 billion is offset by our forecast related to vocational training contribution, which exceeds the appropriation by HUF 7 billion.

The lower revenue figures of labour tax and contribution burdens is somewhat offset by the fact that in the other taxes and contributions row our revenue expectation exceeds the appropriation by HUF 12 billion. This is mainly attributable to two items, i.e. the higher revenues from the healthcare contribution and taxes on public health products. The only measure, not known before, related to the healthcare contribution (apart from reducing the upper rate of the contribution by 2 percentage points) is the cancellation of the 14 per cent progressive tax on property letting, which – also considering the potential whitening of the economy – generates a loss in revenues of not more than HUF 2 billion.

Table 5
Revenues of the central sub-sector – comparison of the forecasts
(HUF billion)

	2017			2018		
	Statutory appropriation	MNB forecast	Difference	Statutory appropriation	MNB forecast	Difference
TAX AND CONTRIBUTION REVENUES OF THE CENTRAL SUBSYSTEM	**13,685**	**13,476**	**-208**	**14,200**	**13,896**	**-304**
Payments by economic organisations	**1,566**	**1,537**	**-29**	**1,350**	**1,332**	**-19**
Corporation tax	596	596	0	363	355	-8
Bank levy	67	65	-2	50	64	14
Sector-specific surtax	0	0	0	0	0	0
Simplified entrepreneurial tax	76	65	-11	70	61	-9
Mining royalty	35	37	2	37	37	0
Gambling tax	31	27	-3	26	30	4
Energy suppliers' income tax	56	49	-6	52	53	1
Small taxpayers' itemised lump sum tax	95	90	-4	113	104	-9
Small enterprise tax	24	15	-8	27	16	-11
E-road toll	170	161	-9	178	167	-11
Utility tax	55	55	0	55	55	0
Other taxes and payments	364	377	13	380	391	11
Early retirement social security contribution	12	13	1	17	14	-3
Consumption taxes	**4,929**	**4,808**	**-121**	**5,254**	**5,089**	**-165**
Value-added tax	3,542	3,442	-100	3,839	3,683	-156
Excise tax	1,069	1,055	-14	1,099	1,092	-7
Registration tax	24	24	0	24	24	0
Telecom tax	54	53	-1	52	53	1
Financial transaction levy	206	199	-7	205	199	-6
Insurance tax	34	35	1	35	37	2
Payments by households	**2,134**	**2,107**	**-27**	**2,332**	**2,269**	**-62**
Personal income tax	1,904	1,874	-29	2,090	2,026	-64
Duties, other taxes	187	187	0	198	198	0
Motor vehicle tax	44	46	2	44	46	2
Tax and contribution revenues of extra-budgetary funds	**531**	**526**	**-5**	**356**	**356**	**0**
Tax and contribution revenues of social security funds	**4,524**	**4,499**	**-25**	**4,908**	**4,850**	**-58**
Social contribution tax and contributions	4,218	4,182	-37	4,592	4,521	-71
Other contributions and taxes	306	318	11	317	329	12
OTHER REVENUES	**535**	**548**	**13**	**356**	**356**	**0**
Other revenues of the central budget	**407**	**413**	**6**	**218**	**218**	**0**
Other revenues of social security funds	**39**	**39**	**0**	**38**	**38**	**0**
Other revenues of extra-budgetary funds	**89**	**96**	**7**	**100**	**100**	**0**
TOTAL REVENUES	**14,220**	**14,024**	**-195**	**14,556**	**14,252**	**-304**

Note: The appropriations for 2017 also contain the amendments of Bill T/15427 on the amendment of Act XC of 2016 on the 2017 Central Budget of Hungary. From 2018, contrary to the former practice, the EU transfer will be received in Chapter XLII – Direct revenues and expenditures of the budget, rather than in Chapter XIX – Developments financed by EU. However, to ease the comparability of the years, we also indicated these revenues in accordance with the earlier practice in 2018.

5.2 PRIMARY EXPENDITURES

In the so called **institutional and chapter** rows, we project a net cash flow expenditure that is lower by HUF 460 billion, in total, than the appropriations in the budget bill. A substantial part of the difference is linked to the EU advances and the absorption of the advances (Chapter 7.5). On the other hand, we projected the usual overperformance of the overdrawable appropriations and also with the – conditional, permitted by law – bonus payments to the Tax Authority's employees.

The 2018 budget act plans the **expenditures related to EU programmes** in the amount of HUF 2,418 billion, of which HUF 2,230 billion belongs to the Széchenyi 2020 programme related to the 2014-2020 budget cycle (the appropriation related to 2017 is HUF 2,239 billion). The cash flow revenues are planned in the amount of HUF 1,911 billion, as a result of which the cash-based deficit linked with the EU budget transfers may amount to HUF 506 billion. The cash-based deficit partly reflects the amount of domestic co-financing, as well as the 10 per cent of the funding that is not reimbursed by the European Commission in 2018, thus it has to be advanced from the budget. The latter can be accounted for as accrual-based revenue, and thus it does not affect the ESA balance, but substantially adds to the financing requirement and public debt. According to our forecast prepared for the March Inflation Report, the appropriation related to the disbursement of funds may materialise, but within that we anticipate a higher ratio of advances that have no own contribution part, which may reduce the accrual-based deficit by roughly 0.3 per cent of GDP.

In the **vocational chapter-managed appropriations** we perceive bidirectional risks. Net expenditures may be higher, if the residual appropriations brought forward from last year are utilised to a high degree, and if the indebtedness of the healthcare institutions continues in 2018 as well. The expenditures may be lower, if – similarly to the 2016 fiscal year – the self-financed capital expenditures falls short of the plan (implementation risk), and if the implementation of the planned fiscal stimulus programmes is delayed (temporary saving is realised on the capital transfer expenditures).

In relation to the expenditures of the **extra-budgetary funds**, our forecast for the passive expenditures of the **Labour Market Fund** is almost the same as the appropriation, based on labour market developments. For certain items of the funds we apply the appropriation, of which the most significant shift can be expected in the case of the Start labour scheme. In 2018, the anticipated saving on expenditures at the Start labour scheme is HUF 100 billion compared to the 2017 statutory appropriation and it is HUF 30 billion compared to the central bank's projection for 2017. The saving on expenditures is the consequence of the labour market's tightness and the fact that the government encourages jobseekers to find employment primarily in the private sector. Depending on the incentives provided by the government, the actual expenditure may remain below the appropriation.

Box 1

Amendment of the 2017 Budget Act and developments in the 2017 cash balance

The Government submitted the bill on the amendment of Act XC of 2016 on Hungary's 2017 central budget to Parliament on 2 May. Based on the amendment, the cash-based deficit specified in the Budget Act will not change. The new measures included in the amendment on the expenditure side amount to HUF 176 billion, within which raising reserves (HUF 66 billion) does not represent an effective increase in the deficit unless additional measures are taken. New expenditures include, among others, the following items:

- Renovation and modernisation of the national public road network (HUF 50 billion)
- Creation of the appropriation for Investment Preparation Fund for the more efficient implementation of investments (HUF 25 billion)
- Renovation of the assets of the Ministry of Defence (HUF 10 billion)
- Implementation of the first sub-programme of the Supplier Action Plan (HUF 6 billion)
- Communication tasks of the Cabinet Office of the Prime Minister (HUF 5 billion)

The **amendments have no impact on the appropriation of the 2018 budget bill**, because in addition to the raising of the expenditures related to 2017, as mentioned above, it updates the budget with the previously announced revenue side measures (reducing the rate of the social contribution tax rate, corporation tax cut).

The deficit-increasing measures are offset by the enforcement of the pass-through of land sales revenues and raising the tax revenue appropriations, which are justified by the favourable macroeconomic developments. The reduction in the net interest expenditure appropriation is supported by the decrease in the yields of government securities, which also provides cover for the increase in expenditures.

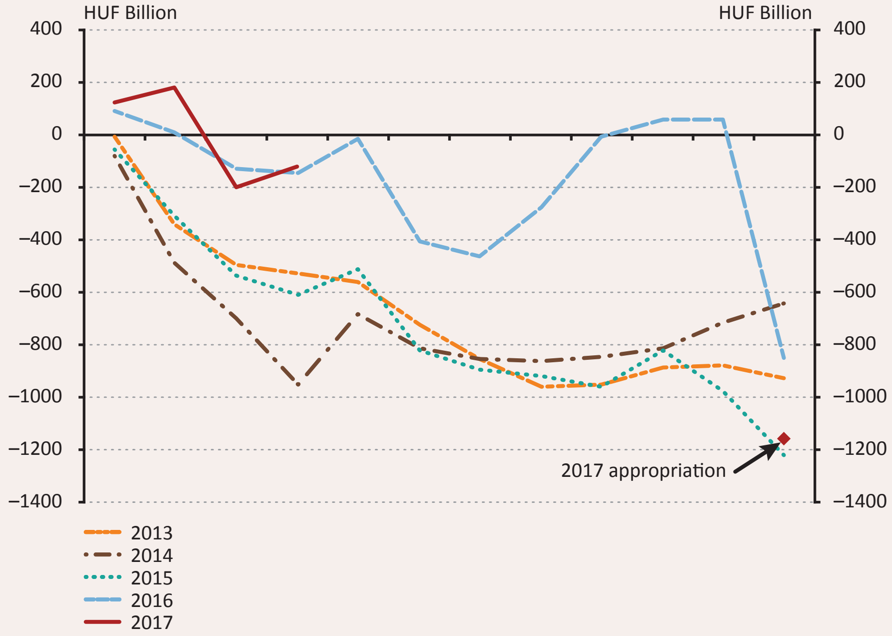
Table 6
Summary of the amendments of the 2017 budget act
(HUF billion)

Amended items	Amount of change
1.) Change in expenditures (2-5.)	**206**
2.) Surplus expenditure (3+4.)	260
3.) Expenditures due to new measures	176
4.) Transfer of previous measures and processes	84
5.) Saving in interest expenses	54
6.) Change in revenues (7-11.)	**206**
7.) Surplus revenue (8+9+10.)	546
8.) Tax revenues, social security contribution and levy	252
9.) Income from land sales	162
10.) Other income	132
11.) Decrease in revenues (12+13+14.)	340
12.) Social contribution tax	192
13.) Corporation tax	139
14.) Other items	9

On the whole, the amendment of the Act increases the expected 2017 deficit by the amount of the new expenditures; however, in our view, based on the figures for the first four months the total expenditures still fall short of the appropriations.

At the end of April, the cumulative deficit of the central sub-sector of the general government amounted to roughly HUF 120 billion. Compared to the figures for past years, the degree of the cumulative deficit is substantially lower and it also slightly less than the 2016 balance (Chart 3). Hence it may be worth examining, in the knowledge of the semi-annual fiscal figures, whether it would be feasible to bring forward certain expenditures of next year to 2017, provided that the 2017 budgetary processes permit this, with a view to fulfilling then safely and facilitating achievement of the 2018 deficit target.

Chart 3
Intra-year cumulative cash balance of the government budget
(HUF billion)



Source: Budget Act of 2017, Hungarian State Treasury.

Our projection for **pension expenditures** falls short of the statutory appropriation by HUF 66 billion; this deviation is the combined effect of three differences pointing in the same direction.

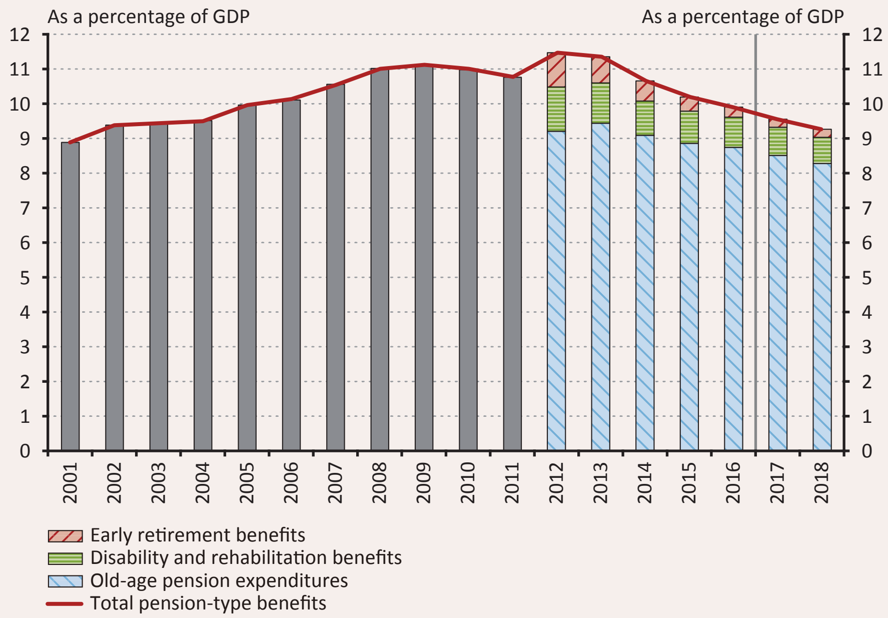
- A difference of HUF 14 billion stems from our projection of the constant expenditure level for *provisions to dependants*, assuming a decrease in the number of beneficiaries and an inflation rate of 3 per cent, while the budget projects an increase of HUF 15 billion in expenditures compared to the anticipated 2017 expenditure level. However, in 2016 the disbursement of provisions to dependants fell short of expectations, and this base effect suggests unchanged expenditures both in 2017 and 2018.

- Our projection also falls short of the appropriation for *pensions due to women after a 40-year eligibility period*: compared to the expenditure of HUF 260 billion included in the budget bill, our estimate is HUF 20 billion lower, which may be attributable to the difference in headcount forecasts. Our projection is based on a gradual increase in the number of women choosing early retirement: compared to 2017, it assumes that expenditure will be HUF 17 billion higher and the number of beneficiaries will be 5.4 per cent higher.

- Our expectations related to *old-age pensions* also falls short of the statutory appropriation. We assume an expenditure level for 2018 that is HUF 32 billion lower, with a good part of the difference attributable to the different expectations related to pension premium. The main cause of the difference is that – in contrast to the budget's GDP growth forecast of 4.3 per cent – we project growth of 3.7 per cent for next year, based on which we expect pension premium payments to be roughly HUF 20 billion lower.

As regards **disability and rehabilitation benefits**, we expect the payments to fall short of the appropriation in the bill by HUF 16 billion. The 2016 realisation fell behind the fiscal expectations, in light of which both the anticipated 2017 expenditure level and the 2018 appropriation can be deemed high. Following the fall in the expenditure level observed in recent years, our forecast assumes a decrease in the number of beneficiaries.

Chart 4
Expenditures of pensions and pension-type benefits between 2001 and 2017
(as a percentage of GDP)



Note: Data between 2001 and 2011 indicate spending on pension-type benefits based on the final budgetary accounts; they do not correspond to the categories of the accounting regime introduced in January 2012. From 2012, the category of 'old-age benefits' includes above retirement age benefits, above retirement age disability benefits, the service dependent pension available for women with 40 years of service, and provisions to dependents. Values for 2016 indicate preliminary cash data, while the 2017 and 2018 time series show our forecast.
Source: HCSO, Hungarian State Treasury, MNB, final accounts.

Our projection related to the **cash benefits** of the National Health Insurance Fund is HUF 14 billion lower than the statutory appropriation. The largest part of the difference occurs in sickness benefit expenditures, where our projection is HUF 8 billion lower.

In the case of **medical and preventive care**, we deem the appropriation included in the budget bill to be realistic. The appropriation for 2018 exceeds the expenditure level expected for 2017 by HUF 161 billion, which represents an increase of around 16 per cent. The planned magnitude of the increase in expenditures exceeds the values observed in previous years and is also higher than the expected growth rate of nominal GDP, which may permit an increase in material expenditures.

According to our forecast, within expenditures related to health insurance benefits in kind, the **net balance of the drug budget** may exceed the estimate included in the budget bill by HUF 18 billion. Within this, we expect drug reimbursements to be overdrawn by HUF 15 billion. In 2016, the appropriation on the expenditure side of the drug budget had to be raised by HUF 41 billion at year-end, in the light of which the appropriation may be underestimated both in 2017 and 2018. Our forecast expects a gradual increase in expenses in order to maintain the service quality, also bearing in mind the impact of ageing on expenditures.

Table 7
Expenditures of the central sub-sector – comparison of the forecasts
(HUF billion)

	2017			2018		
	Statutory appropriation	MNB forecast	Difference	Statutory appropriation	MNB forecast	Difference
PRIMARY EXPENDITURE ITEMS	**14,528**	**14,363**	**–164**	**15,015**	**14,827**	**–188**
Special and normative subsidies and support to the public media	**381**	**413**	**32**	**444**	**444**	**0**
Social policy fare subsidy	**104**	**99**	**–5**	**98**	**98**	**1**
Housing subsidies	**211**	**213**	**2**	**226**	**230**	**4**
Family allowances, social benefits	**562**	**562**	**0**	**554**	**556**	**2**
Early retirement benefits	**96**	**91**	**–5**	**90**	**86**	**–4**
Net expenditures of central budgetary institutions and chapters	**5,580**	**5,490**	**–90**	**5,719**	**5,599**	**–120**
Net own expenditures	4,886	4,299	–587	5,212	4,749	–463
Net expenditures related to EU funds	694	1,191	497	506	850	343
Support to local governments	**649**	**660**	**11**	**696**	**696**	**0**
Contribution to the EU budget	**286**	**286**	**0**	**310**	**310**	**0**
Expenditures related to MNB settlements	**0**	**0**	**0**	**0**	**0**	**0**
Central reserves	**441**	**288**	**–153**	**257**	**257**	**0**
Debt assumption	**0**	**0**	**0**	**0**	**0**	**0**
Other expenditures	**430**	**432**	**2**	**463**	**463**	**0**
Expenditures of extra-budgetary funds	**600**	**536**	**–64**	**553**	**554**	**1**
NEF – Passive allowances	52	49	–3	55	56	1
NEF – Active allowances	325	258	–67	225	225	0
Other expenditures	223	229	6	273	273	0
Expenditures of social security funds	**5,187**	**5,293**	**105**	**5,605**	**5,533**	**–72**
PIF - Pensions	3,152	3,162	10	3,343	3,277	–66
HIF - Disability and rehabilitation benefits	321	300	–21	309	293	–16
HIF - Cash benefits	301	311	10	352	338	–14
HIF - Medical and preventive care	1,040	1,121	82	1,201	1,201	0
HIF - Net expenditures related to drug subsidies	247	267	20	265	283	18
Other expenditures	127	132	5	134	140	6
NET INTEREST EXPENDITURES	**859**	**930**	**72**	**905**	**928**	**24**
TOTAL EXPENDITURES	**15,386**	**15,294**	**–93**	**15,919**	**15,755**	**–164**

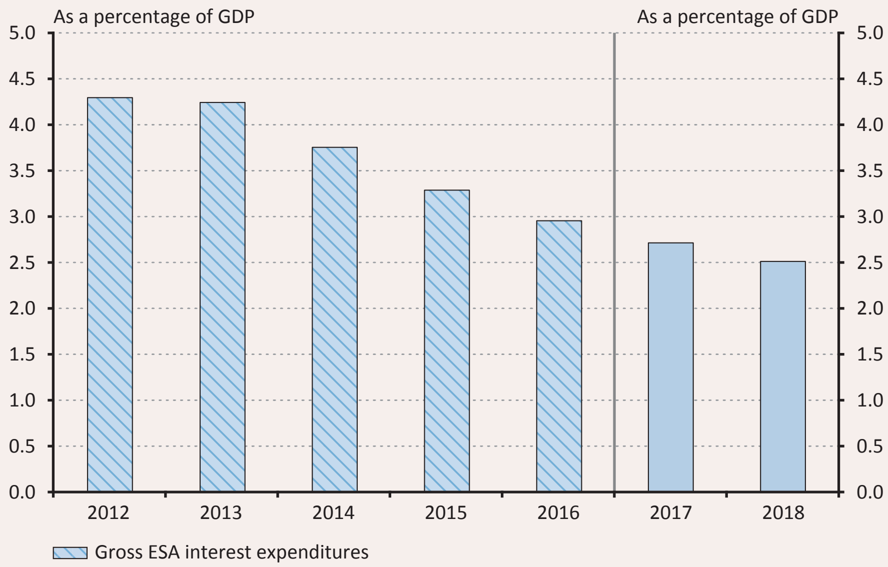
Note: The appropriations for 2017 also contain the amendments of Bill T/15427 on the amendment of Act XC of 2016 on the 2017 Central Budget of Hungary. From 2018, in contrast to the former practice, the EU transfer will be received in Chapter XLII – Direct revenues and expenditures of the budget, rather than in Chapter XIX – Developments financed by EU. However, to ease the comparability of the years, we indicated these revenues in accordance with the former practice in 2018 as well.

5.3 INTEREST BALANCE

Our projection for net interest expenditures on an accrual basis projects an ESA expenditure of HUF 960 billion, amounting to 2.4 per cent of GDP, which corresponds to the figure stated in the bill. Our estimate represents a decrease compared to 2017, amounting to 0.2 per cent of GDP. Based on the correspondence of our projection and the appropriation, both estimates may incorporate the repricing of the government debt at the same rate in the environment of low market yields on domestic government securities.

According to our projection, the net accrual-based interest expenditure of the general government may continue to fall over the entire forecast horizon. The persistence of the present yield level causes a further decrease in interest expenditures, since repricing continues within the debt as the share of new low-interest holdings rises. Further decreases in yields may strengthen this process, but a substantial decrease in GDP-proportionate interest expenditures can still be expected even without a change in yields: after full repricing, interest expenditures may decrease to nearly 2.3 per cent of GDP.

Chart 5
Accrual-based interest expenditures of the general government
(as a percentage of GDP)



Note: Net of imputed interest arising due to the transformation of the pension scheme.
Source: Eurostat and MNB (2017 and 2018 MNB forecast).

Our projection for **net cash interest expenditures** exceeds the appropriation in the bill by HUF 25 billion, i.e. it is slightly higher (which we adjusted for forint and foreign currency settlements that can be considered as non-interest expenditure and for other costs). Our projection is higher than the appropriation both for gross interest expenditures and interest revenues. The higher revenues and expenditure may be both caused by the fact that – due to the fall in yields seen in recent years – the market price of government securities exceeds the nominal value, which represents an interest income upon issue and interest expense upon redemption, and both income and expense at the swap auctions. While the swap auctions increase revenues and expenditures simultaneously, thereby having no effect on interest expenditures, issuance and redemptions only increase revenues and expenditures, respectively. Thus, the difference in net interest expenditures may be attributable to the different perception of the interest expenditure generated on redemptions.

6 Legal compliance of the bill

6.1. THE DEBT RULE OF THE FUNDAMENTAL LAW

According to the budget bill and based on the MNB's projection, the gross public debt-to-GDP ratio defined in line with the Stability Act will decrease, and accordingly the bill satisfies the debt rule requirement specified in the Fundamental Law. Based on the Fundamental Law, in 2018 the rate should decrease by 0.1 percentage point, which is met in the projection of both institutions (Ministry of National Economy: -1.9 percentage points; MNB -1.1 percentage points). The central bank's projection for nominal debt in accordance with the Stability Act for end-2018 corresponds to that included in the bill, while the forecasts for the debt-to-GDP ratio differ substantially, which is explained by the difference in the projections related to nominal GDP.

The projection of the Ministry of National Economy and the MNB with regard to the nominal debt is essentially identical for the end of 2018. According to the MNB's projection – presuming the full blocking of the Country Protection Fund – the cash balance of the central budget in 2018 may be HUF 1,419 billion, which slightly exceeds the amount of HUF 1,361 billion stated in the bill. The value of the debt ratio calculated in accordance with the Stability Act must be adjusted for the absence of EU funds, the degree of which is roughly the same in the two projections. However, the Ministry of National Economy projects an increase in the net liabilities of local governments of roughly HUF 90 billion. We ignored this impact in our projection, because according to our forecast in 2018 the net lending of the entire sector may be substantial. On the whole, as a result of the aforementioned three effects, the Ministry of National Economy's nominal debt projection exceeds our projection by HUF 19 billion.

Due to the different projections related to nominal GDP, the forecasts for the debt-to-GDP ratio differ substantially. The difference in the nominal GDP forecasts for the next two years fully explains the difference of 1.4 percentage points between the two debt projections. The end-2017 debt ratio in the bill falls short of the MNB's expectation by about 0.7 percentage points, due to the different nominal GDP forecast for this year. In addition to the base effect, the assumption for 2018 nominal growth also represents a difference, as according to the MNB's forecast this may be 6.4 per cent, while the Ministry of National Economy anticipates growth of 7.6 per cent. The effect of this on the debt ratio is also 0.7 percentage point.

Table 8
Change of public debt

	Bill	MNB	Bill	MNB
	HUF billion		As a percentage of GDP*	
1. Year 2017 initial government debt according to the Stability Act	26,771	26,771	71.4	72.1
2. 2018 cash-based deficit of the central budget**	1,361	1,444	3.4	3.7
3. Correction of the debt increment resulting from the delay in EU funding	–184	–157	–0.5	–0.4
4. Other effect	96	–8	0.2	0.0
5. Expected gross public debt according to the Stability Act in2018 (1+2+3+4)	28,044	28,050	69.5	71.0
6. Change in public debt-to-GDP ratio in 2017 (5-1)			**–1.9**	**–1.1**

*Note: * The MNB and the Ministry of National Economy use different annual nominal GDPs in their respective calculations. ** MNB forecast with the blocking of free reserves.*

The gross debt-to-GDP ratio of the general government according to the EDP method differs from the above due to methodological differences. Using the end-2016 exchange rate of EUR/HUF 311.0, it is forecast to decline from 74.1 per cent at end-2016 to around 73.1 per cent in 2017, and then to decrease further to 72.4 per cent by end-2018.

6.2. THE 3 PER CENT DEFICIT RULE OF THE STABILITY ACT

The budget balance expected in 2018 satisfies the 3 per cent 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-to-GDP ratio must not exceed 3 per cent. According to the bill, in 2018 the deficit as a percentage of GDP will be fulfilled at 2.4 per cent, while in the MNB's forecast, upon cancelling the Country Protection Fund, it will be also fulfilled at 2.4 per cent of GDP, i.e. the balance meets the target deficit set forth in the Stability Act.

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

The bill complies with the debt formula specified in the Stability Act. The maximum degree of the nominal increase in government debt is prescribed by Article 4 (2) and (2a) of the Act on the Economic Stability of Hungary. The rule stipulates that if the rates of inflation and real economic growth forecast for the fiscal year both exceed 3 per cent, the balance of the budget should be planned in such a manner that the annual growth rate of the nominal government debt must not exceed the rate of the difference between the planned inflation and half of the growth. If at least one of the two ratios is lower than 3 per cent, the debt rule prescribes a decrease in the debt ratio of 0.1 percentage point. According to the bill, although real growth in 2018 will be higher than 3 per cent, the rate of inflation will be lower than that, and **thus the debt formula prescribes a decrease of 0.1 percentage point, which is satisfied on the basis of the bill and of the MNB's projection as well.**

6.4. REQUIREMENT PERTAINING TO THE STRUCTURAL BALANCE OF THE GENERAL GOVERNMENT

According to the bill, the structural deficit will exceed the relevant requirement in 2018, while according to the Convergence Programme it will reach the threshold value in 2020. 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 manner consistent with the achievement of the medium-term budgetary objective. Pursuant to the Convergence Programme of April 2016, the medium-term budgetary objective applicable to Hungary is -1.5 per cent of GDP. The structural balance is the cyclically adjusted balance net of the one-off and temporary items. The 2018 budget bill contains a proposal for the structural balance, set to -2.4 per cent of GDP. According to the projection of the 2017 Convergence Programme, after 2018 the ESA deficit and the structural deficit will gradually decrease, and both will reach 1.5 per cent in 2020.

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

The bill corresponds to the rules of the corrective arm of the EU fiscal framework.

- The Maastricht **rule applicable to 3 per cent deficit** states that the accrual-based ESA deficit of the budget may not exceed 3 per cent of GDP. The 2.4 per cent estimate included in the 2018 budget bill **satisfies** this rule.

- The **debt-rule of the European Union** comprises two parts: according to the rule, the gross Maastricht public debt ratio must not exceed 60 per cent of GDP, or if it does, the rate must be reduced accordingly. The "one twentieth" rule serves the quantification of the latter, i.e. the debt ratio should be decreased by one twentieth of the part that exceeds 60 per cent, which thus prescribes for Hungary a decrease of roughly 0.7 percentage point. The bill presumably will **comply** with the debt rule of the European Union.

Box 2

Debt rule of the European Union

The debt rule of the European Union applies to Hungary in its current form from 2016 for the first time. This is explained by the fact that in the first three years after the termination of the excessive deficit procedure (EDP), i.e. from 2013 until 2015, Hungary had to comply with the temporary rule applicable to the structural balance instead of the public debt rule.

The debt rule of the European Union is defined by the Treaty on the Functioning of the European Union and Decree 1467/97/EC of 7 July 1997 of the Council.

Accordingly, the ratio of the government debt to the gross domestic product (GDP) must not exceed 60 per cent. If the general government debt exceeds this reference value, the debt rule of the European Union prescribes that that difference from the reference value must decrease on average by one-twentieth of the previous three years' benchmark per annum, based on the changes in those previous three years in respect of which data are available. The debt criterion requirement is also satisfied if, according to the Commission's budget forecasts, the difference will decrease at the prescribed rate in the three-year period that covers the two years following the last such year in respect of which data were available. Upon applying the reference value of the adjustment of the debt ratio, the impact of the cycle on the rate of the debt reduction must be taken into consideration.

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

The bill is unlikely to satisfy the preventive arm of the Stability and Growth Pact. Deviation from the two fiscal rules belonging to the preventive arm does not result in an excessive deficit procedure.

- The bill **does not satisfy** the fiscal rule applicable to **structural deficit**. According to the wording of the bill, the structural deficit expected in 2018 is 2.4 per cent, which exceeds the medium-term budgetary objective (MTO) of 1.5 per cent as a percentage of GDP, undertaken by Hungary.

- Upon non-compliance with the MTO rule, the **expenditure rule** of the European Union will enter into force. The rule states that compared to the previous year, the fiscal expenditures may increase by not more than the potential GDP growth rate, unless it is offset by certain discretionary revenue measures. There are major uncertainties about compliance with the rule, but the bill presumably **does not comply** with it. The rise in the fiscal deficit in 2018 is primarily attributable to the significant increase in expenditure items.

Box 3

The medium-term budgetary objective (MTO)

Pursuant to Council Regulation (EC) No 1466/97 of 7 July 1997 both the stability and convergence programmes must contain a medium-term objective regarding the structural balance of the budget. Its value depends on the potential growth rate and the government debt of the country, the interest rate level and the ageing rate. States struggling with sustainability problems must set stricter objectives. If a euro area member country fails to fulfil the medium-term budgetary objective and, in spite of several warnings, no effective intervention takes place in order to achieve it, the Commission may oblige the given country to place a non-interest-bearing deposit (0.2 per cent of GDP). In the case of non-euro area member countries, the Commission only makes a proposal for carrying out the fiscal adjustment. Until 2016, Hungary undertook a 1.7 per cent structural deficit, but revising it in the 2016–2020 Convergence Programme, it set a structural balance target of 1.5 per cent of GDP.

The structural balance is consistent with different statistical deficits depending on the actual situation of the economy. This is because the structural balance is calculated by correcting the official statistical balance indicator – after the exclusion of temporary items – with the impact of the economic cycle (cyclical component). The result is how much the balance would be if the performance of the economy was exactly equal to its potential level. For example, if the output gap is negative, i.e. the level of actual output is below the potential one, the structural balance is more favourable than the general balance indicator, as the starting point is the assumption that if the performance of the economy reaches the potential level, tax revenues increase automatically. Accordingly, the size of the cyclical component depends on the output gap and the relevant sensitivity of the budget.

7 Special topics

7.1 THE MNB'S FISCAL CONTRIBUTION IN THE PERIOD 2013-2018[1]

Since 2013, the activity of the Magyar Nemzeti Bank has exerted a positive impact on the fiscal balance and the government debt through several channels. As a result of the fall in yields in the government securities market, supported by the central bank's programmes, the budget realised substantial savings in interest expenditures, which reduced the government debt-to-GDP ratio by more than 6 percentage points between 2013 and 2018, thereby contributing to lowering Hungary's vulnerability. The profitable operation of the central bank also improves the situation of the budget, as there is no need to reimburse it for its losses and the dividend paid from the MNB's profit further reduces public debt. The lending and growth supporting schemes of the MNB, implemented since 2013, also have an indirect effect on the budget by supporting economic growth, and through the surplus tax revenues realised as a result of new investments and the expansion of employment.

During the last four years, yields on Hungarian government securities decreased substantially, which was also facilitated by the central bank's interest rate cuts and the self-financing programme. By reducing the costs of public finance and the ratio of foreign currency within the debt, the schemes contributed to reducing Hungary's external vulnerability. The cut of the central bank base rate from 7 per cent to 0.9 per cent and the impact of the decline in the government securities market yields are also reflected in the actual fiscal data, as interest expenditures decreased by 1.3 per cent of GDP between 2013 and 2016. The savings on interest is even more significant, if we assume that the yield level of August 2012 had been maintained, as in that case the general government would have faced increasing interest expenditures. The savings realised to date will continue to rise in the coming years, if the yields remain at the present level, as due to the repricing of the debt, the ratio of the low-interest portfolio will increase within the debt.

The bulk of the decline in interest expenditures is caused by domestic processes. This is also evidenced by the fact that according to the European Commission, Hungary is the country in which the government's interest expenditure may decrease to one of the largest degree between 2013 and 2018. According to the projection of the European Commission and the MNB, by the end of 2018 the accrual-based interest expenditure[2] of the general government may fall below 2.5 per cent of GDP in Hungary. As a result of the major decrease, Hungary's interest payment-to-GDP ratio will continue to approximate the EU average: in 2013 interest payment in Hungary was higher by more than 1.5 percentage points, but this difference may fall to 0.4 percentage point by 2018.

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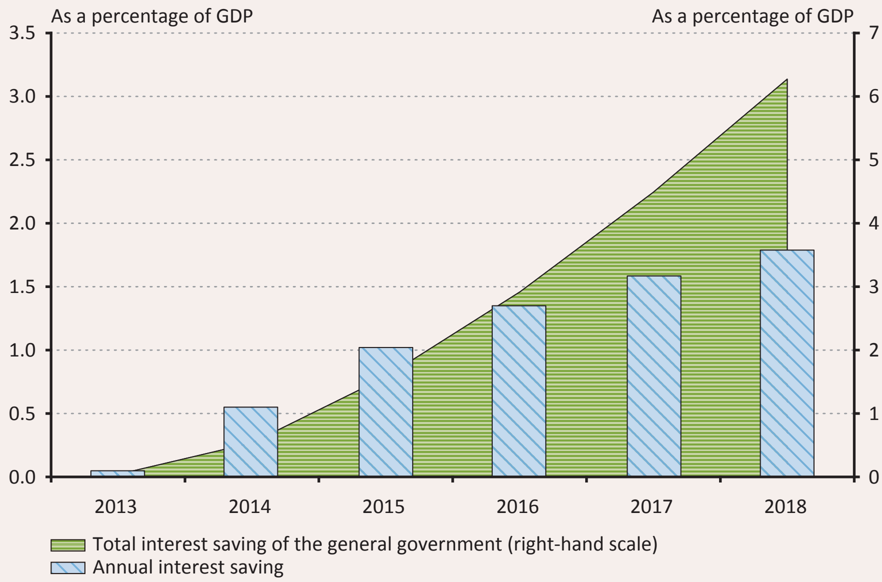
[1] Based on https://www.mnb.hu/letoltes/berta-david-kicsak-gergely-az-mnb-koltsegvetesi-hozzajarulasa-a-2013-2018-kozott.pdf

[2] In the case of interest expenditures, the Hungarian figures do not contain the imputed interest expenditures attributable to the transformation of the pension scheme.

Chart 6
Annual and total interest saving of the general government
(as a percentage of GDP)



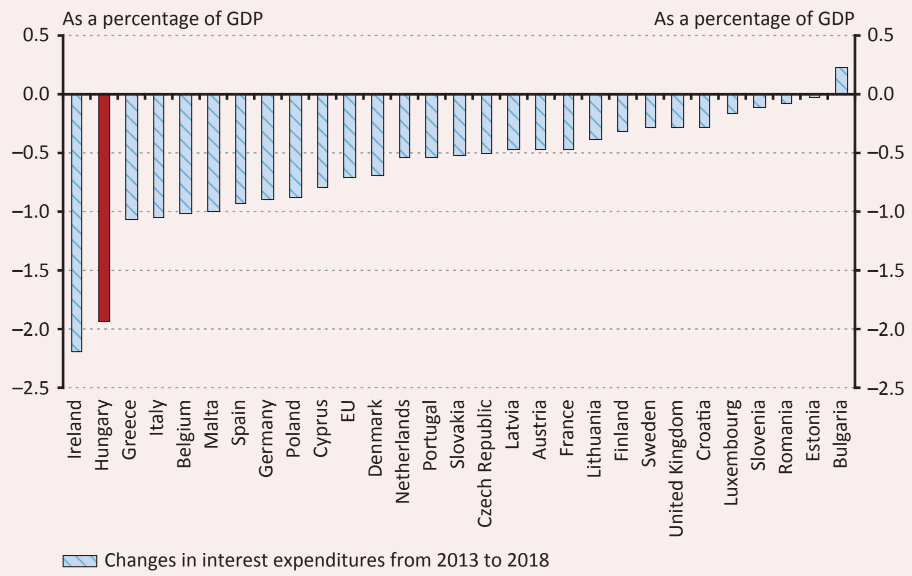
Source: Government Debt Management Agency, MNB.

The self-financing programme also facilitated the positive transformation of the debt structure, as a result of which the share of foreign currency and non-resident's ownership dropped within the government debt. Upon the outbreak of the financial crisis, the processes observed in the Hungarian government securities market highlighted the significant risk inherent in debt held by non-residents: due to the market turbulences the Government Debt Management Agency was unable to issue bonds for several months. As a result of the loans taken from international organisations, in 2011 the share of Hungarian government debt held by non-residents was even higher than before, i.e. 67 per cent. After this, the debt management was dominated by efforts to increase the domestic share and reduce the foreign currency share in the government debt. The *self-financing programme* contributed to the attainment of the strategic goal, as it supported the growth of the domestic financing base and the financing of foreign currency instalments by issuances in forint. As part of the *self-financing programme*, the MNB changed its main policy instrument to the three-month deposit facility, and also limited the volume, thereby diverting banks to other liquid instruments. Thus, a substantial part of the interbank forint liquidity flowed into the government securities market. The success of the scheme is reflected by the fact that by the end of 2016 the share of non-resident holdings within the total public debt fell below 39 per cent, while the share of central foreign currency debt decreased to 25 per cent.

The restructuring in ownership was primarily caused by the increasing demand of domestic credit institutions and households for government securities. As regards the government securities portfolio, the ownership share of credit institutions rose from 22 per cent, i.e. the average recorded in 2012, to over 29 percent by end-2016, while that of households increased from 6 per cent to almost 17 per cent.

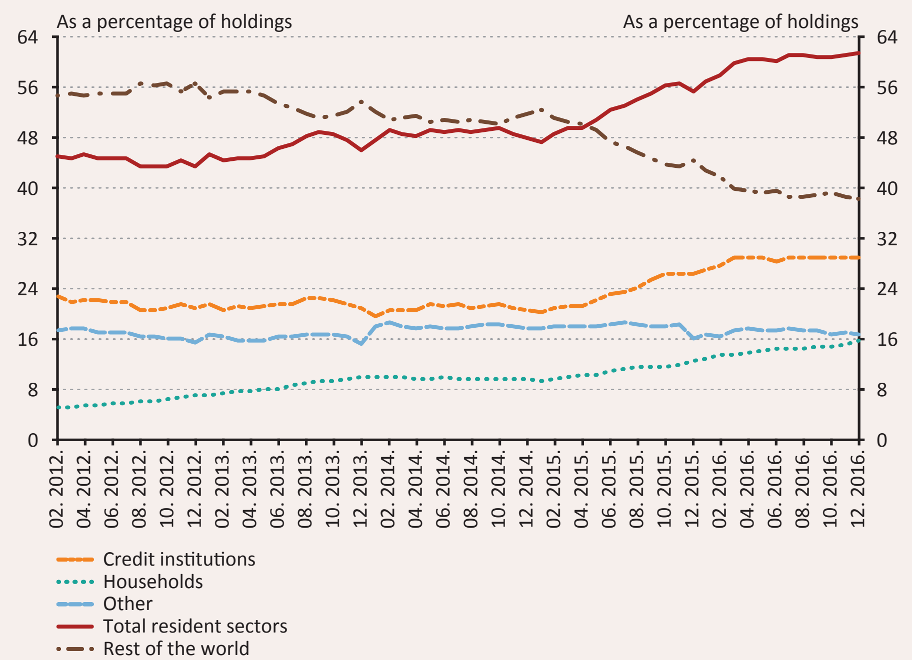
Apart from the interest expenditures, the central bank influences the financing position of the general government in other ways as well. On the one hand, the increase in gross domestic product increases the tax revenues of the budget through the expansion of the tax bases, and the increase in GDP also reduces the general government deficit as a proportion of GDP, as well as the debt ratio. On the other hand, the central bank's profit may also impact the budget of the next years. Since 2013, in the period under review, the Magyar Nemzeti Bank made a positive contribution to the improvement of Hungary's fiscal position in all respects, as the central bank had a favourable impact on the budget through its schemes and profitable operation.

Chart 7
Changes in interest expenditures in the EU
(as a percentage of GDP)



Source: Ameco.

Chart 8
Structure of Hungarian government securities holdings
(as a percentage of holdings)



Source: MNB.

The profit of the MNB had a stabilising, positive effect on the fiscal position. The retained earnings that the Bank is able to recognise in the given year, whether there is any need to use part of the retained earnings, the ability to pay dividends in the next year or the need to reimburse losses from the budget all depend on the profit or loss realised by the central bank. The MNB's result has been positive since 2013, i.e. it has been pursuing profitable operation for several years. The profit of HUF 26-27 billion realised in 2013 and 2014 increased the retained earnings. Of the profit of HUF 95 billion realised in 2015, the central bank paid dividends to the budget in 2016, for the first time since 2002, in the amount of HUF 50 billion. The payment of dividend reduced the gross government debt (by 0.15 percentage point of GDP) through the lower borrowing requirement of the general government. The remaining profit was transferred to retained earnings, just like the full profit of 2016 (HUF 54 billion), and thus the balance of retained earnings exceeds HUF 160 billion.

7.2 DEVELOPMENTS IN THE AVERAGE AND MARGINAL TAX WEDGE IN 2016

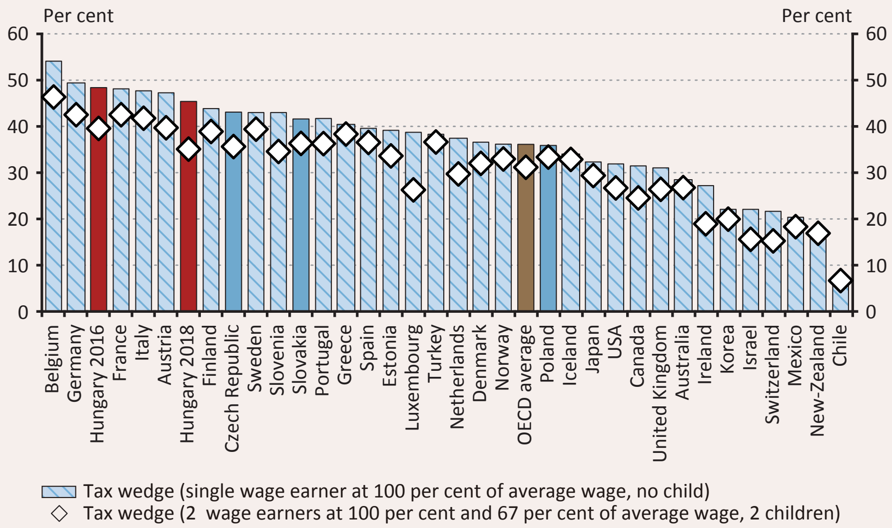
As a result of the measures adopted in 2016, the decrease in labour taxes, which started in 2010, continues in 2017 and 2018 as well, as the rate of the social contribution tax decreases by 5 percentage points this year, and by another 2 percentage points next year. It is worth examining how the various ratios of the Hungarian tax wedge will change in 2018 after the measures.

The tax wedge shows what ratio of the total wage costs paid by the employer is withdrawn in the form of tax and contribution revenues.

Tax wedge = 1 – Net wage/Labour cost

The size of the tax wedge varies in the individual income categories, and its level is also substantially influenced by the use of the various allowances. Usually, two indicators of the tax wedge are used. The first one is the **average tax wedge**, which shows the quotient of the total labour cost and the net wage, at a certain income level. According to empirical studies, this has a substantial influence on the labour supply decision whether an individual opts to work or not (i.e. the probability of access to employment at the extensive margin). The other indicator is the **marginal tax wedge**, which shows the surplus tax burdens charged to the income received for one unit of extra work. The decrease in the marginal tax wedge has stronger effect on the labour supply decisions related to extra work of those already in the labour market (i.e. intensive side). If due to the decrease in the marginal tax wedge a smaller part of the surplus income is withdrawn, the employees will be more interested in working and thus earn more. Based on empirical results, the flexibility on the intensive side is higher primarily in the case of employees belonging to the higher income categories.

Chart 9
Average tax wedge at 100 per cent of the average wage in 2016 and in Hungary in 2018
(per cent)

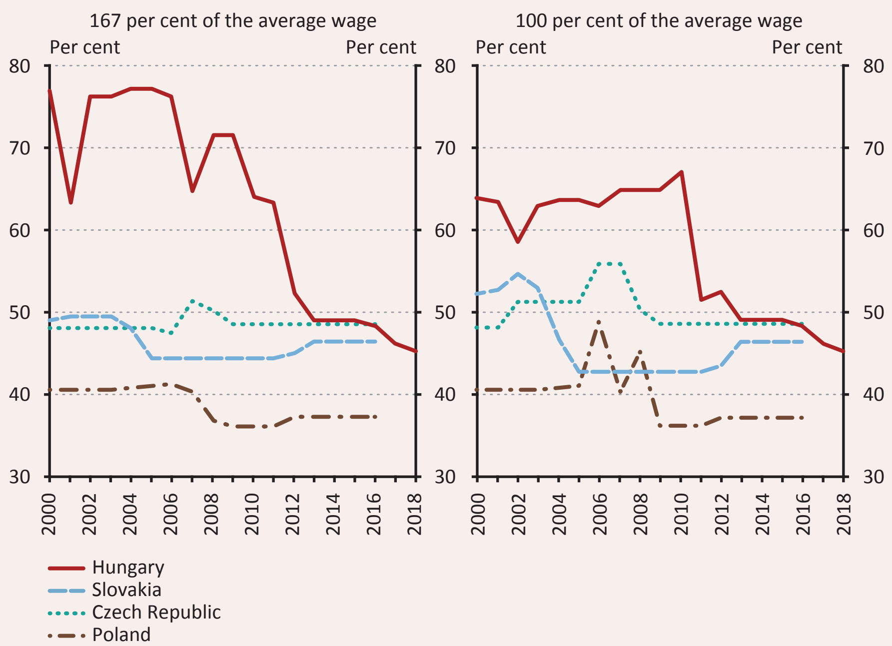


Source: OECD.

In Hungary, the tax burden on labour decreased significantly, while the level of the average tax wedge can still be deemed high. The Hungarian tax wedge in 2016 exceeds the average of the OECD countries by 12 percentage points, while the decrease in the social contribution tax implemented in 2017 and another significant cut in 2018 reduces the average Hungarian tax wedge by 3 percentage points in total (Chart 9). Despite the 7 percentage point cut in the tax rate, the level of the tax wedge only decreases by 3 percentage points, because due to the method of calculating the index, the measures affecting the net wage have a stronger impact on the change in the tax wedge than the reduction of the employer's contributions.[3] In the case of Hungary, this feature of calculating the ratio is reflected in a manner that the reduction of the employer's burdens by a further 1 percentage point and that of the employees' burdens by the same rate would change next year's average tax wedge by 0.45 and 0.82 percentage points, respectively.

The marginal tax wedge, i.e. the tax burden on the income received for one unit of extra work, has decreased significantly since the start of the 2000s (Chart 10). This was primarily attributable to the introduction of the flat income tax and the cancellation of tax credits. The decrease in the marginal tax wedge can be observed both at the average wage and at those with higher earnings, where the intensive side flexibility of the individual income groups is higher. With the decrease, the Hungarian marginal tax wedge may fall to the same level as that of the regional competitors or even below, by 2018. In the past year the Hungarian marginal tax wedge was lower than that in the Czech Republic in the case of those earning the average wage or higher.

Chart 10
Marginal tax wedges in the V4 countries at 100 and 167 per cent of the average wage
(per cent)



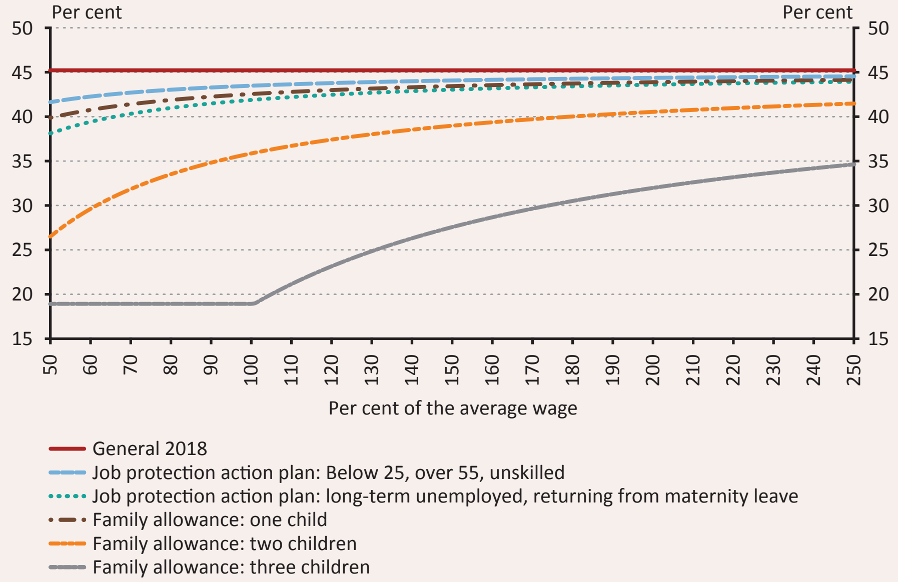
Source: OECD.

The tax wedge indicators are always able to show only a single selected point of a multi-dimensional income situation. In recent years it was a general trend in Hungary that the income tax scheme shifted from the tax allowances enforceable based on subjective rights towards targeted tax cuts, such as the Job Protection Action Plan and the family tax allowance. The commonly used indicators are not always capable of capturing the decreasing effect of the targeted tax cuts on the tax wedges in an adequate manner. Although the OECD uses indicators that also consider the number of children, the tax allowances of employee groups disadvantaged in the labour market are not considered by this institution in calculating the tax wedge.

[3] The reduction of the employer's contributions reduces wage costs to a smaller degree than the reduction of the employee's contribution or the personal income tax increases the net wage, at constant gross wages.

The average Hungarian tax wedge, also considering the targeted allowances, will be significantly lower than the level of the general indicator in 2018. The family tax allowance is applied annually by roughly 1.1 million persons, while within the framework of the Job Protection Action Plan roughly 900,000 entities will resort to the employer's tax allowance: thus both measures represent a cut in tax burdens applied in a very wide range. The tax allowance of families with two children increases to HUF 35,000 per month in 2018, and thus the tax wedge of this group will decrease further in 2018. The tax wedge of families with three children represents merely half of the general tax wedge even at 110 per cent of the average wage.

Chart 11
Expected trends in 2018 in the average Hungarian tax wedges presenting the targeted tax allowance, at different levels of income
(per cent)

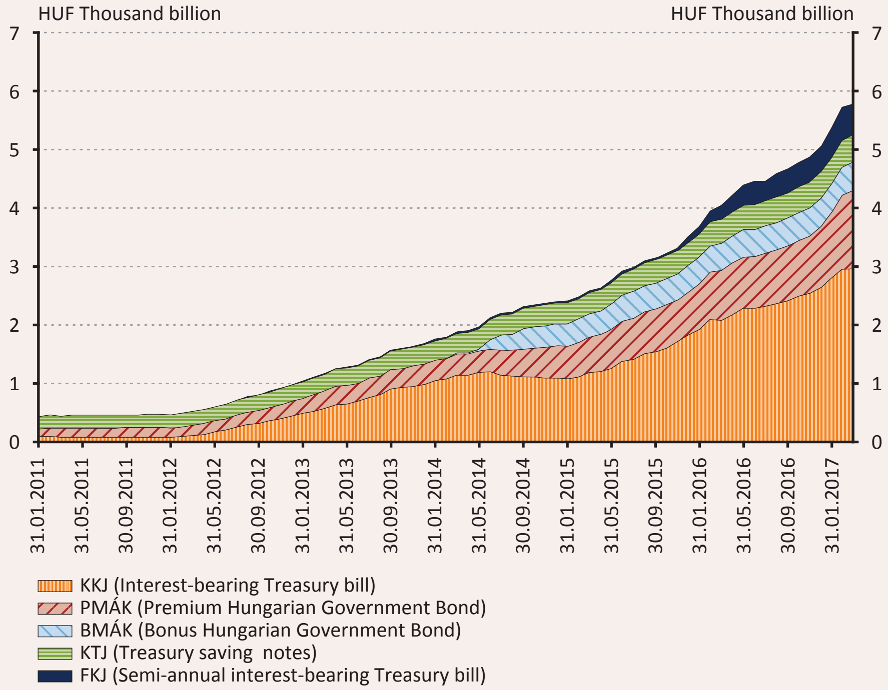


7.3 INCREASED ROLE OF RETAIL SECURITIES IN THE FINANCING OF THE GENERAL GOVERNMENT4

Retail government securities denominated in forint have increased significantly in the past 5 years, with a roughly 13-fold rise since early 2011. All types of securities contributed to the increase of more than HUF 5,000 billion in the portfolio. Within this, the highest increase was recorded in the portfolio of the interest-bearing treasury bill (KKJ), one of the retail government securities which has been in the market the longest, but the share of the newly introduced bonus (BMÁK) and premium Hungarian government bonds (PMÁK), as well as of the semi-annual treasury bills, also became substantial. It can be observed since January 2017 that the Government Debt Management Agency diverts demands towards securities with longer maturity. Recently, the net issuance of PMÁK has been higher compared to the volume of KKJ, as a result of which **debt financing has become more stable due to the rise in the average residual maturity.**

[4] Based on https://www.mnb.hu/letoltes/kicsak-gergely-lakossagi-allampapirok-stabilabb-finanszirozas.pdf

Chart 12
Retail government securities
(HUF thousand billion)

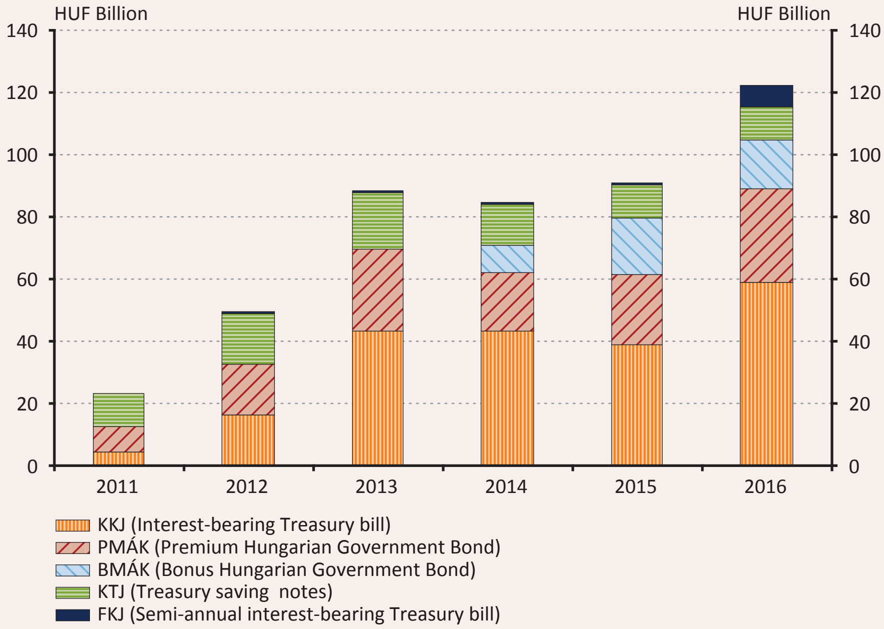


Source: Government Debt Management Agency.

The build-up of the large portfolio was supported by the change in the debt strategy of the Government Debt Management Agency, as a result of which the government securities holding of households increased, while the debt held by non-residents decreased. The rise was simultaneously supported by the introduction of a variety of new government securities and by the favourable interest rates. On the other hand, in the decreasing yield environment, the Debt Management Agency was able to reduce the interest rate of retail government securities in a way that they still remained attractive compared to the alternative investment instruments.

In the period 2013-2015, despite the dynamic portfolio increase, the interest expenses paid on the retail government securities did not increase, while during 2016 they rose at a substantially lower rate than the dynamic growth in the portfolio. The increase in the interest expenditures paid in respect of the retail government securities portfolio fell behind the portfolio's growth rate in the longer run as well. Compared to early 2011, the retail government securities rose almost 13-fold by end-2016, while the interest paid during 2016 was hardly more than five times the 2011 value.

Chart 13
Interest expenditure on HUF retail securities on a statistical accrual basis
(HUF billion)



Source: Government Debt Management Agency, MNB.

Although the nominal yield of the retail government securities is usually higher than that of the government bonds and discount treasury bills, according to our calculations, also considering the indirect effects, they had no negative impact on the budget, as the tax paid by the households on the interest income mostly offset the higher yield. In addition, the stable debt financing reduced the yield of other government securities, which may have changed the budget impact positively. According to our earlier estimate, the surplus interest paid on households' government securities until the first quarter of 2016 may have been around HUF 100 billion, while the extra commission was around HUF 45 billion, compared to a scenario where the Government Debt Management Agency would have issued discount treasury bills and government bonds in the same value as the retail portfolio, at constant yields.[5]

The tax payment on the revenues earned on the retail government securities offsets the higher interest and commission amounts. The general government realised direct income tax revenue on the paid interest, in contrast to the situation where these government securities would have been purchased by non-resident actors instead of households. The income tax revenues resulting from this and the VAT payable on the utilisation of the income are estimated at around and more than HUF 60 billion, respectively, and thus these amounts mostly offset the amount of the government's interest and commission expense. This surplus revenue of around HUF 120 billion is supplemented by the saving realised by the government due to the fact that the surplus supply that would have appeared in the governments securities market without the issuance of retail securities presumably would have given rise to higher bond market yields.

On the whole, as a result of the growth in the amount of retail government securities, the financing of the government debt became more stable, while the resulting surplus expenditures were offset by the surplus revenues of the budget. This is because the substantial growth in retail government securities contributed to lowering Hungary's vulnerability through the reduction of external debt. In addition, it made debt financing more predictable, as until now the households typically held the government securities until maturity. The negative side of these advantages is the interest rate that exceeds the market rate, but this is offset by the

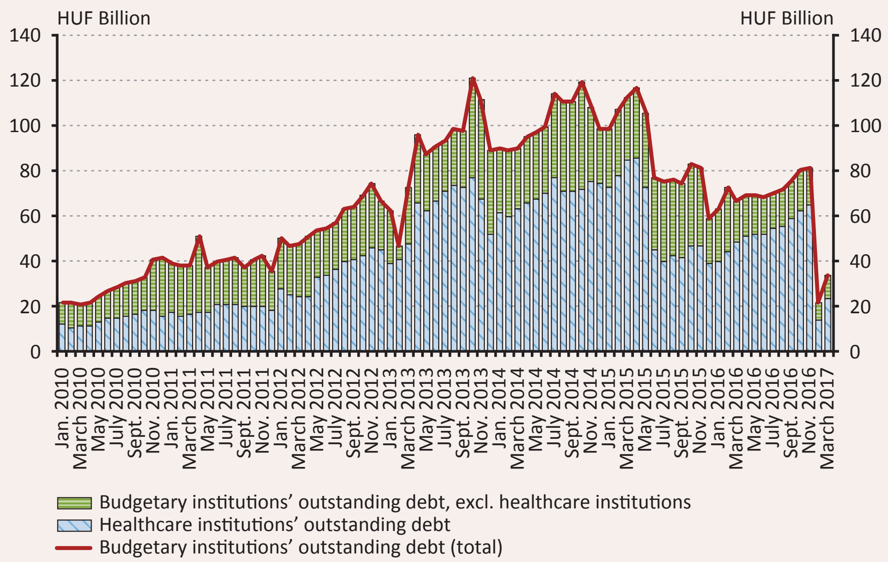
[5] https://www.mnb.hu/letoltes/kicsak-gergely-lakossagi-allampapirok-stabilabb-finanszirozas.pdf

government's tax revenues, which would have not been realised in the case of external funding. All in all, the more stable financing did not generate extra expenditure for the budget.

7.4 DEVELOPMENTS IN THE DEBT BALANCE OF BUDGETARY INSTITUTIONS AND HEALTHCARE INSTITUTIONS

After the decline recorded at the end of 2016, the debt balance of the budgetary institutions once again rose in the first three months of 2017. Within the total debt, the debt balance of healthcare providers represents an increasing share. In 2010-2011 they accounted for half of the budgetary institutions' debt, whereas in 2016 this share was already around two thirds on average (Chart 14). The re-accumulation of debt has necessitated debt consolidation several times in recent years, typically in the form of a one-off consolidation support at the end of the year, or through the reallocation of the residual amount of the appropriation for medical and preventive care, providing the main source of funding for public healthcare institutions. Although due to the consolidation implemented in 2015, the level of the debt balance embarked on a lower path, from January 2016 it once again showed a rising trend.

Chart 14
Outstanding debt of budgetary institutions and healthcare institutions between January 2010 and March 2017
(HUF billion)

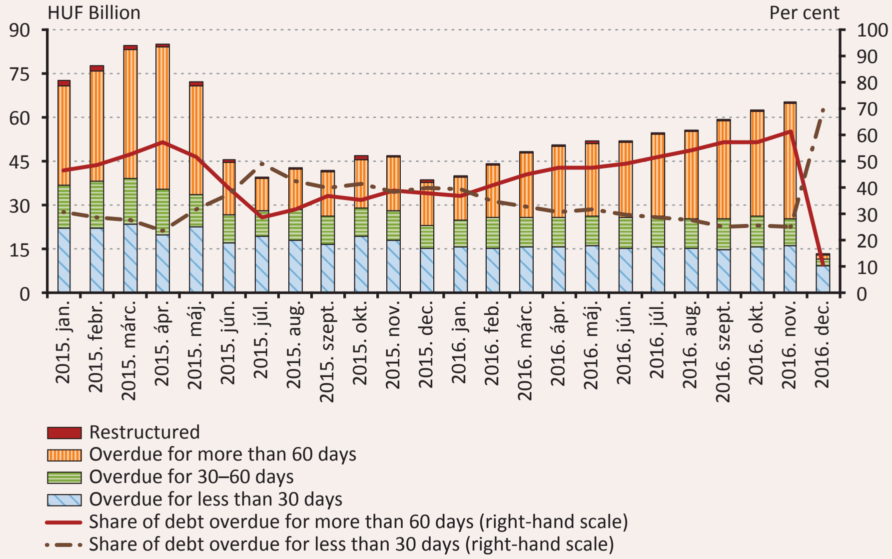


Note: The time series of healthcare institutions includes both out-patient and in-patient healthcare institutions, the background institutions of the healthcare sector, as well as universities with clinical centres. The time series contains an increasing number of institution, hence its comparability is limited.
Source: Hungarian State Treasury.

As a result of the debt consolidation implemented at end-2016, the debt balance of healthcare institutions fell to HUF 13 billion. At the end of 2016 the budget provided the healthcare institutions with operating support in the amount of HUF 60 billion. HUF 45 billion of this was disbursed directly to the healthcare institutions in public, local government and church operation, providing in-patient specialist care, based on the outstanding liabilities overdue for more than 30 days. In addition, the institutions could apply for funding up to the amount of HUF 15 billion for the support of professional, economic and structural measures aimed at sustainable operation. The budget for medical and preventive care rose by further HUF 10 billion. As a result of the capital injection of HUF 70 billion in total, a major debt reduction was implemented: the overdue outstanding debt of the healthcare institutions fell to roughly HUF 13 billion by December from HUF 65 billion recorded at the end of November 2016 (Chart 15). The hospitals used the largest part of this amount for the settlements of debts overdue for more than 60 days, as a result of which in November they settled the outstanding debt of HUF 40 billion almost in full.

The increase in outstanding debt expiring over 60 days qualifies as expenditure in the accrual-based statistics, and thus it deteriorates the ESA balance. On the other hand, the repayment of the debts appears only in the cash-based deficit and does not increase the ESA deficit, as the debt balance has already appeared in the ESA deficit of prior years. Thus the debt consolidation implemented at the end of last year also did not increase the ESA deficit.

Chart 15
Outstanding debt of healthcare institutions by maturity structure in 2015 and 2016



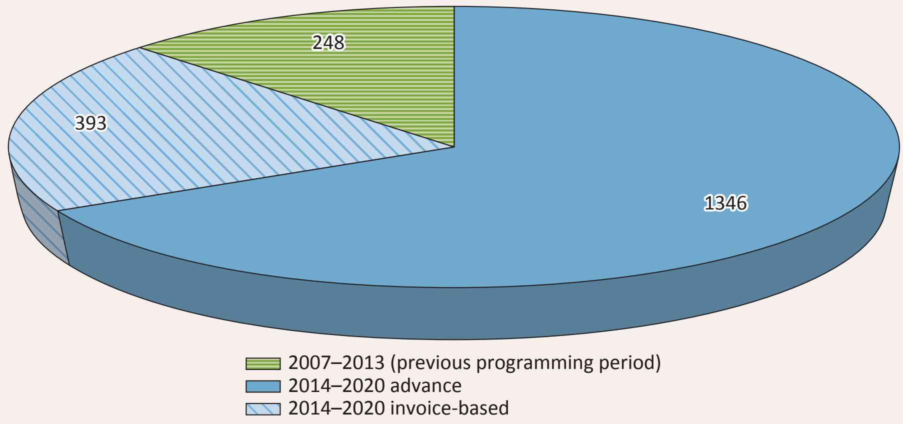
Source: Hungarian State Treasury.

Based on the first quarter's data of the year, the debt balance of the budgetary institutions rose to HUF 33 billion, of which the debt of healthcare institutions amounted to HUF 23 billion. Based on these data, the gradual regeneration of the debt balance may represent a negative risk, as a result of which the need for budgetary intervention may once again arise.

7.5 IMPACT OF THE ADVANCE PAYMENTS RELATED TO THE 2014-2020 EU PROGRAMMING PERIOD

Compared to previous years, the amount of EU funds absorbed by the economy declined considerably in 2016. The main reasons for the decline included the end of the 2007–2013 budget cycle and the slow uptake in the absorption of new funds. Although the amount of the EU funds paid to the winners of tenders in 2016 was close to HUF 2,000 billion, the actual absorption of the disbursed amounts was below HUF 700 billion. This was primarily due to the fact that more than half of the cash disbursements appearing in the budget – mostly to central government organisations, public corporations and local governments – was an advance, and thus the related real economy performance and the EU cash revenues belonging to it, as well as the accrual-based deficit arising from the domestic co-financing are expected to appear only in 2017 and later.

Chart 16
Structure of EU funding paid in 2016
(HUF billion)

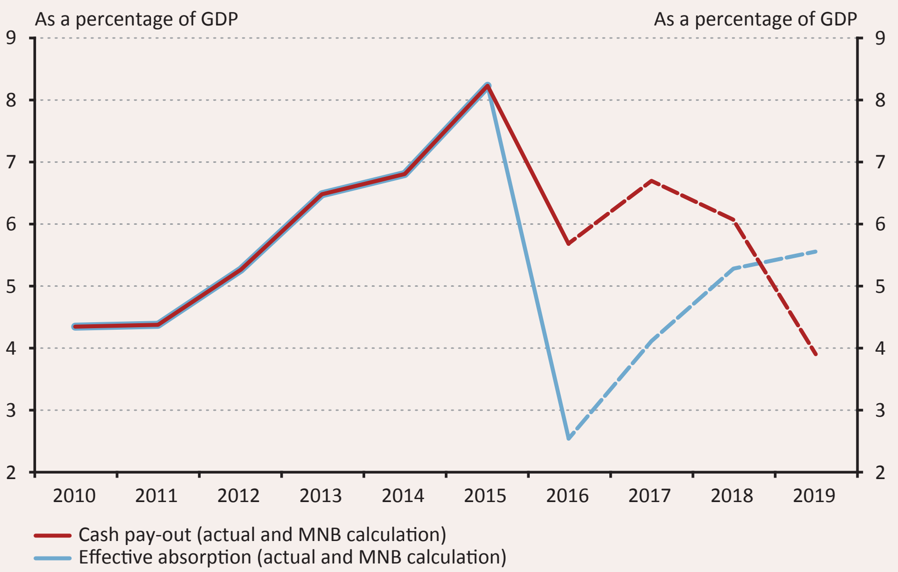


Source: Prime Minister's Office

According to our expectations, the cash disbursement and the effective absorption, signalling the effective implementation will deviate from each other (Chart 17). Although, based on the data available in the first quarter of 2017, advances still account for a substantial part of the disbursements, this year we anticipate a major rise in effective absorption, which will contribute significantly to the pick-up in economic growth. According to our expectations, the rise in effective absorption will be attributable to the higher level of invoice-based disbursements compared to the previous year and to the commencement of the absorption of the advances disbursed in 2016. The higher realisation of effective absorption compared to our projection may result in higher economic growth and through that in higher tax revenues, accompanied by surplus expenditures resulting from the co-financing.

On the whole, advance payments and their absorption, to be realised later, are not expected to have a significant impact on the total fiscal and real economy effect of the funds available in the EU's seven-year budget cycle.

Chart 17
Effective absorption related to EU funding
(as a percentage of GDP)



Source: Prime Minister's Office, MNB projection.

8 Appendix

Table 9
Main revenue side measures in the 2018 budget bill
(HUF billion)

Items	Description	MNB forecast
Family tax allowance	In the case of families with two children the family tax allowance increases to HUF 17,500 per child	–15
Value-added tax	The VAT rate of restaurant catering decreases from 18 to 5 per cent	–19
Value-added tax	The VAT rate of internet utilisation decreases from 18 to 5 per cent	–26
Value-added tax	The VAT rate of fish decreases from 27 to 5 per cent	–4
Social contribution tax	The social contribution tax rate decreases by 2 percentage points to 20 per cent, and it may decrease by further 0.5 percentage points, if in the first nine months of 2017 the gross wage growth exceeds 11 per cent in the private sector	–217
Healthcare contribution	The upper rate of the healthcare contribution decreased from 22 to 20 per cent	–7
Healthcare contribution	The healthcare contribution levied on income from property rental is cancelled from 1 January 2018	–2
Small business tax (KIVA)	The rate of small business tax decreases from 14 to 13 per cent	–1

Note: measures that impair the balance have a negative sign, while balance improving measures have a positive sign.

Table 10
Development of cash-flow revenues of the central government between 2016 and 2018
(as percentage of the GDP)

	2016	2017	2018
	Preliminary actual	MNB forecast	MNB forecast
TAX AND CONTRIBUTION REVENUES OF THE CENTRAL SUBSYSTEM	**37.4**	**36.3**	**35.2**
Payments by economic organisations	**4.6**	**4.1**	**3.4**
Corporation tax	2.0	1.6	0.9
Bank levy	0.2	0.2	0.2
Sector-specific surtax	0.0	0.0	0.0
Simplified entrepreneurial tax	0.2	0.2	0.2
Mining royalty	0.1	0.1	0.1
Gambling tax	0.1	0.1	0.1
Energy suppliers' income tax	0.1	0.1	0.1
Small taxpayers' itemised lump sum tax (KATA)	0.2	0.2	0.3
Small enterprise tax (KIVA)	0.0	0.0	0.0
E-road toll	0.4	0.4	0.4
Utility tax	0.2	0.1	0.1
Other taxes and payments	1.0	1.0	1.0
Consumption taxes	**13.2**	**12.9**	**12.9**
Value-added tax	9.4	9.3	9.3
Excise tax	2.9	2.8	2.8
Registration tax	0.1	0.1	0.1
Telecom tax	0.2	0.1	0.1
Financial transaction levy	0.6	0.5	0.5
Insurance tax	0.1	0.1	0.1
Payments by households	**5.5**	**5.7**	**5.7**
Personal income tax	4.9	5.0	5.1
Duties, other taxes	0.5	0.5	0.5
Motor vehicle tax	0.1	0.1	0.1
Tax and contribution revenues of extra-budgetary funds	**1.1**	**1.4**	**0.9**
Tax and contribution revenues of social security funds	**13.2**	**12.1**	**12.3**
Social contribution tax and contributions	12.3	11.3	11.4
Other contributions and taxes	0.9	0.9	0.8
OTHER REVENUES	**1.2**	**1.5**	**0.9**
Revenues related to state property	**0.6**	**1.1**	**0.6**
Other revenues of the central budget	**0.2**	**1.1**	**0.1**
Other revenues of social security funds	**0.1**	**0.1**	**0.1**
Other revenues of extra-budgetary funds	**0.3**	**0.3**	**0.3**
INTEREST REVENUES	**0.4**	**0.4**	**0.3**
TOTAL REVENUES	**38.6**	**37.8**	**36.1**

Note: partially consolidated data. From 2018, in contrast to the former practice, the EU transfer will be received in Chapter XLII – Direct revenues and expenditures of the budget, rather than in Chapter XIX – Developments financed by EU. However, to ease the comparability of the years, we indicated these revenues in accordance with the former practice in 2018 as well.

Table 11
Development of cash-flow expenditures of the central government between 2016 and 2018
(as a percentage of the GDP)

	2016	2017	2018
	Preliminary actual	MNB forecast	MNB forecast
PRIMARY EXPENDITURE ITEMS	**38.3**	**38.7**	**37.5**
Special and normative subsidies and support to the public media	**1.2**	**1.1**	**1.1**
Social policy fare subsidy	**0.3**	**0.3**	**0.2**
Housing subsidies	**0.4**	**0.6**	**0.6**
Family allowances, social benefits	**1.6**	**1.5**	**1.4**
Early retirement benefits	**0.3**	**0.2**	**0.2**
Net expenditures of central budgetary institutions and chapters	**13.9**	**14.8**	**14.2**
Net own expenditures	10.8	11.6	12.0
Net expenditures related to EU funds	3.2	3.2	2.2
Support to local governments	**1.9**	**1.8**	**1.8**
Contribution to the EU budget	**0.8**	**0.8**	**0.8**
Expenditures related to MNB settlements	**0.0**	**0.0**	**0.0**
Central reserves	**0.0**	**0.8**	**0.7**
Debt assumption	**0.0**	**0.0**	**0.0**
Expenditures related to state property	**1.1**	**1.2**	**1.2**
Other expenditures	**0.4**	**1.2**	**1.2**
Expenditures of extra-budgetary funds	**1.7**	**1.4**	**1.4**
NEF – Passive allowances	0.2	0.1	0.1
NEF – Active allowances	0.8	0.7	0.6
Other expenditures	0.8	0.6	0.7
Expenditures of social security funds	**14.7**	**14.2**	**14.0**
PIF - Pensions	8.7	8.5	8.3
HIF - Disability and rehabilitation benefits	0.9	0.8	0.7
HIF - Cash benefits	0.8	0.8	0.9
HIF - Medical and preventive care	3.1	3.0	3.0
HIF - Net expenditures related to drug subsidies	0.8	0.7	0.7
Other expenditures	0.4	0.4	0.4
NET INTEREST EXPENDITURES	**2.8**	**2.5**	**2.3**
TOTAL EXPENDITURES	**41.1**	**41.2**	**39.9**

Note: partially consolidated data. From 2018, in contrast to the former practice, the EU transfer will be received in Chapter XLII – Direct revenues and expenditures of the budget, rather than in Chapter XIX – Developments financed by EU. However, to ease the comparability of the years, we indicated these revenues in accordance with the former practice in 2018 as well.

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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