PUBLIC FINANCE REPORT

2019
SEPTEMBER

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

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

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Analysis of the public finance developments in 2018–2019 and the 2020 Budget Act

2019
SEPTEMBER

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

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

The analyses in this report were prepared under the general direction of Dániel Palotai, Executive Director for Economic Sciences and Priority Matters. This report was created by the staff of the Directorate for Fiscal and Competitiveness Analysis and the Directorate Economic Forecast and Analysis. It was approved for publication by Governor György Matolcsy.

The analysis is based on information available for the period ending on 20 July 2019.

Tartalom

1 Summary

The purpose of this analysis is to present the developments in public finance in 2018 and the expected fiscal developments for 2019, on the basis of budget figures available for the first half of the year and the MNB's forecast prepared for its June Inflation Report. The analysis also intends to provide an overview of the expected realisation of the targets in the 2020 budget adopted in July 2019. In view of the above, the actual compliance with the national and European Union rules related to the budget balance and government debt for 2018, as well as the expected compliance for 2019 and 2020 are assessed.

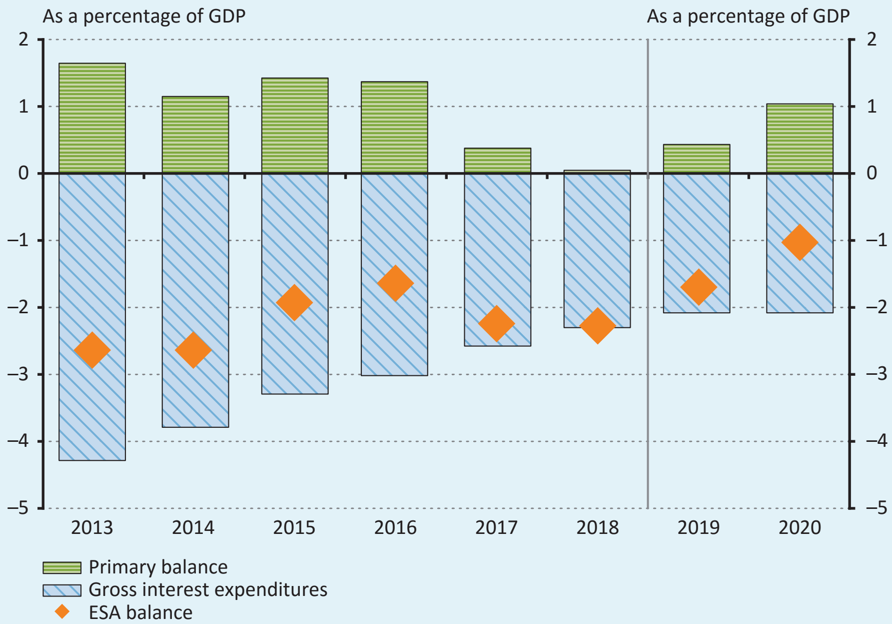
According to the forecast included in the MNB's June Inflation Report, the output of the Hungarian economy will rise by 4.3 percent this year and by 3.3 percent in 2020, primarily relying on the buoyant domestic demand, which may be strengthened primarily by the increase in investments in 2019 and by the improvement of labour productivity in 2020. The rise in consumption and wages also materially supports the increase in tax revenues. As a result of the labour demand generated by the dynamic economic growth, unemployment fell below 4 percent. As a result of the increased demand for labour, the tight labour market entails strong underlying wage trends. On account of this and the substantial increase of the minimum wage and the guaranteed minimum wage, following the increase of 12.9 percent, recorded in 2017, gross whole-economy average earnings increased by 11.3 percent in 2018, and this year the growth is also expected to exceed 10 percent. Consumer prices rose by 2.8 percent last year. According to the Magyar Nemzeti Bank's projection in the June 2019 Inflation Report, inflation is expected to be 3.2 percent this year and 3.4 percent in 2020.

In the favourable economic environment, the fiscal policy accumulates countercyclical reserves through the steadily decreasing deficit, which results that the deficit may be at historically low levels by 2020, around 1 percent of GDP. According to preliminary statistical data, the ESA deficit was 2.2 percent of the gross domestic product in 2018, it is expected to be around 1.6 – 1.7 percent in 2019, and in 2020 – as a result of the rising tax revenues and the spending cuts – it may fall to 0.6 – 1.4 percent, depending on the utilisation of the Country Protection Fund. Such low deficit has been unprecedented since the political transition. In parallel with this, the primary surplus may steadily rise, through which the fiscal policy accumulates countercyclical reserves.

The decrease in interest expenditures as a proportion of GDP observed since 2013 can continue in all three years under review, albeit at a somewhat slower pace than in the previous years. Namely, in the low interest environment the government debt is repriced gradually to the new yield levels; this repricing will be almost completely realised in the coming years. Thus, government interest expenditure may drop below 2.1 percent of GDP, which is close to the average expenditure level observed in the EU.

After 2018, the cash deficit of the budget may exceed the accrual-based deficit in 2019 as well, and then, from 2020 – as a result of the inflow of EU funds in excess of the EU expenditures cash deficit may be lower. In 2018, the high cash deficit was primarily caused by the fact that the payments related to EU transfers substantially exceeded revenues. According to our forecast, substantial advance payments may be expected in 2019 as well, and thus cash deficit may exceed the accrual-based deficit this year too. However, in 2020 the gap between the payments and revenues related to EU transfers will materially decrease, as a result of which the cash deficit may be lower.

Chart 1
Development of the fiscal balance and interest expenditures



Note: The figures do not include the imputed interest expenditures from 2012 related to the reform of the pension system. The point estimates of 2019 and 2020 assume either the cancellation or utilisation of the Country Protection Fund depending on the feasibility of the government's deficit target. This is because the Country Protection Fund may be spent only if the deficit does not exceed the designated deficit target. The point estimate assumes the utilisation of the Country Protection Fund in 2019 and its partial saving in 2020.

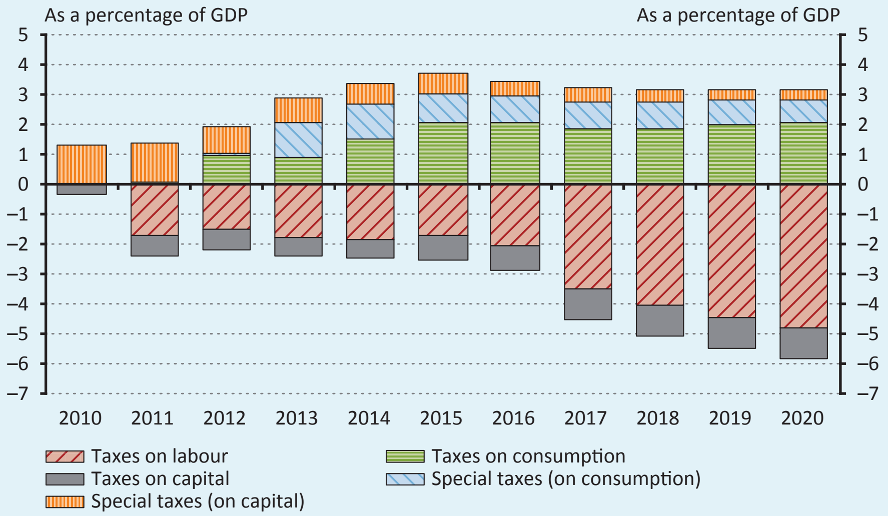
Source: Hungarian Central Statistical Office (HCSO), MNB.

The 2.2 percent ESA deficit-to-GDP ratio in 2018 was lower by 0.2 percentage points than the target in the Budget Act. The primary reason for the deficit being slightly lower than the deficit target is the tax revenue surplus arising from the macroeconomic developments being more favourable than anticipated by the Act. It was particularly the value added tax and personal income tax revenues that materially exceeded the statutory appropriation. In addition, since the effective absorption of EU transfers was lower than planned, the paid co-financing was also smaller.

Depending on the utilisation of the Country Protection Fund, the general government deficit as a percentage of GDP may be around 1.6 – 1.7 percent, which is slightly lower than the deficit target of 1.8 percent specified in the Budget Act. According to our forecast, tax revenues exceed the appropriation by 0.7 percent of GDP, which is primarily attributable to the surplus revenues related to consumption taxes and enterprises, while labour tax revenues may fall short of the appropriation. As regards the expenditures, we expect the actual amount to exceed the appropriation, which is attributable to the Family Protection Action Plan, the pension and healthcare expenditures, and the co-financing related to the EU expenditures.

The 2020 Budget Act adopted in July 2019 stipulated an ESA deficit of 1 percent of GDP, which – according to our forecast – may be achieved by the partial saving of the Country Protection Fund. In our projection, we calculate with lower economic growth than anticipated by the Budget Act, and accordingly also with more moderate tax revenues in the area of consumption taxes, labour taxes and payments by enterprises, by roughly 0.5 percent of GDP, in total. At the same time, the lower than planned revenues are partially offset by the fact that according to our forecast the co-financing related to the EU expenditures and the expenditures related to the prenatal baby support may be lower than those assumed by the Budget Act. Meanwhile, the amount of the Country Protection Fund will be 0.8 percent of GDP, i.e. higher than in the previous years, which may ensure the achievability of the deficit target even if the revenues fall short of the appropriation.

Chart 2
Static budgetary impact of the tax measures implemented between 2010 and 2019 (cumulative value)



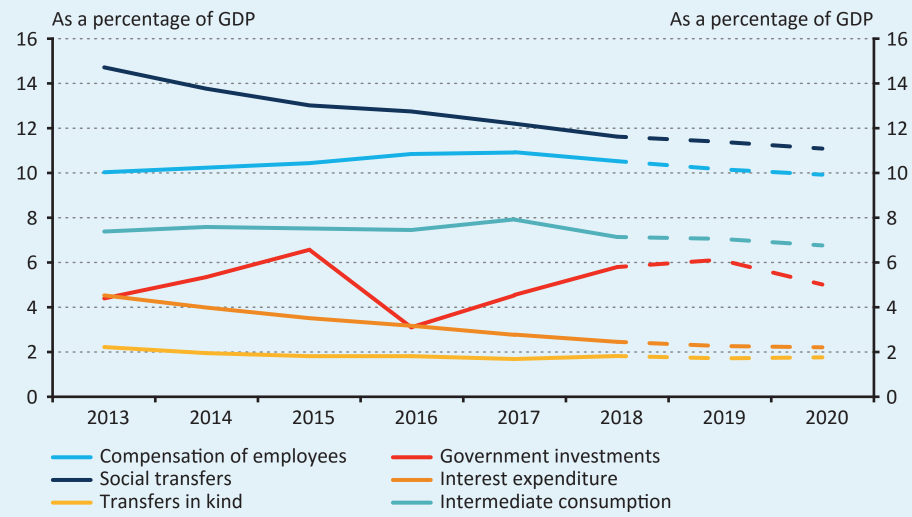
Note: The chart shows the static impacts of the tax measures on the budget. The second-round, dynamic effects of the measures (e.g. higher wage dynamics, shrinkage of the shadow economy) reduce the budgetary impacts of the tax cuts.

Source: MNB calculation.

As a result of the major tax cuts, affecting primarily the labour taxes, the tax centralisation fell from 39.2 percent, registered in 2016, to 37.5 percent by 2018, and according to our expectations the decrease will continue in 2019 and 2020 as well. According to the trilateral wage agreement concluded in 2016, the social contribution tax decreases further in all three years under review. Last year, the tax rate decreased by 2.5 percentage points and from the second half of 2019 it fell by further 2 percentage points, which may be followed by an additional cut of 2 percentage points in 2020, which – according to our calculations – reduces the employers' burdens by 0.3 – 0.4 percent of GDP per percentage point annually. However, the effect of the tax relief will be mitigated by the fact that in parallel with the cutting of the social contribution tax, the benefits under the Job Protection Action Plan were also lowered. The tax burden on incomes is also eased by the gradual reduction of the upper rate of the health contribution, as well as by the implemented narrowing of the tax base (cancellation of the health contribution on property letting). From 2019, the employees' and employers' contribution burdening the wage of pensioner employees substantially decreased, and from 2020 the full exemption from personal income tax will be introduced for women with at least four children, which will contribute to the further decrease in labour taxes. The personal income tax exemption of the interest income on government securities, introduced from June 2019 for households, also reduces tax centralisation.

In the area of sales taxes, the application of targeted measures continued. Pursuant to the Economy Protection Action Plan, announced in May 2019, which contains 13+1 measures, it will also be possible to apply for a VAT refund of up to HUF 5 million for residential properties in small settlements affected by the Home Purchase Subsidy for Families (CSOK), for construction, expansion and renovation. In the area of value added tax, the targeted reduction of tax rates in certain product groups has continued. Following the targeted VAT reductions in 2018, this year VAT on milk decreased from 18 to 5 percent; in addition, the extension of VAT exemption status to annual revenue of HUF 12 million from the previous HUF 8 million, also qualifies as a tax cutting measure. The present VAT rate of 18 percent, payable on commercial accommodation, will decrease to 5 percent in 2020; in parallel with this, the obligation to pay tourism development contribution will be extended to this sector as well. From 1 January 2020, again the normal, i.e. 27 percent, VAT rate will be applicable to the sales of new residential property. Exceptions are those residential properties, for which the final construction permit was already available on 1 November 2018. In this case the VAT rate of 5 percent can be applied until 2024. In addition, the excise duty on tobacco products will be increased in several steps.

Chart 3
Government sector expenditures as a percentage of GDP

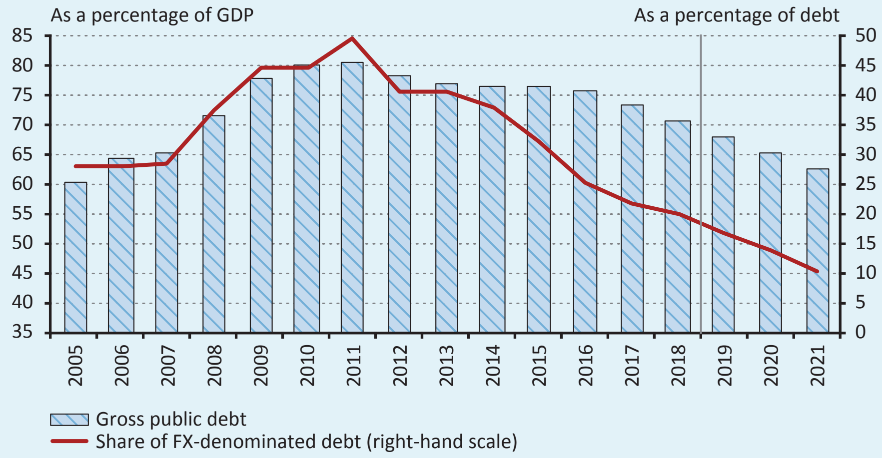


Source: HCSO, MNB.

According to our forecast, government expenditures, as a percentage of GDP, may decrease further. The measures of the Family Protection Action Plan, entering into force from the second half of 2019, point to an increase in expenditures; however, the total amount of financial transfers as a percentage of GDP may continue to decrease at a decelerating rate as a result of the expenditures fixed in nominal terms or adjusted for inflation. The amount of personnel expenditures as a percentage of GDP moderately decreases. Investments show material volatility, primarily in line with the absorption of EU transfers. The level of public investments is at a historically high level, and thus even upon a moderate decrease, expected in 2020, they may exceed 5 percent of the gross domestic product (Chart 3). The corporate and household sectors may contribute to an increasing degree to keeping the whole-economy fixed investments at a high level.

The Hungarian government debt is characterised by continued, gradually declining debt ratio and dynamically falling foreign currency ratio (Chart 4). By the end of 2018, gross government debt as a percentage of GDP declined to 70.8 percent from 73.4 percent, registered one year earlier (the highest year-end value was 80.5 percent in 2011). In the coming years, due to the low deficit and robust economic growth, the decrease in government debt as a percentage of GDP will continue, and by the end of 2019 it may decrease to 68.1 percent and at the end of 2020 to 65.4 percent. The introduction of the tax exemption of interest income on retail government securities and of the new retail government paper, ''MÁP Plus'' (Hungarian Government Paper Plus) in June 2019 – the sales of which attracted extraordinary demand in the first one and a half months – support the favourable restructuring of the debt. The introduction of this government paper also supports the financing of the expiring foreign currency debts from forint, i.e. the transfer of the larger part of the debt to Hungarian holders, due to which the foreign currency ratio of the central government's debt may first fall to 16.8 percent and then below 14 percent in 2019 and 2020, respectively, from the 20 percent registered at the end of 2018.

Chart 4
Gross public debt forecast – calculated with an unchanged (end-2018) exchange rate over the forecast horizon



Source: Government Debt Management Agency, MNB.

In 2018, the Hungarian fiscal developments were in line with the rules related to the ESA balance of the budget and the government debt, and they are expected to be in line with them in the future as well. The 3 percent deficit target used both in the Hungarian and the EU legislation is expected to be achieved in all three years. The annual contraction of government debt also complies with the Fundamental Law's debt rule, the debt formula's requirements, as well as with the Maastricht one-twentieth rule. At the same time, last year and this year the structural balance of the Hungarian budget does not yet satisfy the medium-term budgetary objective; however, the degree of the decrease in deficit, stipulated in the 2020 Budget Act, may comply with the EU criterion.

2 Balance of the government sector in 2018

According to the April 2019 EDP report, the government sector's ESA deficit of 2018 was 2.2 percent of GDP. The accrual-based deficit of the government sector was below 3 percent of GDP in each year since 2012, while from 2015 it was around 2 percent of GDP. The accrual-based deficit of 2018 was lower than the 2.4 percent deficit target, laid down in the Budget Act, and as a percentage of GDP it equals to the accrual-based deficit of 2017. In 2018, the primary surplus was 0.1 percent of gross domestic product, while gross interest expenditures amounted to 2.3 percent of GDP. Overall, in 2018 the trend of previous years continued: the 2.2 percent deficit as a percentage of GDP was realised under primary surplus and declining interest expenditures.

The 2.2 percent ESA deficit of the government sector is the combined result of the 2.1 percent and 0.1 percent accrual-based deficit of the central sub-sector and of the local government sub-sector, respectively. As in previous years, the difference between the cash-based balance and the ESA balance (generally referred to as ESA bridge), developed oppositely in the two sub-sectors in 2018 as well (Table 1). The central sub-sector accumulated high cash-based deficit, amounting to 3.4 percent of GDP, and thus it exceeded the ESA deficit of the sub-sector substantially. However, the accrual-based balance of the local government sub-sector became more unfavourable than the cash-based balance indicator by 0.7 percent of GDP. The statistical corrections of opposite direction can be partly attributed to a common reason, namely to the recognition of EU transfers of HUF 269 billion, related to EU programmes and advanced by the central budget to the local governments. Although the advance payment within the government sector increases the cash-based deficit of the central sub-sector (as an expenditure), the advance type transactions are not taken into account in the expenditures recognised under ESA. Later on those will be recognised when the original purpose of the advance payment (investment or other utilisation) is effectively realised. This approach is also true from the other side: although the revenues received as advance are transferred to the local government sector as cash, according to the ESA accounting these are not actual revenues, since in this case the transactions only qualify as financial operations, as no real economy performance is yet linked to the revenues thus received.

Table 1
Budget balance indicators in 2018

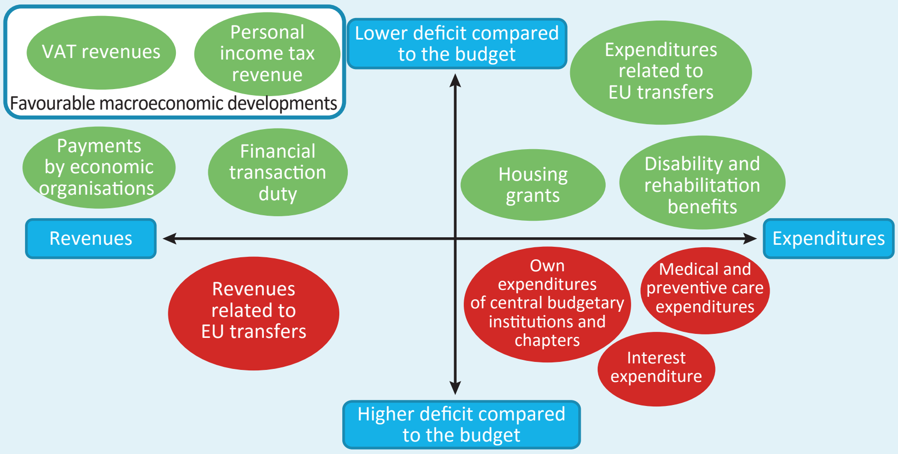
	Cash-based balance	ESA bridge	ESA balance
		HUF billion	
Central sub-sector	-1,445	553	-892
Local governments	254	-297	-42
Total general government	**-1,191**	**256**	**-934**
		As a percentage of GDP	
Central sub-sector	-3.4	1.3	-2.1
Local governments	0.6	-0.7	-0.1
Total general government	**-2.8**	**0.6**	**-2.2**

Source: April 2019 EDP Report, HCSO.

Based on the data in the April 2019 EDP report, the 2018 **cash-based deficit of the general government** (the central and local government sub-sector) amounted to HUF 1,191 billion, which was slightly higher than the cash-based deficit target of HUF 1,158 billion, specified in the Budget Act.

According to the April 2019 EDP report, the cash-based deficit of the central sub-sector was HUF 1,445 billion in 2018. The annual cash-based deficit exceeded the HUF 1,361 billion deficit target specified in the Budget Act by HUF 84 billion, but it was substantially lower than the cash-based deficit of 2017. The higher than planned cash-based deficit is partly attributable to the high EU advances paid to the local governments (which caused no higher deficit at the level of the consolidated general government), and partly to the lower than planned realisation of the EU revenues on a cash basis. The fiscal impact of the tax and contribution cuts implemented in 2018 was more than offset by the favourable macroeconomic developments. The tax and contribution revenues of the central sub-sector substantially exceeded the statutory appropriation; the largest surplus revenue was realised in the consumption-related revenues; in addition, the payments by enterprises and households also exceeded the anticipated amount (Chart 5). In December, the intra-year cash-based deficit declined substantially, by HUF 400 billion, which was mostly attributable to the fact that in the last month of the year EU subsidies were received in the budget in an outstandingly high amount. On the other hand, part of the realised surplus tax revenues were used for financing surplus expenditures, which entailed the reallocation of HUF 184 billion in total, based on the 2019 Convergence Programme.

Chart 5
Decomposition of the major differences between the cash-based balance of the central sub-sector defined in the 2018 Budget Act and the 2018 actual figures



Source: MNB compilation, based on the statutory appropriations included in the 2018 Budget Act and the detailed revenue and expenditure tables containing the data of the Hungarian State Treasury.

2.1 REALISATION OF THE MACROECONOMIC PROJECTIONS UNDERLYING THE BUDGET

Last year, the real growth of the Hungarian economy was 4.9 percent, which exceeded the growth forecast assumed while planning the 2018 Budget Act by 0.6 percentage point. Domestic absorption developed more favourable than the government's forecast. Of the components of absorption, the gross fixed capital formation rose to a higher degree than the dynamics assumed upon compiling the Budget Act, the consumption expenditure of households corresponded to the government's projection, while public consumption fell short of the forecast.

Last year, the growth rate of gross average earnings exceeded 11 percent, which was also due to the wage agreement, and particularly to the increase of the minimum wage and guarantee wage minimum in addition to the tight labour market. Total **employment** rose by 1.1 percent. The greater-than-expected wage outflows increased the budget's revenues through the broadening tax bases, thereby mitigating the revenue shortfall attributable to the cutting of the social contribution tax rate.

The government assumed a 5.4 percent rise in **households' purchased consumption** for 2018, of which the growth in expenditure fell short by 0.1 percentage point. High wage outflow supported the rise in the households' consumption expenditure.

Table 2
Comparison of the macroeconomic projection in the 2018 Budget Act and the actual figures
(percent)

	Government's forecast	Actual
GDP	**4.3**	**4.9**
Exports	6.5	4.7
Imports	8.2	7.1
Gross fixed capital formation	12.9	16.5
Consumption expenditure of households	5.4	5.3
Public consumption	0.9	0.0
Consumer price index	**3.0**	**2.8**
Average gross earnings	**8.8**	**11.3**

Source: HCSO, Budget Act of 2018.

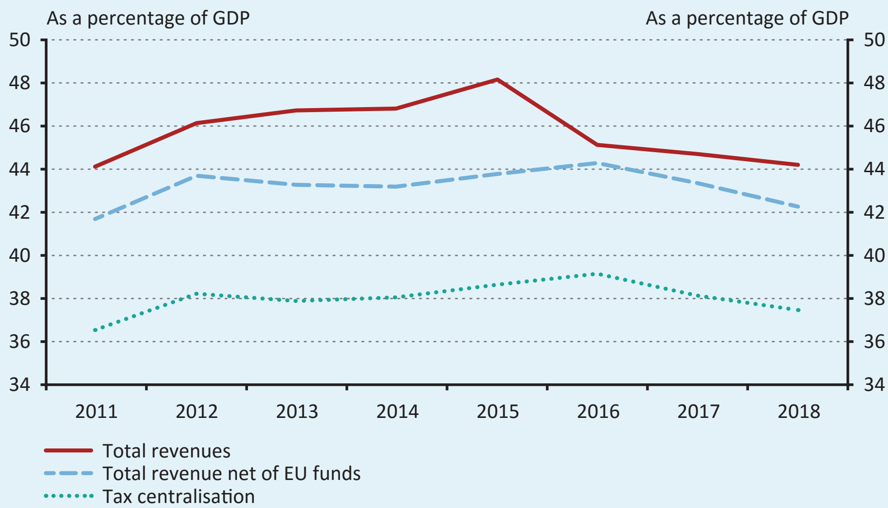
Last year, the **consumer price index** rose by 2.8 percent instead of 3.0 percent expected in the government's forecast, and within that core inflation excluding indirect tax effects rose by 2.4 percent. Developments in inflation during 2018 were mainly determined by the prices of fuel and unprocessed food. In the second half of last year, volatile items, susceptible to global commodity price movements resulted in a higher than usual volatility of domestic inflation. In the first half of last year, underlying inflation indicators capturing the more lasting trends (core inflation excluding indirect taxes, inflation of demand sensitive and sticky price products) were around 2 percent, and then gradually rose.

The **gross fixed capital formation** of the national economy rose by 16.5 percent instead of 12.9 percent, expected in the government's forecast, with positive contribution by all three sectors' (corporate, public, household) investment activity. Dynamic growth was materially supported by the major investments of manufacturing, primarily of the vehicle industry, representing a major weight, as well as by the dynamic growth of the corporate credit market. The developments of state and the industry closely related to the public sector, implemented from EU and own funds, also increased, while in line with the upturn of the housing market, household investments also rose, which was supported by the home purchase subsidy programmes as well.

2.2 BUDGET REVENUES

The accrual-based revenues of the government sector amounted to 44.2 percent of GDP in 2018, representing a decline of 0.5 percentage point compared to 2017. The decrease was caused mainly by the 0.7 percentage point decline in tax centralisation, while the EU transfers to the general government rose in 2018, similarly to 2017.

Chart 6
Accrual-based revenues of the government sector and degree of tax centralisation



Source: HCSO, MNB.

As a result of the tax cuts, in 2018 the tax centralisation rate fell from 38.2 percent registered in 2017 to 37.5 percent (Chart 6). The decline in the tax centralisation in 2018 was the combined result of several tax cuts, which primarily affected labour taxes, and also reduced some of the smaller consumption and capital taxes. In 2018, the degree of the family tax allowance for families with two children rose from HUF 15,000/month for each child to HUF 17,500, while based on the six-year wage agreement, the reduction of the social contribution tax rate continued, which declined from 22 percent of 2017 to 19.5 percent as of January 2018. The upper rate of the healthcare contribution also decreased to 19.5 percent, and the healthcare contribution payable in respect of revenues from real estate leasing was cancelled. In the area of value added tax, the targeted reduction of tax rates in certain product groups has continued. From January 2018, the VAT payable on catering in restaurant and internet usage was reduced from 18 percent to 5 percent, while the VAT rate applicable to fish and pork offal dropped from 27 percent to 5 percent. The rate of small business tax decreased from 14 to 13 percent at the beginning of 2018. On the other hand, the excise duty on tobacco products rose in September 2018. The gradual reduction of the shadow economy may have also contributed to the rise in tax revenues as a percentage of GDP, primarily through the VAT revenues.

The cash revenues of the central sub-sector fell short of the appropriations by HUF 206 billion (Table 3)**.** The budget realised substantially lower revenues than the appropriation under the revenue estimate related to EU transfers, which was primarily caused by the slower than expected rise in the invoiced payments and absorption of advances related to the new programming period. At the same time, the tax contribution revenues of the central sub-sector significantly exceeded the statutory appropriation. Compared to the appropriation, the largest surplus revenue (HUF 146 billion) appeared at the revenues linked to consumption, but payments by enterprises and households also exceeded the estimate. In addition to certain measures, the better than assumed macroeconomic path had favourable impact on the budget's tax and contribution revenues. As regards the VAT revenues, gross payments rose by roughly 13 percent in 2018 compared to the base year, which was also attributable to the introduction of mandatory online invoicing in July 2018. In line with dynamic growth in the gross salary and wage bill, wage-related revenues rose by more than 12 percent in 2018.

Payments by enterprises exceeded the appropriation included in the Budget Act by HUF 75 billion. Of this, **corporate income tax payments** may have exceeded the estimate by HUF 11 billion, essentially due to the better-than-expected economic performance. **Small business tax (KIVA) revenues** and small **taxpayers' itemised lump sum tax (KATA)** revenues exceeded the estimate in the Budget Act by HUF 14 billion and HUF 12 billion, respectively. In both cases, the number of new taxpayers opting for these tax types became substantially higher than assumed by the estimate. This process also affected the **simplified entrepreneurial tax (EVA)**, where payments fell short of the appropriation by HUF 15 billion. Part of the taxpayers that used to pay tax in accordance with the EVA rules, changed over to taxation under the rules of KATA or KIVA in 2018. The process was further strengthened by the fact that as of 20 December 2018, corporate taxpayers were no longer permitted to opt for EVA.

Mining royalty revenues exceeded the statutory appropriation by HUF 7 billion, since the increase in fuel prices exceeded the macroeconomic assumption of the Act, which led to higher tax payment. Surplus revenue, compared to the estimate, was realised at the **income tax of fuels** (HUF 8 billion) and **e-road toll** (HUF 6 billion) as well. In the **other taxes and payments** line, the budget closed with a surplus of HUF 28 billion compared to the appropriations of the 2018 Budget Act. Of the smaller revenue items, **revenues from penalties** stand out, which generated surplus revenue of HUF 20 billion.

Compared to 2017, payments by enterprises decreased by HUF 142 billion in total. At the corporate income tax the decrease of HUF 245 billion was caused by the tax credit for growth, since the payment of large amount of tax credit, assessed in respect of the 2015 corporate tax liability, was completed at the end of 2017. Revenues from the special tax of financial institutions decreased by HUF 9 billion, and payments by credit institutions also declined compared to the previous year. Revenues from the simplified entrepreneurial tax (EVA) became lower by HUF 10 billion compared to the previous year, due to the fall in the number of taxpayers.

In 2018, revenues rose at several items within the payments by economic organisations compared to the base year. Revenues from the small taxpayers' itemised lump sum tax were higher by HUF 27 billion than in the previous year, while revenues from small business tax exceeded those registered in the previous year by HUF 19 billion. There was a major increase in the number of taxpayers during 2018 at both tax types. **Advertising tax revenues** rose by HUF 12 billion compared to 2017; the rise in revenues was attributable to the reimbursement of the advertising tax paid between 2014 and May 2017, most of which was executed by the tax authority in the second half of 2017. Payments from mining royalties rose by HUF 15 billion in 2018, caused by the major increase in fuel prices. Revenues from rehabilitation contribution rose in 2018 to HUF 92 billion from HUF 81 billion paid in 2017. The payments under this tax type are tied to the level of the prevailing minimum wage, and thus the increment is due to the 8 percent increase of the minimum wage, implemented in January 2018 as a result of the trilateral wage agreement concluded at the end of 2016.

Table 3
Partially consolidated revenues of the central sub-sector in 2017 and 2018
(HUF billion)

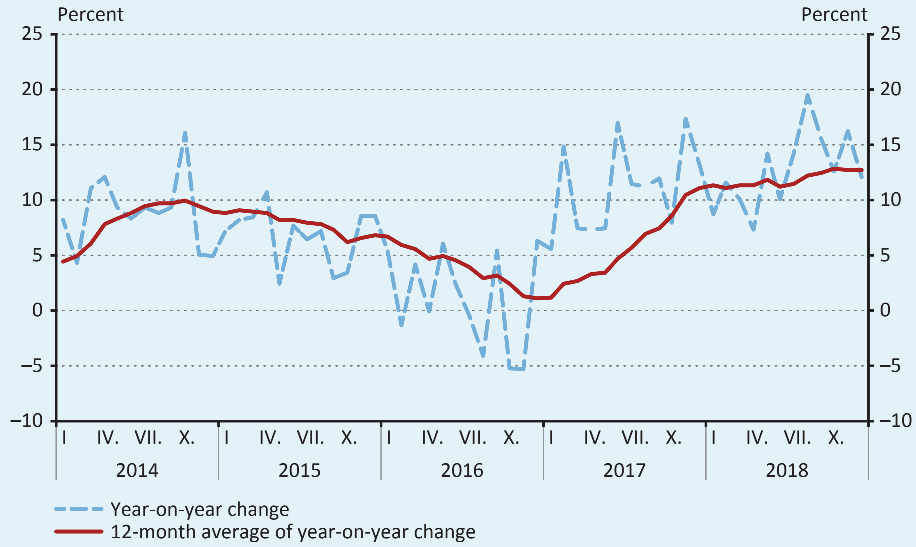
	2017	2018		
	Actual	Statutory appropriation (original)	Actual (preliminary)	Difference (actual – appropriation)
TAX AND CONTRIBUTION REVENUES OF THE CENTRAL SUB-SECTOR	**13,706**	**14,287**	**14,628**	**341**
Payments by economic organisations	**1,572**	**1,354**	**1,430**	**75**
Corporate income tax	625	370	380	11
Special tax of financial institutions	64	50	53	3
Sector-specific surtax	1	0	1	1
Simplified entrepreneurial tax	64	70	54	-15
Mining royalty	29	37	44	7
Gambling tax	27	26	29	3
Income tax on energy providers	53	52	60	8
Lump sum tax of small entrepreneurs	98	113	125	12
Small enterprise tax	22	27	42	14
E-road toll	174	178	184	6
Utility tax	55	55	54	-1
Other taxes and payments	360	363	391	28
Advertising tax	0	14	12	-2
Consumption taxes	**4,879**	**5,266**	**5,412**	**146**
Value added tax	3,525	3,839	3,929	90
Excise duties	1,022	1,099	1,112	13
Registration tax	25	24	25	1
Telecommunication tax	54	52	54	2
Financial transaction levy	217	205	233	29
Insurance tax	36	35	40	5
Tourism development contribution	0	11	19	8
Payments by households	**2,147**	**2,338**	**2,425**	**88**
Personal income tax	1,920	2,096	2,177	81
Duties, other taxes	182	198	200	2
Motor vehicle tax	46	44	48	4
Tax and contribution revenues of extra-budgetary funds	**529**	**356**	**373**	**17**
Tax and contribution revenues of social security funds	**4,579**	**4,973**	**4,988**	**15**
Social contribution tax and contributions	4,257	4,645	4,649	4
Other contributions and taxes	322	329	339	11
REVENUES RELATED TO EU FUNDS	**1,237**	**1,990**	**1,331**	**-659**
OTHER REVENUES	**490**	**277**	**389**	**112**
Revenues related to state property	**266**	**96**	**185**	**88**
Other revenues of the central budget	**77**	**43**	**58**	**15**
Other revenues of social security funds	**43**	**38**	**36**	**-2**
Other revenues of extra-budgetary funds	**104**	**100**	**110**	**10**
INTEREST REVENUES	**104**	**74**	**120**	**47**
TOTAL REVENUES	**15 433**	**16 554**	**16 347**	**-206**

Note: 1) The 2018 cash-based balance, included in the detailed revenue and expenditure tables containing the data of the Hungarian State Treasury before the 2018 final accounts, slightly differs from the value stated in the summary table compiled on the basis of the April 2019 EDP report.
Source: Budget Act of 2018, Hungarian State Treasury

Revenues from consumption taxes, on an accrual basis, exceeded the estimate in the 2018 Budget Act by HUF 146 billion.

Net revenues from **value added tax** amounted to HUF 3,929 billion in 2018, which exceeds the statutory appropriation by HUF 90 billion. Compared to the value added tax revenues realised in 2017, the growth rate of the cash-based revenues was 11.4 percent, which exceeds the growth rate observed in previous years. The intra-year execution of the reimbursements was materially changed by the fact that from January 2018, the deadline for reimbursement was reduced from 45 days to 30 days for reliable taxpayers. Therefore gross payments provide a more accurate picture of the revenue processes and the expected accrual-based revenues than net revenues; the former increased substantially, i.e. by 12.8 percent, compared to the previous year. It may be assumed that the rise in revenues is partly linked to the introduction of mandatory online invoicing in July 2018, since the year-on-year growth of gross payments rose to 15 percent during the second half of the year from 10 percent observed in the first half of 2018 (Chart 7).

Chart 7
Change in gross VAT revenues year-on-year
(percent)



Source: Hungarian State Treasury, MNB calculation.

On the whole, the **excise duty received** by the budget exceeded the statutory appropriation by HUF 13 billion. The growth rate of the excise duty revenues was 8.8 percent compared to 2017, which was substantially attributable to the 21 percent growth in revenues from excise duty on tobacco. This is mostly attributable to the base effect, because since April 2017 tobacco products may be released for free circulation only with an excise stamp containing no price instead of the former tax stamp that contained the price of the product, which encouraged merchants to reduce their stocks in 2017. On the other hand, the intra-year raising of excise duty on tobacco also contributed to the growth.

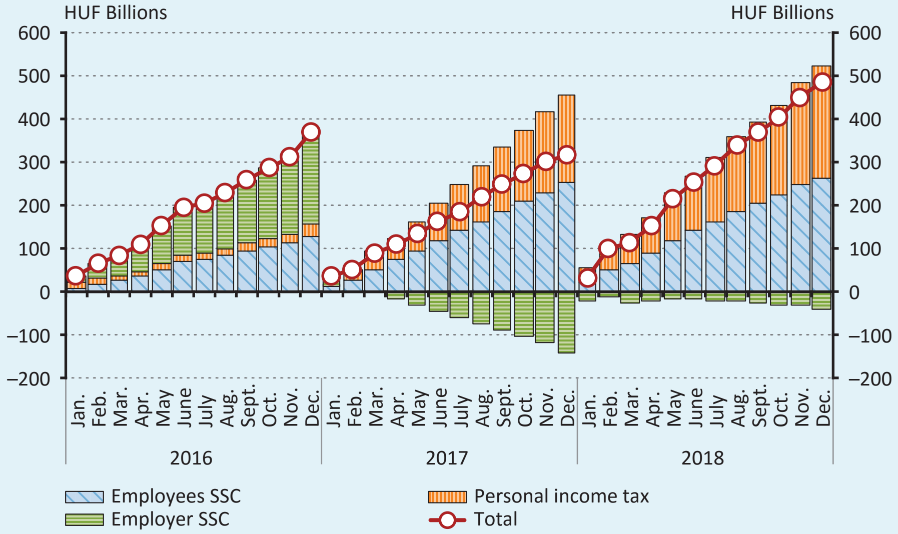
Revenues from financial transaction levy exceeded the statutory appropriation by HUF 29 billion, i.e. by roughly 14 percent. The revenues from this tax type exceeded the estimated value by HUF 11 billion already in 2017, due to the prudent planning of the appropriation. The growth rate of the revenues was over 7 percent, therefore the revenue from this tax type was close to 0.6 percent of GDP.

In 2018, **tax and duty payments by households** to the central budget amounted to HUF 2,425 billion in total, and thus they exceeded the statutory appropriation by HUF 88 billion, i.e. by roughly 4 percent. The payments by households rose substantially, i.e. by 13 percent, compared to the revenue recognised in 2017, which was caused in the personal income tax revenues by the dynamic national economy wage growth and in the duty revenues by the buoyant real property market turnover.

Last year, the budget received by HUF 2,177 billion higher amount from **personal income tax**, which exceeded the statutory appropriation by roughly HUF 80 billion. In 2018, revenues rose by more than 13 percent compared to the payments received in 2017, which may be attributable to the major growth in whole-economy gross salary and wage bill. In 2018, gross average earnings in Hungary was up by 11.3 percent, while the number of employees rose by 1.1 percent compared to 2017. In 2018, personal income tax developments were influenced by several measures, which had minor fiscal impact, but eased tax administration; in addition, in the manner previously prescribed by the law, the family tax allowance for families with two children rose further, from the former HUF 15,000/month per child to HUF 17,500.

The appropriation of **revenues from duties** for 2018 amounted to HUF 187 billion, which were slightly exceeded by the annual actual data, owing to the recovering housing market trends.

Chart 8
Year-on-year changes in labour tax revenues
(year-to-date cumulative data)

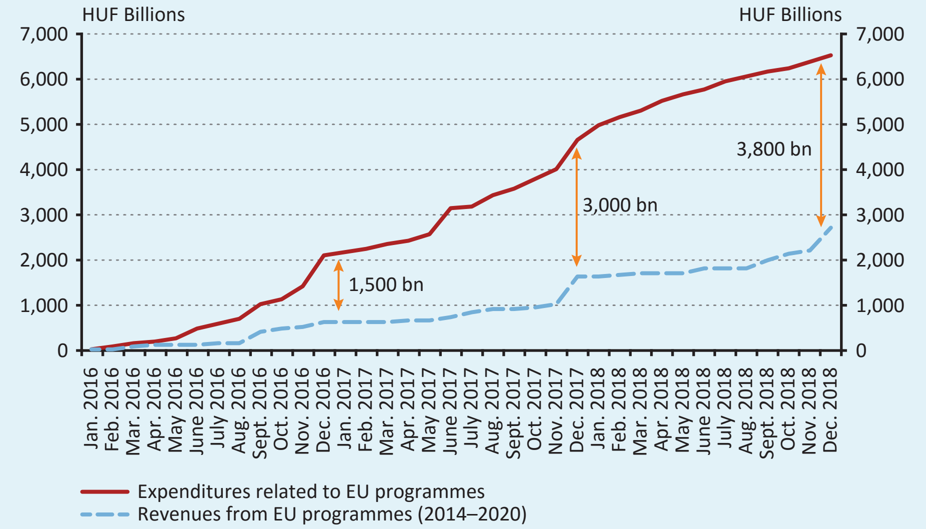


Source: Hungarian State Treasury.

The **contribution revenues of the extrabudgetary and social security funds** represented a total amount of HUF 5,361 billion for the general government in 2018, which exceeded the appropriation in the Budget Act by HUF 32 billion. The **employees' and employers' tax and contribution revenues** were essentially in line with the statutory appropriation; the difference related to the higher than expected realisation of certain smaller tax types. The payments stemming from the vocational training contribution, accident tax and public health product tax exceeded the appropriation in the Budget Act, while the revenues from health contribution slightly fell short of it. In 2018, following the 5 percent decrease registered in the previous year, the social contribution tax rate, and in parallel with this the upper rate of the health contribution, was once again reduced by 2.5 percent to 19.5 percent. The reduction of the tax rate would represent a tax relief of 11 percent in nominal terms; however, the social contribution tax revenues decreased to a smaller degree, merely by 1.9 percent, since the rise in gross wages and employment mostly offset the impact of the tax cut. In 2018, the **revenues from employees' contribution** rose by 12.4 percent year on year, in line with the dynamic growth in the whole-economy gross salary and wage bill. Last year, in relation to wages and other earnings, the budget realised a HUF 490 billion higher revenue in total than one year earlier (Chart 8).

In 2018, **revenues related to EU funds** amounted to HUF 1,331 billion in total, i.e. they fell short of the appropriation by more than HUF 600 billion. The reason for the major difference is the slower than expected pick-up of invoiced payments and absorption of advances belonging to the new programming period. Within the revenues, merely HUF 1,054 billion was linked to the 2014-2020 support budget, which fell short of the target specified in the Act by HUF 850 billion. This was somewhat offset by the fact that on the subsequent reimbursement lines the 2018 actual data became higher by roughly HUF 200 billion, since the larger part of the last 5 percent of funds belonging to the previous seven-year programming period, retained until the final settlement, was transferred in December. As a result of this, the absorption ratio related to the period of 2007-2013 rose from 94 percent above 98 percent. The receipt of the revenues related to the current programming period was facilitated by the fact that the European Commission – similarly to 2017 – settled the Hungarian invoices submitted by mid-December 2018 during the reporting year. With this, the minimum drawdown plan related to EUR 3.11 billion (roughly HUF 1,000 billion) specified in Government Resolution 1367/2018 (VIII. 13) was fulfilled. According to our expectations, the difference between the expenditures and revenues related to the period of 2014-2020, rising to HUF 3,800 billion at the end of 2018, may decrease in the coming years, in line with the receipt of the revenues and the decline in advance payments (Chart 9).

Chart 9
Expenditures and revenues related to the EU budget funds of 2014-2020
(cumulative)



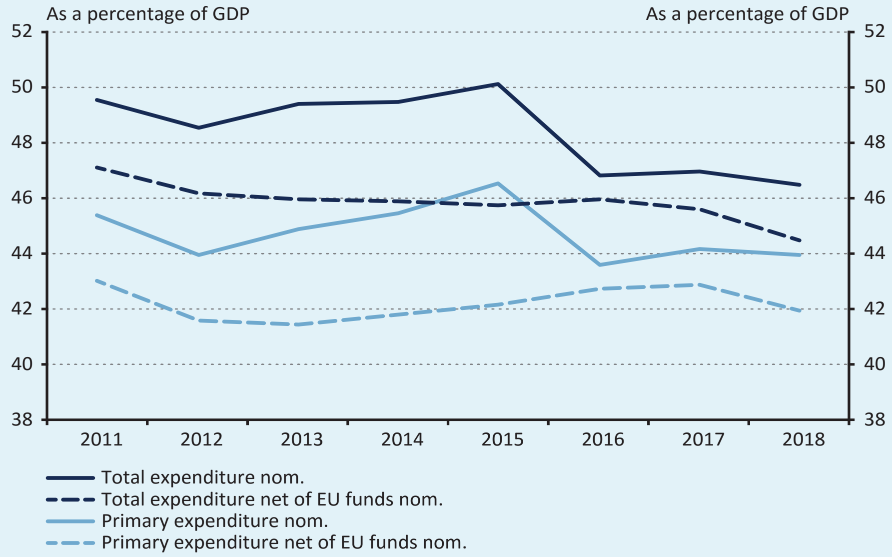
Source: Ministry for Innovation and Technology, Hungarian State Treasury, MNB calculation.

The **budget revenues related to state property management** exceeded the statutory appropriations by HUF 88 billion in total. One of the determinant factors of the large difference is linked to sales of emission units (primarily carbon dioxide quota), on which the budget realised by almost HUF 50 billion higher cash revenue than the statutory appropriation. In addition, the dividend and property sales revenues of the National Asset Management Inc. exceeded the statutory appropriation by almost HUF 24 billion. The revenues related to the National Land Fund also exceeded the appropriation by more than HUF 9 billion; HUF 8 billion of the surplus revenue came from the sales of real properties in excess of the plan.

2.3 EXPENDITURE

In 2018, the government sector's expenditures under ESA, as a percentage of GDP, declined by 0.5 percentage point compared to the previous year, in parallel with the decline in tax centralisation. When the EU funds are filtered out from the expenditures, the government spending declined to an even higher degree, i.e. by 1.2 percent of GDP in 2018, compared to the base year (Chart 10). In nominal terms, expenditures of the government sector rose in 2018 by 8.6 percent compared to 2017; however, the nominal GDP grew at a higher rate, i.e. 9.7 percent, last year. In addition to the government measures, the dynamic economic growth also contributed to the decline in the expenditures as a percentage of GDP compared to the previous year.

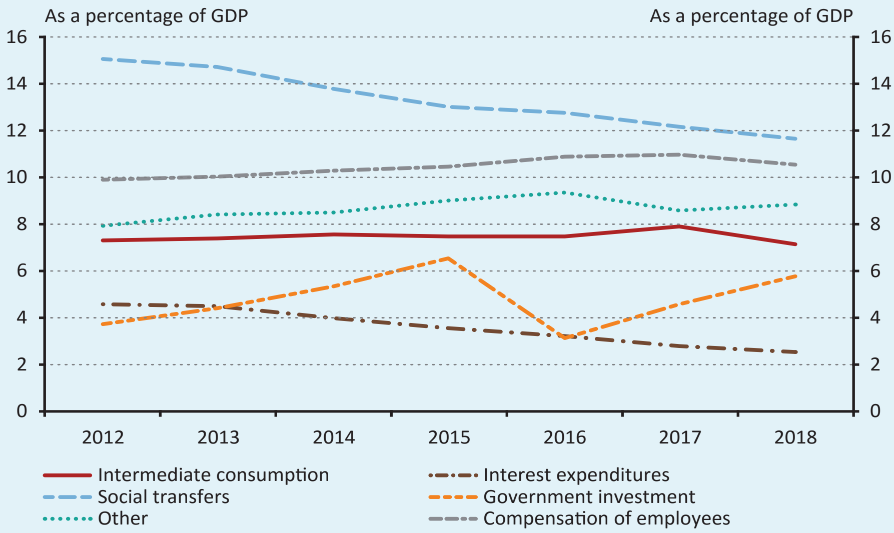
Chart 10
Expenditures and primary expenditures of the government sector
(as a percentage of GDP)



Source: HCSO.

In 2018 the decrease of 0.5 percentage point, as a percentage of GDP, in the budget's accrual-based expenditures took place along a favourable structural change in terms of sustainability (Chart 11)**.** Current primary expenditures declined by 1.3 percentage points of GDP, while capital expenditures rose by 1.1 percentage point of GDP. Thus the expenditure structure of the budget changed in line with the objective formulated in the Convergence Programme (increasing the share of capital expenditures).

Chart 11
Structure of general government expenditures (as a percentage of GDP), 2012-2018



Note: The figures do not include the imputed interest expenditures from 2012 related to the reform of the pension system.
Source: HCSO.

The decline in the general government wage expenditures as a percentage of GDP was primarily caused by the decrease in the social contribution tax, and secondarily the expenditures of the gross wage outflow as a percentage of GDP declined by 0.15 percentage point due to the decrease in the number of public employees. In line with the decline in the costs of finance, gross interest expenditures dropped by 0.25 percentage point of GDP. The key driver of the 1.1 percentage point growth in capital expenditure as percentage of GDP was the rise in the government sector's direct investment spending, which exceeded 1.2 percent of GDP. The dynamic growth was caused by the accelerating absorption of EU funds, the rise in transport and public road development expenditures, and the increase in expenses of military technology procurements, and thus the sector's investment ratio as a percentage of GDP in 2018 was close to 6 percent of GDP, being a high level in historic terms as well.

The cash-based expenditures of the central sub-sector fell short of the appropriation included in the Budget Act by HUF 108 billion (Table 4). The budgetary expenditures fell short of the appropriation primarily due to the lower than planned realisation of the expenditures related to EU funds. By contrast, expenditures exceeded the appropriation in several lines. A substantial part of the surplus expenditures related to the expenses of the budgetary organisations, which is partly attributable to the absorption of the central reserves realised in this line, and on the other hand measures that increased expenditure were also taken mid-year, which was facilitated by the tax revenue exceeding the plan. In addition, the medical and preventive care expenditures exceeded the statutory appropriation by more than HUF 100 billion, partly due to the mid-year debt consolidation of the health institutions, and partly due to the early increase of the wage of the healthcare and social workers.

Special and normative subsidies and support to the public media exceeded the appropriation to a small degree, i.e. by HUF 9 billion in total. The higher expenditure level appeared at the normative subsidies and related to the subsequent settlement of the public transport services of 2017. Compared to the base period, expenditures were up by HUF 55 billion, since the costs related to the maintenance of the railway network and the reimbursements of the passenger services (railway, intercity coach, suburban transport) significantly increased. The amount of the subsidies granted to the public media corresponded to the statutory appropriation in 2018.

The expenditures on **housing grants** fell short of the statutory appropriation by HUF 43 billion, and thus in 2018 only 82 percent of the planned amount was paid. Primarily the expenditures related to the Home Purchase Subsidy for Families fell short of the statutory appropriation, which, however, exceeded the 2017 subsidies by HUF 5 billion. The total amount of housing grant paid in 2018 exceeded the amount recorded in the previous year by HUF 9 billion.

At the family support expenditures, social benefit and early retirement benefits, disbursed from the **National Family and Social Policy Fund,** a saving of roughly HUF 10 billion was realised compared to the base year. Half of the decrease related to the family support payments (family allowance, childcare benefit, etc.). The expenditure of HUF 641 billion, disbursed from the Fund in 2018 (Family allowances, social benefits and early retirement benefits line of Table 4) only slightly departed from the statutory appropriation; within that, the early retirement benefits and various reimbursements exceeded the appropriation, while family allowances and income substitute grants fell short of the appropriation.

The net expenditures – calculated without the EU revenues and payments – of the budgetary institutions together with the central budgetary payments amounted to HUF 5,882 billion in 2018. In 2018, net expenditures of the budgetary organisation rose by HUF 1,061 billion, i.e. by 22 percent, compared to the 2017 base year.

Gross expenditures of the budgetary institutions and chapter-administered appropriations exceeded those of the base period by HUF 814 billion and the statutory appropriation by HUF 1,832 billion. When considering that the institutional and chapter-administered revenues exceeded the statutory appropriations by HUF 1,273 billion, the calculated net surplus expenditure amounts to HUF 559 billion. Since the realisation of the appropriations already contains the absorption of the budget reserves, considering the absorption of the central reserves of almost HUF 260 billion, the original appropriation was exceeded by a surplus spending of roughly HUF 300 billion. The cover for the overspend of HUF 300 billion was the surplus tax revenue, which materially exceeded the plan; the government used the realised surplus revenues primarily for the expenses of the budgetary organisations within the scope of mid-year expenditure raising measures.

The growth in the expenditures of budgetary institutions was dominated by the 9.3 percent rise in gross wage expenses compared to the base of the previous year, the almost 57 percent growth rate of investment spending and the 11 percent increment in the payments for material expenditures. At the same time, according to the available preliminary data, the transfer expenditures of budgetary institutions (subsidies to households and non-governmental enterprises, etc.), slowed down or remained constant in nominal terms compared to the base period.

Table 4
Partially consolidated cash expenditures of the central sub-sector in 2017 and 2018
(HUF billions)

	2017	2018		
	Actual	Statutory appropriation	Actual (preliminary)	Difference (actual – appropriation)
PRIMARY EXPENDITURE ITEMS	**16,280**	**17,010**	**16,878**	**-132**
Special and normative subsidies and support to the public media	**396**	**444**	**453**	**9**
Social policy fare subsidy	**95**	**98**	**90**	**-7**
Housing grants	**185**	**236**	**193**	**-43**
Family allowances, social benefits	**557**	**555**	**548**	**-6**
Early retirement benefits	**95**	**90**	**93**	**3**
Net own expenditures of central budgetary institutions and chapters	**4,820**	**5,292**	**5,882**	**589**
Expenditures related to EU transfers	**2,571**	**2,418**	**1,886**	**-531**
Support to local governments	**700**	**705**	**747**	**41**
Contribution to the EU budget	**260**	**310**	**316**	**7**
Central reserves	**0**	**261**	**0**	**-261**
Expenditures related to state property	**451**	**322**	**283**	**-39**
Other expenditures	**143**	**118**	**118**	**0**
Expenditures of extrabudgetary funds	**630**	**553**	**555**	**1**
NEF – Passive allowances	60	55	68	13
NEF – Active allowances	266	225	173	-52
Other expenditures	305	273	313	40
Expenditures of social security funds	**5,376**	**5,608**	**5,712**	**104**
PIF - Pensions	3,171	3,343	3,346	3
HIF - Disability and rehabilitation benefits	299	309	282	-27
HIF - Cash benefits	316	352	363	11
HIF - Medical and preventive care	1,196	1,204	1,306	102
HIF - Net expenditures of the drug budget	260	265	270	5
Other expenditures	133	134	144	10
NET INTEREST EXPENDITURES	**987**	**905**	**929**	**24**
TOTAL EXPENDITURES	**17,267**	**17,914**	**17,806**	**-108**

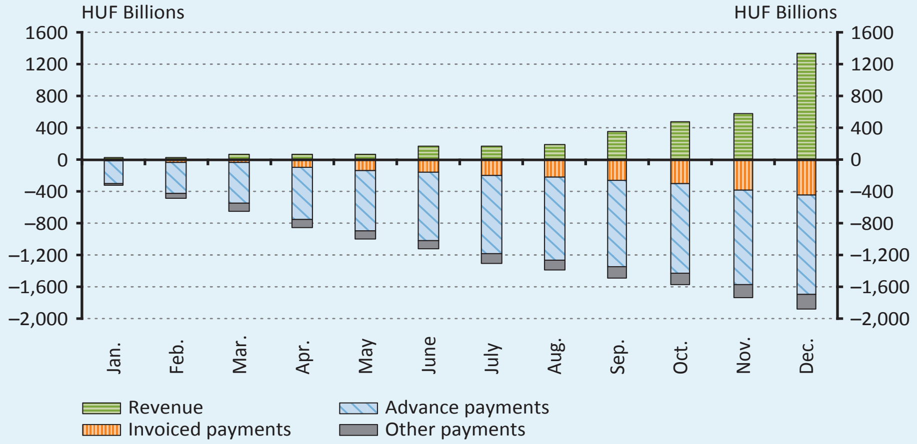
Note: 1) In the absence of knowing the 2018 final accounts, the 2018 cash-based balance, included in the detailed revenue and expenditure tables containing the data of the Hungarian State Treasury, slightly differs from the value stated in the summary table compiled on the basis of the April 2019 EDP report.

Source: Budget Act of 2018, Hungarian State Treasury.

In 2018, **the EU expenditures of the chapter-administered appropriation** amounted to HUF 1,886 billion (Chart 12), which fell short of the statutory appropriation by more than HUF 500 billion. Two-thirds of the payments, i.e. about HUF 1,250 billion, were advance payments (Chart 13). The estimated value of the absorption of formerly paid advances is HUF 870 billion, which is almost three times higher than the 2017 value. As a result of the substantial and fast advance payments, lasting since 2016, according to our estimate the outstanding, yet unabsorbed advances at the beneficiaries amounted to almost HUF 3,200 billion at the end of 2018.

The value of the tenders invited under Széchenyi 2020, belonging to the 2014-2020 EU programming period amounted to HUF 9,893 billion at the end of December, which equals to 108 percent of the reference framework budget, raised in March 2019 from HUF 8,923 billion to HUF 9,185 billion. The balance of awarded tenders closed over HUF 9,560 billion (104 percent of the framework budget), and those also contracted amounted to HUF 9,124 billion at the end of the year, reaching 99 percent of the framework budget (compared to the previous framework budget of HUF 8,923 billion, this ratio is 102 percent). The payments related to the Széchenyi 2020 programmes rose to HUF 5,760 billion at the end of the reporting year. According to our estimate, about 40 percent of the funds disbursed in 2018 qualify as direct economy supporting subsidy.

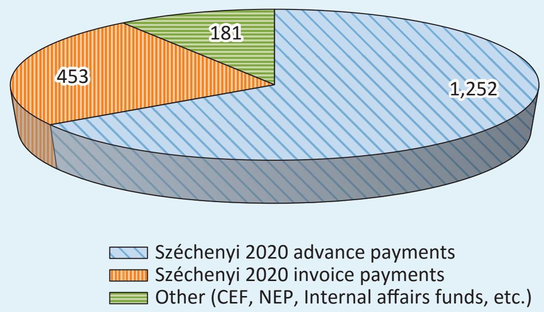
Chart 12
Cumulative revenues and expenditures related to EU programmes in 2018



Note: ''Other payments'' denote the payments not directly linked to the Széchenyi 2020 programmes.
Source: Hungarian State Treasury, Ministry for Innovation and Technology, MNB calculation.

At the appropriation for **subsidies to local governments** expenditures exceeded the original budgetary appropriation by 6 percent, exceeding the 2017 actual data by 6.6 percent. The surplus expenditure relative to the appropriation was caused by the usual absorption of part of the provisions (e.g. subsidy for wage compensation) and by the reallocations from other reserve funds.

Chart 13
Structure of EU disbursements in 2018
(HUF billions)



Source: Ministry of Finance, MNB calculation.

Expenditures related to state property fell short of the approved appropriation by HUF 39 billion. Expenditures in the first 11 months of the year were low, then, as a result of the year-end – partially additional – government measures, expenditures of almost HUF 100 billion were realised in December. Compared to the base period, expenditures fell by 37 percent, which was primarily attributable to the extremely high base.

Net cash-based interest expenses exceeded the budgetary appropriation by HUF 24 billion. This is due to the fact that gross interest expenditures and revenues exceeded those anticipated by the Act by HUF 71 billion and HUF 47 billion, respectively. The fact that revenues and expenditure exceed the appropriations each year is the result of debt management transactions during the year. Within the funding operations the higher than expected interest expenditures are attributable to the redemptions, since in the favourable liquidity situation, with a view to supporting the reduction of the government debt, the Debt Management Agency raised the volume of redemptions during the year. In 2018, the net cash-based interest expenditure decreased in nominal terms compared to the previous year. All this means that the degree of expenditures as percentage of GDP substantially decreased.

Expenditures of extrabudgetary funds exceeded the appropriation by HUF 1 billion, while they decreased by HUF 76 billion compared to the base year. Major difference compared to the budgeted value occurred at the National Employment Fund and the Bethlen Gábor Fund, while at the other funds the departure from the statutory appropriation (and the previous year) amounted to merely a couple of billion forints.

The **expenditures of the National Employment Fund** fell short of the planned amount by HUF 46 billion. *Expenditures related to the Start Labour programme* were realised in the amount of HUF 173 billion compared to the planned HUF 225 billion, i.e. fell short of the appropriation by HUF 52 billion. With this, the process observed in 2017 – when the absorbed amount fell short of the appropriated expenditure to a similar degree – repeated. Compared to 2017, payments from the budget for public employment decreased by more than one third, due to the fact that the number of public workers declined by almost 39,000.

In the case of the **Bethlen Gábor Fund**, the expenditures exceeded the appropriation by HUF 64 billion as a result of the surplus expenditures of subsidies for national policy purposes, based on special government decisions. The average monthly expenditure of less than HUF 4 billion during the year was followed by an expenditure of roughly HUF 45 billion in December, and thus expenditures exceeded those recorded in the previous year by HUF 11 billion.

In 2018, **pension** expenditures amounted to HUF 3,346 billion, which essentially corresponds to the statutory appropriation. Compared to the 2017 actual figures, expenditures rose by HUF 175 billion in 2018, which represents a growth in expenditures of 5.5 percent.

- **In early 2018 pensions were increased by 3 percent**, based on the rate of the consumer price increase planned in the 2018 Budget Act. However, during the year consumer prices rose by 2.8 percent on average, while the pensioner consumer price index amounted to 2.7 percent, and thus the value of pensions rose in real terms during the year.

- In addition to the increasing of pension at the beginning of the year, the **replacement effect** also pointed to a rise in expenditures, since the benefits paid to new pensioners are typically of higher amount than the benefits of the those leaving the scheme.

- In 2018, due to the **raising of the retirement age,** the new age group (those born in the second half of 1954) reached the statutory retirement age only in the first half of the year (Table 5), as a result of which the number of persons that reached the retirement age and receive old-age pension rose gradually in the first half of the year and then decreased in the second half of the year. In 2018, the budgetary expenditure used for service dependent pension available for women with 40 years of service rose. The number of persons receiving early retirement benefit available for women decreased in the first half of 2018, then it increased in the second half of the year in parallel with rising of the retirement age, and the headcount registered at the end of the year exceeded the figure recorded in January.

Table 5
Retirement age in Hungary

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

Source: Act LXXXI of 1997 on Social Security Retirement Provision.

Based on the performance of the economy, pension premium was paid in 2018 as well. Pursuant to the Pension Act,[1] the beneficiaries receive pension premium if the rate of GDP growth expected for the current year calculated at constant prices is above 3.5 percent and the general government's current year balance target is expected to be met. The amount of the pension premium is determined by the economic growth rate and the monthly benefit received by the pensioners. Based on the rule, in 2018 the maximum amount of the pension premium – considering the estimated value of the economic growth – was HUF 18,000, which was paid for pensions of HUF 80,000 per month or higher. In 2018, the average amount of the old-age pension was around HUF 130,000. As in 2017, the Government decided in 2018 as well to extend the payment of the pension premium to those beneficiaries who have not reached the retirement age, for example to those women who receive pension after completing the 40-year eligibility period and those who receive pension-type benefits (e.g. those eligible for disability and rehabilitation benefits). **In November 2018, pension premium was paid from the budget in the total amount of HUF 41 billion.**[2]

Expenditures related to **disability and rehabilitation benefits** fell short of the statutory appropriation by HUF 27 billion and of the 2017 actual figure by HUF 17 billion. The decline in expenditures was due to the gradual decrease of the number of beneficiaries, because those who reach the retirement age are gradually transferred to the group of old-age pensioners, and the number of new beneficiaries is low on account of the tightened rules on eligibility.

The expenditures in 2018 exceeded the appropriation of HUF 353 billion for **cash benefits** disbursed by the **Health Insurance Fund** by HUF 11 billion. The higher expenditure level related to the child-care benefit almost in full. The

[1] Act LXXXI of 1997 on Social Security Retirement Provision
[2] https://www.kormany.hu/hu/nemzetgazdasagi-miniszterium/allamhaztartasert-felelos-allamtitkarsag/hirek/minden-feltetel-adott-a-hianycel-eleresehez

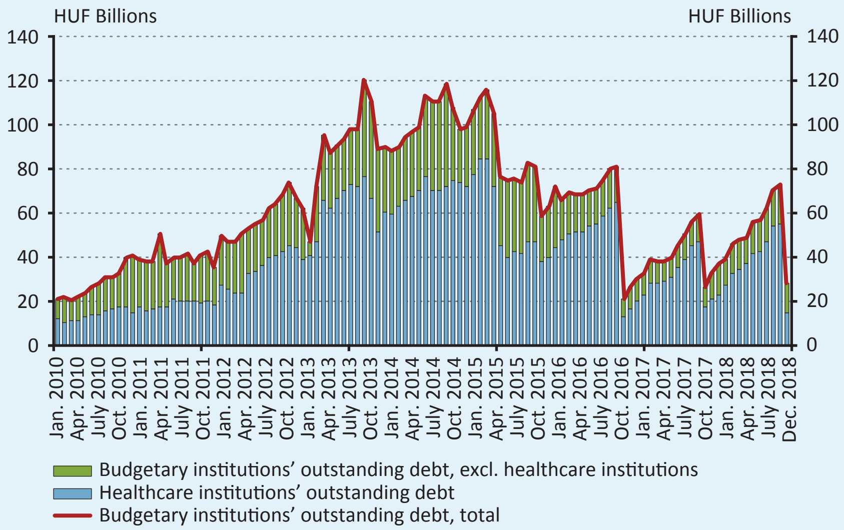
expenditures related to the child-care benefit rose month by month during the year, partly due to the gradually increasing number of beneficiaries – which may have been also attributable to the introduction of "child-care benefit extra" scheme, and on the other hand, the amount paid per person also rose during the year, which may be related to the dynamic whole-economy wage growth (for those newly joining the scheme the amount of the child-care benefit may be established on the basis of higher wage).

The 2018 statutory appropriation for **medical and preventive care** amounted to HUF 1,204 billion, while the expenditures incurred until the end of the year reached HUF 1,306 billion. The cash expenditures of this item exceeded the appropriation by HUF 102 billion, which also includes the hospital consolidation performed at the end of the year, amounting to HUF 55 billion. During the year the annual appropriation was raised by HUF 47 billion, half of which was used for the wage increase – rescheduled from November – for the health and social workers (ambulance staff, nurses), and one-third thereof covered the increasing expenses of the combined specialist care.

In 2018, the rate of debt accumulation by healthcare institutions exceeded that observed in the previous year. Outstanding debt rose on average by HUF 3.5 billion monthly in 2018, while in 2017 the average monthly increment was HUF 3 billion. Similarly to the previous year, **debt consolidation of hospitals** was also performed at the end of 2018, as a result of which the outstanding debt of healthcare institutions fell by roughly HUF 40 billion, dropping to HUF 15 billion by the end of 2018 (Chart 14).

Net expenditures of the drug budget in 2018 amounted to HUF 270 billion, and thus exceeded the statutory appropriation by HUF 5 billion. Drug reimbursement expenditures exceeded the appropriation by HUF 21 billion, which was partially offset by the fact that the payments by pharmaceutical companies exceeded the appropriation by HUF 16 billion. Within that, the contractual payments by the manufacturers and distributors of pharmaceutical products exceeded the statutory appropriation of HUF 17 billion by HUF 12 billion during 2018.

Chart 14
Outstanding debt of budgetary organisations, and within that, of healthcare institutions between January 2010 and December 2018



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

Source: Hungarian State Treasury.

2.4 BUDGET MANAGEMENT OF LOCAL GOVERNMENTS

The 2018 Budget Act planned the cash-based balance of the **local government sub-sector** with a surplus of HUF 203 billion. Based on the EDP report published in April 2019, the local government sub-sector closed 2018 with a higher, i.e. HUF 254 billion cash surplus. The high cash surplus was caused by the revenues from advances belonging to the EU programmes, disbursed by the central budget to the beneficiary local governments. In the EDP report, the HCSO quantified HUF 269 billion advance revenues belonging to EU programmes for 2018. Since for the purpose of statistics the revenues from advances cannot be regarded as ESA revenue, the ESA balance of the local government sub-sector calculated according to the EU methodology showed a minor deficit in 2018. According to the EDP report, the closing ESA balance of the local government sub-sector was a deficit of HUF 42 billion. The local government sub-sector's high, accrual-based surplus, recorded in 2016, substantially declined by 2017 and in 2018 it turned into a deficit.

2.5 STATISTICAL CORRECTION (ESA BRIDGE)

Reconciliation between the cash balance and the ESA balance calculated in accordance with the EU methodology is ensured by **supplementary statistical corrections** (ESA bridge) **applied to the cash accounting.** The statistical corrections are necessary because some of the transactions are recorded, based on the EU statistical accounting method, at the time of the execution (accrual accounting), contrary to the rules of Hungarian budget accounting practice, where they are recorded upon cash movement (cash accounting). Moreover, the EU regulations interpret the general government (government sector) more broadly than the Hungarian statutory regulation, as they also allocate certain non-profit institutions, and state-owned companies to the government sector. Accordingly, the HCSO calculates the ESA balance obtained with the use of the EU methodology for the government sector, and thus this deficit ratio differs from the cash balance of the general government also in terms of sectors.

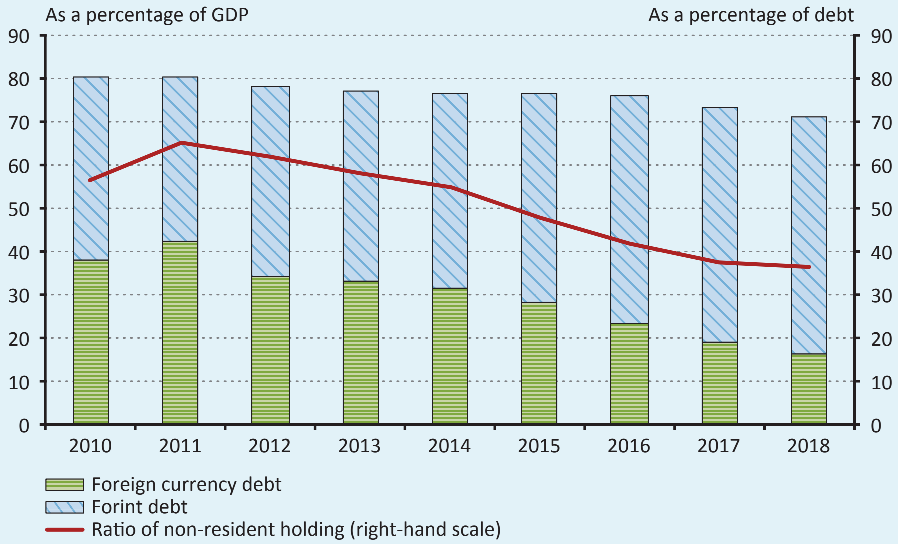
The 2018 Budget Act defined the balance of the accrual-based statistical correction in 0.4 percentage point of GDP (HUF 175 billion). That is, the balance estimate related to the government sector contained a correspondingly more favourable ESA balance compared to the targeted cash balance applicable to the general government, approved in the 2018 Budget Act. According to the data of the EDP report of April 2019, the ESA bridge turned out HUF 256 billion, i.e. 0.6 percent of GDP. The difference is attributable to the partially opposite effect of several factors.

One of the major accrual-based difference relates to the recognition of the EU transfers; the balance of these changed by HUF 47 billion compared to the planned figures, pointing to a lower deficit. The reason for the more favourable adjustment is that structure of the cash realisation of the EU funds differs from the expectation. The HCSO applied by roughly HUF 51 billion higher surplus or statistical correction for the sales and consumption tax revenues compared to the plan, and similarly, the accrual-based tax revenue exceeds the cash realisation by HUF 25 billion also at the payments by enterprises. The difference between the paid and accrued interests, and the balance of swap settlements increased the surplus of the ESA bridge by HUF 56 billion compared to the accounting prepared for the Budget Act. The accrual-based balance of the classified companies and guarantee funds represented a change of opposite direction compared to the foregoing, where the HCSO applied a correction of - HUF 16 billion instead of the balance improving adjustment of HUF 69 billion, expected upon the planning.

2.6 GOVERNMENT DEBT

Last year, the gross government debt-to-GDP ratio declined substantially, by 2.6 percentage points, and by the end of 2018, it fell to 70.8 percent. The decline in the debt ratio was supported both by the low financing need and the dynamic economic growth. The legislative change related to the payment of the advances for EU transfers contributed to the fact that the financing need in 2018 was substantially lower than the cash-based deficit of the central sub-sector. Owing to the 2017 and 2018 government measures, the advances related to EU grants were transferred or paid to the payment accounts of the economic actors belonging to the general government held with the Hungarian State Treasury. This considerably boosted the balances of the accounts of local governments and state-owned enterprises held with the State Treasury, and at the same time reduced the financing need arising from the advance payments on EU funds.

Chart 15
Developments in gross government debt, forint and FX debt within that and the share of foreign ownership



Source: MNB.

The downward trend of the share of FX and in the proportion of foreign ownership within the debt observed since 2011 continued in 2018 as well (Chart 15). The key driver of the structural change in government debt in the recent years was the growing demand for government securities by households and the domestic banking system. As a result, the proportion of the non-residents' share within government debt decreased substantially, dropping from 65 percent at the end of 2011 to 36.5 percent by the end of 2018. Meanwhile, Hungary's FX debt also declined markedly. At the end of 2011, the foreign currency ratio of the central government debt amounted to approximately 50 percent, while this figure declined to 20 percent by the end of 2018. The diminishing FX and external debt contributed to the reduction of the Hungarian economy's vulnerability.

3 Expected general government developments in 2019

3.1 EXPECTED ESA BALANCE OF THE GOVERNMENT SECTOR IN 2019

According to our projection, in 2019 the accrual-based deficit of the government sector (ESA deficit) may be around 1.6-1.7 percent of GDP, depending on the utilisation of the Country Protection Fund, based on which fiscal policy may be countercyclical. Based on our forecast, the cash-based deficit of the budget's central sub-sector may almost be equal to the deficit specified in the Budget Act; however, the balance of the local government sub-sector may show a deficit higher by roughly 0.3 percent of GDP. According to our expectations, the statistical corrections may improve the general government balance in excess of the value stipulated in the Budget Act, which thus may be slightly more favourable than the accrual-based deficit target of 1.8 percent of GDP, specified in the Budget Act.

Table 6
Balance of the government sector in 2019

	Statutory appropriation	MNB forecast	Statutory appropriation	MNB forecast	Difference
	HUF billions		percentage of GDP		
1. Balance of the central sub-sector	-998	-962	-2.2	-2.1	0.1
2. Balance of local governments	-199	-323	-0.4	-0.7	-0.3
3. Cash-based (GFS) balance of the general government (1+2)	**-1,197**	**-1,285**	**-2.6**	**-2.8**	**-0.2**
4. GFS-ESA difference	400	515	0.9	1.1	0.3
5. ESA balance of the government sector (3+4)	**-797**	**-770**	**-1.8**	**-1.7**	**0.1**
6. ESA balance with cancellation of free central reserves	**-737**	**-740**	**-1.6**	**-1.6**	**0.0**

Note: Due to rounding, differences may occur in the table.

The 2019 Budget Act stipulated HUF 998 billion as the cash-based deficit of the general government's central sub-sector; our projection shows a deficit nearly identical to that. According to our projection, the cash-based deficit of the central sub-sector may be close to what is specified in the Budget Act; however, there are major differences in the structure thereof.

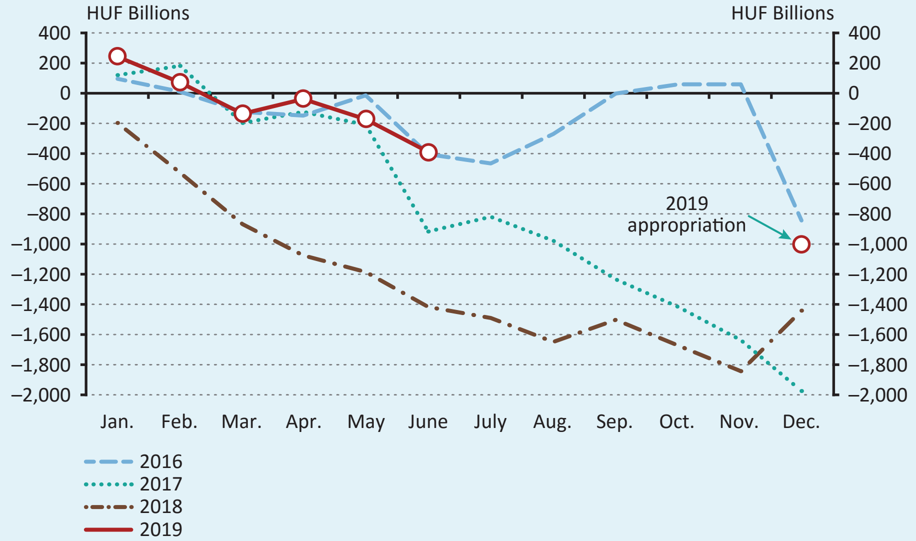
- The *central budget* deficit is expected to fall short of the statutory appropriation by roughly HUF 224 billion. The high tax revenues (mostly the consumption taxes and the personal income tax), and the higher payments related to state property, e.g. concession fees related to the sales of mobile frequency bands, point to a more moderate deficit. The Family Protection Action Plan, announced during the year, increases expenditures, while the expenditures related to the EU programmes may substantially fall short of the appropriation.

- Our projection for the balance of *extrabudgetary funds* is by roughly HUF 50 billion more favourable than the amount stated in the Budget Act. According to our projection, the balance of extrabudgetary funds may show a surplus of almost HUF 40 billion, while the statutory appropriation includes a minor deficit. The more moderate level of expenditures is primarily attributable to the low expenditures related to the Start Labour Programme.

- The Budget Act planned the balance of the *social security funds* with zero balance including the necessary central subsidies, while according to our projection the deficit of the social security funds may be close to HUF 240 billion. The revenues of the funds may fall short of the appropriation by roughly HUF 108 billion, which is mostly caused by the lower realisation of certain labour taxes and contributions, and partly by the shortfall in the revenues from small taxes (accident tax, public health product tax) compared to statutory appropriation. We expect expenditures to become higher by HUF 130 billion, due to the higher amount of pension supplement, the expected pension premium and the surplus expenditures of medical and preventive care.

The cumulative cash-based deficit of the central sub-sector for the first half of the year was lower than in the previous years. The 2019 deficit until June was HUF 390 billion. The tax and contribution revenues of the central sub-sector rose by 13 percent in the first six months of this year compared to the first half-year of last year, which generated a surplus revenue for the budget of almost HUF 900 billion. Payments by enterprises, consumption taxes, as well as labour and other income taxes all positively contributed. By contrast, expenditures rose merely by 0.1 percent compared to the first half of 2018, primarily due to the lower outflow of expenditures related to EU funds.

Chart 16
Intra-year cumulative cash-based balance of the central sub-sector

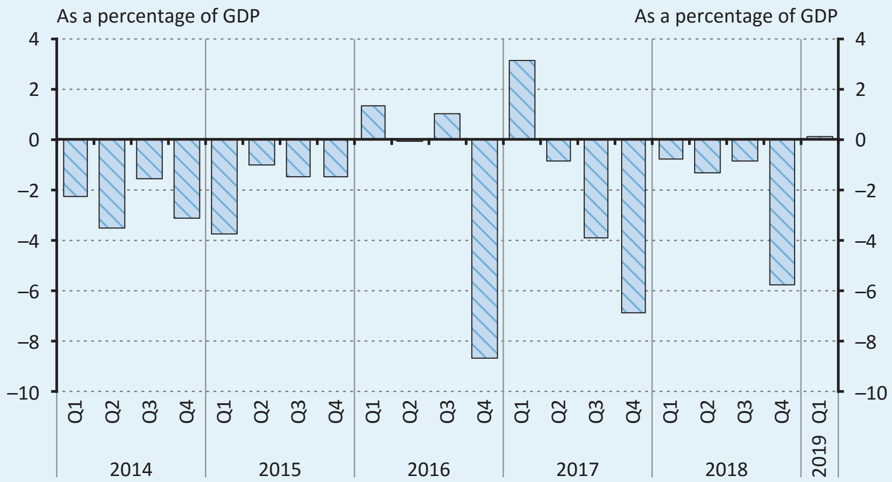


Source: Budget Act of 2019, Hungarian State Treasury.

In the first quarter of 2019, the accrual-based balance of the general government showed a surplus reaching 0.1 percent of GDP. The concentration of the government deficit within the year may be similar to that observed in the previous few years, i.e. a significant part of the deficit may be concentrated in the second half of the year. This trend is strengthened by the fact that the 2019 expenditures related to the Family Protection Action Plan will materialise from the second half of the year, and the rate of the social contribution tax also declined from July by an additional 2 percentage points.

Our ESA deficit forecast of 1.6-1.7 percent departs only slightly from the deficit target of 1.8 percent of GDP. According to our projection, tax revenues may be substantially, i.e. by 0.7 percent of GDP, higher than the appropriation in the Budget Act. At the same time, this is partially offset by the fact that the 2019 Budget Act does not contain the expenditure-increasing effect of the Family Protection Action Plan, announced in February, which, according to our forecast, together with the related statistical factors, may be 0.3 percent of GDP this year. As a result of the pension supplement paid on the basis of the presumably higher inflation and economic growth than stated in the Budget Act and the pension premium, pension expenditures may also be somewhat higher in 2019.

Chart 17
Accrual-based budget balance



Source: HCSO, MNB.

According to our forecast, this year the cash-based deficit of the local government sub-sector will exceed the value stated in the Budget Act. The high cash-based deficit of the sub-sector is primarily linked to the absorption of EU-related advance payments, that were received earlier. According to our forecast, the accrual-based balance of the local governments, calculated in accordance with the EU methodology, may also show a deficit in 2019 (as in 2018).

In 2019, according to our forecast, the statistical corrections between cash-based and accrual-based accounting may exceed that of the Budget Act by 0.3 percent of GDP. A major part of the difference is due to accrual-based corrections related to the expenditures of EU programmes.

3.2 MACROECONOMIC PROJECTION UNDERLYING THE BUDGET

The Budget Act and the MNB's 2019 forecast from the June Inflation report both expect economic growth to be slightly higher than 4 percent. Domestic demand is still a dominant contributor to the robust growth. In connection with the steady and dynamic growth in real wages, the households' consumption may increase further, and major growth in investments will also continue. There is a slight difference between the projection of the MNB and the Budget Act regarding the structure of growth. According to the MNB's forecast, consumption may somewhat exceed the expectation in the Budget Act and the investment growth may also be greater than foreseen in the Budget Act. At the same time, the MNB's projection includes more moderate export growth for 2019, and import growth may also fall behind the dynamics specified in the annex to the Budget Act.

Wages increase dynamically in 2019 as well, and the rise in employment also continues. According to the MNB's current projection, whole-economy average earnings growth may exceed the value stipulated in the Act by 1.8 percentage points, while the rise in the number of people in employment may be somewhat more moderate than the assumptions in the Act.

Table 7
Comparison of the macroeconomic paths included in the 2019 Budget Act and in the MNB's June 2019 Inflation Report
(percent)

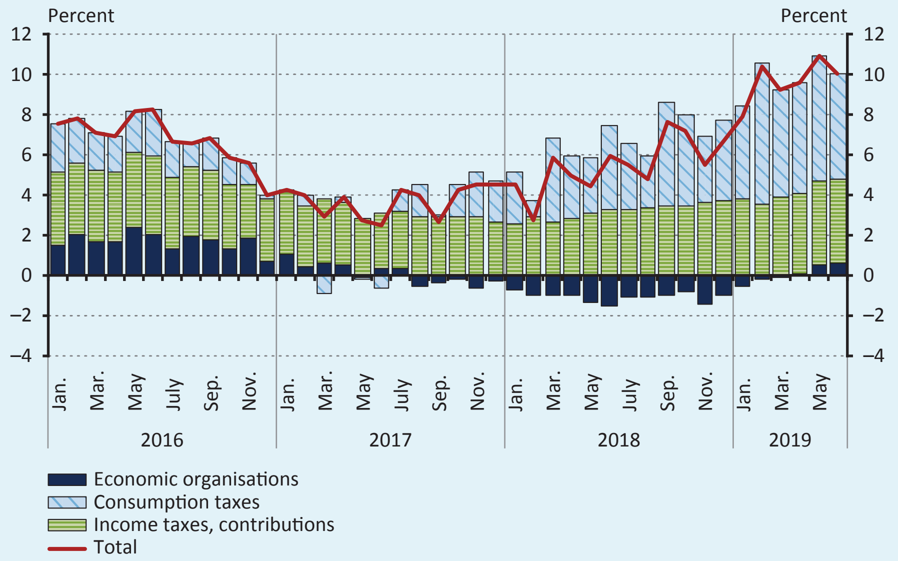
	2019		
	Budget Act	MNB	Difference
GDP	**4.1**	**4.3**	**0.2**
Consumption expenditure of households	4.8	5.1	0.3
Public consumption	1.0	0.7	-0.3
Gross fixed capital formation	7.5	14.9	7.4
Exports	6.9	5.4	-1.5
Imports	7.4	6.5	-0.9
Inflation	**2.7**	**3.2**	**0.5**
Gross wage bill	**10.3**	**12.1**	**1.8**
Gross average earnings	8.8	10.5	1.7
of which: private sector	9.3	10.9	1.6
Number of employees	1.5	1.4	-0.1
of which: private sector	1.9	1.7	-0.2

Source: Annex to the 2019 Budget Act, the MNB's June 2019 Inflation Report.

3.3 CASH-BASED REVENUES OF THE CENTRAL SUB-SECTOR

According to our projection, the primary revenues of the central sub-sector exceed the 2019 statutory appropriation by HUF 63 billion. Tax and contribution revenues may substantially exceed the value stated in the Budget Act, i.e. by almost HUF 320 billion, which, however is offset by the expected lower realisation of the revenues related to the EU funds. Within the tax and contribution revenues of the central sub-sector, we expect the revenues to exceed the statutory appropriation primarily at the consumption taxes; at the same time, payments by economic organisations, taxes and contributions on labour and other incomes also significantly contribe to the dynamic growth in the payments compared to the previous year.

Chart 18
Year-on-year change in the central sub-sector's tax and contribution revenues
(12-month moving average)

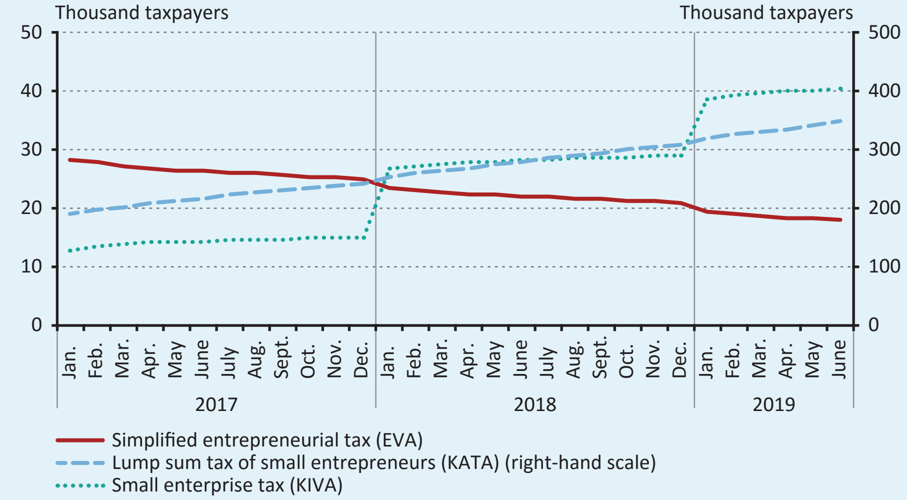


Source: Hungarian State Treasury.

According to our projection, **payments by economic organisations** together may fall short of the appropriation by HUF 4 billion in total, and they may exceed the revenues received in 2018 by HUF 10 billion. There are major differences in composition behind the negligible aggregate differences. The **corporate income tax revenue** and the **revenue from the income tax on energy suppliers** may fall short of the appropriation in the 2019 Budget Act by HUF 103 billion and HUF 29 billion, respectively. The difference is attributable to the fact that the tax package of summer 2019 cancelled the taxpayers' obligation to supplement the tax advance in December. The appropriation does not include the impact of the measure, which is substantial on cash basis this year, but smaller on an accruals basis.

The revenues expected from the **small taxpayers' itemised lump sum tax** (KATA) may exceed the appropriation in the Budget Act by HUF 25 billion. The increment is partly due to the base effect, as the revenues from this tax type exceeded the appropriation last year by HUF 12 billion. The part of the increase other than due to the base effect may be attributable to the higher willingness to choose this type of tax than assumed in the 2019 Budget Act. The **small business tax (KIVA)** is also characterised by similar trends, where revenues are expected to exceed the appropriation in the Budget Act by HUF 14 billion. This year, payments under both tax types applicable to small businesses may substantially exceed the 2018 revenues. One source of the rising number of taxpayers opting for these two tax types may be the taxpayers leaving the **simplified entrepreneurial tax** (EVA). The number of taxpayers assessing their tax under the rules of EVA has been steadily decreasing (Chart 19), and in parallel with that EVA revenues fell to 56 percent of the payments received five years ago, i.e. to HUF 54 billion by the end of 2018. The decrease in revenues from EVA may continue in 2019 as well; the revenue of the budget from this tax type may fall behind that of last year by further HUF 10 billion. As of 20 December 2018, it is no longer possible to register for tax payment under EVA, and the tax type will be phased out starting from 1 January 2020.

Chart 19
Monthly number of taxpayers paying simplified entrepreneurial tax, small business tax and itemised lump sum tax



Source: Ministry of Finance.

According to our forecast, **revenues from e-road toll** will exceed the 2019 appropriation by HUF 21 billion. The difference is partly attributable to the base effect, since last year the revenue exceeded the relevant appropriation by HUF 6 billion. Another factor that explains the difference is the raising of the tolls from 1 January 2019 on average by 5.8 percent, the revenue increasing effect of which is not included in the appropriation enacted in summer 2018. This year revenues from e-road toll may rise by HUF 36 billion compared to 2018. Revenues from **mining royalties** will exceed the appropriation by HUF 12 billion, since as a result of higher revenues expected for 2019 our projection for 2020 also exceeds the appropriation.

Other taxes and payments by economic organisations may exceed the appropriation by HUF 54 billion. Penalty revenues, payments originating from environmental product fees and other payments are expected to exceed the appropriations in the Budget Act by HUF 21 billion, HUF 14 billion and HUF 8 billion, respectively. Compared to the previous year, other taxes and payments may be higher by HUF 31 billion. Revenues from rehabilitation contribution may rise by HUF 8 billion as a result of the 8 percent increase of the minimum wage, while according to our projection the time-based road tolls will be up by HUF 7 billion compared to the previous year due to the price hike of the 10-day motorway tolls in autumn 2018. Revenues from eco taxes may decline by HUF 20 billion compared to the previous year, but the effect of the change is neutral on the balance, since the revenue recognised earlier under energy taxes are recognised from 1 January 2019 under excise tax revenues.

Value added tax revenue, on a cash basis, may be HUF 4,546 billion in 2019, which – according to our forecast – exceeds the statutory appropriation by more than HUF 250 billion. According to our expectations, the realisation over the appropriation may be attributable to the fact that the surplus revenue in 2018, regarded as base year, became substantially higher than the previous expectations of the general government: the actual revenue exceeded the amount stated in last year's Budget Act by almost HUF 100 billion. On the other hand, in the second half of 2018 – presumably due to the introduction of online invoicing last July – growth dynamics significantly increased, which also continued in the first half of 2019. In the first six months of this year, gross VAT revenues rose by 12.9 percent year on year.

Our projection for revenues from **excise duties** this year is HUF 1,204 billion, which exceeds the appropriation by HUF 63 billion. The difference is attributable to the seasonal time profile of the previous year, and the additional increase of the excise duty on tobacco products due from 1 July. In the first half-year, excise duty revenues exceeded the year-on-year figure by 9.1 percent, or disregarding the newly added energy tax, by 7 percent. At the tobacco products, alcoholic beverages and fuels, this can be partly attributed to the increased turnover, and partly to the legislative change, since the tax on tobacco products was increased twice year on year. Due to the favourable revenue trends we expect tax revenues to exceed the statutory appropriation by 5.6 percent.

This year, revenues from **financial transaction levy** may reach HUF 246 billion, which exceeds the appropriation in the Budget Act by HUF 18 billion. The difference arises partly from the different assessment of this year's growth, and partly from the fact that the revenue from this tax type already exceeded the planned level by HUF 29 billion in 2018. In the first half of the year 54 percent of the statutory appropriation was realised, while revenues rose by 8.9 percent year on year, despite the fact that the financial transaction levy on payments below HUF 20,000 was cancelled from 1 January.

This year, revenues from **insurance tax** may reach HUF 88 billion, which exceeds the appropriation in the Budget Act by HUF 20 billion. In the first 6 months of the year, 60 percent of the statutory appropriation was realised on the accident tax revenue line, while revenues doubled year on year, which partly may be attributable to the technical rearrangement related to accident tax. After the cancellation of the accident tax and merging it in the insurance tax, revenues were transferred from the social security funds to the central budget, and thus it has no effect on the balance. As of January, the tax payable on motor vehicle insurances is accounted for as insurance tax, which will gradually increase the revenues under this item in parallel with the renewal of the insurance policies during the year.

This year, revenues from **tourism development contribution** may reach HUF 24 billion, which exceeds the 2019 statutory appropriation by HUF 9 billion. The difference partly comes from this year's actual data – in the first half of the year 75 percent of the statutory appropriation was realised –, and partly from the base effect, considering that the revenue from this tax type exceeded the planned level by roughly HUF 8 billion last year as well.

The 2019 appropriation for **revenues from duties** amounts to HUF 192 billion; however – in the light of the first half-year's actual data – it is expected to be exceeded by HUF 30 billion. In the first half of this year the budget received revenues from duties in the amount of HUF 109 billion, which corresponds to 57 percent of the annual appropriation and exceeds the revenues recorded in the first six months of last year by 17 percent, primarily as result of the payment of duties related to property purchases (Chart 20).

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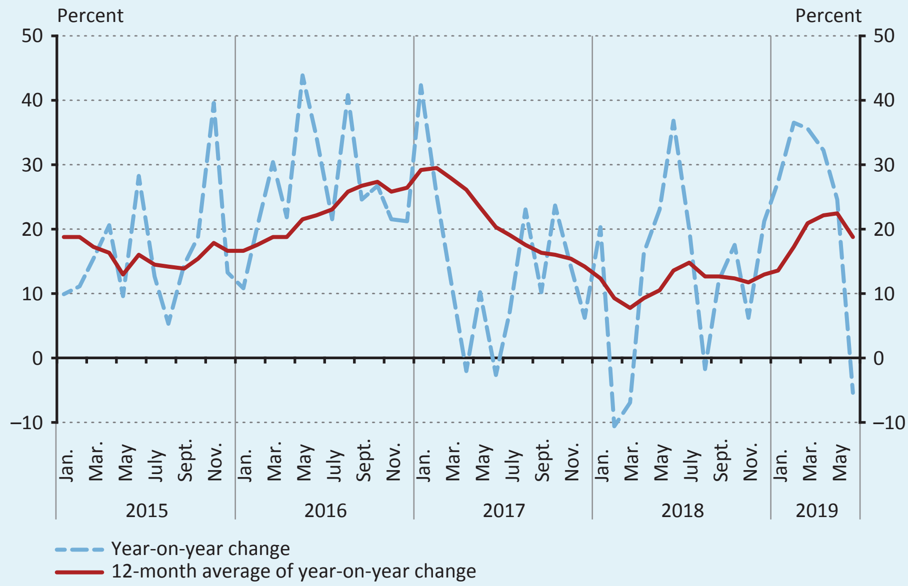
Table 8
Partially consolidated cash revenues of the central sub-sector
(HUF billions)

	2019				
	Statutory appropriation	January-June realisation	Percent of appropriation	MNB forecast	Difference (MNB – appropriation)
TAX AND CONTRIBUTION REVENUES OF THE CENTRAL SUB-SECTOR	**15,651**	**7,716**	**49%**	**15,970**	**319**
Payments by economic organisations	**1,444**	**651**	**45%**	**1,440**	**-4**
Corporate income tax	400	130	33%	296	-103
Special tax of financial institutions	53	28	53%	55	2
Simplified entrepreneurial tax	45	12	27%	44	-1
Mining royalty	36	23	65%	48	12
Gambling tax	31	14	46%	32	1
Income tax of energy providers	59	10	18%	30	-29
Lump sum tax of small entrepreneurs	136	77	56%	161	25
Small enterprise tax	50	32	65%	64	14
E-road toll	198	103	52%	218	21
Utility tax	55	27	49%	55	0
Other taxes and payments	366	192	52%	420	54
Advertising tax	15	1	8%	15	0
Consumption taxes	**5,822**	**2,928**	**50%**	**6,191**	**369**
Value added tax	4,290	2,170	51%	4,546	256
Excise duties	1,141	544	48%	1,204	63
Registration tax	28	13	46%	27	-1
Telecom tax	52	27	51%	57	4
Financial transaction levy	228	122	54%	246	18
Insurance tax	67	41	60%	88	20
Tourism development contribution	16	12	75%	24	9
Payments by households	**2,608**	**1,297**	**50%**	**2,658**	**50**
Personal income tax	2,361	1,156	49%	2,380	19
Duties, other taxes	199	114	57%	229	30
Motor vehicle tax	48	27	57%	50	2
Tax and contribution revenues of extra-budgetary funds	**468**	**200**	**43%**	**481**	**13**
Tax and contribution revenues of social security funds	**5,310**	**2,640**	**50%**	**5,200**	**-110**
Social contribution tax and contributions	5,124	2,527	49%	5,006	-118
Other contributions and taxes	186	113	60%	194	8
REVENUES RELATED TO EU FUNDS	**1,494**	**355**	**24%**	**1,162**	**-332**
OTHER REVENUES	**304**	**277**	**91%**	**380**	**76**
Other revenues of the central budget	**180**	**170**	**95%**	**245**	**65**
Other revenues of social security funds	**34**	**16**	**46%**	**31**	**-3**
Other revenues of extrabudgetary funds	**90**	**91**	**101%**	**104**	**14**
TOTAL REVENUES	**17,449**	**8,348**	**48%**	**17,512**	**63**

Source: Budget Act of 2019, Hungarian State Treasury, MNB.

Chart 20
Year-on-year changes in the revenues of the NTCA duty account (includes the duties related to immovable property purchases)

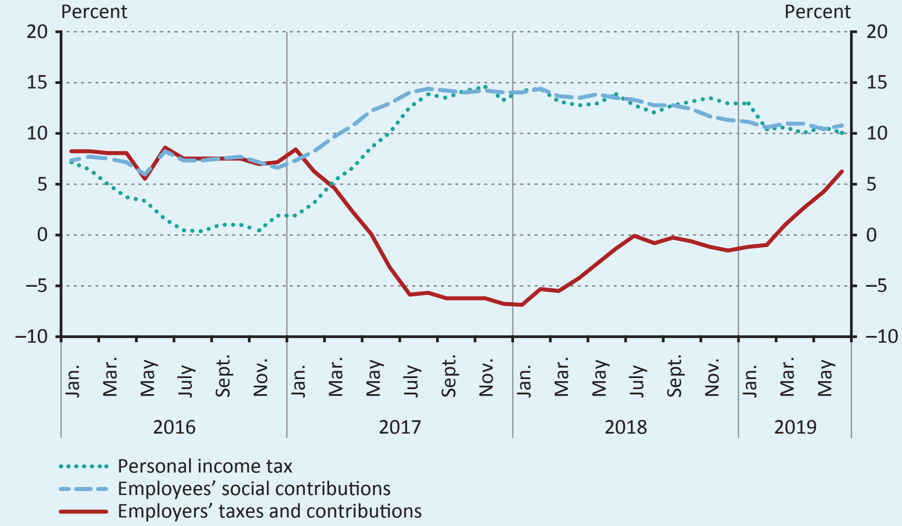


Source: Hungarian State Treasury.

In the first half of this year, revenues from **personal income tax** rose by 10 percent year on year, and thus until June the budget received HUF 105 billion higher amount than in the first six months of last year. According to our forecast, revenues may exceed the annual appropriation by HUF 20 billion. In the first four months of the year, gross average earnings in Hungary rose by 10.4 percent year on year; according to our expectations, the annual ratio will be similarly high under the 1.4 percent increase in total employment. This year the two measures of the largest budgetary impact, affecting the personal income tax, included the major reform of the fringe benefit scheme and the rise in the allowance for families with two children. As a result of the reform of the fringe benefit scheme, the personal income tax revenues related to these items declined by roughly 40 percent in the first quarter, which was presumably offset by the pass-through effect from the benefits to gross wages. The family tax allowance for families with two children rose from last year's HUF 17,500 per month to HUF 20,000 per dependant. The government securities issued as of June 2019 are exempt from PIT, which only results in a minor loss of tax revenues this year.

This year, **the tax and contribution revenues of social security and extra-budgetary funds** may fall short of the appropriation of HUF 5,778 billion by roughly HUF 100 billion. The difference is the combined result of two trends of opposite sign: the revenues from social contribution tax and the contribution of the individual insured may become substantially lower than the statutory appropriation, while revenues from vocational training contribution and health contribution may exceed it. As a result of the growth in gross wages and employment, in the first six months the budget received revenues from employees' and employers' tax and contribution an amount that exceeded the revenues recorded in the first half of last year by HUF 212 billion. In the first six months of 2019, revenues from employee and employer contributions exceeded the amount received until last June by 10.8 and 6.2 percent, respectively (Chart 21). The growth rate of revenues related to wages is gradually declining since 2017, while several tax cuts were also implemented during this period.

Chart 21
Year-on-year change in wage-related revenues
(6-month moving average)

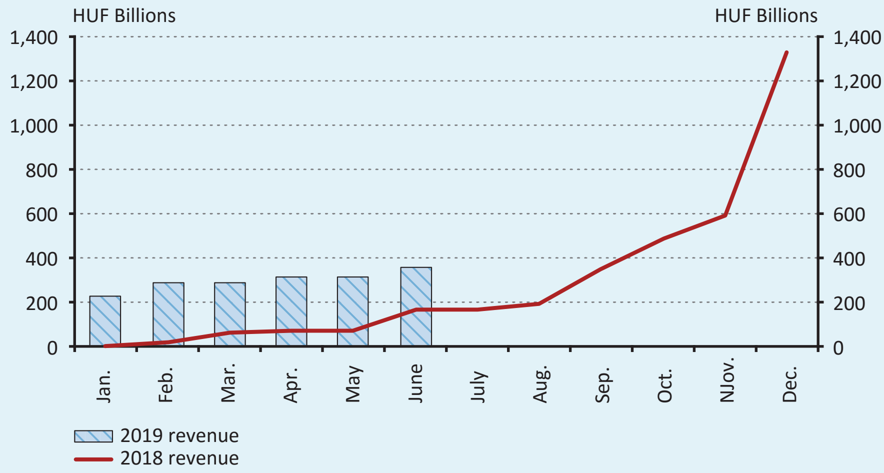


Source: Hungarian State Treasury.

This year several changes affected the tax and contribution revenue of the extra-budgetary and social security funds, of which the most important one – in terms of its budgetary effect – was the repeated reduction of the social contribution tax rate by 2 percentage points in July. Several tax and contribution types disappeared by having been merged with other items: the health contribution was added to the social contribution tax, while the accident tax is phased gradually to the insurance tax revenues. The comprehensive alteration of the fringe benefits scheme, as well as the extension of the major tax allowances available for the employment of pensioner workers also affected the revenues of the funds. By contrast, the range of the beneficiaries of the Job Protection Action Plan substantially declined; by narrowing the target groups, the number of beneficiaries was roughly halved, while the allowances per capita rose as a result of the expansion of the benefit base to the minimum wage and benefits applicable to the new target group, exceeding those of the previous target groups. This year, the rate of the public health product tax, belonging to the revenues of the Health Insurance Fund, rose by more than 20 percent in certain product groups, which materially increased revenues; nevertheless, they may still slightly fall short of the statutory appropriation.

At the end of June 2019, **revenues linked to EU programmes** amounted to HUF 355 billion in total, which is almost twice as high as the value recorded in the first half of last year. However, the level of revenues substantially falls short of the prorated value of the appropriation of HUF 1,494 billion. Although in previous years the major part of the revenues from EU funds were concentrated typically in the last months, according to our expectations, the level of current year's revenues may fall short of the plan. The low level of the EU revenues is attributable, among other things, to the still high ratio of the advances within cash payments (since revenue may only be incurred in respect of the invoices submitted in respect of the actually absorbed transfers).

Chart 22
Cumulative revenues related to EU programmes in 2018-2019



Source: Hungarian State Treasury.

In June, **other revenues of the central sub-sector** amounted to 91 percent of the annual appropriation, which is primarily linked to the high revenues realised by the central budget in the first half-year. According to our forecast, the 2019 revenues may exceed the appropriation by more than HUF 70 billion, as a result of this year's concession revenue from the sale of mobile frequency band, that was not included in the Budget Act. As last year, the sales of emission units (e.g. carbon-dioxide quota, aviation emission quota) may result in a higher than expected government revenue in 2019 as well.

3.4 CASH-BASED EXPENDITURES OF THE CENTRAL SUB-SECTOR

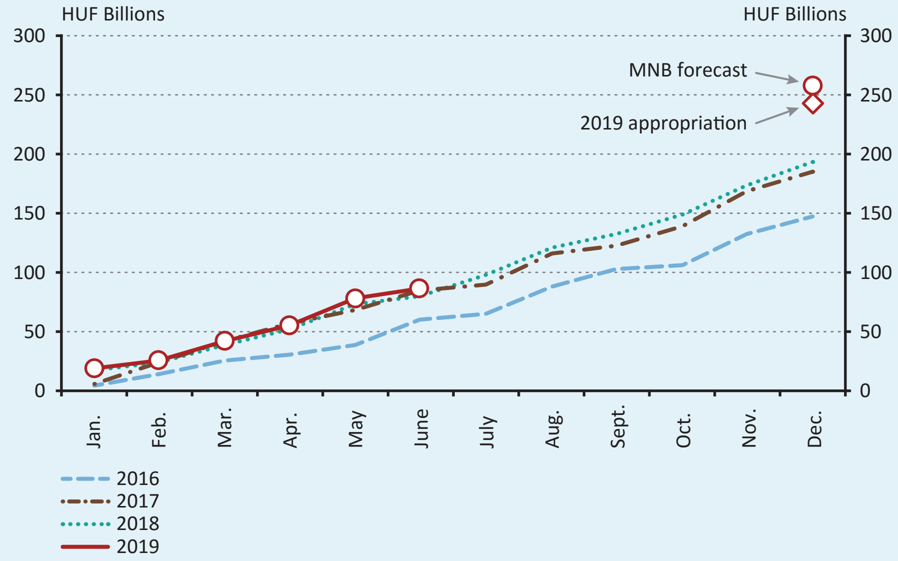
Our projection related to the **primary expenditure** items is close to identical to the appropriations in the Budget Act, but there are major differences in the structure of expenditures. The components of the Family Protection Action Plan announced this year, starting in 2019, have not yet been implemented in the budget adopted last year, which will increase the annual expected expenditures at several items, such as the housing grants and the central budgetary organisations chapters. According to our forecast, the expenditures of the budgetary organisation will exceed the appropriation by more than HUF 500 billion, primarily due to recognising a large part of the fiscal reserves at the organisations, the surplus expenditures of certain family protection measures and the higher wage expenses. We also expect higher expenditure at the social security funds, related to the supplementary pension rise implemented due to the inflation exceeding that anticipated by the Act and to the payment of pension premium. The increase in these expenditures is offset by the lower level of the expenditures related to EU funds, which – according to our forecast – may fall short of the appropriation by almost HUF 470 billion.

Payments related to **special and normative subsidies, as well as support to the public media** reached 60 percent of the annual appropriation in the first six months of the year, which exceeds the average of the previous three years. At the expenditure titles belonging to this category we expect the realisation of the statutory appropriations by the end of the year; at the same time risks pointing to higher subsidy requirement may appear at the enterprises pursuing public transport activity.

The expenditure appropriation of the **National Family and Social Policy Fund** is in line with our expectations at most of the items. The Budget Act appropriated HUF 640 billion for the expenditures of the Fund (approximately half of that for the payment of family allowances), which is essentially equal to the subsidy paid last year.

According to our forecast, expenditures related to **housing grants** may exceed the appropriation of HUF 242 billion by HUF 15 billion. Several measures entered into force after the adoption of the Act, the purpose of which was to increase the amount of the grants available under the Home Purchase Subsidy for Families and to ease access to the subsidies. Based on the data received in respect of the first six months, the expenditures related to housing grants stand at 36 percent of the appropriation, but dynamic rise may be expected as result of the measures effective from the second half of this year (Chart 23). The anticipated annual amount of the state subsidy provided for the building society savings is HUF 80 billion, which is in line with the budgetary appropriation. In the first six months roughly 50 percent of the subsidies for building society savings were paid. The expenditure on the tax refund programme may fall short of the appropriated expenditure of HUF 25.5 billion, since the expenditure realised in the first half of the year was merely HUF 5 billion.

Chart 23
Monthly cumulative expenditure related housing grants between 2016 and 2019

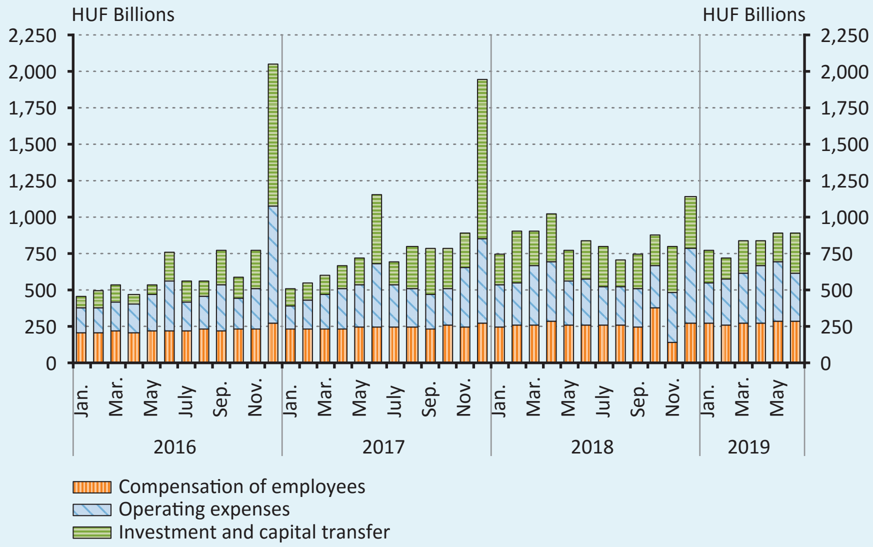


Source: Hungarian State Treasury.

In the first six months of the year, **net expenditures of budgetary institutions and chapters** amounted to 52.4 percent of the annual statutory appropriation. The realisation of the net expenditure in the first six months is similar to the realisation of the base period (Chart 24); last year, in the first six months 52.1 percent of the calculated statutory appropriation was used. When assessing the realisation of the expenditure over the pro rata level it must be taken into consideration that the government uses a significant part of the central free reserves at the institutional expenditures, and the spending of the reserves takes place continuously throughout the year. The budgetary organisations must repay the remainders of the previous year's appropriation not burdened by commitments to the Treasury account of the central budget. Last year, payments of HUF 156 billion were realised in the Central Remainder Settlement Fund; in the first half-year, this amount rose to almost HUF 262 billion, i.e. the payment of the unused and non-committed appropriation increased the gross revenues and expenditures by more than HUF 105 billion.

Our annual projection for the net own expenditures of budgetary institutions and chapters exceeds the appropriation in the Budget Act by more than HUF 500 billion. The difference does not include the absorption of the central free reserves appearing in these lines, and the chapter expenditure increasing effect of certain elements of the Family Protection Action Plan, and the expected overdrawing of certain uncapped expenditure appropriations. Compared to the statutory appropriations we assume surplus expenditures at the wage expenses, we anticipate the payments of the usual quarterly incentive bonuses at NTCA, and we also expect a minor decrease in the remainder appropriation burdened by commitments.

Chart 24
Structure of the expenditures of central budgetary organisations and chapters



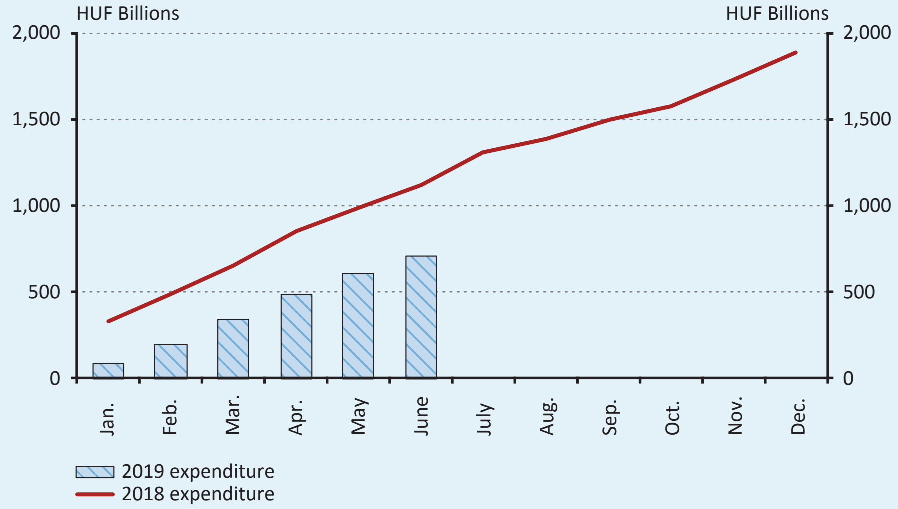
Note: The time series also contains the expenditures related to EU programmes, including the expenditures related to the pre-financing of EU programmes.
Source: Hungarian State Treasury.

The **EU expenditures of chapter-administered appropriations** amounted to HUF 711 billion in the first half of the year, which is 36 percent of the annual statutory appropriation of HUF 1,956 billion. Considering the actual data to date, according to our expectations the amount of the payments in 2019 may be below the appropriation. Slightly more than half of the payments in the first six months were advance payments, to which cash revenue will be connected only later, following the absorption of the advances and the submission of the invoices. The absorption of the advances was around HUF 380 billion in the first half-year, which represents a year-on-year growth of about 50 percent. In the first six months of the year, the largest payments were those from the Integrated Transport Operational Programme (HUF 154 billion), the Economic Development and Innovation Operational Programme (HUF 138 billion) and from the Territorial and settlement Development Operational Programme (HUF 105 billion).

Of the reserve budget of roughly HUF 184 billion, which may still be used from the **central reserves**, free reserves of HUF 130 billion in total are included in the special government measures and in the Country Protection Fund, while at the reserve budget allocated to the industry career paths, the annual appropriation was exceeded by the end of the first quarter. According to our projection, the anticipated additional expenditures may be around HUF 50 billion. The overspending is caused jointly by the government wage measures adopted after the approval of the Budget Act last year (e.g. the wage increase of government officers and the introduction of new wage brackets) and the base effect of the 2018 wage measures. The utilisation of the provision of HUF 20 billion, recognised in the Investment Preparation Fund, was continuous in the first half-year, while there was no disbursement in the first half-year from the provision of HUF 40 billion for the development of public services.

Expenditures related to the **management of state property** were realised in the amount of HUF 139 billion in the first six months of the year. Compared to the seasonality of previous years, the realisation of expenditures may be deemed high despite the fact that only 41 percent of the appropriation was realised (36 percent in last year). According to our forecast, the overspending of roughly HUF 46 billion of the annual cash expenditure appropriation may be expected at this expenditure item, but the surplus expenditures represent a purchase of shareholding or acquisition of receivables, and thus they do not increase the ESA expenditures.

Chart 25
Cumulative expenditures related to EU programmes in 2018-2019



Source: Hungarian State Treasury.

Within the expenditures of the **extra-budgetary funds** we calculate with an annual saving of roughly HUF 36 billion in relation to the active spending of the National Employment Fund compared to the appropriation, due to the lower utilisation of the public work programme. Expenditures on the Start labour programme reached 42 percent of the annual appropriation until the end of June. Expenditures related to public work decreased by 17 percent in 6 months year on year. In the remaining months of the year we expect a minor decrease in the number of public workers, which is also supported by the persistent tightness of the labour market.

In the first six months of 2019, the **pensions** disbursed from the Pension Insurance Fund amounted to HUF 1,702 billion. In the first half of 2019, pension expenditures exceed the year-on-year value by HUF 46 billion, i.e. 2.8 percent. In 2019, pensions were increased by 2.7 percent at the beginning of the year, based on the inflation rate projected in the Budget Act. The MNB's June 2019 Inflation Report forecasts an inflation of 3.2 percent for 2019, and thus in our projection we anticipate a supplementary pension increase to be implemented in November. In addition, we expect that due to the dynamic economic growth, a pension premium may be paid in November in an amount that exceeds the appropriation. The macroeconomic path of the June 2019 Inflation Report contained a GDP growth of 4.3 percent, which is higher than the 4.1 percent projection in the Budget Act. Based on the foregoing, we expected that during the year as a whole pension expenditures may exceed the appropriation despite the fact that the realisation observed in the first half of 2019 essentially corresponds to expenditure level expectable on pro rata basis.

In the first half of the year 49 percent of the expenditures for **medical and preventive care** was realised. This year, in the first five months the **outstanding debt of hospitals** amounted to HUF 37.4 billion. This means that compared to the status recorded in December, the outstanding debt rose on average by HUF 4.4 billion monthly, while last year the average monthly growth amounted to HUF 3.5 billion. The re-accumulation of debt has necessitated debt consolidation several times in recent years, typically in the form of 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 funding for public healthcare institutions. As regards the composition of this year's debt, outstanding debt overdue for less than 30 days exceeds the year-on-year value of 2018 by 3 percent, while those overdue for 30-60 days and over 60 days were up by 9 and 15 percent, respectively. Due to the accumulation of the hospitals' outstanding debt year by year, we anticipate an overspending of the appropriation.

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

	2019				
	Statutory appropriation	January-June realisation	Percent of appropriation	MNB forecast	Difference (MNB – appropriation)
PRIMARY EXPENDITURE ITEMS	**17,511**	**8,374**	**48%**	**17,530**	**19**
Special and normative subsidies and support to the public media	**448**	**269**	**60%**	**448**	**0**
Social policy fare subsidy	**91**	**46**	**50%**	**90**	**0**
Housing grants	**242**	**86**	**36%**	**257**	**15**
Family allowances, social benefits	**551**	**282**	**51%**	**551**	**0**
Early retirement benefits	**89**	**47**	**52%**	**90**	**1**
Net own expenditures of central budgetary institutions and chapters	**5,861**	**3,074**	**52%**	**6,366**	**505**
Support to local governments	**729**	**370**	**51%**	**737**	**8**
Contribution to the EU budget	**352**	**218**	**62%**	**322**	**-30**
Central reserves	**381**	**0**	**0%**	**218**	**-164**
Expenditures related to state property	**340**	**139**	**41%**	**385**	**46**
Other expenditures	**129**	**55**	**43%**	**131**	**2**
Expenditures of extra-budgetary funds	**531**	**202**	**38%**	**508**	**-23**
NEF – Passive allowances	75	36	48%	70	-5
NEF – Active allowances	180	75	42%	144	-36
Other expenditures	276	91	33%	294	18
Expenditures of social security funds	**5,812**	**2,875**	**49%**	**5,937**	**125**
PIF - Pensions	3,445	1,702	49%	3,518	73
HIF - Disability and rehabilitation benefits	287	141	49%	283	-3
HIF - Cash benefits	394	197	50%	402	8
HIF - Medical and preventive care	1,274	628	49%	1,318	44
HIF - Net expenditures of the drug budget	281	143	51%	285	4
Other expenditures	132	64	49%	132	0
Expenditures related to EU transfers	**1,956**	**711**	**36%**	**1,490**	**-466**
NET INTEREST EXPENDITURES	**952**	**364**	**38%**	**945**	**-7**
TOTAL EXPENDITURES	**18,463**	**8,738**	**47%**	**18,474**	**12**

Source: Budget Act of 2019, Hungarian State Treasury, MNB.

In the first six months of 2019, 50 percent of the appropriation for **health insurance cash benefits** were realised. Our forecast slightly exceeds the appropriation, because the expenditures to date are higher than usual for the first half-year due to the higher than expected sickness benefit expenditures, the impact of which will be felt also in the second half of the year.

In the first half of the year, 51 percent of **drug budget's net expenditures** was realised. On the whole, according to our forecast, net expenditures may slightly exceed the statutory appropriation. Gross expenditures rose to a greater degree than expected this year as well – 52 percent of the annual appropriation was realised –, which was somewhat offset by the higher payments by pharmaceutical companies. Payments by pharmaceutical companies, similarly to last year, may exceed the statutory appropriation in 2019 as well, albeit to a smaller degree than before. In the first half-year, payments in the amount of roughly HUF 45 billion were received by the budget, which represents 56 percent of the annual appropriation.

Net cash-based interest expenditures amounted to roughly 40 percent of the annual appropriation in the first half of 2019. The realisation in the first half year, which is materially behind that of last year, is partly due to the fact that interest payments partially moved from the first half to the second half of the year. The highest monthly expenditure was still realised in June, the concentration of which, however, decreased due to the shift. The other reason for the lower expenditure are the persistently low yield levels, which repeatedly decrease to a greater degree. Interest revenues in the first half year materially exceed the statutory appropriation, which is mostly attributable to the debt management transactions, and based on this, the annual interest revenue – similarly to the previous years – is likely to be realised well over the appropriation.

Our forecast with regard to the annual **net cash-based interest expenditure** is almost identical to the appropriation. This may be due to the fact that the yield level observed at the time of compiling the Public Finance Report corresponds to the level that prevailed when preparing the interest expenditure projection in the Budget Act. According to our projection, **net accrual-based interest expenditures** are also basically identical to the government's expectations, which project a decrease of 0.2 percent relative to the previous year.

3.5 BALANCE OF THE LOCAL GOVERNMENT SUB-SECTOR

During the preparation of the June 2019 Inflation Report, our projection assumed that in 2019 the local government sub-sector would close the year with a cash-based deficit exceeding HUF 320 billion. Thus our projection assumes the development of a cash-based deficit higher by more than HUF 120 billion than stated in the Budget Act. The expected high cash-based deficit is linked to the absorption of the previously received advance revenues related to EU programmes, since according to our estimate, in 2019 local governments will absorb EU advance payments of HUF 280 billion, that were received in previous years. The ESA balance of the local government sub-sector, calculated with the EU methodology, also shows a deficit in 2019.

At the end of the first quarter, in accordance with the seasonality characterising the finances of the sub-sector, local governments accumulated a cash-based surplus of HUF 210 billion. Ignoring the revenues related to the EU programmes, the surplus of the sub-sector's cash-based balance in the first quarter of 2019 decreased by more than HUF 60 billion year on year.

3.6 STATISTICAL CORRECTIONS (ESA BRIDGE)

The 2019 Budget Act was adopted assuming a **statistical correction** equivalent to HUF 400 billion. Our forecast, which is consistent with the June Inflation Report, calculates with a statistical correction of HUF 515 billion for 2019. The difference is primarily the consequence of the more moderate development of EU transfers, and change in the accrual-based corrections related to the investment spending.

3.7 EXPECTED DEVELOPMENT OF PUBLIC DEBT IN 2019

According to the MNB's financial account data, at the end of the first quarter of 2019, the gross public debt ratio stood at 70.1 percent of GDP. The debt ratio dropped significantly, by 3.6 percentage points, year on year. Contrary to the previous mid-year trends, this year the decrease in the debt ratio continued already in the first quarter, from 70.8 percent, registered at the end of last year. In the first half of 2019, the foreign currency ratio of the central government debt fell from 20.1 percent registered at the end of 2018 to 18.5 percent, while the ratio of non-residents within total government debt fell to 35.3 percent from 36.5 percent recorded at the end of last year.

According to our forecast, consistent with the June Inflation Report, gross government debt as percentage of GDP will decline further this year and by the end of the year it will fall to about 68 percent, thereby satisfying both the Hungarian and the EU fiscal rules. In addition to the moderate budget deficit, the dynamic – according to the MNB's forecast – 8.8 percent growth of the nominal GDP, also points to the decrease in the ratio this year, which is a composition of a dynamic, 4.3 percent real economic growth and the 4.3 percent GDP deflator.

The continued decline of foreign currency debt could help further reduce the vulnerability of the economy. According to our forecast, by the end of 2019 the foreign currency ratio of the central government debt will decline below 17 percent (while within the total government debt the ratio of foreign currency debt will be somewhat higher, i.e. 19.5 percent). In parallel with the major decline in foreign currency debt, the exchange rate sensitivity of the government debt and the external debt will also decrease further, also supported by the growth in households' government securities holding.

The strengthening of the domestic financing of the government provides material support for the maintenance of the negative net foreign currency issuance and the mitigation of external vulnerability, as part of which the retail securities named Hungarian Government Security Plus (MÁP+) was introduced on 3 June 2019. Since the introduction of the new retail government securities, outstanding demand was observed; in the first two month the paper was issued in excess of HUF 1,400 billion. MÁP+ offers attractive conditions, such as, for example, gradually increasing yields, automatic reinvestment of interest and free of charge redemption at defined times. **The parameters of the MÁP+ may support the maintenance of households' high savings rate and the diversion of households' new savings to the government securities market.** In addition to the attractive parameters, pick-up in demands was also supported by the abolition of the tax on interest in June.

4 Expected general government developments in 2020

The MNB published its analysis of the submitted 2020 budget bill on 11 July 2019[3]. The Parliament adopted the amended budget bill on 12 July 2019. We update our revised forecast, prepared for the June Inflation Report, with the amendments of the Budget Act's original appropriations. Below we compare the MNB's forecast and anticipation with the adopted Budget Act, and the key figures therein.

4.1 EXPECTED ESA BALANCE OF THE GOVERNMENT SECTOR IN 2020

According to the adopted Budget Act, the ESA budget deficit in 2020 may be 1.0 percent of GDP. The set deficit target is lower than the 1.5 percent deficit path stated in the Convergence Programme published in spring 2019, and it is also lower by 0.8 percentage points than the 2019 deficit target of 1.8 percent. After reviewing the details of the budget bill, based on our forecast certain revenue items may fall short of the statutory appropriations; however, this shortfall in revenues is counterbalanced by the fact that we estimate the effective absorption of the EU transfers and the government's co-financing related to the payments, as well as the expenditure of the baby-expecting low to be lower than the statutory appropriations. Thus, according to our forecast, by saving part of the free reserves, the deficit target set in the Budget Act may be fulfilled.

Table 10
Balance of the general government sector in 2020
(percentage of GDP)

	2020		
	Statutory appropriation	MNB forecast	Difference
1. Balance of the central sub-sector	-0.7	-1.1	-0.4
2. Balance of local governments	-0.1	-0.1	0.0
3. Cash-flow balance of the central-sub sector and local governments (1+2)	**-0.8**	**-1.2**	**-0.4**
4. GFS-ESA difference	-0.2	-0.2	0.0
5. ESA balance of the general government sector (3+4)	**-1.0**	**-1.4**	**-0.4**
6. ESA balance if the total Country Protection Fund is saved	**-0.2**	**-0.6**	**-0.4**

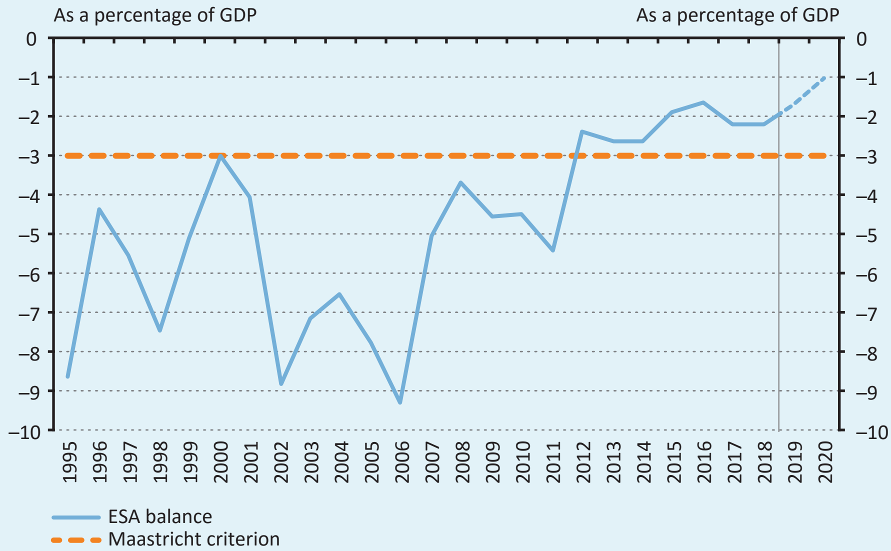
Note: The forecast of the MNB presents the fiscal projection included in the June 2019 Inflation Report.

Fiscal policy may cause a contraction in demand as a result of the decreasing deficit, which overall will result in a countercyclical fiscal policy. Within that, according to our projection, the primary balance surplus of the general government may increase in 2020 by 0.6 percentage point compared to 2019. This trend is supported by the fact that the government sector's accrual-based net interest expenditures decrease further.

In 2020, the budget deficit may decline to a historic low. According to the ESA-based data available since 1995, the accrual-based budget deficit may be the lowest in 2020 upon the fulfilment of the 1 percent target deficit (Chart 26).

[3] There are no material changes in the adopted Budget Act compared to the budget bill submitted on 4 June 2019, and the MNB's fiscal forecast has not changed materially either, and thus our analysis closely follows the content of the previously issued publication: https://www.mnb.hu/en/publications/reports/public-finance-report

Chart 26
Budget balance in 1995–2020



Note: The 2019 and 2020 point estimates assumes the cancellation or utilisation of the Country Protection Fund depending on the feasibility of the government's deficit target. This is because the Country Protection Fund may be spent only if the deficit does not exceed the designated deficit target. The point estimate assumes the utilisation of the Country Protection Fund in 2019 and its partial saving in 2020.

Source: Eurostat and MNB forecast for 2019–2020.

According to our forecast, the deficit target stipulated in the Act can be achieved if some of the free reserves (Country Protection Fund) are saved. According to our current projection, setting out from the macroeconomic path of the June Inflation Report, expects that the tax and contribution revenues of the budget together may fall short of the appropriation stated in the Budget Act by roughly 0.5 percentage point of GDP. The difference is mostly attributable to the lower revenue from income and consumption taxes, which is primarily explained by the different macro paths. At the same time, the lower than planned revenues are partially offset by the fact that according to our forecast the co-financing related to the EU expenditures and the expenditures related to the prenatal baby support may be lower than those assumed by the Budget Act. Upon full utilisation of the reserves, we estimate next year's deficit to reach 1.4 percent of GDP, which, however, the government may reduce to the set 1.0 percent deficit level by the partial saving of the reserves.

In 2020, according to the approved Budget Act, the amount of fiscal reserves will be 1 percent of GDP, i.e. higher than in the past years (Chart 27). The Country Protection Fund and the reserves for extraordinary government measures will amount to HUF 378 billion and HUF 110 billion, respectively, in 2020. Thus their total amount is HUF 488 billion, which exceeds the 2019 appropriation of HUF 225 billion for the same reserves by more than HUF 260 billion. The high amount of the Country Protection Fund contributes to the feasibility of the deficit target to a large degree, because it may be spent only if the deficit does not exceed 1 percent.

Chart 27
Fiscal reserves (extraordinary government reserves and the Country Protection Fund) between 2010 and 2020

Source: Budget Acts of 2010-2020.

The 2020 Budget Act contains several tax measures, which, among other things, serve the further reduction of taxes on labour as well as the stimulation of corporate investment and household savings. Depending on real earnings, during 2020 the social contribution tax rate may decline by a further 2 percentage points, following its fall this year, in line with the 6-year wage agreement. The VAT on accommodation services will decrease from the current 18 percent to 5 percent, which is partly offset by the extension of the tourism development contribution to the aforementioned group of services. The simplified entrepreneurial tax will be terminated, the rate of the advertising tax will decline to zero, while the rate of the small business tax will decrease from 13 percent to 12 percent from the beginning of 2020. In addition to these tax measures, pursuant to the Economy Protection Action Plan, which contains 13+1 measures, it will also be possible to apply for a VAT refund of up to HUF 5 million for residential properties in settlements involved in the rural Home Purchase Subsidy for Families (CSOK) for construction as well as expansion and renovation. The lower limit of investments that can be supported by development tax allowances will gradually be reduced from HUF 500 million to HUF 50 million for small enterprises and to HUF 100 million for medium-sized companies by 2022. In addition, the Budget Act takes into account the interest tax exemption of government securities, as well as the full exemption from personal income tax of women with at least 4 children.

Box 1
Amendments between the submission and approval of the 2020 budget bill

Compared to the provisions of the bill, submitted under no. T/6322, the amended appropriations approved by the Parliament increased the grand total of revenues by HUF 1.2 billion, while the restructuring of the expenditure-side appropriations raised the grand total of expenditures with the same amount; thus, as a result of the amendments, the cash-based deficit of the central sub-sector did not change and there was no change in the general government deficit calculated according to the EU methodology and in the planned amount of the government debt either.

As a result of the amendments on the expenditure side, expenditure appropriation of HUF 104 billion was transferred to other budget chapters, together with the tasks, from the original task owner chapters. Further expenditure appropriation of HUF 31 billion was reallocated to expenditure purposes other than initially planned, which has neutral effect on the balance. Upon amending the expenditure appropriations, surplus expenditure of roughly HUF 2 billion was also approved; the funding for this surplus expenditure is provided by the raising of the VAT revenue appropriation with the same amount. After updating the budget with the aforementioned amendments, the cash-based deficit of the general government's central sub-sector (central budget, social security funds, extrabudgetary government funds) may be HUF 367 billion, corresponding to the budget bill submitted by the government.

In 2020, the reduction of the budget deficit as compared to 2019 will primarily be implemented by cutting expenditures. The decline in the deficit is supported by curbing government investments, which rose to an extremely high level in 2018-2019, and the decrease in personnel expenditure and financial transfers as a percentage of GDP. According to the plans, the appropriations including intermediate consumption will also rise to a lesser degree than the growth in GDP, thereby supporting the deficit reducing budget path. In addition, tax revenues as a percentage of GDP will decrease only to a small degree, since the effect of the announced tax cuts will be offset by the rising tax revenues resulting from the major growth in wages and consumption.

4.2 EVALUATION OF THE MACROECONOMIC PROJECTION UNDERLYING THE BUDGET

The 2020 Budget Act forecasts economic growth of 4 percent both for 2019 and 2020. Growth forecast for this year slightly falls short of the projection in the MNB's June Inflation Report, whereas the 2020 GDP growth is significantly higher than the MNB's projection. The difference between the GDP forecasts is mainly explained by households' consumption and gross fixed capital formation. The MNB's forecast expects lower consumption growth by roughly 0.9 percentage points. The macro path of the Budget Act forecasts lower gross fixed capital formation for 2019 and higher for next year as compared to the MNB's projection. Investments considerably support GDP growth over the whole horizon, which is helped by the investment activity of the corporate sector and households as well as government projects. The MNB expects export growth to be slightly higher than foreseen in the budget in 2019 and considerably more so in 2020. According to the forecasts, net exports may have a negative contribution to GDP growth in 2019, while in 2020 it is once again expected to make positive contribution.

Table 11
Comparison of macroeconomic forecasts
(percentage change compared to the previous year)

	2018	2019			2020		
	Actual	Budget	MNB	Difference	Budget	MNB	Difference
GDP	**4.9**	**4.0**	**4.3**	**0.3**	**4.0**	**3.3**	**-0.7**
Consumption expenditure of households	5.3	4.8	5.1	0.3	4.8	3.9	-0.9
Public consumption	-2.1	1.6	0.6	-1.0	1.7	1.3	-0.4
Gross fixed capital formation	16.5	10.3	14.9	4.6	3.8	2.0	-1.8
Exports	4.7	5.1	5.4	0.3	5.2	6.2	1.0
Imports	7.1	6.5	6.5	0.0	5.4	5.7	0.3
GDP deflator	4.5	3.8	3.8	0.0	3.2	3.3	0.1
Inflation	**2.8**	**2.7**	**3.2**	**0.5**	**2.8**	**3.4**	**0.6**
Gross wage bill	**12.5**	**10.6**	**12.1**	**1.4**	**9.6**	**9.3**	**-0.3**
Gross average earnings	11.3	9.4	10.5	1.1	8.3	8.5	0.2
of which: private sector	10.9	9.8	10.9	1.1	8.9	9.6	0.7
Number of employees	1.1	1.1	1.4	0.2	1.3	0.6	-0.7
of which: private sector*	1.3 (2.0)	1.7	1.7 (1.1)	-0.6	1.6	0.7 (0.4)	-1.2

*Note: * The justification part of the budget bill defines the private sector differently from the central bank's terminology; due to this, the headcount projection comparable with the budget's macro path is shown in brackets, and the difference is also calculated from that.*
Source: 2020 Budget Act, MNB's June 2019 Inflation Report.

As regards the labour market trends, the Budget Act anticipates a more significant rise in employment in 2020 than the MNB's projection. This is why, according to the Budget Act, whole economy wage bill increases to a slightly larger degree.

The inflation projection of the Budget Act is lower for both years than the MNB's projection. The GDP deflator growth included in the Budget Act corresponds to the central bank's expectations.

4.3 CASH-BASED REVENUES OF THE CENTRAL SUB-SECTOR

According to our forecast, in 2020 the **primary revenues of the central sub-sector of the budget** may be lower than the appropriations in the approved Budget Act by HUF 321 billion in total (Table 12). Within that, tax and contribution revenues may be lower than the statutory appropriation by HUF 258 billion, i.e. by roughly 0.5 percent of GDP, most of which appears at consumption taxes. The deviation is larger than the difference between the macroeconomic projections, and thus part of it may be attributable to the reduction of the shadow economy, assumed by the Budget Act, the fulfilment of which, however, requires additional measures. Moreover, according to our forecast, the cash-based revenues related to EU funds may become also lower than the appropriation in the Budget Act.

Our forecast with regard to the **payments by economic organisations** falls short of the planned amount by HUF 30 billion. In the appropriation, revenues from **corporate income** tax exceed our forecast by HUF 29 billion, which may be explained by – in addition to the higher economic growth expected by the Act – the different assumptions related to cash disbursements. The tax packages, submitted in parallel with the 2020 budget, cancelled the obligation to top up the tax advance at the end of the year; however, this measure was introduced already in 2019, and thus its impact on the revenues of 2020 is likely to be negligible; essentially it will only modify the mid-year time profile of the receipt of the revenues.

At the revenues from the **income tax on energy providers**, the appropriation exceeds the central bank's forecast by HUF 19 billion. Since we have no knowledge of any measure related to the change in the tax burden, here the difference may be attributable to the difference between the projections related to the payments by taxpayers. At the **special tax on financial institutions**, our forecast is lower than the appropriation by HUF 5 billion, which may be caused by the different estimation of the degree of tax allowances.

At the **small taxpayers' itemised lump sum tax (KATA)**, our projection falls short of the appropriation by HUF 6 billion. The difference is explained by the fact that the financial government estimates higher growth in the number of taxpayers for 2020 than the MNB's assumption updated in June. With respect to **small business tax (KIVA)** revenues, the appropriation exceeds our expectation by HUF 11 billion, also due to the different assumptions regarding the growth in the number of taxpayers. The tax package reduces the rate of this tax type by one percentage point from 1 January 2020; however, the revenue reducing effect of the measure may be fully offset by the increase in headcount, which is linked to the termination of the simplified entrepreneurial tax at the end of 2019. The statutory appropriation contains by HUF 8 billion higher revenue from **e-road toll** than the central bank's projection; the difference is presumably attributable to the government's macroeconomic projection. Revenues from **mining royalties, penalty revenues** among other centralised revenue and **environmental product levies** may exceed the statutory appropriation by HUF 10 billion, HUF 22 billion and HUF 10 billion, **respectively. The difference at all items may be attributable to the base effect, since the revenues expected by the MNB** for 2019 substantially exceed the 2019 appropriations. The **simplified entrepreneurial tax (EVA)** will be phased out, while the **advertising tax** rate is expected to be 0 percent from 2020, therefore the receipts by the State Treasury from these items may be lower by HUF 44 billion and 15 billion, respectively, compared to 2019.

Table 12
Partially consolidated cash-based revenues of the central sub-sector in 2019-2020
(HUF billions)

	2019			2020		
	Statutory appropriation	MNB forecast	Difference	Statutory appropriation	MNB forecast	Difference
TAX AND CONTRIBUTION REVENUES OF THE CENTRAL SUB-SECTOR	**15,651**	**15,970**	**319**	**17,192**	**16,934**	**-258**
Payments by economic organisations	**1,444**	**1,440**	**-4**	**1,690**	**1,660**	**-30**
Corporate income tax	400	296	-103	501	472	-29
Special tax of financial institutions	53	55	2	65	60	-5
Simplified entrepreneurial tax	45	44	-1	0	0	0
Mining royalty	36	48	12	38	48	10
Gambling tax	31	32	1	36	36	0
Income tax on energy providers	59	30	-29	74	55	-19
Lump sum tax of small entrepreneurs	136	161	25	193	187	-6
Small enterprise tax	50	64	14	88	77	-11
E-road toll	198	218	21	235	227	-8
Utility tax	55	55	0	54	55	1
Other taxes and payments	366	420	54	406	443	37
Advertising tax	15	15	0	1	0	0
Consumption taxes	**5,822**	**6,191**	**369**	**6,637**	**6,484**	**-153**
Value added tax	4,290	4,546	256	4,970	4,782	-188
Excise duties	1,141	1,204	63	1,226	1,256	30
Registration tax	28	27	-1	27	27	0
Telecommunication tax	52	57	4	54	57	3
Financial transaction levy	228	246	18	226	225	-2
Insurance tax	67	88	20	98	103	5
Tourism development contribution	16	24	9	36	35	-1
Payments by households	**2,608**	**2,658**	**50**	**2,899**	**2,844**	**-55**
Personal income tax	2,361	2,380	19	2,609	2,555	-54
Duties, other taxes	199	229	30	238	238	0
Motor vehicle tax	48	50	2	52	51	-1
Tax and contribution revenues of extrabudgetary funds	**468**	**481**	**13**	**451**	**454**	**3**
Tax and contribution revenues of social security funds	**5,310**	**5,200**	**-110**	**5,516**	**5,492**	**-24**
Social contribution tax and contributions	5,124	5,006	-118	5,344	5,340	-4
Other contributions and taxes	186	194	8	172	153	-20
REVENUES RELATED TO EU FUNDS	**1,494**	**1,162**	**-332**	**1,513**	**1,448**	**-65**
OTHER REVENUES	**304**	**380**	**76**	**350**	**353**	**3**
Other revenues of the central budget	**180**	**245**	**65**	**217**	**220**	**3**
Other revenues of social security funds	**34**	**31**	**-3**	**33**	**32**	**-1**
Other revenues of extrabudgetary funds	**90**	**104**	**14**	**99**	**101**	**2**
TOTAL REVENUES	**17,449**	**17,512**	**63**	**19,056**	**18,735**	**-321**

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

Source: Budget Act of 2019 and 2020, Hungarian State Treasury, MNB.

On a cash basis, the Budget Act expects revenues of HUF 4,970 billion from **value added tax,** which exceeds our projection by HUF 188 billion. Part of the difference may be explained by the difference between the macroeconomic projections, since according to the MNB's projection households' consumption expenditure will rise by 3.9 percent, while the Budget Act contains a growth of 4.8 percent. In addition, the government also expects higher growth, compared to the central bank, in public consumption and gross fixed capital formation, which also affect the tax base, albeit to a smaller degree. In addition to the foregoing, the difference between the two forecasts is also influenced by the fact that the Budget Act anticipates additional surplus tax revenues from the processes related to the reduction of the shadow economy, which may require further measures. Our forecast has taken into account that the VAT rate on commercial accommodation services will drop from the current 18 percent to 5 percent next year, which is estimated to result in HUF 35 billion lower revenues.

The 2020 appropriation for the **excise duty** revenues is HUF 1,226 billion, which is HUF 30 billion lower than our forecast. The lower statutory appropriation may be caused by the different assessment of the base; in 2019, we expect surplus tax revenue by more than HUF 60 billion at this tax type compared to the statutory appropriation. The difference is the result of opposite effects: the budget expects lower excise duty revenues from tobacco and other sources (alcoholic beverages, spirits), whereas it foresees higher excise duty revenues from fuel. The excise duty on tobacco will increase in January and July 2020, which is expected to raise revenues by HUF 25 billion as compared to 2019.

Next year's appropriation for the **financial transaction levy** amounts to HUF 226 billion, in line with our forecast. The newly introduced measures include the elimination of the tax for the State Treasury transactions, and the tax on the transactions conducted through the Post will also decline, reducing revenues by HUF 11 billion. The elimination of the financial transaction levy for State Treasury transactions has no effect on the balance, since at the same time it appears at the Treasury as a decrease in expenditure.

Following the revenue of HUF 88 billion from **insurance tax** this year, for next year we calculate with HUF 103 billion, which exceeds the statutory appropriation by HUF 5 billion.

The appropriation of the approved 2020 Budget Act for **personal income tax** revenues is HUF 2,609 billion, which exceeds the 2019 appropriation by more than 10 percent. According to our forecast, the expected revenue – based on the macroeconomic path consistent with the MNB's June Inflation Report – may be lower than that by HUF 54 billion, which difference may be attributable to the slightly different assumption related to the growth in wage bill. According to our projection, the allowances available for personal income tax may be somewhat lower than the values stated in the annex to the Budget Act. The forecasts contain the lifetime tax exemption of the mothers raising at least four children as part of the Family Protection Action Plan, as well as the interest tax exemption of government securities issued from June this year. Our projection for the budgetary impact of the tax allowance for mothers with four or more children is approximately the same as the HUF 22 billion in the bill, while we estimate that the interest tax exemption of household government securities may cause a revenue shortfall of HUF 6 billion.

The statutory appropriation for **revenues from duties** is HUF 229.5 billion, which represents a growth of almost 20 percent compared to this year's statutory appropriation – expected to be over-fulfilled by roughly HUF 30 billion –, and 4 percent compared to our forecast for this year. Revenues from duties are greatly affected by duty payments on real properties, which in the first half of this year exceeded the revenues of the first half of 2018 by 24 percent. Duties on residential property may be paid in 12-month instalments, and thus the effect of this year's dynamic revenue increase may also raise next year's revenues from duties, and thus we deem the statutory appropriation substantiated.

The combined appropriation for **tax and contribution revenues from social insurance and extrabudgetary funds** for 2020 is HUF 5,967 billion, which is practically the same as our forecast. The social contribution tax is expected to decline as set forth in the Act; however, the Act does not include the timing of this in 2020. Upon preparing our forecast, we enforced the tax cut connected to the wage agreement in next year's last quarter, i.e. following the second half of this year, the social contribution tax rate may once again decline by 2 percentage points to 15.5 percent. Our projection related to labour tax and contribution burdens is almost identical to the budgetary appropriations. Most of the tax revenue appropriations for social security funds are in line with our forecast, the only major difference is at the public health product tax, where the appropriation is by HUF 20 billion higher than our expectation.

The budget plans the **cash-based revenues related to EU funds** to be HUF 1,513 billion (out of which HUF 1,482 billion is foreseen to come from EU programme revenues, which is HUF 130 billion higher than the 2019 statutory appropriation, while Other EU revenues amount to HUF 17 billion, and the Other receipts for the EU chapter-administered appropriations amount to HUF 14 billion). The Budget Act does not detail its expectations regarding the structure of payments and the anticipated utilisation of the advances, which form the basis of the expected cash-based revenues. According to our projection, the sum of the invoiced payments and the absorption of the advances, i.e. the effective utilisation of funds may be around HUF 1,800 billion in 2020. If the amount exceeding the co-financing part of this is fully reimbursed by the European Union, revenues may amount to around HUF 1,450 billion.

4.4 CASH-BASED EXPENDITURES OF THE CENTRAL SUB-SECTOR

According to our projection, **the cash-based expenditures of the central sub-sector** will fall short of the statutory appropriation, also including free reserves, by HUF 190 billion in 2020. Expenditures related to EU transfers and net interest expenditure may fall short of the appropriation by almost HUF 110 billion and HUF 56 billion, respectively.

Housing grants are expected to rise by HUF 21 billion compared to 2019. The increment is primarily due to the additional expenditures related to the Family Protection Action Plan and the Hungarian Village Programme adopted during the year (measures of the rural CSOK and the extension of the loan with interest subsidy). The cost of the subsidies granted for the construction and purchase of new and used homes, as well as the interest subsidy provided for the related preferential loan will also increase. Due to the termination of the VAT refund subsidy, available for new constructions, outside the preferred small settlements, tax reimbursement expenditures will decrease, while the expenditures related to building societies will decline due to the absence of new members and the phase-out of existing contracts. Despite the foregoing, we do not expect expenditures to reach the amount stated in the appropriation.

Among the key items of the **National Family and Social Policy Fund**, at the family benefits**,** the 2020 appropriation for family allowance is consistent with our projection, expected to be around HUF 305 billion. At other items of the family allowance, similarly to the income substitute and supplementary social benefits, and benefits under various titles, the appropriations may be realised in accordance with our forecast. The fact that the appropriation is HUF 25 billion higher than in earlier years is mainly linked to the larger appropriation for the performance of social tasks in the country districts. Among other things, the increased home care allowance is recognised here.

Table 13
Partially consolidated cash expenditures of the central sub-sector in 2019-2020
(HUF billions)

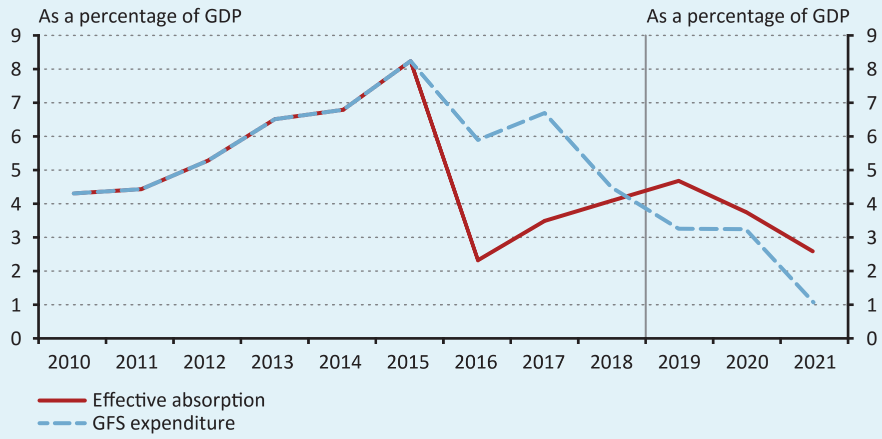
	2019			2020		
	Statutory appropriation	MNB forecast	Difference	Statutory appropriation	MNB forecast	Difference
PRIMARY EXPENDITURE ITEMS	**17,511**	**17,530**	**19**	**18,377**	**18,244**	**-134**
Special and normative subsidies and support to the public media	**448**	**448**	**0**	**487**	**487**	**0**
Social policy fare subsidy	**91**	**90**	**0**	**91**	**91**	**0**
Housing grants	**242**	**257**	**15**	**297**	**278**	**-19**
Family allowances, social benefits	**551**	**551**	**0**	**575**	**575**	**0**
Early retirement benefits	**89**	**90**	**1**	**86**	**90**	**4**
Net own expenditures of central budgetary organisations and chapters	**5,861**	**6,400**	**539**	**5,985**	**6,125**	**140**
Support to local governments	**729**	**737**	**8**	**739**	**739**	**0**
Contribution to the EU budget	**352**	**322**	**-30**	**398**	**386**	**-12**
Central reserves	**381**	**184**	**-198**	**663**	**503**	**-160**
Expenditures related to state property	**340**	**385**	**46**	**433**	**433**	**0**
Other expenditures	**129**	**131**	**2**	**192**	**189**	**-3**
Expenditures of extra-budgetary funds	**531**	**508**	**-23**	**549**	**541**	**-8**
NEF – Passive allowances	75	70	-5	83	83	0
NEF – Active allowances	180	144	-36	140	132	-8
Other expenditures	276	294	18	326	326	0
Expenditures of social security funds	**5,812**	**5,937**	**125**	**6,178**	**6,210**	**32**
PIF - Pensions	3,445	3,518	73	3,580	3,624	44
HIF - Disability and rehabilitation benefits	287	283	-3	282	281	0
HIF - Cash benefits	394	402	8	447	440	-7
HIF - Medical and preventive care	1,274	1,318	44	1,429	1,429	0
HIF - Net expenditures of the drug budget	281	285	4	301	297	-4
Other expenditures	132	132	0	138	138	0
Expenditures related to EU transfers	**1,956**	**1,490**	**-466**	**1,706**	**1,597**	**-109**
NET INTEREST EXPENDITURES	**952**	**945**	**-7**	**1,045**	**990**	**-56**
TOTAL EXPENDITURES	**18,463**	**18,474**	**12**	**19,423**	**19,233**	**-190**

Note: The difference between the expenditure totals shown in the table and those indicated in the Budget Act is due to the fact that, based on the data available, we excluded the effect of cash-transfers within the central sub-sector, and recognised certain expenditure items in net terms, i.e. reduced them by the related direct revenues. Of the reserves, we recognised provisions of HUF 160 billion under the net own expenditures of central budgetary organisations and chapters, since upon the realisation of the budget they will be presumably recognised there.

Source: Budget Act of 2020, Hungarian State Treasury, MNB.

The approved Budget Act defined the **net own expenditure of the central budgetary organisations and chapters** in the amount of HUF 5,985 billion. Our forecasts estimates HUF 140 billion higher net expenditure than the appropriation, mainly because we expect the HUF 160 billion from the appropriation for provisions to be used as institutions' wage appropriation. We forecast to see the uncapped appropriations for language camps and the car purchases of large families under the Family Protection Action Plan to be exceeded by HUF 23 billion, on account of the higher expected utilisation. Compared to the government's plans, the advance revenues related to EU programmes received in the respective year by institutional- and professional-administered appropriations and the utilisation of the advances received earlier in the respective year may reduce the net cash-based expenditure of these bodies by HUF 67 billion, in line with our projection for EU programme expenditures. Next year, we expect the budgetary organisations to utilise HUF 230 billion from the EU advances received in earlier years. As a result of the total effect of the items above, net cash expenditure will exceed the appropriation in the Budget Act by HUF 140 billion, but the reallocation of the provisions in the amount of HUF 160 billion also forms part of this. Therefore in the cash accounting – considering the utilisation of the provisions for wages – the net own expenditure of budgetary organisations is estimated to be by HUF 20 billion lower than the statutory appropriation.

Chart 28
Developments in the actual utilisation related to EU transfers and in cash payments



Source: Hungarian State Treasury, Ministry of Finance, MNB projection 2018–2020.

The 2020 Budget Act foresees the **expenditures of EU programmes** to amount to HUF 1,706 billion, which falls short of the 2019 expenditure appropriation by roughly HUF 250 billion. Considering the utilisation of the advances and the revenue estimate, we may still assume a higher amount of advance payment; however, the Budget Act does not contain the degree of this. According to our forecast, the expenditures of EU programmes expenditures may fall short of the appropriation, amounting to HUF 1,597 billion in 2020. In the first six months of 2019, payments were around HUF 700 billion and we do not expect the rate of the payments to accelerate materially in 2020 either. According to our estimation, about one third of the total payment may be advance payment in 2020. The cash expenditures and, through that, the cash-based deficit reflect the amount of national co-financing, as well as 10 percent of the funding that is reimbursed by the European Commission to the member states only at the end of the programming period, and thus this amount also must be advanced by the budget. As this 10 percent may be recognised as accrual-based revenue, it does not affect the ESA balance, but increases the financing need, and thereby the government debt. According to our expectations, owing to the rise in the invoice payments and utilisation of advances, the effective utilisation, reflecting the real economy implementation of the projects related to the 2014-2020 programming period, may peak in 2019, followed by a decline in 2020.

The 2020 appropriation for **retirement provision** paid from the Pension Fund amounts to HUF 3,580 billion in total. Our forecast expects the pension expenditure to exceed the appropriation by HUF 44 billion. The divergence is explained by our higher expenditure projection for the base year and the difference of the macroeconomic paths. The 2020 Budget Act was prepared based on a 2.8 percent consumer price index, while the MNB's June Inflation Report includes an inflation rate of a 3.4 percent for 2020. Due to the higher consumer price index we assume that in November a supplementary pension increase will take place.

The 2020 appropriation for the largest pension expenditure item, **old-age pensions over the retirement age**, amounts to HUF 2,888 billion, whereas our forecast includes HUF 68 billion higher expenditure. The difference is attributable to the divergence of the base year expenditures and to the higher projected inflation. Similar to 2019, in 2020, the difference between the appropriation and our forecast is also influenced by the differing estimate of the inflation, which serves as the basis for the regular pension increase at the beginning of the year. In 2020, new old-age pensions will be assessed only in the second half of the year, since those born in 1956 retire after reaching the age of 64.5.

For the **pensions due to women after the 40-year eligibility period**, the statutory appropriation for 2020 amounts to HUF 286 billion. Our projection estimates slightly lower expenditure (by HUF 3 billion), which is probably mainly due to the difference in the estimate of the number of beneficiaries. As regards the early retirement benefit of women, we continue to expect increasing utilisation, considering the fact that an increasing number of women complete the 40-year eligibility period necessary for retirement prior to reaching the retirement age, as the retirement age gradually rises.

The 2020 Budget Act calculates with the payment of **pension premium** in 2020 in the amount of HUF 20.4 billion, based on the 4 percent GDP growth included in the macroeconomic path. The MNB's macroeconomic forecast prepared for its June Inflation Report projects GDP growth of 3.3 percent for 2020, and thus we do not include pension premium payments in our forecast for 2020 (according to the law the pension premium is paid if real growth exceeds 3.5 percent).

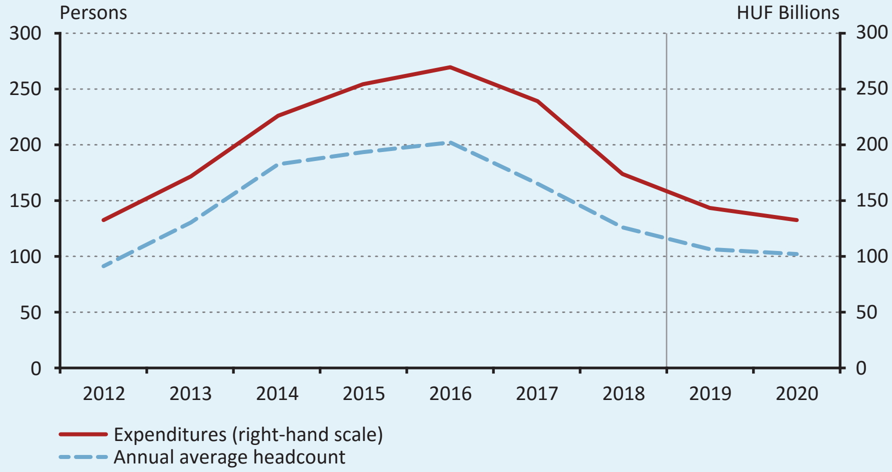
The statutory appropriation for **medical and preventive care** amounts to HUF 1,429 billion in 2020, which exceeds the level of expenditures expected by our 2019 forecast by HUF 112 billion, i.e. 8.5 percent. Compared to the base year, part of the expenditure increment is caused by the fact that the 2020 Budget Act includes surplus expenditure of HUF 40 billion for the reform of the funding scheme and HUF 10 billion for the improvement of primary care. At the same time, it represents a risk for expenditures that the growth rate of the health institutions' overdue outstanding debt has accelerated in the first half of 2019 year on year.

According to next year's appropriation, **cash benefit expenditures** will amount to HUF 149 billion in the case of sick pay and HUF 216 billion in the case of the childcare benefit. For sick pay, the appropriation is higher than our projection by HUF 3 billion, while for the childcare benefit, it is greater by HUF 5 billion. The difference may be attributable to the fact that we assess the expenditure increasing effect of the family protection measures next year differently, and thus the budget calculates with higher utilisation than expected by the central bank.

The 2020 budget contains HUF 393 billion for the **gross expenditures of drug reimbursement**, which – also considering the payments by pharmaceutical companies – represents net drug reimbursement expenditure of HUF 301 billion. The net expenditure for drug reimbursements exceeds our projection prepared in line with our June Inflation Report by HUF 4 billion. In former years, this expenditure item of the budget was often underestimated, but we find the appropriation for next year substantiated.

With respect to the **expenditures of the extrabudgetary funds**, our forecast related to the passive expenditures of the National Employment Fund essentially corresponds to the appropriation, while at the active expenditures we forecast slightly lower expenditure compared to the appropriation. At the Start labour scheme, we assume the persistence of the trends of previous years, i.e. the average number of workers employed in the programme will continue to decline. This trend is supported by the fact that the tightness of the labour market will not slacken next year either, and according to our assumption, the government will continue to encourage the scheme's participants to find work in the private sector. According to our projection, compared to the appropriation a saving of HUF 8 billion will be realised under the expenditures of the public work scheme.

Chart 29
Average annual headcount of those employed in the START labour programme and budgetary expenditure related to the programme



Source: HCSO, Final Account Acts of 2012-2017, Hungarian State Treasury, MNB.

Our forecast for **net cash-based interest expenses** falls short of the appropriation in the Budget Act by HUF 56 billion. According to our forecast, gross interest expenditures may be in line with the statutory appropriation, while – in line with the data of previous year – we estimate interest revenues to become materially higher, since at the mid-year debt management transactions generating revenues, our projection calculates with higher volume than assumed upon the planning of the appropriation.

According to our projection, the **net accrual-based interest expenditure** may correspond to the statutory appropriation, and may be slightly below 2.1 percent of GDP, which would be a moderate decline compared to the previous year.

4.5 BALANCE OF LOCAL GOVERNMENTS

According to the annex to the Budget Act, **the balance of local governments** may close with a cash deficit of HUF 45 billion in 2020. The central bank's projection includes a deficit that is higher by HUF 17 billion, in a structure differing from the plan. According to our expectations, the investment activity of the sub-sector will be high due to the absorption of the available EU advances. According to our estimate, in 2020 the absorption of EU advances may come close to HUF 300 billion, while the capital formation expenditure implemented under the Modern Cities Programme will decelerate compared to the base year.

4.6 STATISTICAL CORRECTIONS (ESA BRIDGE)

According to the Budget Act, the GDP-proportionate ESA bridge containing statistical corrections increases the deficit of the ESA balance by 0.2 percent of GDP (by HUF 73 billion in nominal terms). Our forecast estimates a GDP-proportionate correction of similar direction and degree as the Budget Act, but in a slightly different structure. At the statistical correction related to settlements with the EU, we calculate with smaller deficit increasing effect than the government. The difference is due to the different scheduling of the absorption and drawdown of EU funds. At the same time, their corrections applied to enterprises allocated to the government sector and to the financial transactions, adjust the balance toward a higher deficit compared to the ESA bridge accounting prepared for the Budget Act.

4.7 EXPECTED DEVELOPMENT OF PUBLIC DEBT IN 2020

Calculating, as a rule, with unchanged end-2018 exchange rate of EUR/HUF 321.5, the **gross general government debt-to-GDP ratio according to the EDP methodology** is forecast to decline from 70.8 percent recorded at the end of 2018 to 68.1 percent in 2019, and then to decrease further to 65.4 percent by the end of 2020. The substantial contraction in the debt ratio is supported by the low budget deficit and dynamic economic growth.

In addition to the cash-based deficit of the central sub-sector, the utilisation of the EU advances received earlier by local governments and state-owned enterprises and held on their accounts with the State Treasury represents additional financing need. At the same time, the reimbursement of the absorbed grants from the EU's structural funds also provides coverage for this financing need, if it is realised during the year. Thus, the financing effect of the utilisation of the EU advances held on the accounts with the Treasury extends only to the degree of the national co-financing.

As a result of negative net foreign currency issuance, the foreign currency ratio of government debt is expected to decline further at a fast rate, contributing to the decrease in the external vulnerability of the economy. The foreign currency ratio of the central debt fell from 50 percent registered at the end of 2011 to around 20 percent by the end of 2018, and according to our forecast it will shrink to 14 percent by the end of 2020. In parallel with the major decline in foreign currency debt, the government debt's exchange rate sensitivity and the share of external debt will also substantially diminish.

5 Compliance with the fiscal rules

There are a total of eight fiscal rules that pertain to the Hungarian general government between 2018 and 2020, with four Hungarian and four European Union requirements for the Hungarian budget management. There are two overlaps between the rules: the 3 percent Maastricht deficit criterion and the rules regarding the medium-term budgetary objective. The other two Hungarian rules include the debt rule in the Fundamental Law and the debt formula specified in the Stability Act. The requirements that only appear in the European Union's legal system are the expenditure benchmark and the Maastricht debt rule.

In 2018, the Hungarian fiscal developments were in line with the rules related to the ESA balance of the budget and to the debt, and they are expected to continue to do so in the future. According to our expectations, the 3 percent deficit target used in both legal systems, will be achieved in all three years. The annual decline in government debt also complies with the Fundamental Law's debt rule, the debt formula's requirements and the Maastricht debt rule. At the same time, last year and this year the structural balance of the Hungarian budget has not yet reached the medium-term budget objective, and it does not comply with the EU expenditure benchmark; however, the degree of the decrease in deficit, stipulated in the 2020 Budget Act, may comply with the EU fiscal framework.

As regards the **debt rule of the Fundamental Law**, Hungary's debt ratio is over 50 percent of GDP over the whole forecast horizon, therefore, in accordance with the rule, it has to be reduced in each year. According to the information provided by the Ministry of Finance to the Fiscal Council, the debt ratio defined by the Stability Act dropped by 2.6 percentage points to 70.8 percent in 2018, which is consistent with the requirement of the Fundamental Law. Based on the MNB's projection, the debt ratio calculated with the EU methodology at a constant foreign exchange rate, falls by 2.8 and 2.6 percentage points in 2019 and 2020, respectively, therefore the debt rule is expected to be complied with, even when taking into account that based on the Stability Act, the Hungarian rules define debt slightly differently than the Maastricht methodology.

The other Hungarian fiscal rule applicable to public debt is the **debt formula** of the Stability Act, where calculation of the debt ratio is also determined by the Stability Act's methodology. The 2018 Budget Act calculates with a real economic growth of 4.3 percent and a 3 percent inflation in 2018, and thus the debt formula prescribed a debt reduction of only 0.1 percentage point, which was realised. Among the assumptions underlying this year's Budget Act, the 4.1 percent real economic growth expected for 2019 is significantly higher than the threshold in the debt formula, while the 2.7 percent inflation stipulated in the Act for this year does not exceed it. The annex to the adopted 2020 Budget Act includes an economic growth rate of 4 percent and an inflation of 2.8 percent, i.e. the debt ratio has to be reduced merely by 0.1 percentage point both this and next year, which is likely to be achieved. Based on the MNB's June forecast, inflation will exceed 3 percent in both 2019 and 2020; however, for the purpose of the debt formula of the Stability Act, it is the projection in the Budget Act that has relevance.

The **Maastricht deficit criterion,** included in both the Hungarian and the EU fiscal framework, specifies that the accrual-based deficit of the general government may not exceed 3 percent of GDP.[4] The Hungarian budget deficit was 2.2 percent of GDP in 2018, this year's deficit is expected to be around 1.6-1.7 percent of GDP depending on the utilisation of reserves, and it may be 0.6-1.4 percent of GDP in 2020, therefore the fiscal rule related to the general government's ESA deficit is expected to be complied with in all three years.

Pursuant to the rules on the **medium-term budgetary objective** that are also part of both legal systems, the balance of the general government has to be determined in a way that it should be in line with achieving the medium-term budgetary objective.[5] The objective is measured by the structural balance, which refers to the cyclically adjusted balance net of

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

one-off and other temporary items. For Hungary, the medium-term budgetary objective (MTO) was -1.5 percent of GDP since 2017, which will change to -1.0 percent of GDP from 2020. Based on this year's Convergence Programme[6], Hungary's structural balance was -2.3 percent of GDP in 2018, which will drop to -1.9 percent this year and to -1.6 percent in 2020. Based on the data, the structural balance of the general government is not in line with attainment of the medium-term budgetary objective over the forecast horizon. However, the adopted 2020 Budget Act amended the budget's expected structural deficit to -1.1 percent of GDP, which – although does not reach the reduced MTO – it comes substantially close to it. In the spring 2019 forecast by the European Commission, Hungary's structural balance was -3.7 percent of GDP in 2018, which will rise to -3.3 percent this year before falling to -2.7 percent as a percentage of GDP terms in 2020.[7] Pursuant to the Stability and Growth Pact, the EU may prescribe an adjustment path for the Member States that are not at the MTO, as well as a corresponding annual structural adjustment, which is 0.5 percent of GDP on average by default. According to the Commission, this year Hungary is required to improve the structural balance by 1 percent of GDP and in 2020 by 0.75 percent of GDP, considering good economic times, a debt ratio that is over 60 percent and the positive sign of the output gap. As a result of the failure to converge towards the MTO, the European Council – at the initiative of the Commission – launched an SDP (significant deviation procedure) against Hungary in 2018. The SDP only entails concrete financial sanctions (blocking of an interest-bearing deposit) for euro area Member States.

According to the Budget Act, the structural deficit may remain slightly above the target in 2020; however, the degree of decrease in the deficit may be sufficient for Hungary to comply with the MTO framework. By reaching the set ESA deficit target of 1 percent, the budget may be in line with the adjustment path; however, it should be noted that the exact rate of the change in the structural deficit is surrounded by significant methodological uncertainties (bearing in mind factors such as the output gap and the estimation of potential GDP, the uncertainty surrounding the elasticity between the real economy and the budget, the multi-year smoothing of net government investments, or the variability of the one-off and temporary budgetary items, etc.). If the required 0.75 percentage point structural adjustment, expected for next year, is achieved (which caps the annual growth rate of net primary expenditures at 4.7 percent), both the expenditure benchmark and the MTO criterion may be complied with.

The **European debt rule** states that the Member States' government debt ratio[8] must not exceed 60 percent of GDP, or if it does, the debt ratio must be reduced by a satisfactory pace. The appropriate decrease in the debt is quantified by the one-twentieth rule, according to which the debt ratio should be reduced by one twentieth of the part that exceeds 60 percent on average over three years. Based on its own forecast, the European Commission calculates the extent of the change of the debt ratio using three different methodologies (forward-looking, backward-looking and cyclically adjusted), and if the one-twentieth drop is satisfied based on any of them, the rule is deemed to have been complied with.

Hungary's gross government debt ratio was over 60 percent of GDP in all three years under review, but the extent of the expected reduction satisfies the requirements of the debt rule on average. The 2018 debt ratio amounted to 70.8 percent of GDP, which represents a 2.6 percent decline compared to the end of the previous year. According to the MNB's projection, the debt ratio may fall by 2.8 and 2.6 percentage points this year and next year, respectively, while the European Commission expects a drop of 1.6 and 1.5 percentage points, i.e. based on all forecasts, the expected reduction of government debt will be realised.[9]

[6] Hungary's Convergence Programme 2019-2023, Table 4

[7] Assessment of the 2019 Convergence Programme for Hungary, 05 June 2019, 4.2. Compliance with the MTO or the required adjustment path towards the MTO, Table 5

[8] Gross, consolidated debt at nominal value, which, in contrast to definition of the debt ratio in the Stability Act, includes the additional debt arising from the subsequent return on EU funds and the impact of exchange rate movements.

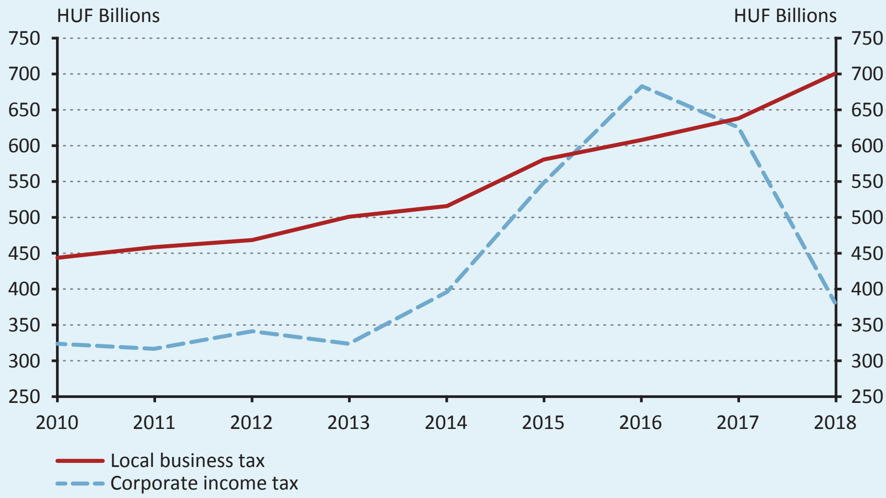
[9] Assessment of the 2019 Convergence Programme for Hungary, 05 June 2019, 3.4. Debt developments, Table 3

6 Special topics

6.1 THE DEVELOPMENT AND DISTRIBUTION OF LOCAL BUSINESS TAX

The local business tax is one of the largest item among corporate tax payments, but it is received by the local governments rather than by the central budget. The local government sector earned revenues under this title in the amount of HUF 600 billion in 2016, HUF 637 billion in 2017 and HUF 700 billion in 2018. For the sake of comparison, in these three years the budget revenues from corporate income tax amounted to HUF 683, 624 and 380 billion, respectively (Chart 30). As regards the revenues from corporate income tax, in 2016 and 2017 it is due to the Growth Tax Credit in the amount of HUF 265 billion and HUF 268 billion, respectively, that in these two years payments exceeded or were close to the value of the local business tax revenues.

Chart 30
Cash revenues from corporate income tax and local business tax, 2010-2018



Source: Hungarian State Treasury.

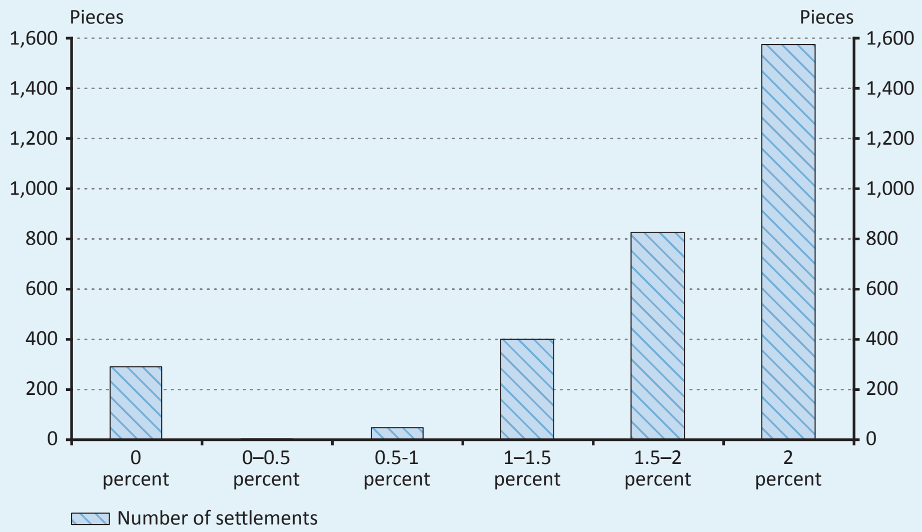
This tax type is one of the most important pillars of local government funding. In the past years, local business tax accounted for roughly 20-25 percent of the local governments' total revenues (including subsidies).

The base of the local business tax is broader than the corporate income tax base. The base for the local business tax is the company's net sales revenues less cost of goods sold, services used, material costs, subcontractors' performance and the direct cost of R&D activities recognised in the tax year. This tax base is slightly higher than the value added, and thus it covers the profit, depreciation and labour costs; in addition, the interest expenditures also form part of the tax base, and thus overall it is materially broader than the corporate tax base.

In addition to the tax base, the range of taxpayers is also broader; by default, the taxpayers opting for small business taxes are also obliged to pay local business tax. The tax type is independent of the financing structure of the company, since the interest expenditure does not reduce the tax base, and thus it gives no preference to loan financing over capital financing.

Local governments define the rate of the local business tax independently, within the statutory interval of 0 and 2 percentage points. According to the Hungarian State Treasury's data for 2019, the rate of the local business tax was higher than 0 percentage point in 2,867 out of 3,155 settlements. The rate was 2 percent in more than half of the settlements, i.e. in 1,581 local governments, it was 0 percent in 288 settlements, and in the remaining 1,286 settlements it was between 0 and 2 percent (Chart 31).

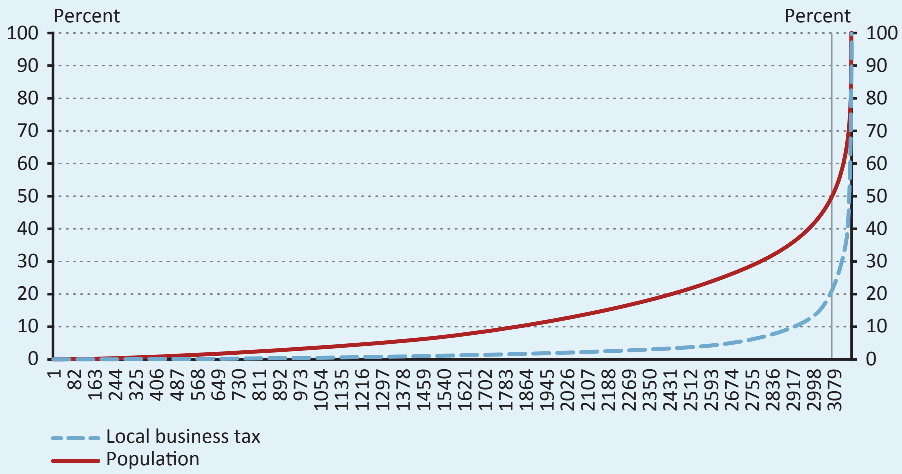
Chart 31
Distribution of settlements by the rate of the local business tax in 2019



Source: Hungarian State Treasury.

The distribution of the revenues among the local governments is uneven. In 2017, 81 settlements received 80 percent of the local business tax payments. These settlements accommodate roughly half of Hungary's population (Chart 32). The share of settlements with population below 5,000 persons from the local business tax revenues is extremely low compared to the ratio of their population (Chart 33). One reason for the deviation from the distribution as a percentage of the population is that revenues are earned in the medium-sized and large towns serving as business sites for several companies, while the settlements in the suburbia of those do not benefit from the impact of the taxation of the assets created by the employees commuting to the central location.

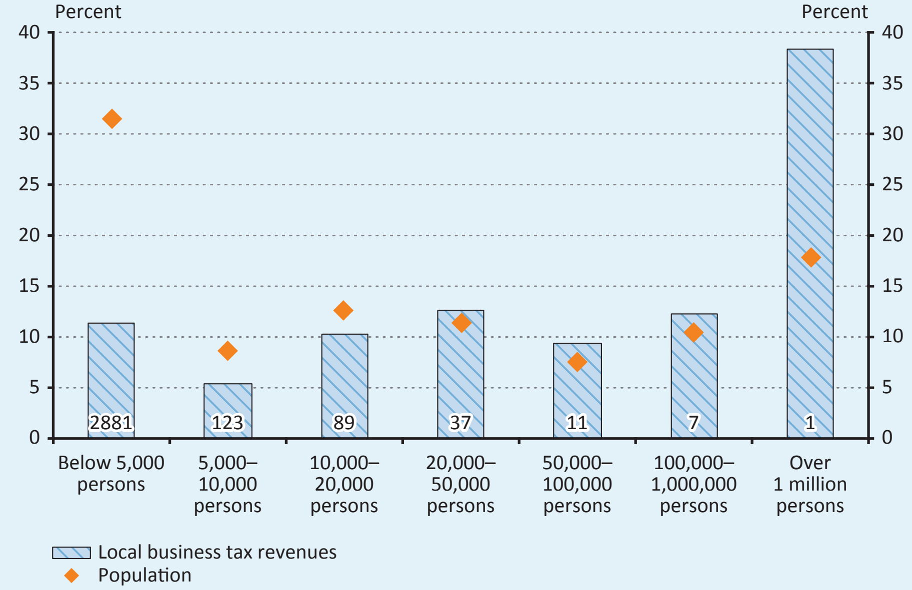
Chart 32
Cumulative distribution of local business tax revenues and of the population in 2017



Note: The vertical line shows 50 percent of the population, i.e. half of the population lives in the settlements to the left and to the right from the line.

Source: Hungarian State Treasury, HCSO.

Chart 33
Ratio of certain groups of settlements by local business tax revenues and population in 2017



Note: the captions show the number of settlements in each groups
Source: Hungarian State Treasury, HCSO.

6.2 THE EFFECT OF THE INTRODUCTION OF THE ONLINE CASH REGISTERS ON THE REPORTED TURNOVER[10]

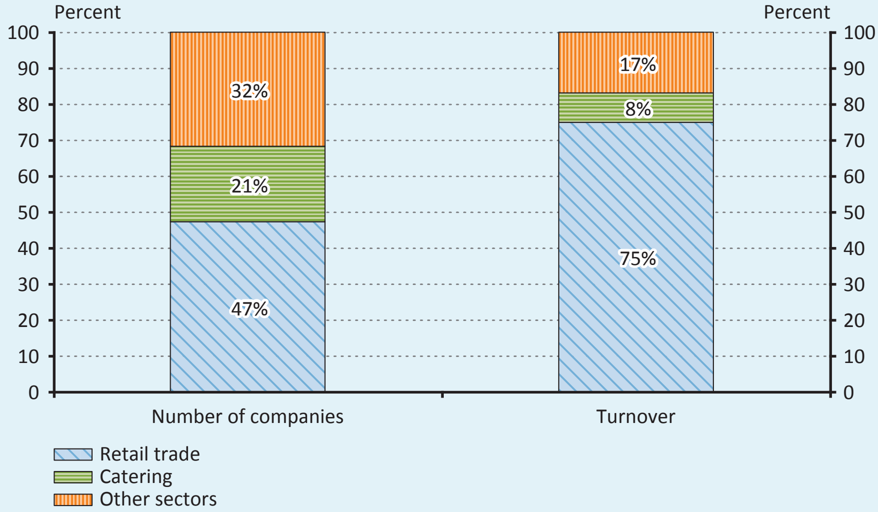
With a view to reducing the shadow economy, in recent years the deployment of online cash registers (OCRs) became mandatory for a wide range of companies. The Government announced the programme in October 2012, while the OCRs were deployed between September 2013 and 2014, on a continuous basis. The equipment differs from the formerly used cash registers in that it contains a tax control unit, which records the content of the receipts issued by the cash registers and forwards it to the tax authority through mobile internet.

As a result of the measure, roughly 100,000 companies deployed almost 200,000 online cash registers. 70 percent of the companies purchased one online cash register, but there were more than 4,000 companies that replaced more than five cash registers. The core activity of half of the small companies using OCR is retail trade. 83 percent of the turnover registered by the online cash registers can be linked to retail or accommodation and food services (AFS) sector.

Based on the research conducted by the experts of the MNB, the Ministry of Finance and HCSO, the introduction of the online cash registers increased the reported turnover, i.e. it resulted in a material reduction of the shadow economy in the retail – net of fuel sales – and AFS sectors. The effect is usually stronger in the AFS sector than in retail trade, and also among the smaller companies than at the larger ones. For the purpose of more accurate estimation, the companies are allocated to three categories based on their turnover in both sectors.

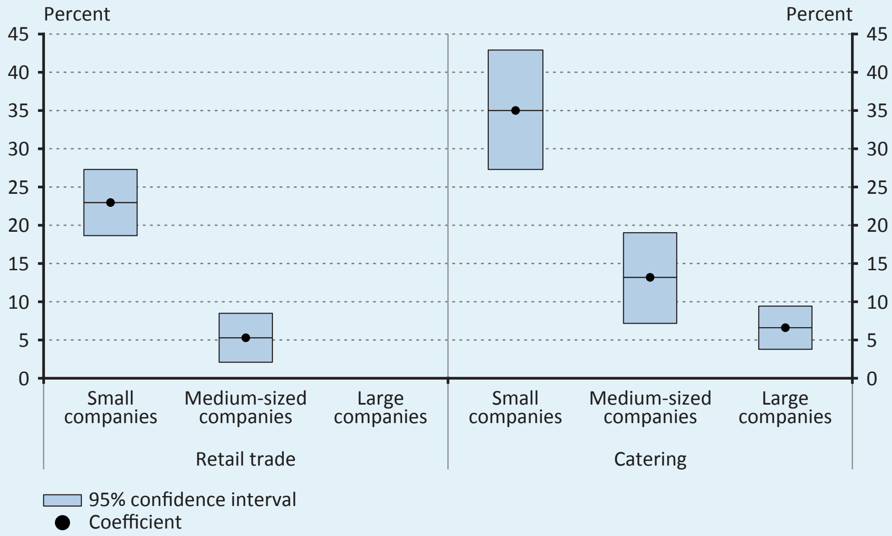
[10] Based on the paper of Lovics, G. (HCSO) – Szőke, K. (MNB) – Tóth, G. Cs. (MNB) – Ván, B. (MoF) entitled: Megugrott a kis cégek bejelentett forgalma az online pénztárgépektől (Reported turnover of small companies soared after the introduction of online cash registers) https://www.mnb.hu/letoltes/megugrott-a-kis-cegek-bejelentett-forgalma-az-online-penztargepektol.pdf

Chart 34
Distribution of the companies introducing the online cash registers based on the number of companies and the turnover recorded in the online cash registers
(2015)



Source: MNB-MoF-HCSO calculations based on NTCA data.

Chart 35
Impact of the introduction of online cash registers (OCRs) on the turnover by sector and size



Note: The analysis identified no significant impact at the larger companies of the retail trade sector. In the estimation, the small companies, based on sales revenue, belong to the lower fifth, the medium-sized companies to the second fifth, while the large companies account for further sixty percent of the population. Assessment of the turnover growth between 2013 and 2015.

Source: MNB-MoF-HCSO calculations based on NTCA data.

In the retail sector, the annual turnover of the smallest companies rose by 20-26 percent as a result of the introduction of the online cash registers, while that of the medium-sized companies was up by 3-7 percent. The introduction of OCRs contributed to the growth in the retail sector by HUF 0.3-0.5 percentage point through the reduction of the shadow economy. The moderate effect is due to the fact that significant reduction of the shadow economy was observed at the smaller and medium-sized companies, accounting for a relatively small part of the turnover, while almost 80 percent of the retail sales volume is linked to the upper 10 percent ranked based on turnover, where no impact was perceived.

In the AFS sector, the annual turnover of the smallest companies rose by 30-40 percent as a result of the connection of the online cash registers. Following the connection of the online cash registers, the shadow economy declined by 9-17 percent at the medium-sized companies and by 5-9 percent at the large companies. The introduction of OCR made the AFS sector contribute to the annual growth by 4-5 percentage points.

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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