PUBLIC FINANCE
REPORT

2015
AUGUST

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

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

PUBLIC FINANCE REPORT

Analysis of the public finance developments in 2014–2015 and the 2016 Budget Act

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With the aim to support the fulfilment of its fundamental duties stipulated in Act CXXXIX of 2013 on Magyar Nemzeti Bank, and particularly the task related to the definition and implementation of monetary policy, the Magyar Nemzeti Bank analyses developments in budgetary deficit and debt, monitors the financing of the general government, analyses the impact of financing on the monetary processes, on the capital markets and on liquidity, and researches fiscal policy issues.

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

This report was prepared by the staff of the Directorate Fiscal Analysis. The publication was approved by Dániel Palotai, Executive Director.

Contents

1. Summary

The purpose of this analysis is to present public finance processes in 2014 and the expected budget developments for 2015 on the basis of budget figures available for the first half of 2015, our macroeconomic forecast and the new measures affecting the current year budget. The analysis is also intended to provide an overview of the expected achievement of the budget targets approved in June 2015 for 2016. In consideration of these factors, for 2014 we assess actual, and for 2015 and 2016, expected compliance with the debt rule.

According to preliminary data, in 2014 the ESA deficit of the general government was 2.6 per cent of GDP, 0.3 percentage points lower than the deficit target set in the 2014 Budget Act. *The better than expected ESA balance is primarily attributable to the significant surplus in tax revenues stemming from favourable macroeconomic trends. Owing to higher than expected employment and wage growth, social contribution tax and contribution revenues exceeded the appropriation significantly, while VAT revenues and corporate income tax revenues were higher than the appropriations due to the improved efficiency of tax collection and the higher profitability of the business sector, respectively. The interest balance exceeded the appropriation by 0.2 per cent of GDP as a result of a continuous decline in yields in the context of the central bank's easing cycle, Hungary's improved risk perception and low inflation. At the same time, however, expenditures in cash flow terms also exceeded the budgeted level, which can be mainly attributed to a number of state acquisitions during the year. Although the original appropriation did not include these items, most of them did not increase the ESA deficit. Moreover, public work expenditures, the expenditures of budgetary institutions and chapters and, the public sector expenditures related to EU funds (own resources) were also higher than the budgeted figures. Some of the additional expenditures were covered by the central reserves earmarked upon budget planning and by the savings realised from lower-than-expected expenditures for welfare benefits.*

According to our projection, the 2.4 per cent GDP-proportionate ESA deficit target may be achieved in 2015; however, this requires the cancellation of the National Protection Fund, which comprises 0.1 per cent of GDP. *With respect to tax and contribution revenues, we expect a significant revenue surplus in excess of 0.3 per cent of GDP, primarily because of favourable developments in consumption-related revenues (VAT, excise duty). This, however, is well offset by the fact that, in the absence of publicly available plans and measures, we do not consider the sales and utilisation revenue targets to be attainable, which results in a 0.5 per cent GDP-proportionate difference between our revenue projection and the appropriation. The expenditures in cash-flow terms are likely to fall short of the appropriation; however, this is offset by accrual-based corrections; consequently, the difference is negligible from the aspect of the ESA balance. We assume lower absorption of EU transfers than envisaged by the government and accordingly, the amount of related own resources to be provided from the budget is also lower in our projection.*

The ESA deficit target set by the 2016 budget is 2 per cent of GDP. While according to our projection the deficit may be somewhat higher at around 2.2 per cent of GDP (assuming the full cancellation of free reserves), it still reflects a downward trend compared to this year. *According to our forecast, the primary revenues of the central sub-sector of the budget may fall short of the appropriations specified in the Budget Act by 0.4 per cent of GDP. The major part of the difference is attributable to the fact that – similar to our expectations for 2015 –, in the lack of publicly available plans we still do not calculate with the realisation of the revenue budgeted for the item of other sales and utilisation revenue related to state property. In addition, we expect slightly lower revenues from labour taxes and consumption taxes as compared to the budgeted figures, while owing to the higher inflation forecast, our projection regarding pension expenses is moderately higher than the appropriation. These effects are partly offset by the fact that the absorption of the funds available under the 2014–2020 budget cycle of the European Union is expected to be concentrated in the second half of the* *period; thus, according to our projection, in 2016 it may fall short of the level assumed in the budget and the resulting savings on own resources may be close to 0.2 per cent of GDP.*

By the end of 2014, the GDP-proportionate gross government debt dropped to 76.9 per cent compared to 77.3 per cent in the previous year. *By the end of last year, the debt ratio calculated in accordance with the Fundamental Law excluding the effect of exchange rate changes declined to 75.3 per cent; therefore, in 2014 the debt rule defined in the Fundamental Law was fulfilled.* ***According to our projection, the debt rule of the Fundamental Law will be satisfied across the entire forecast horizon, i.e. both in 2015 and 2016.*** *Based on our forecast (calculated at the HUF/EUR exchange rate prevailing at the end of 2015), gross public debt may decrease to 75.6 per cent of GDP by the end of 2015. The decline is equally supported by persistently dynamic economic growth and the surplus of the primary general government balance. We expect gross public debt to decrease to 73.9 per cent of GDP by the end of 2016. As a result of the modification of the debt formula, the level of public debt in 2016 may also comply with the requirements of the Stability Act that entered into force this year. The continued decline in yields may pose an upside risk to the debt path compared to the baseline projection, while downside risks are posed by the strengthening of the dollar against the euro and the potential pre-financing requirements of EU transfers.*

For the assessment of 2014 budgetary processes we relied on preliminary cash-flow data and data included in the April 2015 EDP Report. Besides the approved Budget Acts, our analysis of the budgetary processes in 2015 and 2016 was based on the macroeconomic and general government projections presented in the Inflation Report published on 25 June 2015 and, pertaining to 2015, we supplemented the range of the information processed with the cash-flow data of the central sub-sector for the first six months of the year. The analysis is based on information available for the period ending on 2 July 2015.

2. Analysis of public finance developments in 2014

2.1. ESA BALANCE OF THE GOVERNMENT SECTOR IN 2014

According to the EDP Report published by the Hungarian Central Statistical Office in April 2015, on an ESA basis, the deficit of the general government stood at 2.6 per cent of GDP in 2014 (Table 1). As in previous years, the GDP-proportionate accrual-based deficit remained below the 3 per cent deficit criterion in 2014 as well, standing at a level even lower than the government's 2.9 per cent deficit target set in the 2014 Budget Act.

The 2014 ESA balance represents a 0.3 per cent improvement compared to the deficit target approved in the original Budget Act, primarily stemming from the fact that the cash deficit proved to be lower than envisaged by 0.6 per cent of GDP. While the deficit of the central sub-sector was defined at 3.2 per cent of GDP in the Budget Act approved in December 2013, the cash deficit recorded for 2014 was significantly lower, 2.6 per cent of GDP.

Table 1
Projections for the 2014 balance of the government sector
(percentage of GDP)

	December 2013		July 2014	Actual data (Preliminary)[5]	Actual data – Appropriation
	Appropriation	MNB-forecast[3]	MNB-forecast[4]		
1. Cash balance of the central government	–3,2	–2,8	–3,5	–2,6	0,6
2. Cash balance of local governments	0,1	0,2	0,4	0,3	0,2
3. Cash balance (GFS) of the general government (1+2)	**–3,1**	**–2,6**	**–3,1**	**–2,3**	**0,8**
4. GFS-ESA difference	0,2	0,2	0,4	–0,3	–0,5
5. ESA balance of the government sector (3+4)	**–2,9**	**–2,5**	**–2,7**	**–2,6**	**0,3**

Notes: 1. The MNB's forecasts were based on the assumption that the HUF 100 billion reserve earmarked in the Country Protection Fund would not be spent. 2. In the budget bill the government set the balance target based on the methodology of the EDP Report, from September 2014 the methodological difference between EDP and ESA settlements was eliminated. Actual data and the July 2014 projection of the MNB reflect the balance figure in compliance with the ESA2010 methodology. 3. The MNB's December 2013 forecast is identical with the data indicated in the Inflation Report published in December 2013. 4. The July 2014 forecast reflects the data included in the 2014 semi-annual assessment prepared for the Fiscal Council. 5. Preliminary actual data are derived from the April 2015 EDP Report of the CSO and from data released by the Hungarian State Treasury. 6 Due to rounding, certain items of the table may show differences.

The favourable outcome of the cash balance may be largely attributed to a significant over-performance of tax revenues owing to favourable macroeconomic developments and the improved efficiency of tax collection: as a result of a higher increase in the wage bill, social contribution tax and contribution revenues exceeded the appropriation significantly, while VAT revenues and corporate income tax revenues were also higher than the appropriations. Besides a revenue surplus amounting to 1.1 per cent of GDP, the 0.6 percentage point increase in the cash balance compared to the budget also reflected a more favourable interest balance, which was higher than the appropriation with 0.2 per cent of GDP. The effect of these items, however, was partly offset by the expenditures of the budget, which exceeded the original appropriation by 0.7 per cent of GDP. The latter difference is nearly completely attributable to originally unbudgeted state acquisitions during the year. All other differences on the expenditure side essentially neutralised the impact of one another. Public work expenditures, expenditures related to the drawdown of EU funds, as well as the expenditures of budgetary institutions and chapters were also higher than the budgeted figures. At the same time, some of the additional expenditures were covered by the central reserves[1] earmarked upon budget planning; moreover, savings were realised from a number of appropriations, as the expenditures of certain social benefits (e.g. pension expenses, housing subsidies) fell short of the appropriations by a total of 0.3 per cent of GDP.

The original Budget Act was amended in December 2014 – partly in consideration of the state acquisitions taking place during the year –, as a consequence of which the cash-based deficit target was revised to 3.6 per cent of GDP.[2] The appropriation for expenditures resulting in an increase in state holdings was raised by HUF 187 billion. Moreover, the amendment included additional items increasing expenditures by a total of HUF 48 billion. This amount was covered by the partial depletion of the Country Protection Fund. The vast majority of acquisitions above the original appropriation only increased the cash-based deficit without affecting the ESA balance, as the acquisitions took place at market price (see Sub-chapter 2.3 for more details on acquisitions).

In addition, the favourable ESA balance may be partly attributed to the GDP-proportionate cash balance of local governments which, according to preliminary data, improved by 0.2 percentage points compared to the budget. This improvement largely resulted from the fact that the central budget assumed further outstanding local government debts, which reduced the interest burden of local governments and thus improved their economic position.

Finally, the statistical corrections between the accrual-based deficit and the cash-based deficit (ESA bridge) proved to be worse than the value anticipated in the budget by a total of 0.5 per cent of GDP, which partly offset the impact of the lower cash-based deficit and the surplus recorded for the local sub-sector. Some of this was consistent with changes in the cash balance and had a neutral effect on the ESA balance overall (accrual-based correction of the cash impact of the acquisitions and EU transfers), while another part actually increased the deficit compared to the original expectations (correction of interest expenses).

The MNB's projection prepared in December 2013 – which assumed the full cancellation[3] of the free reserves comprising 0.3 per cent of GDP – expected an ESA deficit of 2.5 per cent, nearly identical with the 2.6 per cent preliminary actual figure. The cash-based deficit of the central sub-sector fell slightly short of our projection (by 0.2 per cent of GDP). Government revenues surpassed our projection owing to higher VAT revenues and wage-related revenues. As regards the expenditure side, the increased drawdown of EU funds, the higher expenses of budgetary institutions and chapters and the partial utilisation of the Country Protection Fund resulted in a higher expenditure level than anticipated in our projection. Since the majority of state acquisitions during the year did not affect the ESA balance, they did not influence the differences between actual developments and our forecast.

[1] At the time of budgeting, central reserves amounted to a total of HUF 289 billion, and with the exception of a portion of the Country Protection Fund, they were used in full. The Country Protection Fund comprised HUF 100 billion, of which HUF 45 billion was spent at the end of the year compared to HUF 48 billion budgeted in the December 2014 amendment of the Budget Act, and the remaining HUF 55 billion supported the achievement of the fiscal deficit target.

[2] The amendments were included in Act LXXXIV of 2014.

[3] The cancellation of free reserves means that, instead of financing new expenditures or revenue reducing measures, the reserves will be strictly used to manage recognised risks surrounding the revenue and expenditure sides. If the revenues fall short of the budget, the cancellation of the reserves in proportion to the revenue shortfall can reduce the expenditure side in order to ensure a constant balance. If the expenditures exceed the target, the disposable reserves may be cancelled in proportion to the extra expenditure to ensure a constant balance.

2.2. CASH REVENUES OF THE CENTRAL SUB-SECTOR

In 2014, the revenues of the central sub-sector exceeded the partially consolidated total revenue figure of the Budget Act approved in December 2013 by a total of HUF 579 billion, i.e. 1.8 per cent of GDP (Table 2). Within this, tax and contribution revenues were higher than budgeted by HUF 268 billion, with the increase mainly stemming from wage-related revenues. As a result of the decline in yields observed in recent years, interest revenues exceeded the original appropriation significantly, by HUF 243 billion. Other revenues outperformed the budget by HUF 68 billion, reflecting higher-than-expected revenues related to state property.

Payments by businesses fell short of the appropriation by HUF 47 billion, mainly as a result of lower-than-expected income tax revenues from energy suppliers and small company taxes (small taxpayers' itemised lump sum tax – KATA – and small business tax – KIVA). In the case of KATA and KIVA, the shortfall can be explained by the fact that fewer taxpayers opted for these particular tax categories than expected. The smaller number of switchovers, however, generated extra revenues in other revenue lines (simplified business tax, social contribution tax and contributions, vocational training contribution, personal income tax); thus, the fiscal balance improved overall. The loss of revenues from the income tax of energy suppliers can be explained by a substantial amount of reclaims in 2014 in relation to the tax advance top-up of 2013. At the same time, revenues from corporate income tax exceeded the budget significantly, with the surplus materialising in relation to the end-of-year tax advance top-up. A substantial portion of corporate income tax payments is usually executed in December, and the magnitude of payments largely depends on current year corporate results and the level of the tax allowances applied for. Corporate income tax revenues for 2014 exceeded the actual figure recorded for 2013 by a large margin, 22 per cent. This favourable result may reflect the higher-than-expected growth rate of corporate profits in 2014, while changes in the magnitude of the tax allowances applied for may also have contributed to the revenue increase.

Consumption-related tax revenues surpassed the statutory target by HUF 19 billion, of which the budget realised an amount of HUF 21 billion **from VAT revenues** compared to the appropriation. Changes in the 2014 macroeconomic trajectory point to a lower-than-budgeted revenue amount overall, as the consumption of households – i.e. the tax base determining VAT revenues – slightly fell short of the value included in the budget bill, while the consumer price index proved to be 2.6 per cent lower than expected. The effects of these macroeconomic developments were offset by the whitening effect of the installation of online cash registers, which had already been considered upon the calculation of the budget appropriation. In its June 2014 flash report, the Ministry for National Economy (MNE) estimated the revenue increasing effect of the measure to HUF 153 billion. Although the scheduled deadline of the installation of the cash registers had been modified several times, all online cash registers were up and running by the end of August 2014, generating a significant increase in VAT revenues collected in the second half of the year (Chart 1). In the absence of the relevant micro data, for the time being, only rough estimates can be made with respect to the fiscal effect of the measure: according to the preliminary calculations of the MNB, the revenue surplus stemming from the measure may be as high as HUF 150 billion.[4]

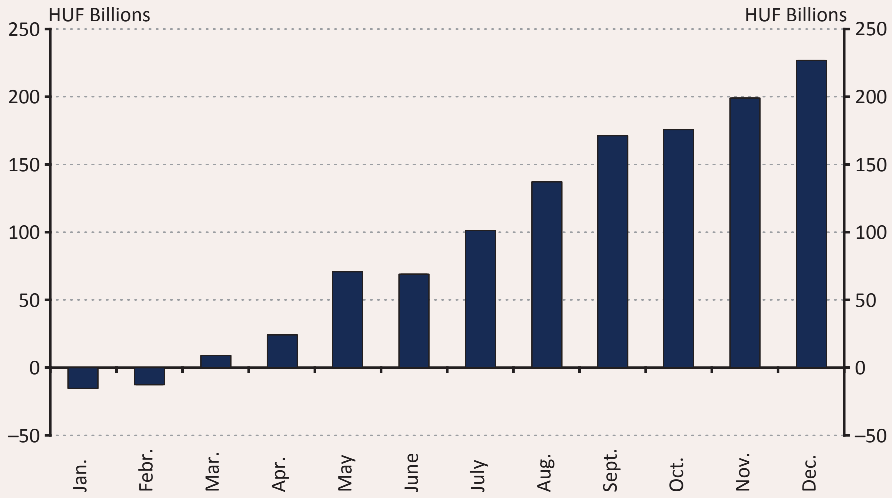
[4] For more details, see Chapter 8.2 of the *Public Finance Report* published by the MNB in May 2015.

Table 2
Partially consolidated cash revenues of the central sub-sector in 2014
(HUF billions)

	December 2013		July 2014	Actual data (preliminary)[3]	Actual data-appropriation
	Appropriation (original)	MNB-forecast[1]	MNB-forecast[2]		
TAX AND CONTRIBUTION REVENUES OF CENTRAL GOVERNMENT	**11 448**	**11 424**	**11 450**	**11 716**	**268**
Payments by economic units	**1 352**	**1 287**	**1 251**	**1 305**	**–47**
Corporate income tax	359	360	355	395	36
Special tax of financial institutions	144	138	144	149	5
Sector-specific tax	0	0	0	–1	–1
Simplified entrepreneurial tax	67	70	90	97	30
Mining royalty	65	53	57	63	–2
Gambling tax	33	33	33	35	2
Income tax of energy companies	61	52	49	35	–26
Lump sum tax of small entrepreneurs	78	52	44	42	–36
Small business tax	45	36	13	13	–33
E-road toll	134	134	121	127	–7
Utility tax	53	53	54	55	2
Other taxes and payments	313	306	291	297	–16
Taxes on consumption	**4 317**	**4 198**	**4 187**	**4 336**	**19**
Value added tax	3 014	2 908	2 915	3 036	21
Excise duties	932	926	910	919	–13
Registration tax	16	16	16	19	3
Telecom tax	57	56	56	56	–1
Financial transaction levy	269	264	260	278	9
Insurance tax	28	28	29	29	1
Payments by households	**1 700**	**1 701**	**1 709**	**1 754**	**54**
Personal income tax	1 550	1 549	1 555	1 589	39
Duties, other taxes	111	111	111	122	11
Motor-vehicle tax	39	41	43	42	3
Tax and contribution revenues of Extrabudgetary Funds	**248**	**262**	**267**	**277**	**30**
Tax and contribution revenues of Social Security Funds	**3 832**	**3 977**	**4 036**	**4 044**	**212**
Social security contributions	3 571	3 724	3 780	3 788	217
Other contributions and taxes	261	252	255	256	–4
OTHER REVENUES	**398**	**397**	**403**	**465**	**68**
Other revenues of central government	**281**	**281**	**286**	**357**	**76**
Other revenues of Social Security Funds	**44**	**44**	**44**	**37**	**–7**
Other revenues of Extrabudgetary Funds	**73**	**73**	**73**	**71**	**–1**
INTEREST REVENUES	**92**	**105**	**154**	**334**	**243**
TOTAL REVENUES OF CENTRAL GOVERNMENT	**11 937**	**11 926**	**12 006**	**12 516**	**579**

Notes: 1. The MNB's December 2013 forecast reflects the budget forecast included in the Inflation Report published in December 2013. 2. The July 2014 forecast reflects the projection included in the 2014 semi-annual assessment prepared for the Fiscal Council. 3. Preliminary actual data are derived from data released by the Ministry for National Economy and the Hungarian State Treasury. 4. 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 by the related direct revenues.

Chart 1
Annual cumulated change in net cash VAT revenues in 2014 compared to 2013
(HUF billions)



Source: Hungarian State Treasury

Revenues from **excise duty** were lower than the appropriation by HUF 13 billion in total, which, however, conceals significant differences between individual items. The excise duty of fuels exceeded the target set in the Budget Act by HUF 32 billion, as the descent in oil prices heightened the demand for fuels, and the excise duty levied on fuels is calculated on the basis of volume rather than current value. At the same time, the revenue from the excise duty on tobacco products was significantly lower than envisaged, falling short of the appropriation by HUF 50 billion, primarily because of the transformation of the sale of tobacco products and a decline in consumption.

Revenues collected from the **financial transaction tax** exceeded the appropriation by HUF 9 billion, owing, for the most part, to higher than expected transaction tax revenue payments by the State Treasury.

Payments by households outperformed the target by HUF 54 billion. A significant part of the difference affected personal income tax revenues, which exceeded the unchanged statutory target by HUF 39 billion, i.e. 2.5 per cent. The surplus revenue was mainly due to the fact that the growth rate of the gross wage bill was considerably higher than the 4.8 per cent growth rate envisaged in the Budget Act. According to our current estimation, the acceleration may have reached 9.3 per cent, which is expected to have produced a HUF 60 billion surplus in tax revenues compared to the budget. On the other hand, the so-called payer taxes fell short of the target set in the Budget Act by HUF 12 billion, possibly due to the shortfall in interest taxes in the context of continuously declining yields. In addition, **duty payments** exceeded the appropriation in the Budget Act by HUF 11 billion, which may have resulted from the upswing in housing market turnover.

Total tax and contribution revenues from social insurance and extrabudgetary funds were higher than the target by HUF 242 billion, i.e. 5.9 per cent. The higher-than-expected growth of the gross wage bill may account for HUF 170 billion of the surplus revenues. The loss of revenues stemming from lower-than-expected recourse to the new business tax categories (KIVA, KATA) generated social contribution tax revenues amounting to around HUF 40–45 billion. The surplus revenues from the social contribution tax reflected, in part, less than expected recourse to the targeted benefits of the Job Protection Action Plan (with the shortfall amounting to around HUF 10 billion). Recourse to the family contribution allowance was also lower – by HUF 5–10 billion – than envisaged in the Budget Act. Of the most important revenue items, only the health care contribution produced lower revenues than anticipated in the budget; the shortfall amounted to HUF 5 billion.

A substantial part of the HUF 68 billion surplus in **other revenues** was realised under the revenues related to state property. The sale of the state's stake in Főgáz Zrt. by the Hungarian National Asset Management Zrt. to MFB Zrt. in October was not included in the original budget; thus it produced unbudgeted revenues in the amount of HUF 42 billion.[5] Revenues from the sale of frequency licenses reached HUF 131 billion compared to the budgeted appropriation of HUF 120 billion, and they were realised from the sale of the 800 MHz, 900 MHz, 1800 MHz, 2100 MHz and 2600 MHz frequency bands.

Interest revenues were higher than the appropriation by HUF 240 billion. The reason for the high revenues was the fact that, due to the sharp fall in yields, the expected yields on government securities dropped below the coupons of government securities issued; thus the debt management agency sold the papers with a surcharge at the auctions, and the surcharges are recognised among cash interest revenues. This effect was reinforced by a substantial increase in the amount of swap auctions, which involve redemption and issuance simultaneously; therefore, interest revenues were realised on these issuances as well.[6]

2.3. CASH EXPENDITURES OF THE CENTRAL SUB-SECTOR

The expenditures of the central sub-sector exceeded the budgeted level by HUF 420 billion, i.e. 1.3 per cent of GDP (Table 3). Within primary expenditures, the net expenses of budgetary institutions and chapters surpassed the appropriation by HUF 363 billion, which was partly covered by the reallocation of central reserves. Similarly, interest expenses were higher than expected; a large part of the HUF 181 billion difference resulted from the interest expenses recognised upon redemptions. At the same time, social transfers (such as pension expenditures and family allowances) fell short of the appropriation by HUF 100 billion.

Within primary expenditures, the amount spent on **home construction subsidies** was lower than budgeted by HUF 31 billion, owing to lesser than expected recourse to the exchange rate cap scheme. **Family allowances and social benefits** fell short of the appropriation by a total of HUF 29 billion. For the most part, the difference emerged in relation to the family allowance and the child raising allowance, possibly due to the smaller number of applicants.

In the central reserves line, a total of HUF 289 billion was earmarked upon budgeting. Special reserves (HUF 76 billion) and the reserves for extraordinary government measures (HUF 113 billion) were fully depleted during the year, covering the expenses of budgetary institutions on the one hand, while, on the other hand, the Hungarian State Holding Company received a substantial amount of funding to cover its expenses. Pursuant to the December 2014 amendment of the Budget Act, a decision was made to utilise HUF 48 billion from the Country Protection Fund comprising HUF 100 billion, of which ultimately, HUF 45 billion increased the expenditures of budgetary institutions and chapters. The remaining HUF 55 billion supported the achievement of the fiscal deficit target.

[5] While the transaction increased cash revenues, it did not improve the ESA deficit.
[6] For more details regarding cash interest revenues, see Sub-chapter 5.2.

Table 3
Partially consolidated cash expenditures of the central sub-sector in 2014
(HUF billions)

	December 2013		July 2014	Actual data (preliminary)[3]	Actual data-appropriation
	Appropriation (original)	MNB-forecast[1]	MNB-forecast[2]		
PRIMARY EXPENDITURES	**11 756**	**11 598**	**11 840**	**11 992**	**236**
Subsidies to economic units, support to the media	**353**	**353**	**353**	**354**	**1**
Consumer price subsidy	**104**	**104**	**104**	**103**	**-1**
Housing grants	**159**	**159**	**159**	**128**	**-31**
Family benefits, social subsidies	**539**	**538**	**522**	**510**	**-29**
Benefits under retirement age	**176**	**181**	**179**	**173**	**-2**
Net expenditures of central goverment agencies and chapters	**3 475**	**3 362**	**3 475**	**3 838**	**363**
Net own expenditures	3 037	2 947	3 045	3 288	251
Net expenditures related to EU funds	438	416	430	550	112
Support to local governments	**716**	**716**	**741**	**724**	**8**
Contribution to EU budget	**289**	**304**	**304**	**291**	**2**
Central reserves	**289**	**189**	**115**	**0**	**-289**
Debt assumption	**64**	**64**	**68**	**69**	**5**
Expenditures related to state property	**181**	**181**	**355**	**399**	**218**
Other expenditures	**169**	**169**	**169**	**169**	**0**
Expenditures of Extrabudgetary Funds	**451**	**477**	**509**	**453**	**2**
NEF – Passive allowances	56	49	42	50	-7
NEF – Active allowances	184	213	252	226	42
Other expenditures	211	214	214	178	-33
Expenditures of Social Security Funds	**4 793**	**4 802**	**4 788**	**4 783**	**-10**
PIF – Pensions	2 948	2 947	2 936	2 915	-33
HIF – Disability and rehabilitation benefits	345	346	340	336	-9
HIF – Cash benefits	217	218	221	224	7
HIF – Medical and preventive care	932	932	932	946	14
HIF – Net expenditures related to drug subsidies	238	242	239	245	7
Other expenditures	113	117	120	118	5
INTEREST PAYMENTS	**1 165**	**1 190**	**1 223**	**1 346**	**181**
TOTAL EXPENDITURES OF CENTRAL GOVERNMENT	**12 921**	**12 788**	**13 063**	**13 338**	**417**

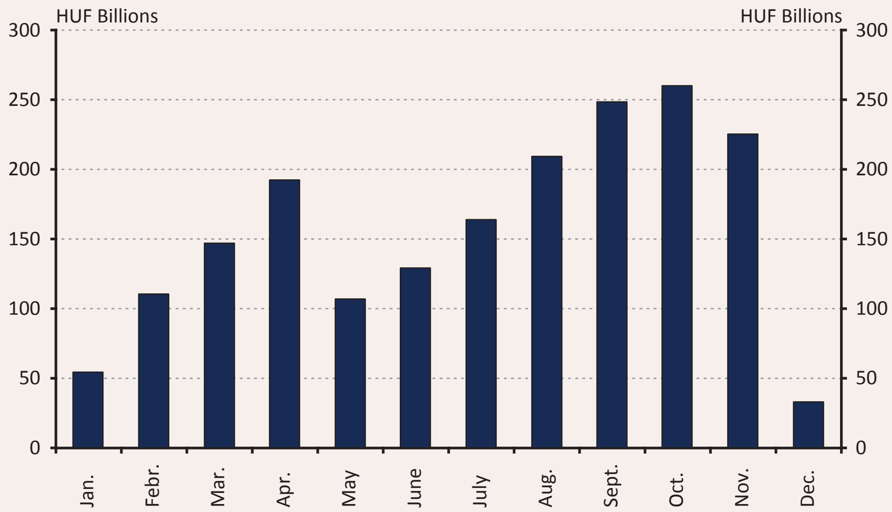
Notes: 1. The MNB's December 2013 forecast reflects the budget forecast included in the Inflation Report published in December 2013. 2. The July 2014 forecast reflects the projection included in the 2014 semi-annual assessment prepared for the Fiscal Council. 3. Preliminary actual data are derived from data released by the Ministry for National Economy and the Hungarian State Treasury. 4. The MNB's projections assumed the full cancellation of the HUF 100 billion Country Protection Fund in the interest of achieving the deficit target. 5. 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 by the related direct revenues.

The **net expenses of budgetary institutions and chapters** surpassed the statutory target defined upon budgetary planning by HUF 363 billion.

- Within this amount, *net own expenditures* were exceeded by HUF 251 billion. A large part of the difference can be attributed to the fact that, upon the planning of the budget, the actual spending of the expenditures included in the central reserves line took place primarily within this consolidated expenditure item. Pursuant to the December 2014 amendment of the Budget Act, an amount of around HUF 40 billion was reallocated to the own expenses of budgetary institutions and chapters. Eximbank Zrt. received a capital injection of HUF 20 billion; the spending on public road maintenance was raised by HUF 10 billion, while the universal postal service provider was allocated HUF 9 billion as a compensation for its unfair extra burden. In line with the original plans, a significant portion of the HUF 76 billion budget for special reserves was appropriated to cover the wage compensation of public sector employees. As in recent years, the reserve for extraordinary government measures, for the most part, was allocated to budgetary institutions, primarily for material and wage expenditures. In addition, human services for public education purposes and supplementary financial assistance exceeded the appropriation by HUF 30 billion, primarily due to the undershooting of public education spending.

- *Net expenditures related to EU transfers* were higher than the appropriated amount by HUF 112 billion. This is partly because, on the revenue side, EU transfers fell short of the appropriation by around HUF 60 billion. A half of this shortfall was related to slightly lower than expected drawdown, while the delayed disbursement of EU funding accounted for the other half. During 2014, the postponed EU funding related to EU projects was advanced from the own resources of the budget. In certain months, the advance payments were as high as HUF 200 billion; however, at the end of the year the EU transferred a substantial amount of grants for the retrospective funding of EU programmes, bringing down the amount of the advances to around HUF 30 billion by the end of December (Chart 2). Another contributor to the higher than expected EU spending was the fact that the own resources required for the utilisation of the funds exceeded the budgeted expenditures by HUF 55 billion.

Chart 2
Advance financing from the budget in relation to EU transfers in 2014
(HUF billions)



Source: Hungarian State Treasury, MNB estimate

Expenditures related to state property exceeded the appropriation approved upon budgetary planning by a large margin, HUF 218 billion.

- Of this, a difference of HUF 200 billion resulted from higher than expected *expenditures related to state acquisitions* (Table 4). In 2014 the ownership structure of Főgáz Zrt. was changed in two steps: in April, MVM Zrt. paid HUF 41 billion to RWE for a 49.83 stake in the Budapest gas company, and in October MVM Zrt. proceeded to purchase the majority stake from the Municipality of Budapest. The required funds were allocated to MVM Zrt. from the state budget. At the end of May, Antenna Hungária Zrt. was acquired by Nemzeti Infokommunikációs Szolgáltató Zrt. through a stock transaction amounting to HUF 56 billion. Following the approval of the Hungarian Competition Authority in June, Nemzeti Hulladékgazdálkodási és Szolgáltató Kft. purchased AVE Magyarország Kft. for HUF 14 billion. In September 2014 the state acquired MKB Bank Zrt. as well, implying and expenditure of HUF 17 billion for the budget. The acquisition was financed from extraordinary government reserves. In October, a decision was made to transfer the shares owned by MVM in Paks II. Atomerőmű Fejlesztő Zrt. to the state, which increased expenditures by HUF 10 billion. In addition to the above, as a result of one-off government decisions, the expenditures of MNV Zrt. exceeded the original appropriation by HUF 34 billion.

- The reallocations required to cover the state acquisitions not included in the original appropriations were performed in the December 2014 amendment of the Budget Act. While the above transactions raised cash expenditures compared to the original budget estimates in 2014, most of them – with the exception of the increased expenditure of MNV Zrt. – did not affect the ESA balance. Indeed, based on the ESA methodology, these transactions are not considered to be budget expenditures as in this case, state property merely takes a different form, changing from deposit to equity stake.

- The excess expenditure of HUF 18 billion arising under the expenditures related to state property was spent on the purchase of real assets and on additional subsidies extended to state-owned companies.

Table 4
Expenditures related to state acquisitions
(HUF billions)

	Appropriation in 2014 (original)	Amended appropriation in 2014	Actual payments in 2014	Actual - appropriation (original)
Expenditures related to the exercise of ownership rights by MNV Zrt.	20	56	54	34
Expenditures related to the exercise of ownership rights by MFB Zrt.	13	3	3	-11
Expenditures related to the acquisition of the shareholding in Főgáz Zrt.		79	79	79
Acquisition of the shareholding in Antenna Hungária Zrt.		56	56	56
Acquisition of the shareholding in AVE Magyarország Kft.		14	14	14
Acquisition of MVM Paks II. Atomerőmű Fejlesztő Zrt.		10	10	10
Acquisition of the shareholding in MKB Bank Zrt.		17	17	17
Total expenditures related to state acquisitions	**34**	**236**	**233**	**199**

Source: Hungarian State Treasury

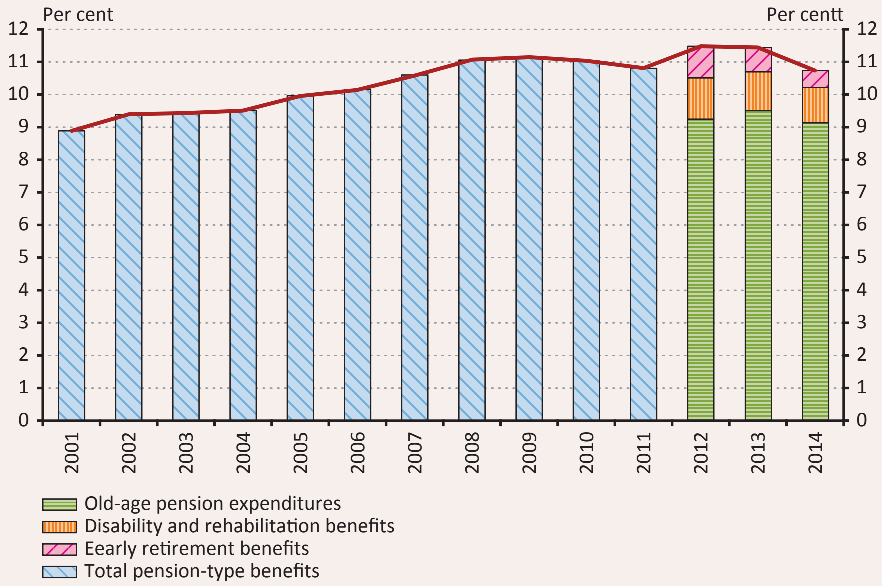
The expenditures of extrabudgetary funds were only slightly higher than the statutory target; however, there were significant differences between the individual items involved. As a result of the surge in wintertime public work scheme, public work spending (Start Labour Programme) surpassed the appropriation by HUF 42 billion, generating an unbudgeted rise in the number of public workers. In the first few months of 2014 the average headcount was more than 200,000, which represented a substantial increase even compared to the value recorded in 2013 (Chart 3). Parallel to the heightening of labour demand in the private sector and the increase in the number of public workers, the number of unemployed persons dropped to a lower than expected level; consequently, the amount spent from the budget on jobseekers' allowances was HUF 7 billion less than expected. Within the other expenditures of extrabudgetary funds, due to technical reasons, there was a shortfall of HUF 15 billion in the expenditures allocated for the support of Hungarian innovation from the Research and Technological Innovation Fund, while expenditures also underperformed in relation to the Social Renewal Operational Programme (TÁMOP) financed from the National Employment Fund and co-financed by the EU.

Chart 3
Cumulated monthly public work expenditures (left panel) and number of public workers (right panel) in 2013 and 2014

Source: CSO, Hungarian State Treasury

In 2014, **spending on pensions and pension-type benefits** fell short of the appropriation by HUF 44 billion in total. The shortfall in old-age pensions disbursed from the Pension Fund may be attributed – among other things – to the raising of the retirement age from 62 to 62.5 in January 2014: as a result, there was a month-to-month, gradual decline in old-age pension expenditures in the first half of the year; new allocations, in turn, were concentrated in the second half of the year. Dependent pension expenditures and disability and rehabilitation benefits may have fallen short of the appropriation due to the lower than expected number of beneficiaries. Although expenditures on pensions and pension-type benefits were raised at the beginning of the year by the rate of inflation expected in the 2014 Budget Act (2.4 per cent), as the consumer price index stood at – 0.2 per cent in 2014, the value of pensions increased significantly in real terms. Despite the increase in real pensions, in 2014 GDP-proportionate pension expenses declined by 0.7 per cent of GDP compared to 2013 due to the fact that the indexation was lower than the nominal GDP growth rate, and as a result of the measures affecting the number of beneficiaries (Chart 4).

Chart 4
Expenditures of pensions and pension-type benefits in Hungary between 2001 and 2014
(as a percentage of GDP)



Notes: Data between 2001 and 2011 indicate spending on pension-type benefits based on the final budgetary accounts; they do not correspond to the categories of the accounting regime introduced in January 2012. From 2012, the category of "old-age benefits" includes above retirement age benefits, above retirement age disability benefits, the service dependent pension available for women with 40 years of service, and provisions to dependents. Data pertaining to 2012 and 2013 reflect the figures of the final accounts. Values for 2014 indicate preliminary monetary flow data. The nominal GDP time series is consistent with the ESA2010 methodology.
Source: CSO, Hungarian State Treasury, MNB, final accounts

The **cash benefits covered by the Health Insurance Fund** were higher than the statutory target by HUF 7 billion in total. HUF 5 billion of the difference can be associated with higher than expected sick pay expenses. During the autumn and winter months these expenses increased, possibly due to the number of beneficiaries, which was even higher than warranted by the usual seasonality. Prenatal allowances exceeded the estimate by HUF 4 billion; at the same time, child-care benefit (GYED) expenditures underperformed slightly. In the case of GYED, the number of beneficiaries increased significantly in 2014 compared to previous years, also boosted by the introduction of GYED extra in January 2014.

Medical and preventive care expenditures exceeded the statutory target set upon budget planning by HUF 14 billion. The difference can be explained by the government's decision at the end of the year to raise the appropriation of the budget by HUF 10 billion. Presumably, healthcare institutions spent the additional funds on purchasing products subject to itemised reimbursement (e.g. high-value oncology medications) and pharmaceutical devices. Healthcare institutions financed from the medical and preventive care budget received financing from the appropriation twice during the year for the reduction of outstanding debts: firstly, HUF 10 billion in July through the reallocation of special reserves, and secondly, HUF 10.5 billion through the end-of-year distribution of the residual budget.[7]

The net expenditures of the drug budget exceeded the statutory target set upon budget planning by HUF 7 billion. Within these expenditures, payments by pharmaceutical manufacturers and distributors were consistent with the appropriation; the difference is attributable to higher than expected drug reimbursement expenditures. The original appropriation for drug reimbursement in 2014 was practically identical with the actual spending recorded for 2013; however, reimbursement expenses exceeded the monthly figures of the base year throughout the year, especially in the second half of the year. Based on a government resolution, in

[7] For an overview of the outstanding debt of healthcare institutions, see Sub-chapter 5.3.

November 2014 the appropriation was raised, mainly for technical reasons, by HUF 13 billion. The additional funds were intended to cover expenditures before manufacturers' payments became due in December. In addition, the annual overrun of the budgeted expenses also necessitated the raising of the appropriation.

Interest expenses exceeded the estimate by HUF 181 billion due to high-value redemptions and swap auctions during the year, in the context of which interest expenses were recognised in the statistics on redeemed, higher-coupon bonds. The assumption of local government debt also contributed to higher expenditures; however, it only increased the interest expenses of the central budget while reducing the interest expenses of local governments and as such, it had a neutral effect on the balance at the level of the total general government.

Given that the surplus in interest expenses was smaller than the increase in interest revenues, the cash interest balance had a favourable budget variance overall, amounting to HUF 60 billion. This reflects a faster than expected deceleration in the yield environment which, in turn, can be attributed to the easing cycle of the central bank, the improved risk perception of Hungary and low inflation.

2.4. BALANCE OF LOCAL GOVERNMENTS IN 2014

The local government sector closed 2014 with an accrual-based surplus of HUF 445 billion, instead of the originally estimated HUF 30 billion deficit. This remarkable difference was caused by the accounting of the debt assumption. In 2014 the central sub-sector assumed local government debt amounting to HUF 470 billion in total. Disregarding the balance improving effect of this factor, the sub-system would have closed the year with a deficit of HUF 25 billion in 2014. Apart from the technical effect of the debt assumption on the balance, the appropriation defined in the Budget Act was consistent with the preliminary plans; at the same time, however, there were structural changes both on the expenditure and the revenue side compared to the base year.

The high growth dynamics observed for **local taxes** in previous years decelerated in 2014, and the growth rate of tax revenues fell behind the growth rate of nominal GDP by around one percentage point.

The expenditure structure of the **local government sector** was different from expectations. Wage costs proved to be higher than expected by HUF 75 billion (11.1 per cent). The difference is linked to regular wage expenses, caused, on the one hand, by higher than expected public employment expenditures; on the other hand, the expenditure increasing effect of the government's wage measures was underestimated. Thirdly, the decline in local governments' tax burdens allowed some local governments to increase wages. At the same time, material expenditures fell short of the expected expenditure level by HUF 37 billion, i.e. 5.1 per cent. Capital expenditures from own resources were higher than envisaged, by HUF 34 billion as, on the one hand, the drawdown of EU funds exceeded expectations by HUF 68 billion, while, on the other hand, the co-financing of EU funds were also higher than originally estimated. In line with the surge in public employment programmes, social and social policy subsidies proved to be lower by HUF 25 billion relative to both the basis year and the planned expenditure level.

2.5. STATISTICAL CORRECTIONS (ESA BRIDGE)

Reconciliation between the GFS balance – the cash balance of the revenues and expenditures indicated above – and the ESA balance (which is of key importance from the aspect of Hungary's obligations toward the EU) is ensured by **statistical corrections** (ESA bridge). This is necessary because some of the transactions are recorded, based on the EU settlement method, at the time of the execution (accrual accounting), as opposed to the Hungarian practice, where they are recorded upon cash movement (cash accounting). Moreover, the government sector specified on the basis of the ESA methodology is broader than that included in GFS statistics (for example, it includes certain quasi-fiscal activities as well), and some financial transactions, such as acquisitions at market price, are not taken into account for the calculation of the budget balance.

Upon the approval of the 2014 Budget Bill, the estimated level of accrual-based statistical corrections (ESA bridge) amounted to 0.2 per cent of GDP which, however, was found to be –0.3 per cent based on preliminary actual data, which implies a worsening of the ESA balance (by 0.3 per cent of GDP) in 2014 compared to the cash balance.

The difference compared to the Budget Bill (which approaches 0.5 per cent of GDP) reflects the opposing effects of several factors. The settlement of interests deriving from swap transactions intended to manage public debt reduced the ESA bridge by 0.3 per cent of GDP compared to the original estimate.[8] Another factor pointing to a negative ESA bridge was the fact that there was a lesser need to advance from the state budget the funds required to cover the costs of EU projects. However, these factors were partly offset by positive statistical corrections linked to cash expenditures serving the purpose of increasing state property.

2.6. PUBLIC DEBT IN 2014

By the end of 2014, gross public debt dropped to 76.9 per cent of GDP compared to 77.3 per cent at the end of 2013. The decline in public debt reflects the combined effect of several factors. The decrease in the debt ratio was supported by dynamic real economy growth last year, the rate of which surpassed both market and government expectations. Moreover, the lower than expected government deficit-to-GDP ratio also pointed to a lower debt rate. However, the positive effects of these factors on the debt ratio were partly offset by the depreciation of the forint against the euro (from HUF/EUR 296.9 to HUF/EUR 314.9). The exchange rate sensitivity of public debt is caused by the ratio of FX debt which, at nearly 40 per cent, is still high, despite a significant (more than 12 percentage-point) decline since 2011. This means that each 1 forint change in the EUR/HUF exchange rate adjusts public debt-to-GDP ratio by around 0.1 percentage point. Similarly, the appreciation of the dollar against the euro had a debt increasing effect through USD-denominated debt issuance.

After 2013, the central budget continued the debt consolidation of the local sub-sector in 2014 as well, which, however, had no impact on the consolidated gross public debt of the total sector. In the framework of the consolidation, the state budget assumed local government debt – mainly denominated in foreign currency – in a total amount of HUF 470 billion. HUF 69 billion of the debt expired in 2014, which was repaid last year and was recognised under the cash expenditures of the central sub-sector.

In 2014 the debt rule of the Fundamental Law was satisfied. The debt rule of the Fundamental Law prescribes the annual reduction of the gross public debt-to-GDP ratio (excluding exchange rate effects) as long as it is above 50 per cent. In 2014, the revaluation increased the debt ratio by more than 1.6 per cent of GDP. Excluding this effect, the gross public debt ratio would have been around 75.3 per cent. Since this value represents a 2 percentage-point decrease compared to the end of 2013, the government debt rule was enforced last year.

[8] The balance stated by the government in the Budget Bill is not precisely consistent with ESA statistics; it is based on the methodology of the EDP Report – the relevance of which is determined by the fiscal rules of the EU – and accordingly, in the case of swap contracts concluded for the management of public debt, the interest burden on the given debt was taken into account after the swap transaction, which has had an expenditure reducing effect in recent years. From September 2014, however, the calculation method of the EDP balance changed (it became identical with that of the ESA balance), and now the interest burden on the original debt item is being considered; in other words, the deficit reducing correction has been eliminated.

3. Expected public finance developments in 2015

3.1. EXPECTED ESA BALANCE OF THE GOVERNMENT SECTOR IN 2015

According to our forecast, the 2.4 per cent deficit target for the ESA balance of the government sector is attainable in 2015. Based on our projection, the ESA deficit of the general government may be 2.4 per cent of GDP assuming the complete cancellation of the available reserves comprising 0.1 per cent of GDP, which, according to the Budget Act, may not be utilised until the attainment of the deficit target is deemed feasible. Although the planned ESA deficit figure is identical with our accrual-based deficit forecast, their structure is different in several respects. Although our forecast for the cash-based deficit of the general government is lower than the appropriation by 0.35 per cent of GDP, this is offset by our different estimate regarding the statistical corrections between the accrual-based and cash-based deficit (Table 5).

Table 5
Balance of the government sector in 2015
(percentage of GDP)

	2014	2015		
	Preliminary data	Appropriation	MNB-forecast[2]	Difference
1. Cash balance of the central government[1]	–2,6	–2,7	–2,2	0,4
2. Cash balance of local governments	0,3	–0,1	–0,1	0,0
3. Cash balance (GFS) of the general government (1+2)	**–2,3**	**–2,7**	**–2,3**	**0,4**
4. GFS-ESA difference	–0,3	0,3	–0,1	–0,4
5. ESA balance of the government sector (3+4)	**–2,6**	**–2,4**	**–2,4**	**0,0**

Note 1. The cash balance reflects the amended statutory target. 2. The MNB's forecast was based on the assumption that the HUF 30 billion reserve earmarked in the Country Protection Fund would not be spent.

The Budget Act approved in December 2014 determined the 2015 cash deficit of the central sub-sector of the general government as HUF 877 billion. Pursuant to the June 2015 amendment of the Budget Act[9], the cash-based deficit target was raised to HUF 892 billion. The deficit envisaged by the MNB's projection is lower than the current cash-based deficit target by HUF 146 billion, i.e. 0.4 per cent of GDP. Within this, the cash interest balance may improve by HUF 63 billion compared to the amended appropriation in view of the yield decline observed in the government securities market since the adoption of the Budget Act, while the primary surplus of the budget may be HUF 83 billion higher than the value specified in the Budget Act. Since our projection assumes the full cancellation of the Country Protection Fund which is incorporated into the budget as freely disposable reserves, this could imply a HUF 30 billion decline in the deficit.

The difference between our projection pertaining to the balance of the central sub-sector and the amended appropriation is as follows (Table 6):

[9] The amendment of the 2015 Budget Act is included in Act LXXIII of 2015, which is presented in Sub-chapter 5.1 in more details.

- Our projection for the *central budget balance* is lower than the amended appropriation by HUF 114 billion. The cash balance may prove to be even more favourable if the free reserves earmarked in the Country Protection Fund are not utilised, in which case it may fall below the target of the Budget Act by HUF 144 billion. On the revenue side, consumption-related revenues may exceed the appropriation by HUF 90 billion: VAT revenues may improve relative to the planned value primarily because of a base effect, while excise duty revenues may increase on the back of the increased fuel consumption prompted by the oil price slump. As a result of a higher increase in the wage bill than expected in the macroeconomic trajectory envisaged by the Budget Act, personal income tax revenues may be HUF 20 billion higher than the appropriation. On the expenditure side, we assume a lower drawdown of EU funds – and hence, a smaller amount of co-financing – compared to the Budget Act, which points to a lower than expected deficit level. Similarly, the effect of the HUF 63 billion improvement in the interest balance we expect in comparison to the appropriation will be also reflected in the central budget. As opposed to the Budget Act, we do not envisage the realisation of HUF 169 billion planned in the line of *other sales and utilisation revenue* which, in our projection, partly offsets the favourable effects described above.

- Our projection for the balance of *extrabudgetary funds* represents an improvement of HUF 14 billion compared to the appropriation. On the revenue side, our revenue forecast for certain items (e.g. innovation contribution, gambling tax) is higher than the estimate in the Budget Act by around HUF 10 billion in total. According to our forecast, in view of headcount data for the first quarter, public work expenditures may fall below the budgeted level.

- For *social security funds* we forecast a deficit of HUF 12 billion compared to the break-even scenario expected by the budget. The revenues of the *Pension Fund* may exceed its expenditures by HUF 31 billion in 2015. On the one hand, contribution revenues may exceed the appropriation due to a higher increase in the wage bill than expected in the Budget Act, while we expect lesser savings with respect to pensions compared to the appropriation. Given that, in accordance with the Budget Act, the surplus of the *Pension Fund* is to be paid in full to the central budget at the end of the year, we assume that the surplus accumulated during the year will be fully depleted, as was the case last year (with a neutral effect on the balance at the level of the general government). A HUF 12 billion deficit is expected to accumulate in the *Health Insurance Fund* in 2015: according to our projection – which is supported by factual data for the first half of the year –, the net expenses of the drug budget and the therapeutic equipment reimbursement may exceed the appropriation by a total of HUF 16 billion.

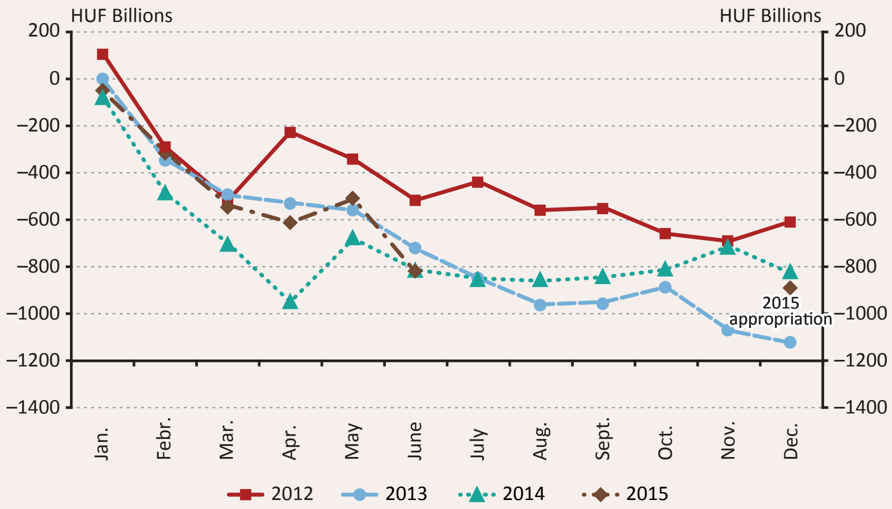
Table 6
Cash balance of the central sub-sector in 2015
(HUF billions)

	2014	2015		
	Preliminary data[1]	Amended appropriation	MNB-forecast[2]	Difference
1. Balance of the central sub-sector	–834	–841	–728	114
2. Balance of extrabudgetary funds	6	–51	–37	14
3. Balance of social security funds	6	0	–12	–12
I. Balance of the central government total (1+2+3)	**–822**	**–892**	**–777**	**116**
of which:				
a. Cash interest balance	–1 011	–987	–925	63
b. Primary balance	**189**	**95**	**148**	**53**
II. Effects the Country Protection Fund's cancellation on the balance	**0**	**0**	**30**	**30**
III. MNB balance without the utilisation of the Country Protection Fund (I.+ II.)		**–892**	**–747**	**146**

Notes: 1. Preliminary actual data for 2014 are derived from the April 2015 EDP Report of the CSO and from data released by the Hungarian State Treasury. 2. The forecast of the MNB presents the fiscal projection included in the June 2015 Inflation Report.

The cash-based deficit of the state budget – less local governments – amounted to HUF 823 in the first half of the year, representing 92 per cent of the amended appropriation, and 106 per cent of the MNB's deficit projection that assumes the full cancellation of free reserves. The deficit of the first six months is practically the same as the deficit generated in the same period of last year (Chart 5), and the 2015 cumulated deficit expressed as a percentage of the appropriation is close to the value recorded for the first half of last year, expressed as a percentage of the 2014 actual cash-based data. The accumulation of the bulk of the annual deficit in the first half of the year can be explained by several factors. Several revenue items are paid in the second half of the year (for instance, a substantial part of corporate income tax revenues is transferred to the budget in December). As regards to the expenditure side, several items – such as the better part of interest expenses – are concentrated in the first half of the year. On the other hand, in the first half of 2015, revenues related to EU projects fell short of the payments and accordingly, advance payments had to be made from the budget. These advances are not expected to affect the 2015 ESA balance. On the one hand, we expect the larger part of delayed EU transfers to arrive by the end of the year; on the other hand, if the grants related to regular payments are put on hold until 2016, they will be recognised in the 2015 ESA balance retrospectively through accrual-based corrections.[10]

Chart 5
Intra-year cumulated balance of the state budget
(HUF billions)



Source: Hungarian State Treasury

[10] These advance payments may increase the ESA deficit if the state provides assistance to projects which, eventually, will not be supported by EU funds, or will receive less funding than originally expected.

Box 1
Main measures of the 2015 Budget Act

The 2015 Budget Act includes a number of new measures affecting revenues; however, they do not have a significant impact, overall, either on the balance, or the structure of the budget. On the revenue side, some measures have a revenue increasing, while others have a revenue decreasing effect. Under the electronic toll system applicable to trucks, charges were increased by 5 per cent from January 2015, which may raise the revenues collected from the toll system by HUF 7 billion in 2015. The health contribution obligation of tobacco industry enterprises was included, for the first time, in the 2015 Budget Act, which is expected to yield revenues in the amount of HUF 13 billion. As regards revenues from the environmental product fee, the range of taxable items was extended from 2015 with a parallel increase in charges; their combined revenue increasing effect may reach HUF 13 billion. With respect to corporate income tax revenues, two new measures point to the reduction of the revenue amount. On the one hand, owing to decisions regarding foreign currency loans in 2015, a tax revenue shortfall of 25–30 billion may be expected in relation to corporate income tax allowances available for previously submitted tax returns. In addition, certain items will be deductible from the corporate income tax base, such as some of the support extended to tertiary education, while the regulation concerning tax credits for supporting films, performance arts and sports has been changed. The combined effect of these factors may amount to HUF 11 billion.

Among the measures affecting the expenditure side, those intended to assist the functioning of the national healthcare system are of special significance. In the 2015 Budget Act, HUF 60 billion was earmarked to settle the outstanding debt of healthcare institutions in the line of special reserves of the Prime Minister's Office. Pursuant to a Government Decision in April 2015, the available appropriation was transferred to the budget of the Ministry of Human Resources, and the payment of expired debts commenced in May. Moreover, primary care received additional funds of HUF 10 billion in the curative-preventive care budget for the renewal of the general practitioner system. Disbursements began in February 2015, providing extra funds of HUF 130,000 per month per GP practice. As of 1 July 2015, the base remuneration of military and law enforcement workers was increased by 30 per cent on average, which is expected to increase the expenditures of the budget by HUF 44 billion. Owing to the continued expansion of the number of public workers, public employment expenditures may rise by HUF 40 billion in 2015 compared to 2014. As a result of increasing wages on the back of the extension of career path models in the public sector, budget expenditures allocated to wage compensation may decline by HUF 25 billion in 2015 compared to the previous year.

3.2. CASH REVENUES OF THE CENTRAL SUB-SECTOR

According to our forecast, the **primary revenues of the central sub-sector** may fall short of the appropriation specified in the Budget Act by 0.1 per cent of GDP. With respect to tax and contribution revenues, we expect a significant revenue surplus in excess of 0.3 per cent of GDP, primarily because of favourable developments in consumption-related revenues (VAT revenues, excise duty revenues). At the same time, as opposed to the Budget Act, in the absence of publicly available measures we do not consider the other sales and utilisation revenue targets to be attainable, which results in a 0.5 per cent GDP-proportionate difference between our revenue projection and the appropriation.

According to our projection, the **payments by businesses** may fall short of the appropriation by HUF 14 billion in total. A large part of the shortfall emerges in relation to two items. Revenues from mining royalties may fall short of the appropriation by HUF 11 billion owing to a lower oil price trajectory than that envisaged upon budgetary planning. Revenues from the electronic road toll levied in proportion to road use may fall short of the target by HUF 12 billion. These items, however, are compensate by the fact that revenues from the road toll levied time proportionately may be HUF 10 billion higher than planned in the Budget Act.

Table 7
Partially consolidated cash revenues of the central sub-sector in 2015
(HUF billions)

	2014	2015				
	Preliminary data	Appropriation	I-VI. month	Per cent of the appropriation	MNB forecast	Differcence: MNB - appropriation
TAX AND CONTRIBUTION REVENUES OF CENTRAL GOVERNMENT	**11 716**	**12 056**	**5 854**	**49%**	**12 169**	**113**
Payments by economic units	**1 305**	**1 306**	**601**	**46%**	**1 292**	**–14**
Corporate income tax	395	341	162	47%	341	0
Special tax of financial institutions	149	144	73	51%	144	–1
Simplified entrepreneurial tax	97	84	23	28%	83	–1
Mining royalty	63	49	20	40%	38	–11
Gambling tax	35	40	19	49%	37	–3
Income tax of energy companies	35	45	20	46%	42	–3
Lump sum tax of small enterprenuers	42	56	26	46%	52	–4
Small business tax	13	16	6	35%	13	–3
E-road toll	125	149	67	45%	137	–12
Utility tax	55	54	28	51%	57	3
Other taxes and payments	297	–312	–430	138%	–257	55
Taxes on consumption	**4 336**	**4 397**	**2 091**	**48%**	**4 486**	**89**
Value-added tax	3 036	3 172	1 487	47%	3 202	30
Excise duties	919	914	443	49%	961	48
Registration tax	19	20	10	53%	20	0
Telecom tax	56	56	27	49%	58	2
Financial transaction levy	278	206	108	52%	215	9
Insurance tax	29	29	16	54%	30	2
Payments by households	**1 754**	**1 807**	**913**	**51%**	**1 823**	**17**
Personal income tax	1 589	1 640	824	50%	1 659	19
Duties, other taxes	122	121	66	54%	120	–1
Motor-vehicle tax	42	46	23	51%	44	–1
Tax and contribution revenues of Extrabudgetary Funds	**277**	**283**	**130**	**46%**	**292**	**9**
Tax and contribution revenues of Social Security Funds	**4 044**	**4 264**	**2 119**	**50%**	**4 276**	**12**
Social security contributions	3 788	3 983	1 970	49%	3 995	12
Other contributions and taxes	256	281	149	53%	281	0
OTHER REVENUES	**465**	**424**	**181**	**43%**	**270**	**–155**
Other revenues of central government	**357**	**317**	**100**	**32%**	**163**	**–155**
Other revenues of Social Security Funds	**37**	**37**	**37**	**101%**	**37**	**0**
Other revenues of Extrabudgetary Funds	**71**	**70**	**44**	**63%**	**70**	**0**
INTEREST REVENUES	**334**	**125**	**155**	**124%**	**247**	**122**
TOTAL REVENUES OF CENTRAL GOVERNMENT	**12 516**	**12 605**	**6 190**	**49%**	**12 685**	**81**

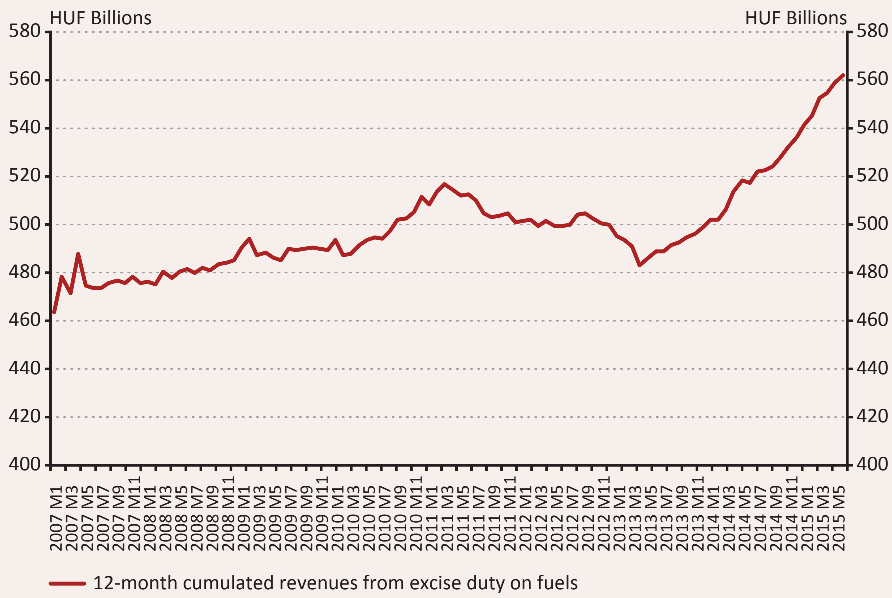
Notes: 1. Preliminary actual data for 2014 are derived from the April 2015 EDP Report of the CSO and from data released by the Hungarian State Treasury. Actual data for the first half of 2015 reflect data released by the Hungarian State Treasury. 2. The forecast of the MNB presents the fiscal projection included in the June 2015 Inflation Report. 3. 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 by the related direct revenues.

Our projection for revenues from the **corporate income tax** is identical with the HUF 341 billion appropriation included in the Budget Act. On the one hand, we envisage a corporate tax revenue shortfall of nearly HUF 20 billion in consideration of the growth tax credit programme, as the option of instalment may be requested as early as the tax advance top-up in December 2015. Under the growth tax credit programme, companies that have managed to achieve an additional fivefold increase in their pre-tax profit are permitted to pay the additional corporate income tax arising from the growth in equal instalments over the next two tax years. On the other hand, this is offset by the surprisingly high tax advance top-up recorded last year, which increases our projection by HUF 20 billion.

According to our estimate, annual revenues from the **value-added tax** may amount to HUF 3,202 billion, up 1 per cent compared to the amount specified in the Budget Act. For the most part, this difference can be explained by a base effect, as the accrual-based VAT revenue for 2014 was higher than the amount envisaged at the end of last year upon the planning of the 2015 budget. While the MNB expects this year's consumer price index to be lower than the inflation rate indicated in the macroeconomic forecast underlying the budgeting process, the revenue decreasing effect of this factor is attenuated by household and public consumption, which may increase, according to the latest forecast of the MNB, at a faster rate than expected. The mandatory installation of online cash registers commenced in August 2014 and accordingly, we expect the impact of their introduction to be incorporated into the base by the second half of 2015; thus, the 8 per cent revenue increase recorded in the first half of the year compared to the previous year may drop to 3 per cent in the second half of the year.

We expect **excise duty** revenues to reach HUF 961 billion this year, HUF 48 billion higher than the appropriation included in the Budget Act. The nearly 5 per cent difference can be almost fully attributed to the excise duty on fuels. As a result of increased consumption reflecting, in part, the decline in oil prices, excise duty revenues from fuels were up 16 per cent compared to the previous year, while this index stood at 8 per cent in 2014 on average (Chart 6).

Chart 6
Revenues from the excise duty on fuels
(12-month cumulated value)



Source: Hungarian State Treasury

Our projection for **financial transaction tax** revenues is HUF 215 billion, HUF 9 billion higher than the appropriation. The difference is presumably due to the different assessment of the payments constituting the tax base.

Compared to the time profiles of previous years, tax revenues from the **personal income tax** surpassed the appropriation in the first half of this year. Based on our macroeconomic projection and data pertaining to the first six months, we expect a revenue surplus of HUF 20 billion for 2015 compared to the appropriation in the personal income tax revenues. This can be primarily associated with labour market developments; indeed, we calculated with higher wage bill growth than the Budget Act.

With respect to the **revenues of extrabudgetary funds,** we foresee a revenue surplus of HUF 9 billion in total compared to the appropriation in the lines of innovation contribution and gambling tax. Similar to previous years, around 30 per cent of the annual appropriation for innovation contribution was realised by the end of June which, however, is not expected to affect the realisation of the annual target, as most of the payments are usually transferred to the budget in December. As regards gambling tax revenues, we expect a higher revenue figure compared to the appropriation owing to winnings accumulating in the first half of the year.

In the first half of the year, the **tax and contribution revenues of social security funds** were in line with the appropriation on a prorated basis. Based on our projection, on an annual basis we expect a moderate, HUF 12 billion surplus revenue compared to the appropriation in the case of social contribution taxes. The difference is due to the fact that the MNB forecasts a higher increase in the wage bill in 2015 than that anticipated in the macroeconomic path of the Budget Act. Owing to the increase in wages and employment, contribution revenues were up 5.7 per cent in the first half of the year compared to the same period of the last year.

According to our forecast, **other revenues** will amount to HUF 270 billion, lower than the appropriation in the Budget Act by HUF 155 billion, reflecting our lower projection for the other revenues of the central budget. This is because, as opposed to the Budget Act, we do not envisage the realisation of HUF 169 billion planned in the line of other sales and utilisation revenue under **revenues related to state property** as so far, we have no information available about the measure supporting the realisation of the revenue plans. At the same time, however, some minor items under other revenues (e.g. fines) surpassed the budgeted amount by a total of HUF 14 billion in the first half of the year.

3.3. CASH EXPENDITURES OF THE CENTRAL SUB-SECTOR

Our projection for **primary expenditure items** reckons with an expenditure level lower than that foreseen in the Budget Act, with the negative difference amounting to 0.4 per cent of GDP. We expect the net own expenditures of budgetary institutions and chapters to be higher than the appropriation by 0.3 per cent of GDP, primarily because we considered that some of the expenditures indicated under central reserves upon budget planning have already been allocated in the case of this consolidated expenditure item. The difference seen in the case of central reserves also reflects the fact that in our projection we assumed the cancellation of the Country Protection Fund – which comprises 0.1 per cent of GDP – for the achievement of the deficit target. According to our projection, net expenditures related to EU transfers may be lower than the appropriation by 0.15 per cent of GDP due to the smaller amount of co-financing required in the context of lower than expected drawdown. Amid persistently falling yields, the cash interest balance may outperform the appropriation by 0.2 per cent of GDP in 2015.

Payments related to **special and normative subsidies, as well as support of the public media** reached 60 per cent of the annual appropriation in the first half of the year, which is consistent with last year's seasonality. The higher than time-proportionate expenditure level was associated with special and normative subsidies; however, since the time profile of the item during the year is typically not even, payments are not expected to overrun the annual appropriation.

As regards **housing grants,** the performance of the first half of the year fell behind the values seen in recent years. Nevertheless, we do not envisage a material underperformance of this expenditure item compared to the appropriation as, for the time being, we cannot predict the level of recourse to the home creation programme launched on 1 July in the second half of the year.

Table 8
Partially consolidated cash expenditures of the central sub-sector in 2015
(HUF billions)

	2014	2015				
	Preliminary data	Appropriation	I-VI. month	Per cent of the appropriation	MNB forecast	Difference: MNB - appropriation
PRIMARY EXPENDITURES	**11 992**	**12 385**	**6 325**	**51%**	**12 290**	**–95**
Subsidies to economic units, support to the media	**354**	**372**	**221**	**60%**	**372**	**0**
Consumer price subsidy	**103**	**104**	**52**	**50%**	**104**	**0**
Housing grants	**128**	**129**	**53**	**41%**	**124**	**–5**
Family benefits, social subsidies	**510**	**574**	**287**	**50%**	**565**	**–8**
Benefits under retirement age	**173**	**134**	**72**	**54%**	**135**	**1**
Net expenditures of central goverment agencies and chapters	**3 838**	**4 109**	**2 375**	**58%**	**4 161**	**52**
Net own expenditures	3 288	3 321	1 722	52%	3 418	97
Net expenditures related to EU funds	550	788	653	83%	743	–45
Support to local governments	**724**	**658**	**304**	**46%**	**668**	**11**
Contribution to EU budget	**291**	**296**	**180**	**61%**	**296**	**0**
Central reserves	**0**	**286**	**0**	**0%**	**147**	**–139**
Debt assumption	**69**	**0**	**0**	**0%**	**0**	**0**
Expenditures related to state property	**42**	**129**	**53**	**41%**	**124**	**–5**
Other expenditures	**525**	**191**	**91**	**48%**	**200**	**9**
Expenditures of Extrabudgetary Funds	**453**	**528**	**208**	**39%**	**523**	**–4**
NEF – Passive allowances	50	50	23	47%	48	–2
NEF – Active allowances	226	270	124	46%	263	–7
Other expenditures	178	208	61	29%	212	4
Expenditures of Social Security Funds	**4 783**	**4 877**	**2 428**	**50%**	**4 871**	**–7**
PIF – Pensions	2 915	3 007	1 493	50%	2 993	–14
HIF – Disability and rehabilitation benefits	336	336	162	48%	322	–14
HIF – Cash benefits	224	229	119	52%	235	6
HIF – Medical and preventive care	946	949	469	49%	949	0
HIF – Net expenditures related to drug subsidies	245	240	126	52%	250	10
Other expenditures	118	116	59	50%	122	6
INTEREST PAYMENTS	**1 346**	**1 112**	**688**	**62%**	**1 172**	**60**
TOTAL EXPENDITURES OF CENTRAL GOVERNMENT	**13 338**	**13 497**	**7 013**	**52%**	**13 461**	**–36**

Notes: 1. Preliminary actual data for 2014 are derived from the April 2015 EDP Report of the CSO and from data released by the Hungarian State Treasury. Actual data for the first half of 2015 reflect data released by the Hungarian State Treasury. 2. The forecast of the MNB presents the fiscal projection included in the June 2015 Inflation Report. 3. 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 by the related direct revenues.

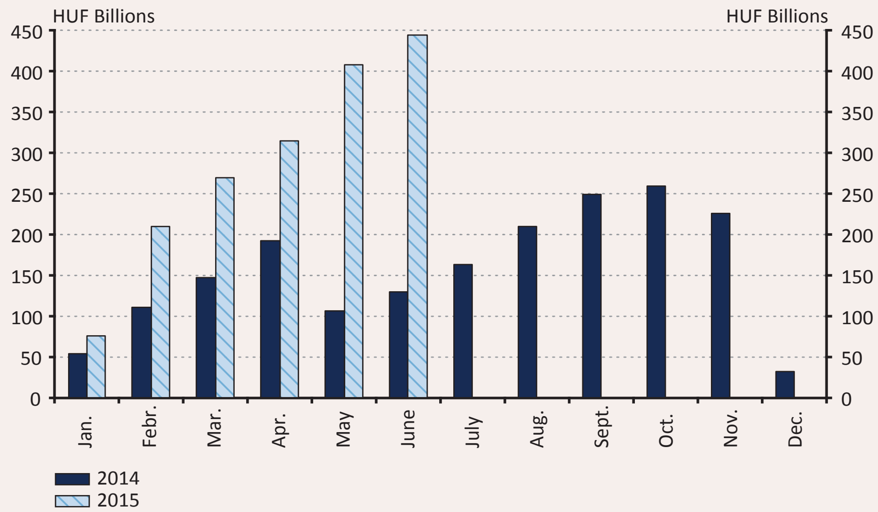
In view of the developments of the first half of the year, we do not expect a significant difference between our projection and the appropriation in the case of **family allowances and income supplement benefits.**

With respect to the **net expenditures of budgetary institutions and chapters[11],** the performance of the first half of the year accounts for 58 per cent of the appropriation. This may appear to point to a rather significant overrun of the budget; however, upon the assessment of the actual figures, two factors should be considered. On the one hand, the amount of advances under expenditures related to EU transfers is even higher than the value recorded in the previous year; on the other hand, an amount of almost HUF 100 billion has already been spent in this line from the reserve appropriations (special reserves, reserve for extraordinary government measures).

- Our projection for the **net expenditures of budgetary institutions and chapters** surpasses the appropriation by HUF 98 billion. This, however, is fully covered by reallocations from the reserves; thus its impact on the balance is neutral overall. Based on incoming data – and also in consideration of the appropriation for the reserves –, the annual appropriation may be achievable.

- **Net expenditures related to EU transfers** reached 83 per cent of the annual appropriation during the first six months of the year and significantly exceed the value recorded in the previous year, as the inflow of EU funds did not keep up with dynamically increasing payments. The amount of the advances can be divided into two parts. A part of them is short-term, and is expected to be recovered within a year, similar to last year, when the amount of the advances approached HUF 250 billion during the year before it dropped to HUF 30 billion by the end of the year. On the other hand, some of the advances expected for 2015 – HUF 200 billion in total – will take years to be reimbursed by the EU. This amount is related to the last 5 per cent of the project costs which, in accordance with EU regulations, will be transferred by the EU to Member States only after the complete ex post review of the completed programmes. In general we may conclude that neither form of the advances affects the ESA deficit: the advanced expenditures will be offset in accrual-based corrections. Nevertheless, they may result in a temporarily higher level of public debt through the increase in the borrowing requirement.

Chart 7
Cumulated value of advance financing from the budget in relation to EU transfers in 2014 and 2015
(estimate, excluding co-financing)



Source: Hungarian State Treasury, MNB estimate

In the **transfer to local governments** line we expect an expenditure overrun of HUF 11 billion compared to the appropriation, primarily because of reallocated funds from the central reserves to local governments.

[11] In calculating net expenditures, we deducted from the expenditures the own revenues of budgetary institutions and chapters, as well as their revenues from the EU.

Contribution to the EU budget exceeded the 60 per cent of the appropriation in the first half of the year, thereby demonstrating a seasonality in 2015 similar to that seen in recent years, which is not expected to influence the realisation of the annual appropriation.

Expenditures related to state property were less than the prorated amount expected for the first six months (e.g. in the line of subsidy payments to state-owned companies), this shortfall, however, does not influence the realisation of the annual appropriation.

Within the **expenditures of extrabudgetary funds,** the prorated shortfall in the active expenditures line is related to public work expenditures. Based on the data available, the number of public workers was below expectations in the first four months of the year; however, we expect an increase in the headcount at the beginning of the third quarter.

According to the developments observed in the first six months of the year, the **expenditures of social security funds** may be close to the appropriation in 2015; however, within these pension expenditures may fall short of the budgeted level by 0.1 per cent of GDP in total, which may be partly offset by additional expenditures in the case of drug reimbursement, therapeutic equipment reimbursement and cash benefits.

Based on our projection prepared for the June *Inflation Report,* we expect annual savings in the total amount of HUF 27 billion compared to the appropriation in the case of **pensions and pension-type benefits**.

- As regards *early retirement benefits,* the slightly higher value compared to the prorated expenditure level is not expected to affect the realisation of the appropriation and our annual projection. This is because the uneven time profile of the expenditures during the year: there was a slight downward shift in the expenditure level during the first half of the year, which may be continued by stagnation in the second half of the year as a result of the raising of the old-age retirement age (because of the latter there are no flows in the second half of the year into the group of pensioners above the retirement age).

- Expenditures related to *disability and rehabilitation benefits* were slightly lower in the first half of the year than the prorated amount of the appropriation, and according to our forecast, the expenditure level may be lower than expected by HUF 14 billion for 2015 as a whole.

- In our projection prepared for the June *Inflation Report,* we forecasted a similar level of saving – HUF 14 billion – in the case of *old-age pensions* as well. Due to the raising of the old-age retirement age, the monthly profile of pension expenditures is uneven during the year (Table 9). The generation born in 1952 reaches the retirement age at the age of 62.5, i.e. in the second half of 2014 and the first half of 2015, while those born in 1953 will retire in 2016. Consequently, new retirements will fall sharply in the second half of 2015 compared to the first half of the year, which may result in a slightly declining expenditure level on a monthly basis in the second half of the year.

Table 9
Old-age retirement age in Hungary

Birth year	Retirement age	The year of reaching the retirement age
1951	62 years	2013
1952	62.5 years	Second half of 2014 - first half of 2015
1953	63 year	2016
1954	63.5 years	Second half of 2017 - first half of 2018
1955	64 years	2019
1956	64.5 years	Second half of 2020 - first half of 2021
1957	65 years	2022

Source: Act LXXXI of 1997 on Social Security Retirement Provision

Based on data pertaining to the first half of the year, the **cash benefits covered by the Health Insurance Fund** moderately exceeded the prorated amount of the annual appropriation. The difference was predominantly due to sick pay expenditures and the higher than expected number of beneficiaries.

Our projection for expenditures related to **curative and preventive care** is identical with the appropriation. Cash figures for the first six months of the year are slightly lower than the prorated amount of the appropriation; however, we assume that the entire amount of the appropriation will be spent by the end of the year. Looking at the budgetary processes of previous years, in the case of curative and preventive care we found that any savings accumulated during the year relative to the appropriation regularly led to a higher expenditure level in the last month of the year compared to the previous months, reflecting the end-of-year "clearance" of funds.

The **net expenditures of the drug budget** slightly exceeded the prorated appropriation in the first half of the year, and incoming actual data indicate that, in line with our projection, the balance of the drug budget will have a deficit of around HUF 10 billion compared to the appropriation, reflecting higher than budgeted drug reimbursement expenditures. Meanwhile, the **expenditures of therapeutic equipment reimbursement** may slightly overrun the budget as well (by HUF 6 billion). The difference will materialise in the other expenditures line.

In the first half of 2015, **cash interest expenditures** were higher than the prorated amount of the amended appropriation, while **interest revenues** exceeded the amended annual appropriation in the first half of the year already. As a result, during the year the budgeted value may be exceeded significantly by interest revenues and overrun slightly by interest expenditures. The high level of cash interest revenues in the first half of the year is related to the yield decline observed in the government securities market since the approval of the Budget Act; thus the budget realises a higher premium upon issue at auctions and switch auctions.[12] The prorated overperformance of gross interest expenditures is caused by the fact that interest expenditures are concentrated in the first half of the year – particularly in February and June –, while in the second half of the year it is only in November that the expenditure is expected to be far higher than the average.

According to our projection, in 2015 **accrual-based interest expenditures** may be lower than the amended appropriation of the budget by HUF 26 billion. The difference can be explained by the yield decline observed since the amendment of the appropriation, and by incoming actual interest revenue data. Resumed in 2015, the MNB's easing cycle also contributed to the yield decline along with the continuation of the self-financing programme and the reform of the central bank's monetary instruments. The amendment of the appropriation increased the cash interest revenues included in the budget by HUF 42 billion. Assuming constant ESA interest corrections, in 2015 accrual-based net interest expenditures may be lower than the original appropriation by a corresponding degree.

3.4. BALANCE OF LOCAL GOVERNMENTS IN 2015

According to cash-flow-based data available for the first quarter of the year, at the end of the first quarter of 2015 the **balance of local governments** was above HUF 91 billion. While this surplus is lower than that achieved by the sub-sector in the past two years, quarterly changes in the balance tend to be volatile; thus we may not draw any conclusions regarding the annual balance from this figure alone. Moreover, since the funds received from the central budget are lower than usual on a prorated basis, the financial performance of the first quarter is particularly difficult to compare to the balances recorded in the same period of previous years. The sub-system responded to the reduction of central funding by increasing its own revenues. On the expenditure side, the shedding of debt burdens paved the way for increasing wage costs and purchasing goods and services. According to our forecast, with upside risks, local governments may achieve a deficit amounting to 0.1 per cent of GDP.

[12] The reasons for this are described in detail in Sub-chapter 5.2.

3.5. STATISTICAL CORRECTIONS (ESA BRIDGE)

The 2015 Budget Act was approved with an accrual-based correction corresponding to HUF 82 billion. The projection of the MNB presented in the June *Inflation Report* included an accrual-based correction of HUF 19 billion. The difference can be attributed to two factors: the accrual-based correction of interests and the correction of EU transfers.

Based on the Budget Act, the accrual-based correction of cash-based interest accounting may be HUF –72 billion compared to the MNB's estimate of HUF –100 billion. For the most part, the difference reflects a technical item; the difference between the Budget Act and our projection for the ESA-based, net interest balance is merely HUF 4 billion.

According to the government's expectations, the accrual-based correction of EU transfers may amount to HUF 211 billion. According to the MNB's forecast, this amount may be HUF 35 billion lower, as our estimate regarding the expected advances from our own resources for the last 5 per cent of the EU transfers is lower.

3.6. MAIN RISKS SURROUNDING THE 2015 BALANCE

Our forecast differs from the Budget Act in several points, as our forecasts with regard to the macroeconomic path, the baseline processes of 2014, and the impacts of the measures may differ from the assumptions of the Budget Act. We do not regard these as risks, but rather we apply these differences in our own projection. Accordingly, in this sub-chapter we present the risks that surround the baseline scenario of our projection.

Based on the **underlying fiscal developments** identified in the first half of the year, our annual balance projection is surrounded by both upside and downside risks.

- **Expenditures related to pensions and pension-type benefits** fell slightly short of the prorated value expected on the basis of our projection. In view of the actual data available so far and the continued impact of the raising of the old-age retirement age in the second half of the year, expenditures may be reduced by HUF 15 billion compared to our baseline scenario.

- The drawdown of **EU funds** is surrounded by a number of risks. On the one hand, if the government's projection of a higher drawdown than expected by the MNB materialises, it may generate a higher accrual-based expenditure due to the higher level of co-financing it would require. This effect, however, would be more subdued with a parallel acceleration of economic growth, which would generate additional revenues for the budget. On the other hand, the proportion of co-financing may exceed the level envisaged in the budget, which may entail an uncertain degree of downside risk.

- If the **settlement of the disputes** between the European Commission and Hungary (the so-called "asphalt case") ends with an unfavourable decision for Hungary, the associated expenses may increase the deficit.

Measures included in the Budget Act may be subject to risks for two reasons: measures may be surrounded by risks either for the lack of details, or for the uncertain impact they may have. The two factors below may represent an upside risk to the balance compared to our forecast:

- In respect of revenues related to state property, the realisation of **other sales and utilisation revenue** implies an upside risk of 0.4 per cent of GDP compared to our baseline scenario, also in consideration of the fact that in that case, there would be no need for the partial blocking of the Investment Fund.

- As regards VAT revenues, the efficient functioning of the **Electronic Trade and Transport Control System** may generate a surplus revenue amounting to as high as 0.2 per cent of GDP.

3.7. EXPECTED DEVELOPMENTS IN PUBLIC DEBT IN 2015

According to the financial account data published by the MNB at the end of June 2015, at the end of the first quarter of 2015, the gross public debt ratio stood at 77.6 per cent of GDP. In the first quarter of 2015, the debt ratio was 4.7 percentage point lower relative to the same period of the previous year; however, it is up 0.7 percentage points compared to the level recorded at the end of 2014. However, the rise in the gross debt rate at the beginning of the year is typically a seasonal phenomenon, given that a large portion of the cash-based budget deficit emerges in the first half of the year in line with the heightened financing needs. Therefore, the temporary rise in public debt can be attributed to the seasonality of the deficit and the rise in the liquid reserves of the government. At the same time, the increase in the debt ratio in 2015 Q1 falls short of the 3.9 percentage point average of the same period of the previous two years. The moderate increase was supported by the unexpectedly high dynamics of the real economy, the disciplined fiscal policy and the 5 per cent appreciation of the forint against the euro in the first quarter of the year. The latter reduced nominal debt by HUF 440 billion. The FX ratio of total debt declined to 37.9 per cent from 39.8 per cent recorded at the end of 2014.

According to our 2014, end-of-year projection (calculated at a constant HUF/EUR exchange rate), gross public debt-to-GDP ratio may decrease to 75.6 per cent by the end of 2015, which means that the debt rule of the Fundamental Law is expected to be adhered to this year as well. The decline in debt rate is equally supported by persistently dynamic economic growth and the moderate net financial needs of the general government. FX debt may decline further in the context of the expected negative net foreign currency debt issuance, bringing down its ratio to total debt to 36 per cent. The continued decline in yields may pose a positive risk to the debt path compared to the baseline projection, while negative risks are posed by the strengthening of the dollar against the euro and the potential pre-financing needs of EU tranfers.

4. Expected public finance developments in 2016

In May 2015, the MNB published its analysis of the 2016 budget bill in its *Public Finance Report* series.[13] The main findings of the Report are still valid; however, since the General Assembly modified the bill slightly when discussing the budget, and the MNB also revised its macroeconomic forecast for the *June Inflation Report*, below we present the adopted bill and the updated forecast of the MNB.[14]

4.1. EXPECTED ESA BALANCE OF THE GOVERNMENT SECTOR IN 2016

According to the Budget Act, for 2016 the ESA budget deficit target is 2.0 per cent of GDP, which implies an improvement of 0.4 percentage points compared to the deficit planned for 2015. According to our forecast, some revenue items may fall short of the appropriation, and thus the deficit target may be approached only in case of the full cancellation of the Country Protection Fund; in that case, according to our forecast, a deficit of 2.2 per cent can be achieved in 2016 (Table 10).

Table 10
Balance of the government sector in 2016
(percentage of GDP)

	2016		
	Appropriation	MNB-forecast	Difference
1. Balance of the central government	–2,2	–2,4	–0,2
2. Balance of local governments	–0,1	–0,1	0,0
3. Cash balance (GFS) of the general government (1+2)	**–2,2**	**–2,5**	**–0,3**
4. GFS-ESA difference	0,2	0,1	–0,2
5. ESA balance of the government sector (3+4)	–2,0	–2,4	–0,4
6. ESA balance with cancellation of free reserves	**–2,0**	**–2,2**	**–0,2**

Notes: 1. The 2015 cash balance reflects the amended statutory target. 2. The forecast of the MNB presents the fiscal projection included in the June 2015 Inflation Report. 3. Due to rounding, certain items of the table may show differences.

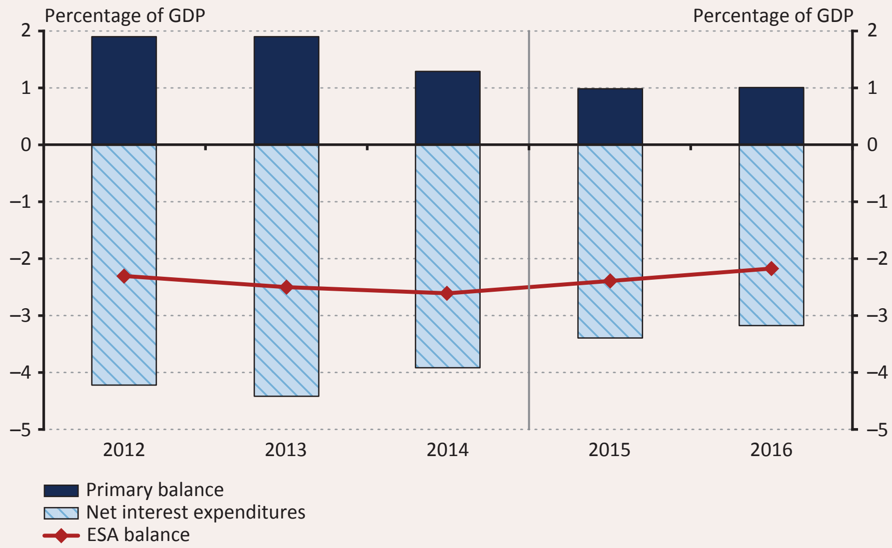
According to our forecast, in case of the full cancellation of the free reserves, **the ESA deficit of the general government may be higher than the target set in the budget by 0.2 per cent of GDP.** According to our forecast, the primary revenues of the central sub-sector of the budget may fall short of the appropriations specified in the approved Budget Act by 0.4 per cent of GDP. The major part of the difference is attributable to the fact that we do not calculate with the HUF 133 billion revenue budgeted for the item of other sales and utilisation revenue related to state property. In addition, we also forecast slightly lower revenues from labour taxes and consumption taxes as compared to the appropriations included in the Budget Act. Lower than expected revenues and higher pension expenditures resulting from higher inflation expectations are partly offset by the fact that the absorption of the funds available under the 2014–2020 budget cycle of the European Union is expected to be concentrated in the second half of the period; thus, in 2016 it may fall short of the level assumed in the budget and the resulting savings on co-financing may approach 0.2 per cent of GDP. In addition,

[13] http://www.mnb.hu/letoltes/koltsegvetesi-jelentes-2015-eng-0624.pdf
[14] Changes compared to the May *Public Finance Report* are presented in Box 2.

we assume the full cancellation of the Country Protection Fund, which improves the balance by 0.2 per cent of GDP in itself.

The improvement of the budget balance expected for 2016 can be fully attributed to the estimated decline in interest expenses, while our projection for the primary balance is identical for both years (Chart 8). The unchanged primary ESA balance is based on slightly declining GDP-proportionate revenues and expenditures. The most pronounced decline affects turnover taxes, corporate and personal income taxes and EU transfers on the revenue side, and transfers to households, material expenditures and government investment on the expenditure side. The GDP-proportionate decline in financial transfers is caused primarily by expenditures (primarily pensions) indexed by inflation dynamics currently falling far behind the growth rate of nominal GDP. Several government measures point to a decline, including the gradual raising of the retirement age, the tightening of disability and rehabilitation benefits, the phasing out of early retirement benefits, and declining unemployment and social benefits amid the extension of the public work programme. In 2016, GDP-proportionate public wages and personnel expenditures may remain at the level observed in the previous year as a net result of several factors. The 2016 Budget Act includes the extension of the public work programme and, with the exception of pay increases under the career path programmes, general wage freezes. In 2016, both material expenditures and government investment will be restrained by the lower absorption of EU transfers in the context of the reduced inflow of funds at the beginning of the new EU budget cycle. This effect, however, will be cushioned by an upswing in state projects funded from co-financing in the area of public road developments.

Chart 8
Budget balance and the interest expenses of the government



Notes: In line with ESA2010 requirements, from 2012 interest expenses include the imputed interest expenditures incurred as a result of the pension system reform.
Source: MNB

Box 2
Amendments between the submission and approval of the 2016 budget bill

The May issue of the *Public Finance Report* includes the analysis of the 2016 budget bill submitted to Parliament on 13 May. However, the approved bill reflects several modifications compared to the original proposal. After the amendment, the general government balance was approved with a deficit HUF 5.5 billion higher compared to the proposal analysed in May. In accordance with the amendments, the Country Protection Fund was reduced by HUF 30 billion, the appropriation for other sales and utilisation revenues was increased by HUF 17.9 billion, and other miscellaneous expenditures were reduced by HUF 19.0 billion. Based on the above, the amendments improving the balance amounted to HUF 67 billion in total. At the same time, the bill was updated to reflect several deficit-increasing measures as well: the inclusion of the solidarity tax of financial organisations reduces the revenues expected from credit institutions by HUF 10 billion; the budget now has an additional amount of HUF 30 billion available for investment expenditures compared to the bill; and raising the amount available for other miscellaneous expenditures increased the appropriations concerned by HUF 32.4 billion.

These amendments implied only a negligible change to the balance targeted in the Budget Act: the accrual-based deficit target of the government remained the same as planned originally, i.e. 2.0 per cent of GDP. However, we modified the deficit path indicated in the May issue of the Public Finance Report. On the one hand, this is because in our analysis we calculated with the full cancellation of the Country Protection Fund, which was reduced by HUF 30 billion as a result of the amendments, while this expenditure cut was offset by an increase in other appropriations. On the other hand, with the lack of information about the measures, our baseline scenario did not expect the realisation of any other sales and utilisation revenues. Thus, overall, the amendments of the budget bill increased the ESA deficit by 0.15 per cent of GDP compared to the fiscal path presented in the May issue of the Public Finance Report.

Nevertheless, our expectations regarding the balance next year did not change materially as, during the preparation of the June issue of the *Inflation Report,* incoming macroeconomic data changed the structure of the central bank's growth projection compared to the growth path outlined in March; therefore, our increased tax and contribution revenue projection neutralised the deficit increasing effect of the amended appropriations on our projection.

Box 3
Main measures of the 2016 Budget Act

Among the key measures of the Budget Act, the following items should be highlighted: the reduction of the personal income tax rate by 1 percentage point; the extension of the family tax allowance of families with two children; the reduction of the VAT on pork to 5 per cent; the reduction of the levy on banks; the continuation and extension of the career path models (teachers, law enforcement professionals, government officials), the launch of high-value public road projects.

Starting from 2016, the standard rate of personal income tax (PIT) will be reduced from 16 to 15 per cent, while the total family tax allowance for families with two children (including the part that can be applied to contributions) will increase from the current HUF 10,000 per child per month to HUF 12,500. According to our forecast, in 2016 PIT revenue will decrease by a total of HUF 122 billion as a combined result of the two measures. The extension of the family allowance alone generates a PIT shortfall of HUF 14 billion, while the rate cut will reduce PIT revenue by an additional HUF 112 billion. At the same time, the latter change reduces the level of the family tax allowance utilisation by HUF 4 billion. The increased consumption prompted by the tax cut may generate surplus VAT revenues in the amount of HUF 15 billion; thus the net deficit increasing effect on the 2016 budget may be around HUF 100 billion, i.e. 0.3 per cent of GDP.

Under the growth tax credit programme, companies achieving an additional fivefold increase in their pre-tax profit are permitted to pay the additional corporate income tax arising from the growth in equal instalments over the next two tax years. According to our forecast, this measure may affect nearly 18,000 companies, and may result in a corporate income tax shortfall of HUF 9 billion in 2016.

The most important change in the value-added tax is the reduction of the VAT payable on pork from the current 27 per cent to 5 per cent next year. According to our estimate this measure will generate a revenue shortfall of HUF 29 billion.

The solidarity tax levied on financial organisations is affected by several measures, as a result of which revenues expected for 2016 are reduced substantially both in the appropriation and in our forecast. In the case of credit institutions, the upper rate of the tax will be reduced from the current 0.53 per cent to 0.31 per cent. An additional change is that the tax base is to be defined on the basis of the balance sheet total of 2014 rather than that of 2009. These two measures alone (primarily the rate cut and, to a lesser extent, the change in the tax base) reduce revenues from the solidarity tax on financial organisations by HUF 62 billion in 2016.

Among the measures affecting the expenditure side, we should note that the budget appropriates HUF 113 billion for the capital increase of Paks II Atomerőmű Fejlesztési Zrt.; thus budget expenditures related to the development of the nuclear power station increase by 0.3 per cent of GDP compared to the base year. Owing to the expected decline in EU transfers, the investment spending of the government are set to decline significantly in proportion of GDP. The growth restraining effect of this measure is intended to be alleviated by the HUF 160 billion priority appropriation for public road development.

4.2. CASH REVENUES OF THE CENTRAL SUB-SECTOR

The **primary revenues of the central sub-sector** may be lower than the appropriation by HUF 150 billion. In the absence of the measures substantiating the revenue, we do not expect any other sales and utilisation revenue under the revenues related to state property, while the Budget Act indicates revenues of HUF 133 billion under this heading. According to our projection, **tax and contribution revenues** may fall short of the appropriation by around HUF 20 billion, which implies a minor difference relative to the total amount.

Our forecast with regard to the **payments by businesses** falls short of the appropriation by HUF 6 billion. Within this, our forecast with regard to revenues from corporate tax is lower than the appropriation by HUF 23 billion, which may be attributable to the different assessment of the impact of last year's tax advance top-up on the forecast on the one hand and, on the other hand, the appropriation presumably does not calculate with the impact of the growth tax credit.

In addition, the government's estimate with regard to the willingness to changeover to the **small taxpayers' itemised lump sum tax** (KATA) is higher than our assumption, as a result of which the bill expects the tax revenue under this tax type to be higher by HUF 15 billion (at the same time, the expected lower changeover to the KATA increases the revenues from other taxtypes, and thus it has a positive impact on the budget overall).

Table 11
Partially consolidated cash revenues of the central sub-sector in 2015 and 2016
(HUF billions)

	2015			2016		
	Statutory target	MNB forecast	Difference	Statutory target	MNB forecast	Difference
TAX REVENUES AND CONTRIBUTIONS OF CENTRAL GOVERNMENT	**12 056**	**12 169**	**113**	**12 514**	**12 495**	**–19**
Payments by businesses	**1 306**	**1 292**	**–14**	**1 267**	**1 262**	**–5**
Corporate income tax	341	341	0	401	377	–23
Special tax of financial institutions	144	144	–1	79	77	–3
Sector-specific tax	0	0	0	0	0	0
Simplified entrepreneurial tax	84	83	–1	75	76	1
Mining royalty	49	38	–11	32	43	11
Gambling tax	40	37	–3	41	38	–3
Income tax of energy companies	45	42	–3	41	45	4
Lump sum tax on small enterpreneurs	56	52	–4	70	55	–15
Small business tax	16	13	–3	14	14	0
E-road toll	149	137	-12	141	141	0
Utility tax	54	57	3	52	52	0
Other taxes and payments	476	486	9	462	485	22
Consumption taxes	**4 397**	**4 486**	**89**	**4 612**	**4 598**	**–14**
Value-added tax	3 172	3 202	30	3 352	3 298	–54
Excise duties	914	961	48	952	970	17
Registration tax	20	20	0	21	21	0
Telecom tax	56	58	2	56	60	4
Financial transaction levy	206	215	9	201	218	17
Insurance tax	29	30	2	30	32	2
Payments by households	**1 807**	**1 823**	**17**	**1 829**	**1 805**	**–23**
Personal income tax	1 640	1 659	19	1 658	1 636	–22
Duties, other taxes	121	120	–1	125	124	–1
Motor-vehicle tax	46	44	–1	46	45	0
Tax revenues and contributions of Extrabudgetary Funds	**283**	**292**	**9**	**287**	**298**	**11**
Tax revenues and contributions of Social Security Funds	**4 264**	**4 276**	**12**	**4 519**	**4 532**	**13**
Social security contributions	3 983	3 995	12	4 230	4 238	9
Other contributions and taxes	281	281	0	289	294	4
OTHER REVENUES	**424**	**270**	**–155**	**379**	**244**	**–135**
Other revenues of central government	**317**	**163**	**–155**	**263**	**130**	**–133**
Other revenues of Social Security Funds	**37**	**37**	**0**	**36**	**36**	**0**
Other revenues of Extrabudgetary Funds	**70**	**70**	**0**	**79**	**77**	**–2**
INTEREST REVENUES	**125**	**247**	**122**	**74**	**190**	**116**
TOTAL REVENUES OF CENTRAL GOVERNMENT	**12 605**	**12 685**	**81**	**12 967**	**12 929**	**–38**

Notes: 1. The 2015 cash balance reflects the amended statutory target. 2. The forecast of the MNB presents the fiscal projection included in the June 2015 Inflation Report. 3. 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 by the related direct revenues.

According to the Budget Act, mining royalties may decrease substantially in 2016, which – in the absence of announced measures – we do not deem justified, and therefore our expectation exceeds the appropriation by HUF 11 billion. Under the heading "other centralised revenues" we expect additional revenues of HUF 20 billion compared to the appropriation. Most of the difference can be attributed to our different projection regarding revenues from fines, which is supported by data pertaining to 2015.

Value-added tax revenues are lower in our projection by HUF 54 billion compared to the appropriation included in the Budget Act, primarily because – in line with the principle of conservativeforecasting –, our projection does not include additional revenues in relation to the implementation of the Electronic Trade and Transport Control System, as opposed to the HUF 60 billion expected by the budget. The estimated effect of online cash registers is included in our forecast via a base effect.

Our **excise duty** projection is significantly higher than the value stated in the budget appropriation (by HUF 17 billion), which may be attributed to our different assessment of the persistence of the prevailing favourable trends. Based on the developments seen in the first half of 2015, we expect higher revenues primarily from the excise duty on tobacco products. We also expect higher revenues from the **financial transaction levy,** which, according to our forecast, may exceed the appropriation by HUF 17 billion next year. According to the Budget Act, revenues from the transaction levy may decrease in 2016 compared to this year; however, we do not find this expectation justified.

The Budget Act expects revenues of HUF 133 billion under the title of „**other sales and utilisation revenues"** for 2016; this appropriation, however, is not supported by measures in the Act. Accordingly, for the time being this revenue is not taken into account in our forecast.

We regard the **tax and contribution revenue appropriations of social security funds as** justified; the appropriations are lower than our forecast by HUF 13 billion. According to our estimate, the extension of the targeted social contribution tax allowance of the Job Protection Action Plan to agricultural employees of 25–55 years of age may generate a tax shortfall of HUF 10 billion in 2016. We estimate the total amount of such allowance to HUF 147 billion. According to our estimate, the new rules related to the reform of the vocational education scheme reduce next year's vocational training contribution revenues by HUF 11 billion. The conversion of the one-off health contribution obligation of certain actors in the tobacco industry in 2015 to a permanent obligation may generate additional revenues of HUF 13 billion, which is consistent with the appropriation. According to the government's forecast, family contribution allowance will amount to HUF 37 billion in total next year, which does not differ materially from the amount we expect.

4.3. CASH EXPENDITURES OF THE CENTRAL SUB-SECTOR

According to our projection, **primary budget expenditures** – in consideration of partially consolidated figures – may fall short of the appropriations included in the Budget Act by 0.3 per cent of GDP, i.e. HUF 107 billion in total (Table 12). A substantial partof the difference reflects the item of reserves, as our forecast envisages the cancellation of the Country Protection Fund of HUF 70 billion, which is set to reduce central reserves. In addition, according to our forecast, expenditures may prove to be lower if a part of the drawdown of EU funds is implemented at a later point rather than in 2016 as planned, because that would reduce the amount of the co-financing required next year. At the same time, in the case of pensions and pension-type expenditures, in view of the higher inflation projection, our forecast expects a higher expenditure level than the Budget Act, and we also expect higher expenditures under health insurance benefits in kind (drug reimbursement, therapeutic equipment reimbursement) compared to the appropriations.

Our estimate for the cash balance of **net expenditures of central budgetary institutions and chapters** falls short of the balance calculated from the relevant appropriations by HUF 57 billion. The difference is attributable to the different projection with regard to the drawdown of EU funds. According to the MNB's forecast, the drawdown of EU funds, appearing in cash flows, will fall short of the appropriation by HUF 234 billion, while we estimate about HUF 57 billion related to savings on own resources. The difference is primarily attributable to the fact that – as opposed to the government's plans, which calculate more or less steady use of the funds available in the 2014–2020 budget cycle – our forecast expects the utilisation of the funds to be more concentrated toward the end of the cycle.

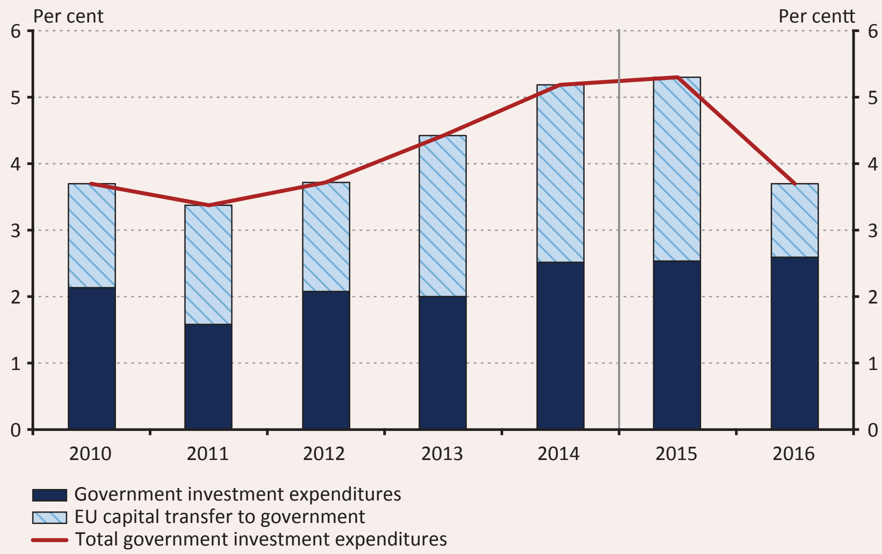
Due to the difference in the gross revenues and expenditures linked to EU transfers, our projection with regard to government investment is somewhat lower for 2016 than that included in the Budget Act. In the case of the own revenues and expenditures of budgetary institutions and chapters, we took the statutory appropriations as we consider them well-founded.

Table 12
Partially consolidated cash expenditures of the central sub-sector in 2015 and 2016
(HUF billions)

	2015			2016		
	Statutory target	MNB forecast	Difference	Statutory target	MNB forecast	Difference
PRIMARY EXPENDITURES	**12 385**	**12 260**	**–125**	**12 680**	**12 573**	**–107**
Subsidies to economic units, support to the media	**372**	**372**	**0**	**374**	**374**	**0**
Consumer price subsidy	**104**	**104**	**0**	**104**	**104**	**0**
Housing grants	**129**	**124**	**–5**	**104**	**119**	**15**
Family benefits, social subsidies	**574**	**565**	**–8**	**571**	**570**	**–1**
Benefits under retirement age	**134**	**135**	**1**	**113**	**106**	**–7**
Net expenditures of central goverment agencies and chapters	**4 109**	**4 161**	**52**	**4 147**	**4 090**	**–57**
Net own expenditures	3 321	3 418	98	3 605	3 605	0
Net expenditures related to EU funds	788	742	–46	542	485	–57
Support to local governments	**658**	**668**	**11**	**662**	**662**	**0**
Contribution to EU budget	**296**	**296**	**0**	**315**	**315**	**0**
Central reserves	**286**	**117**	**–169**	**331**	**261**	**–70**
Debt assumption	**0**	**0**	**0**	**0**	**0**	**0**
Other expenditures	**320**	**324**	**4**	**412**	**412**	**0**
Expenditures of Extrabudgetary Funds	**528**	**523**	**–4**	**581**	**561**	**–20**
NEF - Passive allowances	50	48	–2	52	47	–5
NEF - Active allowances	270	263	–7	340	330	–10
Other expenditures	208	212	4	189	184	–5
Expenditures of Social Security Funds	**4 877**	**4 871**	**–7**	**4 965**	**4 998**	**33**
PIF - Pensions	3 007	2 993	–14	3 042	3 062	20
HIF - Disability and rehabilitation benefits	336	322	–14	323	325	2
HIF - Cash benefits	229	235	6	249	245	–4
HIF - Medical and preventive care	949	949	0	982	982	0
HIF - Net expenditures related to drug subsidies	240	250	10	247	257	10
Other expenditures	116	122	6	122	127	5
INTEREST PAYMENTS	**1 112**	**1 172**	**60**	**1 048**	**1 132**	**84**
TOTAL EXPENDITURES OF CENTRAL GOVERNMENT	**13 497**	**13 431**	**–66**	**13 728**	**13 706**	**–22**

Notes: 1. The 2015 cash balance reflects the amended statutory targets. 2. The forecast of the MNB presents the fiscal projection included in the June 2015 Inflation Report and assumes the full cancellation of the HUF 30 billion Country Protection Fund. 3. The MNB forecast for 2016 assumes that the HUF 70 billion available in the Country Protection Fund will not be spent. 4. 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 by the related direct revenues.

Chart 9
Composition of government sector investment expenditure
(percentage of GDP)



Source: CSO, MNB

Most family allowances and social benefits may remain at the same nominal level next year, as, similar to previous years, the amount of the various benefits will not change. At the same time, the expenditures of maternity pay(GYES) may increase: with the introduction of the child-care benefit (GYED) extra, upon the birth of an additional child or when the mother's taking up a job, eligibility for the GYES is no longer lost. Accordingly, the budget, as well as the MNB's projection calculates with an increasing appropriation compared to 2015.

According to our forecast, **pensions and pension-type benefits** may exceed the appropriation by HUF 20 billion in total. The difference may be primarily attributable to the different inflation forecasts: the Budget Act includes a consumer price index of 1.6 per cent, while the MNB's latest, March issue of the *Inflation Report* foresees an inflation rate of 2.4 per cent for 2016. On balance, GDP-proportionate pension expenses may continue to decrease next year. In addition to the fact that the indexation is lower than the nominal GDP rate, the decrease in proportion to GDP is attributable to the measures affecting the number of beneficiaries.

In the case of **medical and preventive care**, we adopt the appropriation included in the Budget Act. The appropriation for 2016 exceeds our forecast for 2015 by HUF 34 billion, which represents an expenditure increase of 3.6 per cent. A major part of this increase is related to new measures. On the one hand, wage payment to healthcare workers may increase by HUF 16 billion in 2016 because of the wage increase performed in 2012–2013 in the healthcare sector will be integrated into the basic wage that underlies the calculation of allowances (variable pay) and, on the other hand, because of the wage adjustment of the specialist physicians finishing the internship programme. The reform of the primary healthcare, launched in 2015, continues: in the first phase in 2015 the financing of GP practices is increased by HUF 10 billion, and additional resources in the same amount will be injected into primary care during the second phase in 2016. In addition, in 2016 the receipt of the spare capacities aimed at the reduction of waiting lists is expected to generate a HUF 5 billion increase in expenditures. Based on foregoing, the material expenditures of the medical and preventive budget may essentially remain constant in nominal terms in 2016 compared to 2015, which, in the lack of structural reforms, may put a pressure on expenditures.

According to our forecast, within expenditures related to health insurance benefits in kind, the **net balance of the drug budget** and the **reimbursement of therapeutic equipment** may exceed the estimate included in the Budget Act by HUF 15 billion in total. The statutory appropriation for 2016 falls short of the expenditure level expected in 2015 for both items; however, in the lack of new measures, we do not consider this justified. Our forecast calculated for the net expenditures of the drug budget – under a higher revenue and expenditure level than stated in the Budget Act – exceeds the appropriation by HUF 10 billion in 2016. In the case of the therapeutic equipment reimbursement, assuming a constant service level and taking into account the impact of demographic ageing, we project an expenditure level that exceeds the appropriation by HUF 5 billion. In the case of **labour market active and passive expenditure**, there is no significant difference between our forecast and the estimate. Next year, according to our expectations, the budget may spend HUF 330 billion on the Start labour programme – compared to HUF 263 billion this year –, which is only a slight shortfall compared to the HUF 340 billion included in the appropriation. In view of the fact that the number of participants in the public labour programme at the beginning of 2015 was less than expected, we assumed in our forecast that the Labour Market Fund would not be able to utilise a minor part of the increasing limit (about 3 per cent) next year.

4.4. MAIN RISKS SURROUNDING THE 2016 BALANCE

In addition to the risks surrounding the macroeconomic path, the following main risks may materialise compared to the baseline scenario of our projection.

Positive risks:

- The most important positive risk may arise from the fact that within revenues related to state property, the budget envisages revenues of HUF 133 billion in the line „**other sale and utilisation revenues”**. We do not take this revenue into account in our baseline projection, as the manner in which this revenue may be realised is not known. Should it be realised, it would improve the budgetary position significantly compared to our current estimate.

- Under VAT revenues, our baseline scenario does not calculate with any additional revenues from the Electronic Trade and Transport Control System and accordingly, any extra revenues from this item increases the amount indicated in our current projection.

Negative risks:

- The **recurring debt of healthcare institutions** may increase next year's budget deficit by 0.1–0.2 per cent of GDP as a carry-over effect, unless full debt consolidation takes place in 2015 at the institutions concerned.

- In the case of **EU transfers**, if the drawdown stipulated in the Budget Act – which is higher than our forecast – materialises, the higher own resource requirement may generate a larger fiscal deficit, and the level of the estimated risks may be around 0.2 per cent of GDP. If the government's plan with regard to the higher utilisation of EU funds materialises, it may generate a higher deficit than in our baseline scenario, but at the same time, it may imply a more intensive investment activity. The impact of this may be partially offset by the fact that, through its favourable effect on economic growth, tax revenues may also be higher.

Two-sided risk:

- The Budget Act contains HUF 85 billion for the settlement of disputes that may arise upon the financial closing of the projects co-financed by the EU in the period of 2007–2013. In our forecast we accepted the assumption of MNE, and a deviation is possible from this estimate in both directions.

4.5. EXPECTED DEVELOPMENTS IN PUBLIC DEBT IN 2016

According to our latest forecast – which is consistent with the June 2015 issue of the *Inflation Report* –, calculated on the basis of the EDP methodology, the gross public debt-to-GDP ratio may decline to 73.9 per cent of GDP in 2016, which points to the fulfilment of the debt rule stipulated in the Fundamental Law. The sustained reduction of the debt ratio may be ensured by dynamically growing nominal GDP over the medium term, the maintenance of tight budget management and moderate cost of funds. The latter is greatly supported by the growth-stimulating interest policy and self-financing programme of the MNB, which may contribute to reducing ratio of FX debt to 32 per cent by the end of 2016. A significant decline in the foreign currency exposure of public debt, in turn, may significantly contribute to reducing the external vulnerability of Hungary.

In our projection we do not reckon with changes in the exchange rate and in the liquid deposits of the government. If an exchange rate stronger than that recorded at the end of 2014 (HUF/EUR 314.9) materialises across the forecast horizon, it may result in a more favourable Maastricht public debt ratio than our current estimate.

As a result of the modification of the debt formula, the level of public debt in 2016 may also comply with the requirements of the Stability Act. The public debt formula stipulated by the Stability Act was changed in May 2015 in that the original formula[15] will only be applicable if both the planned inflation for the current year and real GDP growth exceed 3 per cent. In all other cases, it will suffice to achieve a minimum 0.1 percentage point debt ratio reduction. According to the new, modified debt formula, the 2016 budget complies with the provisions of the Stability Act as well.

[15] The original debt formula that entered into force this year and was applicable, for the first time, to the 2016 budget, stipulated that the design of the budget should ensure that the expected growth rate of gross public debt does not exceed the difference between planned inflation for the current year and 50 per cent of the real growth rate.

5. Special topics

5.1. AMENDMENT TO THE 2015 BUDGET ACT

The General Assembly approved the amendment to the 2015 Budget Act (Act LXXIII of 2015) on 9 June. The amendment increased the cash expenditures of the central budget by HUF 62 billion, revenues by HUF 47 billion, and the cash deficit by HUF 15 billion in total. The amendment included the following key modifications:

- acquisition of a 15 per cent stake in Erste Bank in the amount of HUF 15 billion;
- several minor expenditures (support of settlements not participating in the debt consolidation; participation of the Hungarian Armed Forces in the military action against the Islamic State; the Liget Budapest Project; support of persons with disabilities in finding employment; priority public road projects; support of children's catering) in the amount of HUF 42.2 billion;
- increasing the revenues and expenditures of the Integration Fund of Cooperative Credit Institutions by HUF 4.7 billion;
- increasing the budget estimation of cash interest revenues by HUF 42.2 billion;
- takeover of the debt of the Budapest Transport Company (BKV) in the amount of HUF 52 billion with no effect on the cash balance;

The legislative amendment raises the level of the ESA deficit by HUF 52 billion, as opposed to a HUF 15 billion increase in the cash-based deficit. The difference between the two balances can be attributed to two items: BKV debt takeover on the one hand, and the acquisition of a stake in Erste Bank on the other hand. Since the BKV debt takeover does not entail cash-based flows, it is not reflected in the cash-based deficit either. However, it increases the ESA deficit, as in the statistical sense, BKV is a company outside of the government sector. The case is the opposite with the acquisition of a stake in Erste Bank. Although the transaction involves a cash expenditure, it is treated simply as a financial transaction in the ESA statistics and as such, it does not impact the ESA deficit of the general government.

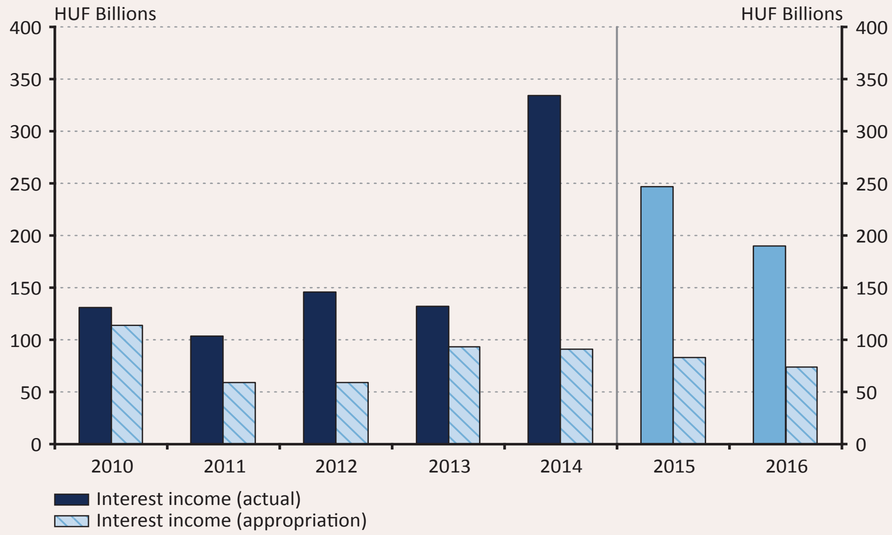
New expenditures and debt takeover increase public debt by 0.2 per cent of GDP. Besides the HUF 15 billion increase in the cash balance, the debt consolidation of BKV constitutes a part of the public debt as well. As a result, the modification may increase public debt by a total of HUF 67 billion – regardless of whether it is calculated at a constant exchange rate in accordance with the Stability Act, or computed in accordance with the EU methodology.

5.2. CHANGES IN CASH INTEREST REVENUES

Due to the decline in government securities market yields in recent years, cash interest revenues have significantly surpassed the levels seen in previous years, and according to our forecast this trend may continue in the coming years. The increased interest revenues reduce the net cash expenditures of the general government which, in turn, reduces the cash deficit of the general government and public debt. However, this only has a minor impact on the ESA balance as, based on the ESA methodology, interest revenues from the premium upon issue are not recognised at the time of the issuance, but they are distributed evenly across the remaining maturity of the individual government securities.

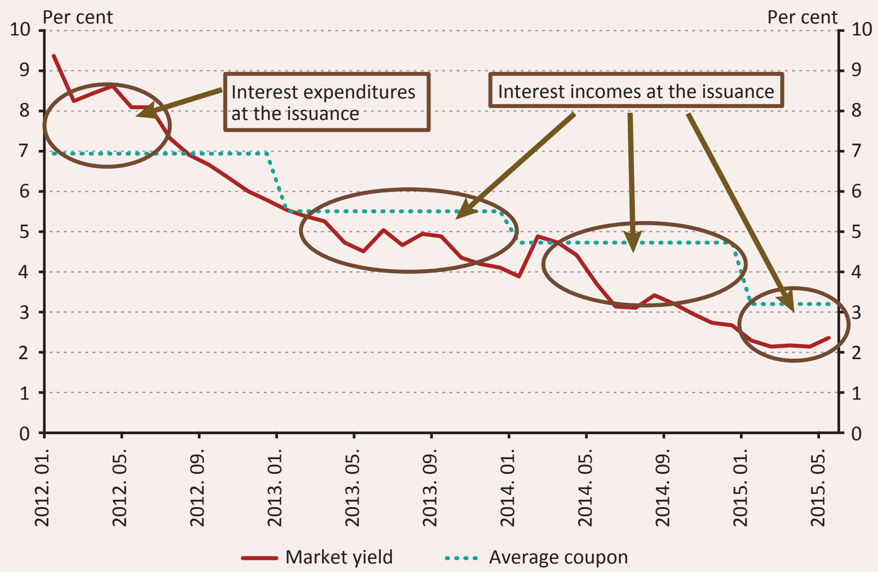
Cash interest revenues have exceeded the budget appropriation consistently in recent years (Chart 10). The main reason behind the high level of interest revenues is the steep decline in yields observed since 2012. As a result of the improvement of Hungary's risk perception, low inflation, the central bank's easing cycle and the self-financing programme, yields declined by 460 basis points on average. In response to the fall in yields, the market price of government securities issued with coupons higher than the expected yield increased significantly and consequently, they may be reissued at auctions or switch auctions above face value (with a premium). The premium implies an immediate cash interest revenue for the budget. On a cash basis, looking ahead, the favourable effect of the interest revenues will be partly offset by the interest expenditures paid for government securities with higher coupons and by the discount – realised as interest expenditure – on higher coupon bonds repurchased at buyback and switch auctions.

Chart 10
Changes in cash interest revenues
(HUF billion)



Notes: Data pertaining to 2015 and 2016 are MNB projections.
Source: Budget acts, Hungarian State Treasury, MNB

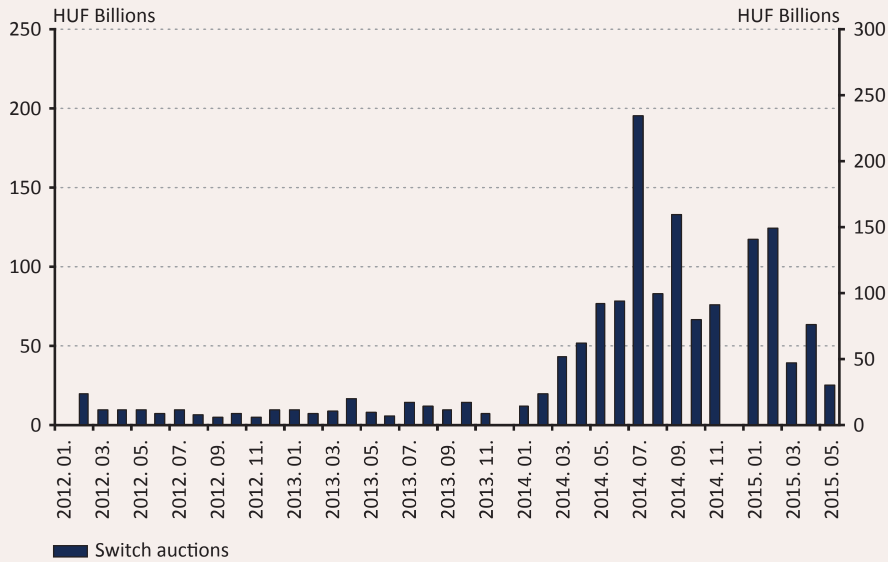
Chart 11
Changes in average three-year government securities' coupons and the benchmark yield



Source: Government Debt Management Agency (ÁKK)

Besides issuances, in 2014 and in the first half of 2015 substantial cash interest revenues were realised at switch auctions as well. At standard government bond auctions and switch auctions – which have boasted an increasing turnover in recent years (Chart 12) – interest revenues realised due to the decline in yields improve the cash balance of the general government immediately upon issuance, and thus contribute to the reduction of public debt. Since the market rate of issued and redeemed government bonds is the same at the switch auctions, the face value of high market value papers issued with longer maturities and higher coupons will be lower than the face value of government securities previously traded in the market. In such cases, the budget realises an immediate interest revenue, which is reflected in a parallel, slight decline in nominal public debt. However, a new trend has emerged over the past two months, whereby the debt management agency replaces high coupon, maturing government bonds in the market by new series of securities with market price close to the face value. This has an opposite effect on interest expenditures and public debt and with that in mind, our projection anticipates lower interest revenues for 2015 compared to 2014.

Chart 12
Turnover of switch auctions
(HUF billion)



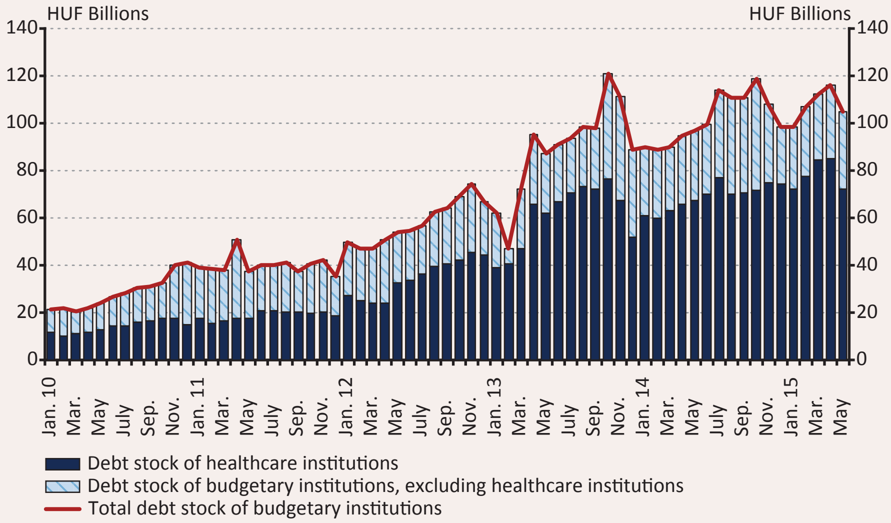
Source: Government Debt Management Agency (ÁKK)

The effect that increases cash interest revenues is reflected differently in the ESA interest balance. Indeed, according to the ESA methodology, the price gain realised upon issue is not recognised as an immediate interest revenue; instead, it is distributed evenly across the entire maturity of the government paper issued. Therefore, the favourable effect observed in the cash-based interest balance materialises over a protracted period but at a lesser extent on an annual basis. The substantial difference seen between the ESA and GFS type interest balances is largely due to this process which, according to our forecast, may continue in 2015 and 2016 as well.

5.3. ACCUMULATED DEBT OF HEALTHCARE INSTITUTIONS

The accumulated debt of healthcare institutions has increased gradually in recent years, reaching HUF 85 billion in April 2015. The debt of healthcare providers represents an increasing share within the liabilities of budgetary institutions: while it accounted for half of the debt of budgetary institutions in 2010–2011, its share has risen to around three fourth on average in the first five months of 2015 (Chart 13). According to maturity structure, within the accumulated debt of the healthcare delivery system, the share of debt overdue by 30 days declined to 30 per cent by the beginning of 2015 compared to 40 per cent in January 2014, while accounts payable overdue by more than 60 days shows a growing trend (Chart 14).

Chart 13
Developments in debt stock of budgetary institutions and healthcare institutions between January 2010 and May 2015

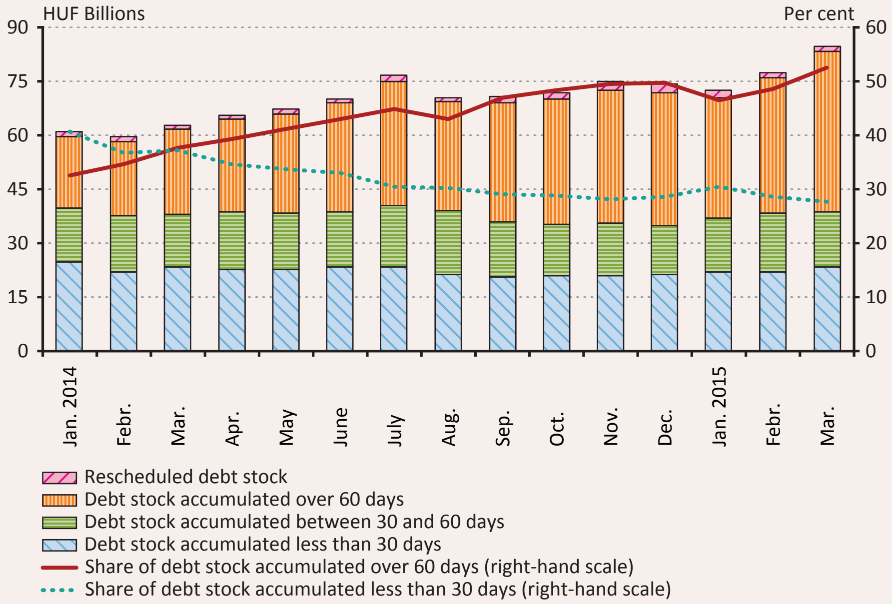


Note: The time series of healthcare institutions includes both out-patient and in-patient healthcare institutions, the background institutions of the healthcare sector, as well as universities with clinical centres.
Source: Hungarian State Treasury

Several factors may have contributed to the increase in debt. On the one hand, the takeover of institutions previously maintained by counties or by the capital city and of non-profit institutions in the 2012–2013 by central budget increased the statistical number of institutions five-fold. On the other hand, the increase in debt also reflects the financial deficit between the monthly revenues and expenditures of the institutions concerned. The emergence of this deficit may be partly attributed to financing charges that are sometimes insufficient to cover actual costs.

The re-accumulation of debt has necessitated debt consolidation several times in recent years, typically in the form of a one-off consolidation support at the end of the year, or through the reallocation of the residual amount of the appropriation for medical and preventive care (which is the main source of funding for public healthcare institutions). In the 2015 Budget Bill, in addition to the budget of the Health Insurance Fund, HUF 60 billion was earmarked to settle the outstanding debt of healthcare institutions in the line of special reserves of the Prime Minister's Office. In May, the repayment of debt overdue to the largest suppliers commenced, bringing down the debt level by HUF 13 billion compared to April (Chart 13). Given that the debt of healthcare institutions amounted to HUF 85 billion at the end of 2015 Q1, a full-scale debt consolidation would require, in addition to the HUF 60 billion earmarked for this purpose, an additional amount of HUF 25 billion. Moreover, the gradual re-accumulation of debt (entailing an increase by HUF 2–3 billion per month on average in recent months) poses a negative risk, and the outstanding debt may increase further until the end of the year. In consideration of these factors, further measures (structural reforms) may become necessary in the healthcare sector for a sustainable settlement of debt.

Chart 14
Outstanding debt of healthcare institutions by maturity structure in 2014 and 2015



Source: Hungarian State Treasury

5.4. REFORM OF THE WELFARE SYSTEM

As of March 2015, significant changes affected the welfare system. On the one hand, tasks were delegated to lower levels in the hierarchy. According to the Budget Act, this decision was mainly intended to circumvent potential fraud, and since it is hard to track fraud in a centralised framework, the level of administrative districts and local governments is in a more suitable position to grant social benefits. On the other hand, the state wishes to steer active-age former beneficiaries of the aid toward public work programmes. The reform consists of the following elements:

- Starting from March, new benefits are not granted in the context of *regular social aid, debt management support* and *housing subsidies.* Previously granted benefits are provided until the end of the pre-defined period. The *kindergarten attendance allowance* will be eliminated from September, with a similar phase-out process.

- Those entitled to the eliminated regular social aid may apply for other aids, while the rest of the benefits will be permanently terminated.

- The various social aids not subject to the reform will be retained but delegated to administrative districts. The amount of the benefits delegated from the local governments to administrative districts is HUF 62 billion in 2015 and HUF 71 billion in 2016, to be financed from the central budget (the growth does not reflect an expansion; it is due to the fact that financing is to be provided for the entire year in 2016).

- Local governments are required to provide a new form of benefit, the *settlement benefit,* which can be granted for unexpected, one-off expenditures up to HUF 28,500. Local governments may determine the details at their discretion.

- Besides the settlement benefits, local governments may decide the range of available benefits. They enjoy a larger room of manoeuvre from the aspect of financing as well.

The four eliminated benefits entailed an expenditure of HUF 34 billion in 2013. Excluding the regular social aid from this amount (as the persons entitled to this aid may apply for other benefits at the administrative districts), the benefits to be terminated permanently amount to HUF 23 billion. It remains to be seen whether the settlement benefit and other benefit types granted within the local governments' scope of competence cover the benefits eliminated. We presume that welfare expenditures will decline, as the objective of the government is to reduce benefits while increasing expenditures for public work programmes. The 2015 Budget Act demonstrates the government's intention to gradually steer the beneficiaries of employment replacement support to public employment in the coming years.

5.5. TRANSITIONAL DEBT RULE OF THE EUROPEAN UNION (MLSA)

According to the fiscal rules of the European Union, **a transitional debt rule[16] is applicable** to countries subject to the excessive deficit procedure in November 2011 **for a period of 3 years after the termination of the procedure,** before they are subjected to a general debt reduction rule. The European Union lifted the excessive deficit procedure against Hungary in 2013 and accordingly, Hungary was subject to the transitional debt rule between 2013 and 2015. In this paper we provide a brief account of the transitional rule and the underlying general debt rule and present Hungary's compliance with the transitional debt rule between 2013 and 2015.

5.5.1. Debt rule of the European Union

The MLSA rule can be derived from the general debt rule of the European Union; indeed, the transitional debt rule essentially prescribes a fiscal path for Member States which allows them to comply with the general debt rule at the end of the transition period.[17]

Under the debt rule of the European Union, the ratio of public debt to gross domestic product (GDP) must not exceed 60 per cent. If it still exceeds this reference value, the ratio must "diminish sufficiently", approaching the reference value "at a satisfactory pace". The reduction will be deemed to take place "at a satisfactory pace" if the debt path of the given country meets at least one of the following criteria:

- backward-looking criterion: the Member State will meet the criterion if the debt-to-GDP ratio falls by an average of one-twentieth of the difference between the actual debt ratio and 60 per cent of GDP for three years preceding the current year.

- forward-looking criterion: similar to the backward-looking criterion, essentially, debt should be reduced to a sufficient degree as an average of three years. The forward-looking method, however, takes into account debt before, during, and following the current year.

- cyclically adjusted criterion: essentially, the cyclically adjusted criterion considers the impact of the cyclical position of the economy on the debt ratio in order to exempt the given country from meeting the previous two criteria in cases where non-compliance is caused by the direct, negative effect of the cyclical position of the economy.

These three criteria ensures a measure of flexibility to the rule, as it assesses changes in public debt across several years, while the third criterion is also intended to consider the impact of fluctuations in the cyclical position of the economy.

[16] This rule is known as "minimum linear structural adjustment" (MLSA).

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

5.5.2. Transitional debt rule of the European Union (MLSA)

As a supplement to the Stability and Growth Pact, on 8 November 2011 the European Parliament adopted the so-called "Six Pack", which modified the fiscal rules of the European Union. Upon the adoption of the Six Pack, however, several countries were under the excessive deficit procedure, in the context of which they were required to follow a fiscal consolidation path negotiated with the European Union. Therefore, for these countries the regulation introduced a three-year-long transition period following the closure of the EDP, during which the Member States concerned are required to comply with a transitional debt rule before being subjected to the general debt reduction rule.

The rule takes the expected reduction of the debt rate as a basis to determine the structural balance to be achieved in order to achieve the reduction (excluding the effects of the business cycle and one-off items). The rule defines the structural balance improvement required (or, as appropriate, the structural balance deterioration allowed) to ensure that the general debt rule is met at the end of the transition period. Therefore, the required (or allowed) balance change should be defined for all three criteria of the general debt rule described above, and apply the least severe of the three. As a result, the transitional rule will also ensure the flexibility offered by the general debt rule.

In determining the criterion values of the MLSA, a relatively large number of input data must be used, some of which are based on the forecast of the Commission or can only be estimated. Consequently, the rule is not only difficult to calculate, but changes continuously during the year in line with adjustments to the forecast of the Commission. Some of the input data – such as potential output, the cyclical component or the structural balance – are surrounded by methodological uncertainties.

As is the case with the general debt rule, breaching the transitional debt rule may lead to the launch of an EDP. It should be noted, however, that no EDPhas been launched so far in the European Union on the grounds of breaching the transitional rule alone.

5.5.3. Compliance with the transitional debt rule of the European Union

The European Commission assesses Member States' compliance with fiscal regulations on a continuous basis, providing a regular assessment in parallel with its projections. According to its forecast published in May 2015, as in 2013, Hungary met the requirements of the transitional debt rule in 2014 as well and is expected to meet them in 2015. The MLSA rule permitted a 1.1 percentage point GDP-proportionate deterioration of the structural balance for 2014. According to the calculations of the Commission, the annual percentage change of the structural balance was –1.3 per cent; however, given the uncertainty of some indicators, the rule permits a 0.25 percentage point deviation from the criterion value, and thanks to this tolerance band, Hungary complied with the transitional debt rule in 2014.

It should be stressed, however, that during 2014 and even at the beginning of 2015, the Commission did not expect Hungary to meet the transitional debt rule in 2014 and indicated that Hungary needed significant fiscal adjustments. Table 13 indicates the changes in the MLSA values determined by the European Commission for 2014 and the resultant modifications to the required fiscal adjustments. In 2014 the Commission considered a fiscal adjustment in the range of 0.7 and 1 per cent of GDP (HUF 220–320 billion) necessary to ensure Hungary's compliance with the transitional debt rule.

Table 13
Changes in Hungary's permitted structural deficit in 2014 based on the MLSA criterion, as indicated in the forecasts of the European Commission
(GDP per cent)

	Permitted structural balance based on MLSA criteria	Structural balance, forecasts of the European Commission	Expected fiscal adjustments in 2014
May 2013	–2,4	–1,9	–0,5
November 2013	–1,6	–2,1	0,5
February 2014	–1,5	–2,5	1,0
June 2014	–1,7	–2,6	0,9
November 2014	–2,0	–2,6	0,7
February 2015	–1,7	–2,4	0,7
May 2015	–2,3	–2,5	0,2

Source: European Commission, MNB

The level of the expected adjustment variedduring 2014: while at the beginning of the year the Commission expected Hungary to perform a structural adjustment corresponding to 1 per cent of GDP, by the end of the year this value was reduced to 0.7 per cent of GDP without any considerable fiscal intervention. The change can be primarily attributed to the continuous revision of the macroeconomic and fiscal forecasts of the Commission.

Even in February 2015 the Commission continued to indicate that Hungary breached the transitional debt rule in 2014 with the structural balance having fallen to a level 0.7 percentage point below the permitted value. In May 2015, however, incoming actual data and improving forecasts altered the criterion value of the MLSA significantly, which caused that Hungary complied with the debt rule in 2014.

The MLSA rule would permit a 0.8 percentage point structural balance deterioration in 2015, while the May 2015 forecast of the Commission anticipates an unchanged structural balance. Consequently, Hungary is likely to meet the transitional debt rule in 2015 as well.

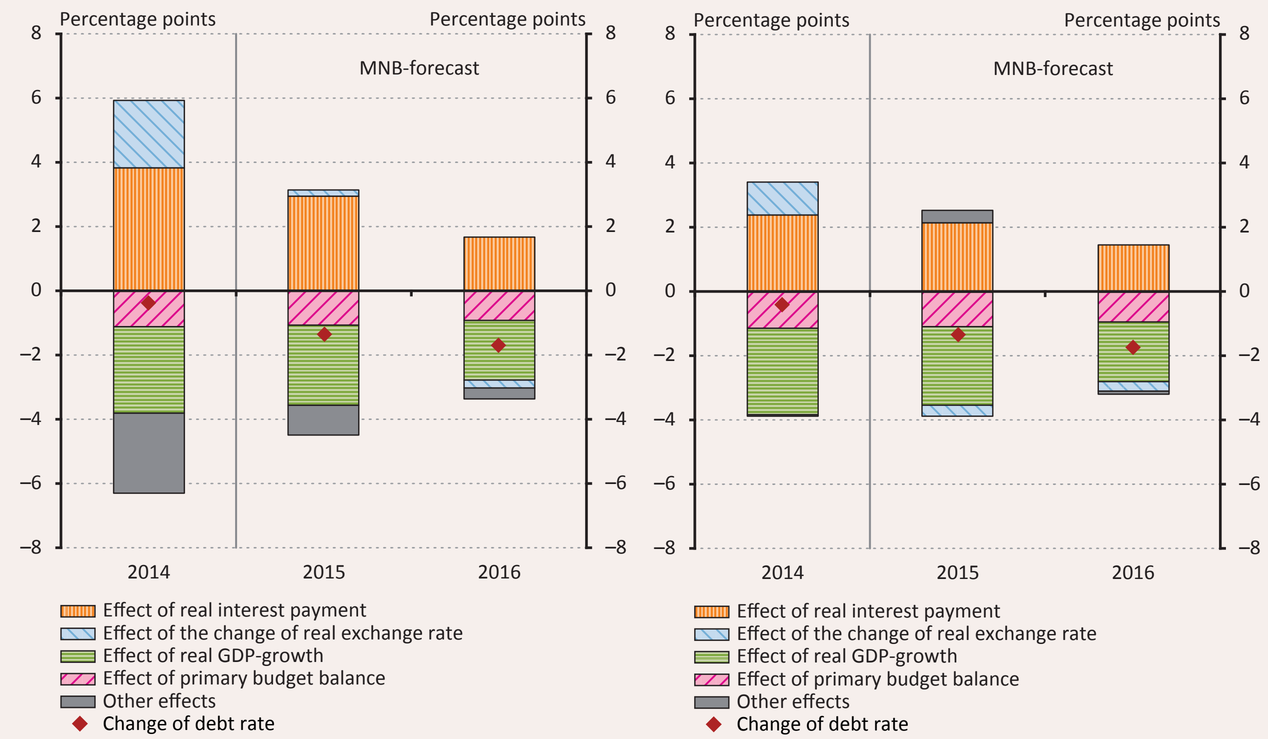
5.6. MAIN REASONS FOR THE ANNUAL CHANGE OF THE HUNGARIAN GROSS PUBLIC DEBT RATIO BETWEEN 2014 AND 2016

Below we examine the main factors behind the decline in the gross public debt-to-GDP ratio between 2014 and 2016. We also describe the extent to which the effects of these factors change in our projection depending on whether inflation (Chart 15, left hand panel) or the GDP deflator (Chart 15, right hand panel) is considered in the calculation of the real indices.

The decline in the public debt ratio last year was primarily supported by high real growth and the surplus of the primary general government balance, which were largely offset (albeit to a different degree, depending on the methodological approach applied) by the debt increasing effects of real interest payments and changes in the real exchange rate. The 0.4 percentage point decline in the 2014 debt ratio was supported to the largest degree (by 2.7 percentage points) by the dynamic (3.6 per cent) growth of the real economy. In addition, stemming from tight budget management, the surplus of the primary balance contributed to the decline in the gross public debt ratio by 1.1 percentage points last year. The positive effects of these factors were offset, to the largest degree, by the debt increasing effect of real interest payments; however, the extent of this was different depending on the two different calculation methods. Calculating with inflation, the debt ratio increasing effect is 3.8 percentage points, while based on the deflator, this effect amounts to only 2.4 percentage points. The reason for the significant discrepancy is the extremely low, –0.2 per cent annual consumer price index emerging in Hungary in 2014, while the GDP deflator was 3.1 per cent. Consequently, the application of these two price variables will yield completely different real interests despite the identical nominal interest used as a basis for the calculation. Essentially, this phenomenon is captured by the 2014 value indicated for "other effects" on the left side panel of Chart 15. The 1.4 percentage point difference resulting from the application of these two approaches is sufficient to induce a so-called "snowball effect" (debt effect of the difference between real interest and real growth). According to the inflation-based estimate, the snowball effect increased the debt ratio by 1.1 percentage points last year, while based on the deflator-based estimate, it reduced the debt ratio by 0.3 percentage points. The application of the different approaches also affects the debt effect of real exchange rate changes. According to the inflation-based approach, the shift in the real exchange rate increased the debt ratio by 2.1 percentage points, while in case of the deflator, it entailed only a 1.1 percentage point increase.

Real growth and the primary surplus may support the reduction of the debt ratio over the long term as well; however, the expected decline in the debt increasing effects of real interest payments and real exchange rate changes are equally important. Looking ahead – fixing the HUF/EUR 314.9 nominal exchange rate prevailing at the end of 2014 as constant – the basis for the expected decline in the debt ratio will continue to be the real economic growth and the surplus of the primary general government balance. However, while the debt reducing effect of the latter component may remain at the level seen last year, this effect may decrease considerably in the case of the former component until the end of 2016. At the same time, this trend may be offset by the fact that the debt ratio increasing effect of real interest payments may decline gradually as a result of a decline in nominal interest rates and an upward drift in the price level change. Looking forward, the debt increasing effect of real exchange rate changes may decrease significantly in both scenarios and indeed, next year it may directly contribute to the reduction of the debt rate.

Chart 15
Decomposition of the annual change of gross public debt-to-GDP ratio between 2014 and 2016, calculating real values with inflation (left panel) and GDP deflator (right panel)



Source: MNB

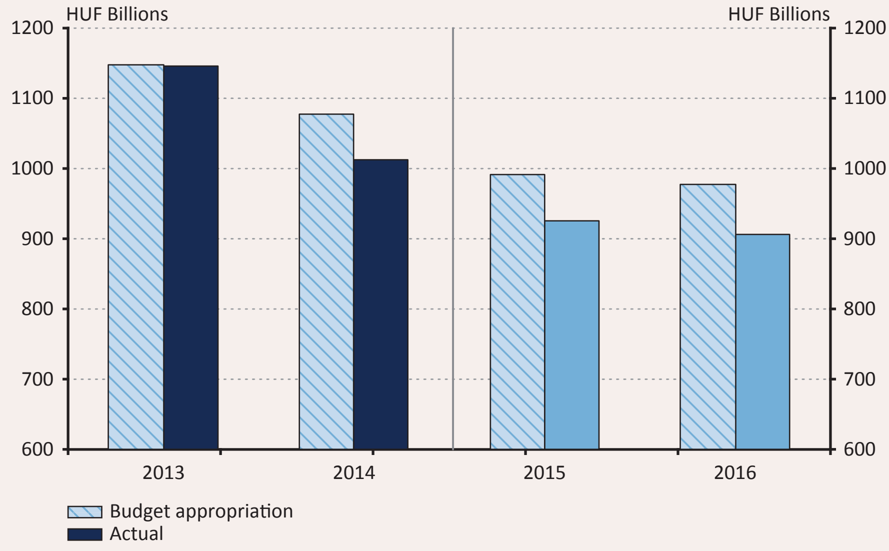
5.7. DECLINE IN INTEREST EXPENDITURES IN THE LIGHT OF BUDGETS

Since August 2012, reflecting the favourable international and Hungarian environment and the impact of central bank programmes, a yield decline has materialised in the government securities market. From a fiscal aspect, the easing cycle exerted a favourable impact on government securities market yields. While the central bank base rate was reduced by 565 basis points, the secondary market yields' decline reached 480 basis points on average. The decline in yields was supported further by the self-financing programme announced by the central bank, which pushed short-term yields well below the level of the key policy rate and, for example, the three-year yield approached the level of the central bank base rate.

In response to falling yields, the annual appropriations for net interest expenditures were reduced significantly, but the actual decline in expenditures exceeded expectations in all three years. Expenditures expected for this year are lower than 2013 actual figures by more than HUF 200 billion. Excluding the financial transaction duty and technical settlements, the appropriation for 2013 was HUF 1,146 billion. Actual data at the end of the year was slightly more favourable. By 2014, the corresponding value included in the Budget Act was far lower, HUF 1,076 billion, with an even more favourable actual figure recorded at the end of the year (HUF 1,012 billion). The amended appropriation for this year is down to HUF 990 billion and according to our forecast, the decline in net cash interest expenditures may turn out to be even higher by HUF 60 billion.

Due to the accounting specificities of the ESA methodology, the decline in accrual-based interest expenditures may materialise at a slower pace. At the same time, between 2013 and 2014 even the accrual-based interest balance of the general government decreased by 0.4 per cent of GDP, and an additional decline of 0.4 percentage points is expected for 2015.

Chart 16
Changes in net cash interest expenditures



Note: MNB forecast for 2015 and 2016.

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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AND THE 2016 BUDGET ACT

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