PUBLIC FINANCE REPORT

2024

OCTOBER

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

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

PUBLIC FINANCE REPORT

Semi-annual analysis of
public finance developments

2024
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To support the fulfilment of its fundamental duties set forth in Act CXXXIX of 2013 on the Magyar Nemzeti Bank, in particular the tasks related to the determination and implementation of monetary policy, the Magyar Nemzeti Bank analyses developments in the budget deficit and debt, monitors the financing of the general government, analyses the impact of financing on monetary developments, capital markets and liquidity, and researches fiscal policy issues.

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

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

The analysis is based on information available for the period ending on 26 September 2024.

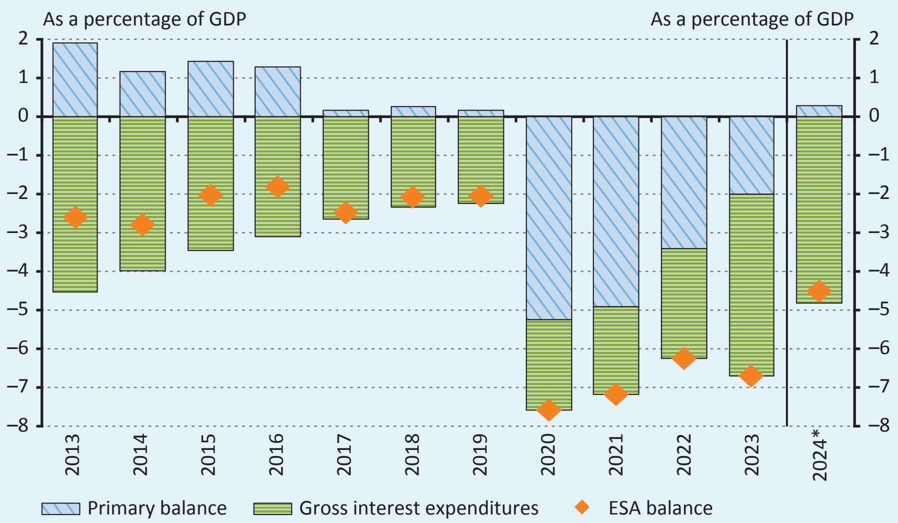
Contents

1 Summary

The aim of this analysis is to present the public finance developments in 2023 and the expected budgetary developments in 2024, based on the available fiscal data for the first half of the year and the forecast of the MNB for the September Inflation Report. Against this background, we assess actual compliance with national and EU rules on budgetary balances and government debt in 2023 and expected compliance in 2024.

Hungarian fiscal developments in the 2020s are characterised by a higher general government deficit than in the previous decade. The economic crisis following the COVID epidemic, and later the Russo-Ukrainian war, coupled with the sharp rise in global energy prices and inflation, have resulted in a persistent fiscal deficit of more than 6 per cent of GDP since 2020 (Chart 1). Inflation continued to place a significant burden on public finances in 2023, in the form of significantly lower-than-planned tax revenues due to falling consumption and inflation-linked expenditures, including, in particular, significantly higher public expenditure on energy, interest expenditures and pensions. Inflation has fallen substantially this year, and real economic growth of around 1.0 to 1.8 per cent is expected in 2024, after last year's GDP contraction, so the fiscal position could improve compared to 2023.

Chart 1
Development of the budget balance as a percentage of GDP



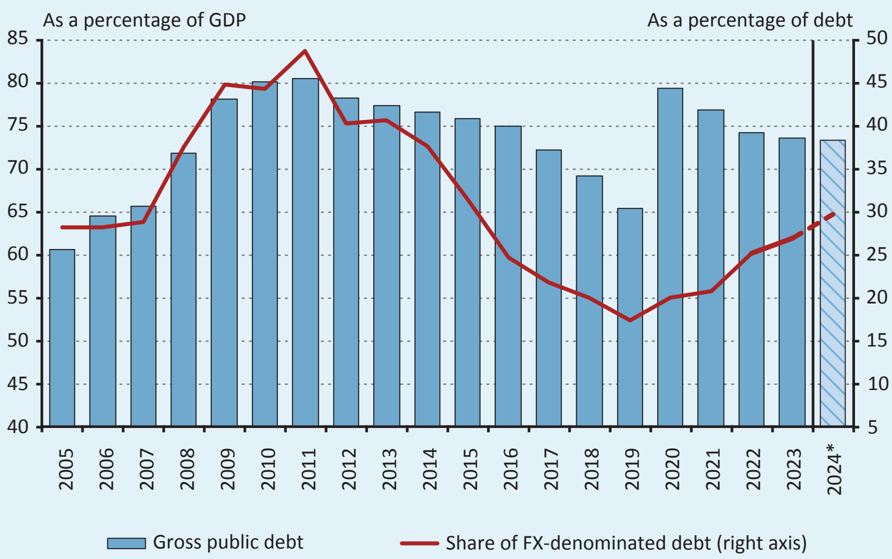
*Note: *The chart shows the midpoint of the 4.3 to 4.7 per cent of GDP forecast band of the MNB.*
Source: HCSO, MNB

In 2023, the budget deficit was 6.7 per cent of GDP. The original deficit target for last year was 3.5 per cent of GDP, which the government revised to 3.9 per cent of GDP at the end of 2022, and then raised to 5.2 per cent in October 2023.The actual deficit in 2023 reached 6.7 per cent of GDP, which was the second highest value in the European Union. In 2023, tax revenues were significantly lower than previously expected due to high inflation and the real economic downturn, partly offset by lower-than-planned realisation of some expenditure items, but interest expenditure was substantially higher than a year earlier, by almost 2 per cent of GDP.

In H1 2024, the cash deficit of the central government sub-sector amounted to HUF 2,656 billion, which was 106 per cent of the appropriation and 67 per cent of the expected cash deficit published in the April EDP notification. The cash deficit target for the central sub-sector set in the Budget Act is HUF 2,515 billion, which was increased to HUF 3,982 billion in the EDP notification.

According to our forecast, in 2024, the budget's accrual-based deficit may be between 4.3-4.7 percent of GDP, which means that in order to reach the deficit target, it is necessary to maintain control over expenditures for the rest of the year. The deficit target for 2024 was raised from 2.9 per cent of GDP to 4.5 per cent in the spring. Our forecast for this year's deficit in the September Inflation Report was for a deficit between 4.3 and 4.7 per cent of GDP. The measures announced this spring and at the beginning of July increased the government's budgetary room for manoeuvre by about HUF 1,000 billion. This year's measures partly include the postponement and reallocation of expenditures and affect tax and fine revenues. Our forecast assumes less favourable macroeconomic assumptions than expected in the Budget Act, which could result in tax revenues being substantially lower than forecast by about HUF 850 billion in 2024, after last year. EU revenues are also expected to be lower than the statutory expectation due to the absence of cohesion and RRF funds. For budgetary expenditure, despite the structural differences, we expect expenditures to be broadly in line with the Budget Act.

Chart 2
Expected development of government debt as a percentage of GDP

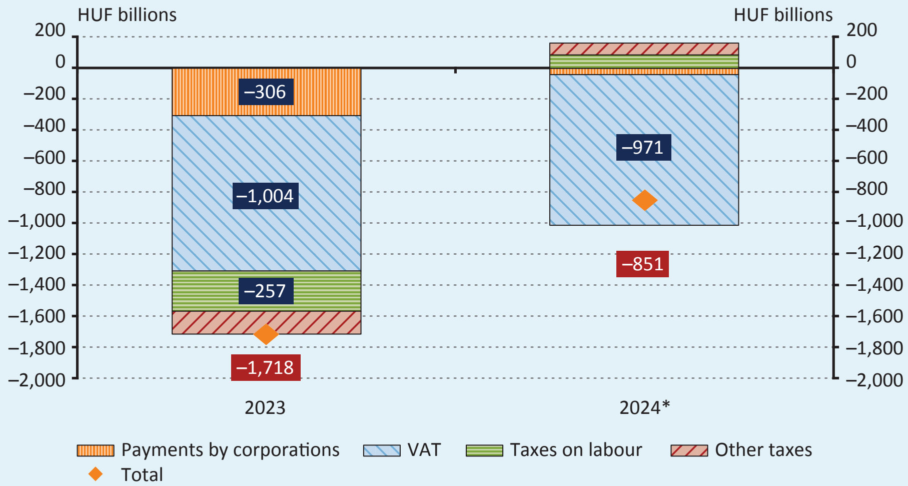


*Note: *Forecast consistent with the midpoint of the forecast band for the budget balance.*
Source: GDMA, MNB

Gross public debt as a percentage of GDP declined from 74.1 per cent at the end of 2022 to 73.5 per cent at the end of 2023. We expect that, if the deficit target is met, the decline in gross public debt-to-GDP ratio will continue this year and the debt ratio could fall to 73.2 per cent by the end of 2024 (Chart 2). Last year, the decline in the public debt ratio was mainly supported by the high GDP deflator, as nominal GDP rose by almost 14 per cent despite the contraction in the real economy, and the strengthening of the forint exchange rate also contributed to the decline in the debt ratio. At the same time, the continued decline of the national debt ratio in 2024 is surrounded by risks. In order for the decrease to be realised, net debt issuance consistent with the cash flow deficit expectation in the April EDP notification, an adequate increase in nominal GDP, and a low level of central and non-central debt issuance in the second half of the year are required. We project that in 2024, FX issuance could result in an FX ratio of above 29 per cent of central government debt at the end of the year.

The level of tax and contribution revenues as a share of GDP stagnated at around 35 per cent in 2023 compared to the previous year and is forecast to remain close to this level this year. In total, cash-based tax and contribution revenues were more than HUF 1,700 billion lower than the appropriations in the amended 2023 Budget Act, while the size of the shortfall from appropriations could reach HUF 850 billion this year (Chart 3). The difference is largely due to the shortfall in VAT revenues due to falling domestic consumption caused by high inflation, thus, revenues could fall short of the appropriation in the Budget Act by around HUF 1,000 billion last year and this year. In 2023, labour and corporate taxes, in particular the income tax on energy suppliers, were substantially below the high target. In H1 2024, cash-based tax revenues increased by almost 10 per cent compared to the first six months of last year. This was mainly due to a dynamic increase of 14 per cent in labour tax revenues and in social security contributions and, to a lesser extent, a moderate increase in consumption taxes.

Chart 3
Actual and expected tax revenues compared to budgetary appropriations



*Note: Actual data for 2023 are from the Hungarian State Treasury, *MNB forecast for 2024.*
Source: Hungarian State Treasury, MNB

Primary public expenditure in 2023 was below the amended budgetary appropriation, while in 2024 it is projected to be in line with it, with substantial structural differences. Last year, partially consolidated primary budget expenditures were around HUF 500 billion below the target, mainly due to the shortfall in EU spending, but also due to lower global energy prices during the year, which provided savings in public finances compared to the significantly increased target set in the budget amendment. In contrast, net cash-based interest expenditure was almost HUF 250 billion higher than budget expectations, which meant that total cash expenditure ended up some HUF 250 billion lower than the revised estimate. In 2024, we forecast that primary expenditure could be around HUF 300 billion lower than the statutory target, while cash interest expenditure could be almost the same. The more than HUF 1,300 billion budgetary impact of the shortfall in EU spending is partly offset by the fact that we forecast that public asset management spending, operating subsidies to health care institutions under medical and preventive health care and pension spending could exceed the statutory expectation in 2024.

Fiscal developments in 2023 were still in line with domestic and international fiscal rules concerning general government balance and debt, with the application of the relevant escape clauses, but with the deactivation of the general escape clause in 2024, the budget deficit of over 3 per cent last year and this year resulted in an Excessive Deficit Procedure (EDP). The Maastricht deficit criterion in both the Hungarian and EU fiscal frameworks requires that the general government accrual-based deficit should not exceed 3 per cent of GDP. The 2023 budget deficit was 6.7 per cent of GDP, and the deficit of 4.5 per cent planned for this year is also above the threshold. The Maastricht deficit target for 2023 was still subject to escape clauses in both the EU and Hungarian fiscal frameworks, but this year's expected government deficit does not comply with domestic and EU rules. The reduction in public debt complied with the debt rules of both the Fundamental Law and the Stability Act last year and, in our assessment, could continue to do so this year.

In April this year, the new EU economic governance framework, which has been reformed and brought significant changes to the fiscal rules, came into force. From this year onwards, the former EU debt reduction benchmark of the one-twentieth rule no longer applies, but instead the net expenditure path in the national medium-term fiscal-structural plan to be submitted under the reformed budgetary framework and the resulting debt reduction must be complied with. The first fiscal-structural plan will be published in the autumn, so compliance with it cannot be assessed at this stage. The main changes to the EU's fiscal rules are presented in more detail in this Report.

2 Balance of the general government sector in 2023

The ESA deficit for the general government in 2023 was 6.7 per cent of GDP, according to the April EDP notification. The 2023 Budget Act adopted in July 2022 set a deficit target of 3.5 per cent of GDP, which the government raised to 3.9 per cent at the end of 2022 and to 5.2 per cent, in line with the publication of the October 2023 EDP notification. Last year, high inflation and a slowdown in real economic growth resulted in tax revenues that were significantly lower than previously expected, partly offset by lower-than-planned expenditure. Based on a deficit of 6.7 per cent, the general government deficit in 2023 was 3.7 percentage points above the Maastricht reference value, but the excess over the deficit criterion was allowed by the escape clauses in both the EU and domestic fiscal frameworks. **In 2023, the decline in the gross public debt-to-GDP ratio continued,** with the debt ratio declining from 74.1 per cent at the end of 2022 to 73.5 per cent at the end of 2023.

According to the April EDP notification of the HCSO, the ESA deficit of HUF 5,018 billion was the result of a deficit of HUF 4,846 billion in the central sub-sector (balance of central government and social security funds) and a deficit of HUF 172 billion in the local government sub-sector. The accrual-based deficit was higher than the cash-based deficit for the central sub-sector due to statistical corrections. For the local government sub-sector, the positive statistical corrections resulted in a slight surplus in the cash balance (Table 1).

The **cash-based deficit of the general government** (central and local government sub-sectors combined) amounted to **HUF 4,574 billion** at the end of 2023. **The cash-based deficit of the central sub-sector was HUF 4,593 billion in 2023.** According to the EDP notification, the annual cash-based deficit was HUF 1,193 billion higher than the HUF 3,400 billion deficit target set in the amended Budget Act.

Table 1
Budget balance indicators in 2023

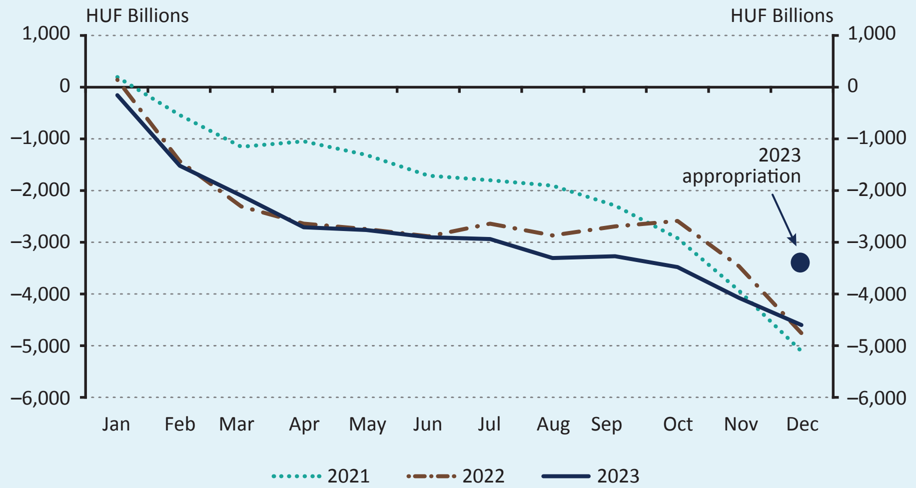
	Cash balance	ESA bridge	ESA balance
	HUF billions		
Central sub-sector	-4,593	-253	-4,846
Local governments	20	-192	-172
Total general government	**-4,574**	**-445**	**-5,018**
	As a percentage of GDP		
Central sub-sector	-6.1	-0.3	-6.5
Local governments	0.0	-0.3	-0.2
Total general government	**-6.1**	**-0.6**	**-6.7**

Note: Differences may occur in the table due to rounding.
Source: HCSO, April 2024 EDP notification

Overall, **the cash revenue of the central sub-sector** was HUF 1,447 billion below the main revenue target set in the Budget Act, as amended in March, according to partially consolidated data. The revenue shortfall is mainly explained by slowing consumption due to high inflation. Due to lower-than-expected household consumption expenditure, net VAT revenues were HUF 1,004 billion below the amended budget target.

According to the partially consolidated data, the total **cash expenditure of** the **central sub-sector** was HUF 251 billion below the appropriations of the Budget Act. The planned expenditure was mainly exceeded by central government expenditure, expenditure on public asset management and pension expenditure. However, the lower realisation of 2021-2027 EU cohesion and RRF expenditures has led to an overall reduction in planned expenditure. In addition to these, net interest expenditure exceeded the statutory target by HUF 247 billion.

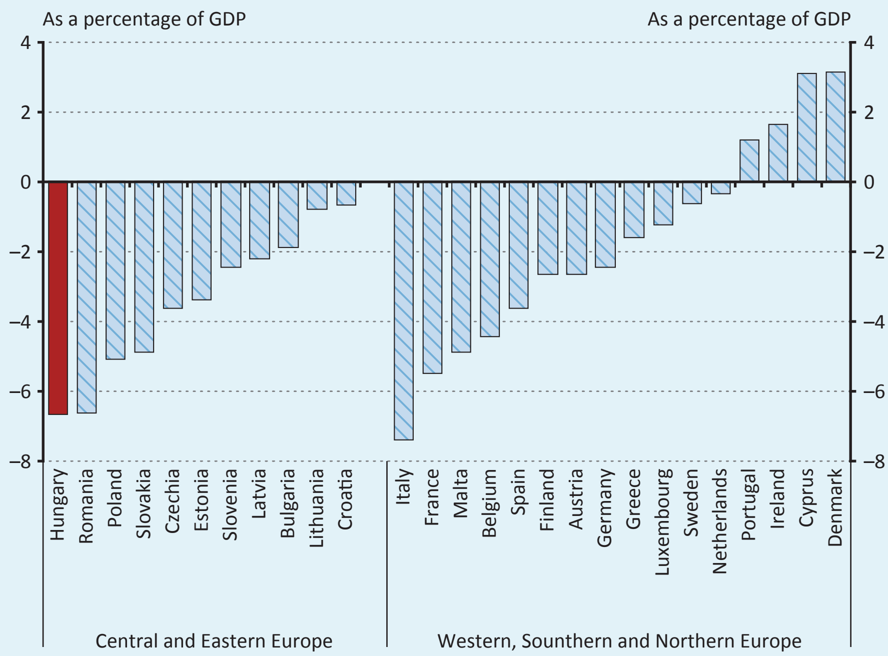
Chart 4
Intra-year cash balance of the central sub-sector (year-to-date cumulated value)



Source: 2023 Amended Budget Act, Hungarian State Treasury

The Hungarian budget deficit in 2023 was the second highest in the European Union (Chart 5). The Hungarian accrual-based deficit of 6.7 per cent was lower than the 7.4 per cent deficit in Italy, while Hungary and Romania had the highest deficits in the region. The average budget deficit in the EU was 3.5 per cent, but 16 Member States achieved deficits below 3 per cent, 4 of which had a surplus in 2023.

Chart 5
Development of the budget balance in EU Member States in 2023



Source: Eurostat

2.1 REALISATION OF THE MACROECONOMIC PROJECTIONS UNDERLYING THE BUDGET

After a rapid recovery following the COVID crisis, growth in the Hungarian economy slowed down, with its output contracting by 0.9 per cent in 2023. The growth rate was below the 1.5 per cent expected in the 2023 Budget Act, caused by declining domestic consumption and moderately growing exports. In 2023, gross fixed capital formation fell by 7.4 per cent, 6.4 percentage points below the budgetary expectation. Household final consumption expenditure was 3.0 percentage points lower than the forecast in the Budget Act, while community consumption was lower by 2 points, exports by 1.9 points and imports by 5.7 percentage points.

In 2023, employment in the national economy rose by 0.6 per cent to a historically high level. Labour demand moderated slightly over the year. The growth rate of gross average wages in 2023 was 14.3 per cent, below the 15.8 per cent expected in the Budget Act. Annual wage dynamics were boosted by the large increases in the minimum wage and guaranteed minimum wage at the beginning of the year and the high inflation environment. However, high inflation led to an average annual decline in real wages of around 3 per cent. The fall was more pronounced in the first half of the year, and from September onwards real wages started to rise on an annual basis.

Table 2
Comparison of the forecasts in the 2023 Budget Act and actual data (per cent)

	Budget Act	Actual data
Real GDP growth	**1.5**	**-0.9**
Export	2.8	0.9
Import	1.4	-4.3
Gross fixed capital formation	-1.0	-7.4
Consumption expenditure of households	0.8	-2.2
Intermediate consumption	0.5	-1.5
Consumer price index	**15.0**	**17.6**
Average gross earnings	**15.8**	**14.3**

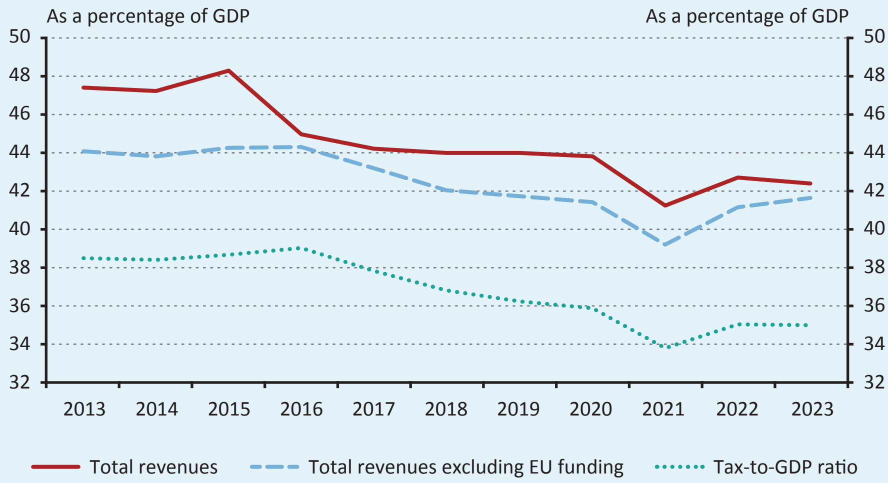
Source: 2023 Budget Act, as amended in March 2023, HCSO

The consumer price index was 17.6 per cent in 2023, instead of the 15.0 per cent assumed when the 2023 Budget Act was amended. Following a rise in inflation during 2022, the rate of inflation peaked at 25.7 per cent in January 2023, the highest in the European Union, but was followed by a rapid disinflation. By the end of the year, the consumer price index fell to 5.5 per cent. In a European comparison, Hungary saw the largest fall in inflation over the year, and by the end of the year it was the lowest among the countries in the region. The sharp deceleration in inflation was the result of a combination of disciplined monetary policy, pro-competitive government action, subdued demand, base effects, and a significantly lower external cost environment.

2.2 BUDGET REVENUES

General government accrual-based revenues accounted for 42.4 per cent of GDP in 2023, a slight decrease from 42.7 per cent in the previous year. By contrast, excluding EU subsidies, revenues grew by 0.5 percentage points (Chart 6). Tax-to-GDP ratio stagnated at around 35 per cent. The unchanged level of tax revenues as a share of GDP is explained by a dynamic increase in labour tax and contribution revenues, in addition to lower consumption tax revenues due to higher inflation. Taxes on production and imports as a share of GDP fell by 0.7 percentage points in 2023 compared to 2022, while current taxes on income and wealth increased by 0.5 percentage point and net social security contributions by 0.1 percentage point.

Chart 6
Accrual-based revenues of the general government and the tax-to-GDP ratio



Source: HCSO, Eurostat

Partially consolidated cash-base revenues of the central sub-sector amounted to HUF 28,239 billion in 2023, of which HUF 24,454 billion related to tax and contribution revenues (Table 3). Tax and contribution revenues were HUF 1,718 billion below the revised statutory target, mainly due to lower-than-expected developments in consumption tax revenues and, to a lesser extent, in payments by economic organisations.

Revenues from the **income tax on energy providers** were HUF 281 billion lower than forecast. The exchange rate of the forint against the dollar and the euro, which has a significant impact on tax revenues from this tax, has appreciated compared to the assumptions of the Budget Act. Revenues from **mining royalty** were HUF 92 billion below target, also partly as a result of the exchange rate effect and partly due to an intra-year measure. From September 2023, the relevant taxpayers could enter into an official contract to maintain their 2022 production until the end of 2024 in exchange for reduced tax rates. Revenues from the **tax on pharmaceutical manufacturers** were HUF 31 billion below target, with part of the expected revenues realised in 2024 instead of 2023. Revenues from the **lump sum tax of small entrepreneurs** (KATA) were HUF 11 billion lower than the corresponding estimate. As a result of the September 2022 reform of this tax, the number of taxpayers decreased by a larger amount in 2023 than assumed in the Budget Act. Revenues from **retail tax** exceeded the Budget Act's target by HUF 37 billion, mainly due to the higher inflationary environment. The revenues from **fines** exceeded the target by HUF 17 billion, while **other payments by economic organisations** exceeded the target by HUF 12 billion.

Tax revenues in 2023 were also significantly affected by fiscal consolidation measures in 2022-24. In the case of the **special tax of financial institutions**, in H1 2023, the special tax was based on the fees and commission income collected by the credit institution, while the tax rate was 8 per cent. In H2, the windfall profit tax base became 50 per cent of the previous year's pre-tax profit, with the first HUF 10 billion of the windfall profit tax base subject to a tax rate of 13 per cent and the amount above that to 30 per cent. For **retail sales** tax, the 2022 surtax was replaced by an increase in tax rates, thus increasing the progressivity of the tax rate. The tax rate remained 0 per cent for net sales of less than HUF 500 million and increased to 0.15 per cent from 0.1 per cent between HUF 500 million and HUF 30 billion. Between HUF 30 billion and HUF 100 billion, the rate of 0.4 per cent was increased to 1 per cent and above HUF 100 billion the rate increased from 2.7 per cent to 4.1 per cent. In the case of the **income tax on energy providers**, the 95 per cent special tax on profits from the difference between the Brent and Ural exchange rates resulted in lower-than-expected additional revenue for the budget due to the reduction in the differential, while taxpayers producing petroleum products were also required to pay an additional 2.8 per cent special tax on their 2022 turnover. In the case of the **mining royalty**, following a series of changes, the tax burden on oil and gas was increased by around three times the pre-consolidation rates, before the relevant taxpayers were allowed to enter into an official contract from September 2023 to maintain their 2022 production until the end of 2024 in exchange for reduced rates.

For two new tax types, the first revenues to the State Treasury were made in 2023. The **tax on pharmaceutical manufacturers** tax was introduced at the end of 2022. This tax is progressive, based on the net sales of pharmaceutical companies. The tax rates were as follows in 2022 and 2023: 1 per cent up to HUF 50 billion, 3 per cent between HUF 50 billion and HUF 150 billion, and 8 per cent above HUF 150 billion. Taxpayers had to pay both the 2022 and 2023 tax liabilities during 2023. The **carbon dioxide quota tax** was introduced in July 2023. The tax is targeted at companies with high carbon dioxide emissions and is therefore based on the amount of carbon dioxide emitted, at a rate of €40 per tonne. Payments by economic organisations were also affected by the introduction of the **extended producers' responsibility** (EPR) fee for environmental product fees in 2023, as EPR fees paid by producers will reduce producers' product fee liabilities from H2 2023.

Compared to 2022, payments by economic organisations increased by HUF 738 billion. The increase is largely due to the measures introduced during 2022, which increased revenues in H2 2022 and throughout 2023. The revenue-raising measures in 2022-24 explain why revenue from the income tax on energy providers increased by HUF 231 billion, retail tax revenues by HUF 66 billion, company car tax by HUF 29 billion and special tax revenues of financial institutions by HUF 26 billion in 2023 compared to the previous year. The revenues from the two new taxes account for a total increase of HUF 132 billion (HUF 91 billion from the tax on pharmaceutical manufacturers and HUF 41 billion from the carbon dioxide quota tax). The direct effect of the autumn 2022 restructuring of KATA is a HUF 115 billion reduction in revenue, and a partial indirect effect is a HUF 38 billion increase in tax of small enterprises revenue compared to 2022. The introduction and deductibility of the EPR fee in July 2023 has led to a reduction of HUF 32 billion in environmental product fees. The HUF 267 billion increase in corporate income tax revenue is attributable to the rise in corporate profits. Revenues from the rehabilitation contribution increased by HUF 28 billion in 2023, mainly due to the increase in the minimum wage (the tax rate is defined as a multiple of the minimum wage). Electronic tolls were up by HUF 29 billion and time-based tolls by HUF 14 billion, in a rising inflationary environment, tolls continued to rise in 2023.

Table 3
Partially consolidated cash-based revenues of the central sub-sector in 2023 (HUF billions)

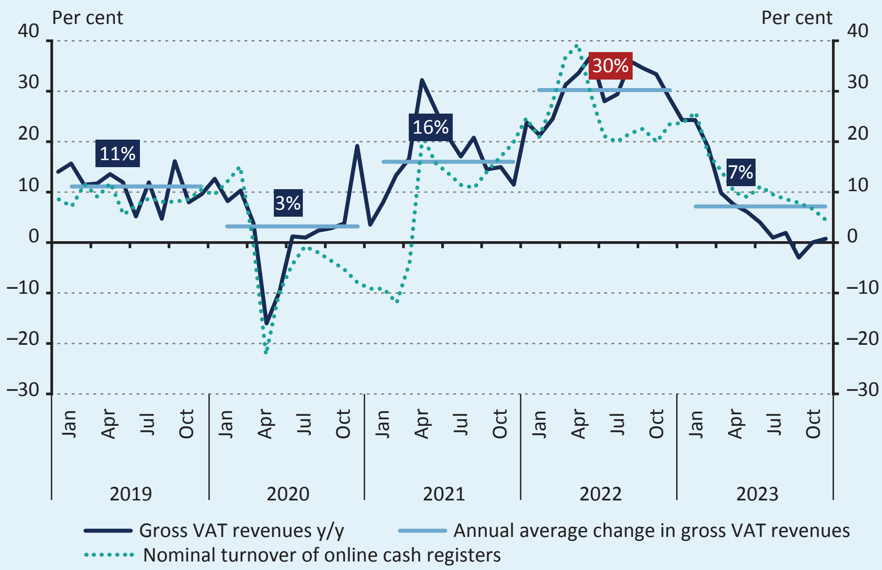
	2023		
	Statutory appropriation	**Actual**	**Difference**
TAX AND CONTRIBUTION REVENUES OF THE CENTRAL SUB-SECTOR	**26,171**	**24,454**	**-1,718**
Payments by economic organisations	**3,939**	**3,633**	**-306**
Corporate income tax	1,005	1,014	9
Special tax of financial institutions	358	353	-5
Lump sum tax of small entrepreneurs	81	71	-11
Tax of small enterprises	184	183	0
Utility tax	53	54	1
Eco-tax	5	5	-1
Mining royalty	334	242	-92
Gambling tax	47	52	5
Other taxes and payments	25	37	12
Other centralised revenues	566	570	4
Income tax on energy providers	716	435	-281
Company car tax	79	79	0
Retail tax	205	242	37
Tax on pharmaceutical manufacturers	123	91	-31
Rehabilitation contribution	158	164	6
Carbon dioxide quota tax	0	41	41
Consumption taxes	**10,188**	**9,054**	**-1,133**
Value added tax	7,986	6,982	-1,004
Excise duties	1,465	1,360	-105
Motor vehicle registration duty	17	14	-3
Telecommunication tax	96	98	2
Financial transaction levy	332	333	1
Insurance tax	219	183	-37
Airline tax	35	35	0
Tourism development contribution	37	49	13
Payments by households	**4,435**	**4,333**	**-102**
Personal income tax	4,061	3,996	-64
Duties, other taxes	274	241	-33
Motor vehicle tax	100	96	-5
Tax and contribution revenues of extra-budgetary funds	**515**	**507**	**-7**
Tax and contribution revenues of social security funds	**7,095**	**6,926**	**-170**
Social contribution tax and contributions	6,876	6,692	-184
Other contributions and taxes	219	234	15
EU RELATED REVENUES	**2,286**	**2,263**	**-23**
OTHER REVENUES	**1,230**	**1,523**	**293**
Revenues related to public asset management	**629**	**942**	**313**
Other revenues of the central budget	**457**	**434**	**-23**
Other revenues of social security funds	**46**	**51**	**5**
Other revenues of extra-budgetary funds	**98**	**96**	**-2**
TOTAL REVENUES	**29,687**	**28,239**	**-1,447**

Note: Partially consolidated data: the fiscal impact of the revenues and expenditures within the general government central sub-sector are stated in net terms.

Source: Hungarian State Treasury, 2023 Amended Budget Act, MNB

The net revenue from **VAT** amounted to HUF 6,982 billion in 2023. Compared to the previous year, net revenues were only 2 per cent higher at HUF 122 billion, while the growth rate of gross revenues was 7 per cent, after a record 30 per cent increase in the previous year (Chart 7). Consumer prices rose by 17.6 per cent in 2023, which curbed household consumption and retail sales. As a result, nominal consumption expenditure, which is important for the evolution of VAT revenues, rose by 12.3 per cent, while nominal retail sales increased by 7.9 per cent. The increase in net VAT revenues was lower than these, which can be explained by several factors. The shift in the composition of consumption also pointed towards lower revenues: the turnover of products with a high VAT rate (fuel, consumer durables) decreased compared to foodstuffs with a lower effective VAT rate. In addition to consumption, the VAT base is also affected by developments in public investment, which fell substantially as a share of GDP in 2023, while nominal investment expenditure declined in the first half of last year compared with the same period of the previous year. In addition, the phasing out of the home renovation programme at the end of 2022 may have contributed to the decline in VAT revenues, which may have temporarily increased the effective VAT rate for the sector. In Hungary, the so-called VAT gap, i.e. the proportion of unpaid VAT relative to the estimated tax base, has historically fallen below the EU average[1], but in 2022 the preliminary estimate shows a slight increase. Tax evasion rates may rise in an unfavourable economic environment.

Chart 7
Change in gross VAT revenues compared to the same period of the previous year

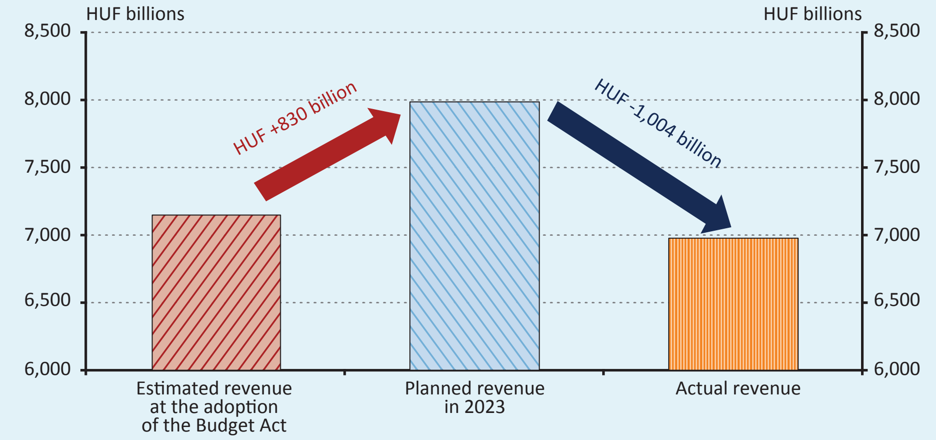


Source: Hungarian State Treasury, NTCA

The low level of net cash-based revenues from VAT is due to a significant slowdown in the growth dynamics of gross revenues as a result of the above factors, on the one hand, and higher than expected refunds, on the other. The high level of VAT refunds may also be explained by the fact that the higher interest rate environment has led firms to accelerate the submission of VAT refund invoices. The budget amendment increased the VAT revenue target for 2023 by HUF 830 billion, but the actual net revenue was HUF 1,004 billion lower, i.e. HUF 170 billion lower than the original target (Chart 8).

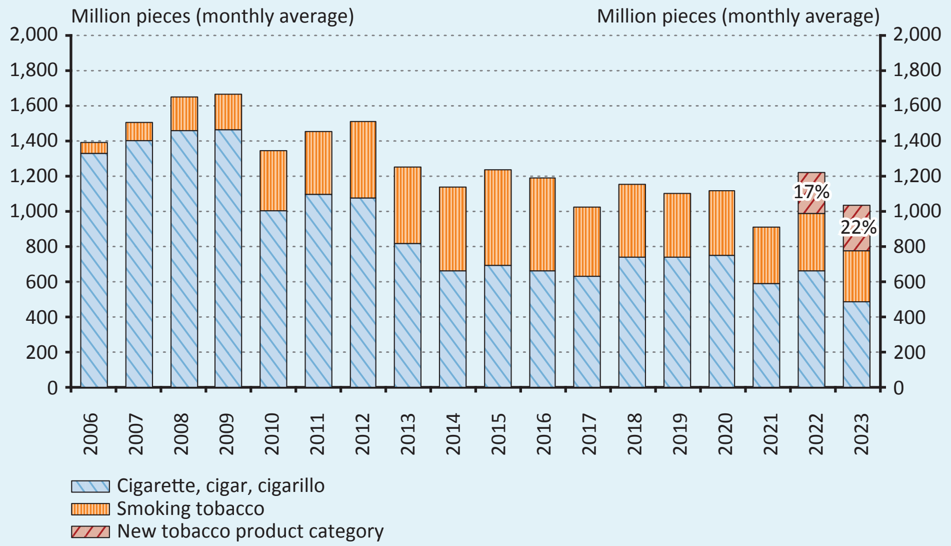
[1] European Commission VAT Gap Report 2023 (https://taxation-customs.ec.europa.eu/taxation/vat/fight-against-vat-fraud/vat-gap_en)

Chart 8
Change in net VAT revenues based on the appropriation and actual data in 2023



Source: Hungarian State Treasury, 2023 Amended Budget Act

Chart 9
Evolution of the structure of cigarettes, cut tobacco and new tobacco product categories



Note: Estimated value for consumer tobacco.
Source: NTCA

Excise duty revenues amounted to HUF 1,360 billion in 2023, HUF 105 billion below the budget target. The 2023 revenues were only HUF 130 billion higher than the previous year, despite the fact that several items were subject to higher taxes in 2023. From 1 January 2023, the specific tax on cigarettes was increased and the tax on the new categories of tobacco products (heated tobacco product), which dominate a fifth of the market, was also increased from HUF 15 to HUF 35 per stick, bringing it closer to the price of cigarettes per stick (Chart 9). In addition, at the beginning of 2023, the excise duty on petrol and diesel reverted to the original rates of HUF 120/l and HUF 110/l respectively, following a temporary two-stage reduction of HUF 5 and HUF 20 in excise duty per litre of petrol and diesel between February and December 2022.

Revenues from **telecommunication tax** amounted to HUF 98 billion in 2023, of which HUF 42 billion came from the windfall profit tax. The telecommunications tax is paid by telephone operators on calls and subscribers, while the new type of special tax is broader because it also covers internet service providers as well. The additional telecommunications tax rate is 0 per cent on the part of net turnover not exceeding HUF 1 billion, 1 per cent on the part exceeding HUF 1 billion but not exceeding HUF 50 billion, 3 per cent between HUF 50 billion and HUF 100 billion, and 7 per cent on the part exceeding HUF 100 billion.

The revenue from the **financial transaction levy** amounted to HUF 333 billion in 2023, HUF 1 billion above the statutory appropriation and HUF 40 billion above the 2022revenues. The annual increase is explained by the mid-year tax increase in 2022, which has a full annual effect from 2023.

Revenues from the **insurance tax** amounted to HUF 183 billion in 2023, HUF 37 billion below the 2023 budget target. The amount of the windfall profit tax on insurance amounted to approximately HUF 82 billion. The windfall profit tax introduced in 2022 was amended at the end of the same year, almost doubling the tax rate for the largest insurance companies, from 7 to 12 per cent on the part of non-life insurance premiums exceeding HUF 36 billion and from 3 to 5 per cent on the part of life insurance premiums exceeding HUF 36 billion.

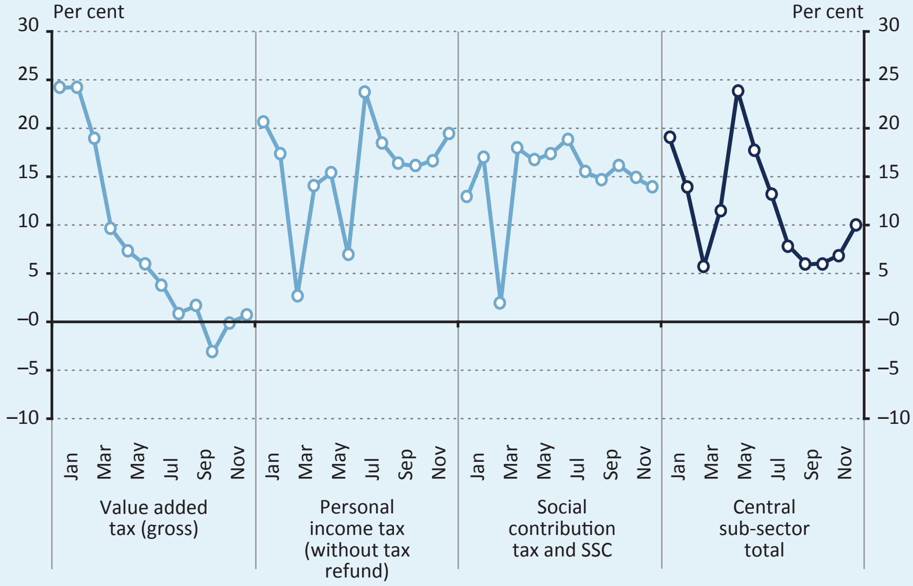
The **airline tax** in 2023 was HUF 35 billion, in line with the forecast. The amount of this tax, introduced in 2022 as a windfall profit tax and then converted into a permanent environmental tax, has been diversified depending on the emissions per passenger and the destination of the journey, giving a discount to less polluting aircraft. The per capita contribution ranges from HUF 1,600 to HUF 6,200 for intra-European destinations and from HUF 3,900 to HUF 15,600 for destinations outside Europe, depending on the per capita emissions value.

Revenues from **the tourism development contribution** amounted to HUF 49 billion in 2023, HUF 13 billion more than the statutory allocation. The tax exceeded the planned amount, despite the fact that the sectors concerned were exempted from paying the tax between 1 October 2022 and 31 March 2023, thus subsidising hospitality and commercial accommodation providers by around HUF 20 to 25 billion. Around 48,000 catering facilities and 2,600 commercial accommodation establishments were affected.

The **personal income tax** revenue of HUF 3,996 billion in 2023 was significantly, by more than HUF 260 billion higher than the original 2023 appropriation, while it was HUF 64 billion below the revised budgetary target. Revenues were 43 per cent higher last year than a year earlier, as the 2022 net cash revenue base was reduced by the impact of the tax refund to families. After adjusting for the impact of the refund, revenue growth between 2022 and 2023 could be around 16 per cent, mainly due to high wage dynamics of over 14 per cent and rising employment. Last year, the partial tax exemption for young people was extended so that from 2023, mothers under 30 years of age are exempt from paying PIT up to the average wage of July of the previous year if they give birth to or adopt a child between their ages of 25 and 30.

Last year, HUF 241 billion in revenue was **collected from the duties**, which is HUF 33 billion less than the statutory target. Duties decreased by 8 per cent year-on-year, by a total of HUF 21 billion compared to 2022. The decline was caused by a fall in property transfer tax, which can be explained by the subdued performance of the real estate market.

Chart 10
Annual change of major taxes and contributions



Source: Hungarian State Treasury, MNB calculation

The combined **tax and contribution revenues of extra-budgetary and social security funds** in 2023 were HUF 177 billion below the amended statutory target, while the increase in revenues was 15 per cent compared to the previous year. The increase was mainly due to a HUF 618 billion increase in employees' social security contributions, but social contribution tax revenues also contributed to the rise in revenues with an increase of HUF 278 billion. In 2023, a new measure was introduced which reduced social contribution tax revenues in the first half of the year due to a tax credit under the business labour support scheme and, from the second half of the year, a social contribution tax on interest income. In addition, the tax measures introduced in 2022 have already increased government revenues for the whole of last year, including increases in several tax types, such as the lump sum values of the public health products tax and simplified employment as well as the tax rate paid by pharmaceutical distributors.

Total **EU revenues** amounted to HUF 2,263 billion, representing 99 per cent of the revised budget plan, but the structure of revenues deviated from the target. Revenue from centrally managed appropriations amounted to around HUF 250 billion, mainly technical revenue (reallocations, refunds by beneficiaries). Just over HUF 2,000 billion were accounted for in the revenue line of EU programmes showing the receipt of EU funds, of which around two-thirds, HUF 1,300 billion, related to the 2014–2020 Cohesion Operational Programmes, which were expected to be significantly lower than the appropriations. Higher revenues in the ending cycle fully offset the shortfall in revenues in the new cycle. The budget was unable to draw down funds from the Recovery and Resilience Facility (RRF) in 2023, and the revenues of the operational programmes for 2021–2027 were some HUF 200 billion below the planned level.

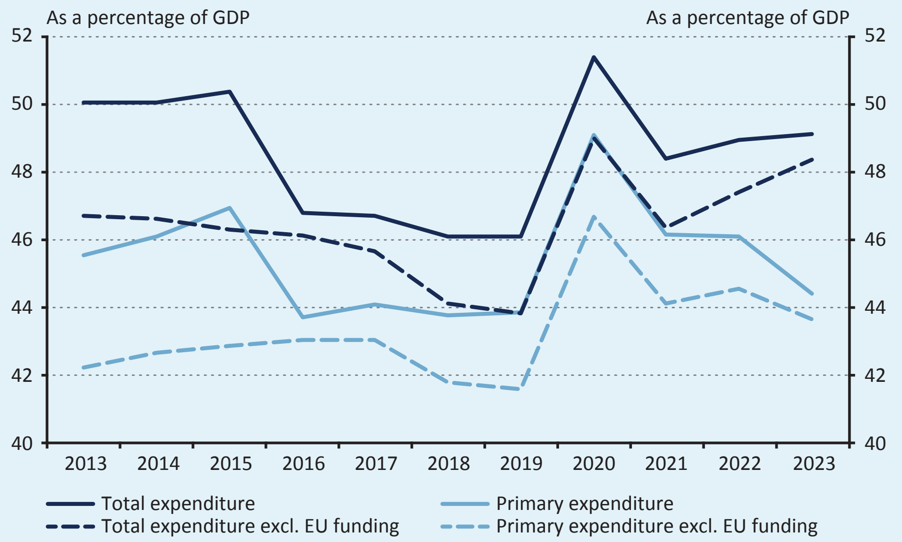
Other revenue of the **central sub-sector** totalled HUF 1,523 billion, which is HUF 293 billion more than the estimate. Budget revenue from **public asset management** amounted to HUF 942 billion. Asset management revenues exceeded the statutory target by almost 50 per cent, by HUF 313 billion. The difference is explained by the significant increase in revenues related to the exercise of state ownership rights, the highest of which being MVM Zrt.'s HUF 309 billion interim dividend payment. The over-fulfilment was offset by a shortfall in planned revenues from the National Land Fund. **The** total **other revenues of the central budget** were HUF 23 billion below the estimate of the Budget Act.

2.3 DEVELOPMENTS IN EXPENDITURE

Accrual-based expenditure in the general government was above projections in 2023 as well, as a result of rising public expenditure on wages and material expenses, pension expenditures and interest expenditures, driven by higher inflation. Expenditure rose by 0.2 percentage points year-on-year to 49.1 per cent of GDP, while primary expenditure excluding EU subsidies and interest expenditure fell to 43.7 per cent of GDP last year (Chart 11).

Consolidated cash expenditure of the central sub-sector amounted to HUF 32,836 billion, of which HUF 30,514 billion related to primary expenditure items (Table 4). Primary expenditure was HUF 498 billion below the estimates of the Budget Act. The planned expenditure was mainly exceeded by central budgetary organisations, expenditure on public assets and pension expenditure. At the same time, the lower-than-expected EU payments for cohesion and RRF in 2021–2027 led to an overall reduction in planned spending. In addition, net interest expenditure exceeded the statutory target by HUF 247 billion.

Chart 11
Expenditures and primary expenditures of the general government (as a percentage of GDP)



Source: HCSO, MNB

The combined statutory appropriation for the **special and normative subsidies** item was HUF 2,698 billion, while the total amount of expenditures made was HUF 2,597 billion, resulting in a saving of HUF 100 billion. The dynamic increase in expenditure of more than HUF 1,600 billion compared to the previous year is the result of higher energy costs. In the Utility Protection Fund, there were savings achieved compared to planned expenditure, while individual subsidies to companies exceeded the statutory appropriations by nearly HUF 170 billion. The extra support was justified by the government's recent economic development decisions and the fulfilment of new contracts with foreign partners. Expenditure on individual and per-capita subsidies includes subsidies paid to universal service providers under the heading of subsidies on household utilities and compensation to district heating companies.

The budget allocation for the **social policy fare subsidy** was HUF 105 billion and expenditures amounted to HUF 124 billion. The higher-than-planned expenditure was expected due to the fact that the HUF 118 billion in subsidies paid out in 2022 was already higher than last year's statutory appropriation. The introduction of county passes in 2023 also led to an increase in subsidies, due to higher service usage than in the past.

Table 4
Partially consolidated cash-based expenditures of the central sub-sector in 2023 (HUF billions)

	2023		
	Statutory appropriation	Actual	Difference
PRIMARY EXPENDITURES	**31,013**	**30,514**	**-498**
Special and normative subsidies	**2,698**	**2,597**	**-100**
Support to the public media	**110**	**110**	**0**
Social policy fare subsidy	**105**	**124**	**19**
Housing grants	**383**	**445**	**62**
National Family and Social Policy Fund	**755**	**754**	**-1**
Net own expenditures of central budgetary org's and chapters	**8,598**	**9,211**	**613**
EU related expenditures	**3,794**	**2,812**	**-981**
Support to local governments	**1,113**	**1,177**	**64**
Contribution to the EU budget	**662**	**674**	**12**
Central reserves	**977**	**0**	**-977**
Other expenditures	**1,770**	**2,232**	**462**
Expenditures of extra-budgetary funds	**579**	**651**	**72**
NEF - Passive allowances	116	146	30
NEF - Active allowances	118	112	-6
Other expenditures	346	393	48
Expenditures of social security funds	**9,469**	**9,726**	**257**
PIF - Pensions	5,546	5,760	214
HIF - Disability and rehabilitation benefits	375	379	4
HIF - Cash benefits	735	686	-48
HIF - Medical and preventive care	2,306	2,410	104
HIF - Net expenditures of the drug budget	354	352	-2
Other expenditures	155	139	-16
NET INTEREST EXPENDITURES	**2,074**	**2,321**	**247**
TOTAL EXPENDITURES	**33,087**	**32,836**	**-251**
BALANCE	**-3,400**	**-4,596**	**-1,196**

Note: Partially consolidated data: the fiscal impact of the revenues and expenditures within the general government central sub-sector are stated in net terms.
Source: Hungarian State Treasury, 2023 Amended Budget Act, MNB

Expenditure **on housing grants** reached HUF 445 billion, more than HUF 46 billion below the original 2023 target, while it exceeded the revised target by HUF 62 billion, which was HUF 108 billion lower than the original target, presumably largely due to higher interest subsidies and additional expenditure on home improvement subsidies. The HUF 190 billion lower expenditure in 2023 than in 2022 is mainly explained by the reduction in expenditure related to the Home Purchase Subsidy for Families (for the construction and purchase of new and second-hand homes and for investments in preferred small settlements) launched in 2021, which still accounted for 55 per cent of annual expenditure. The interest payment liability for several past and current housing subsidy schemes has increased by 2.5 times to HUF 51 billion in 2022, due to higher usage and a high yield environment. In contrast, spending on home improvement fell to HUF 246 billion, spending on HPS and in connection with preferred settlements to HUF 74 billion, while spending on housing savings subsidies fell to HUF 28 billion, i.e. 60 to 65 per cent of the previous year's spending.

Expenditure of the **National Family and Social Policy Fund** amounted to HUF 754 billion, which is broadly in line with the revised estimate, but also about 5 per cent above the original estimate and the previous year's figures. **Family benefits** paid out of the Fund accounted for HUF 405 billion of expenditure, HUF 4 billion below the estimate, offset by an over-realisation of **social benefits** of HUF 200 billion. **Reimbursements disbursed under various titles** accounted for HUF 23 billion of the Fund's expenditure, while **early retirement benefits** accounted for HUF 126 billion, in line with the forecast. Early retirement benefits increased by more than 9 per cent compared to the previous year, mainly due to a 15 per cent increase in pensions in January and a further 3.1 per cent increase in November, while the number of beneficiaries decreased by 8 per cent.

According to the consolidation based on the available data, the **net expenditure of budgetary organisations** including central budget expenditures amounted to HUF 9,211 billion in 2023, which is HUF 642 billion, or 7.5 per cent, higher than in 2022. The net expenditure calculated from the appropriations of the Budget Act was HUF 8,598 billion, HUF 613 billion lower than the implementation according to the preliminary data, so the overrun of the statutory appropriations was 7.1 per cent. At the same time, if we take into account the reserve provisions of the Budget Act, it can be concluded that the expenditures of budgetary chapters were successfully limited by the measures taken during the year. The planned amount of the *central reserves* was HUF 977 billion, and a total of HUF 926 billion of the reserves was decided to be used. As in previous years, the government has spent an increasing share of available reserves on public asset management expenditure or other central appropriations. The revenue of the budgetary organisations amounted to HUF 3.106 billion instead of the HUF 1.839 billion appropriation. Most of the difference was due to the accumulation of transfers of appropriations between chapters. Expenditures to the central budget by budgetary organisations amounted to HUF 616 billion instead of the planned HUF 342 billion. The difference between the appropriation and the actual figure was mainly due to the revenue of the Central Residue Settlement Fund and the Central Savings Fund (payments due to the centrally imposed obligation to pay the appropriations for the previous year's remaining appropriations). Overall, on the revenue side of the central budget, the statutory appropriations for the revenues of budgetary bodies and centralised expenditures were fulfilled to HUF 3,722 billion instead of the planned HUF 2,181 billion.

The **gross expenditure of budgetary institutions and chapter-administered appropriations** was HUF 728 billion (6 per cent) higher than the base period, while it exceeded the appropriations of the Budget Act by HUF 2,153 billion (20 per cent). Since the actual expenditures already include the use of budgetary reserves and payments to the Central Residue Settlement Fund and the Central Savings Fund, the assessment of expenditures consolidated with payments to these Funds better captures the trends. Total expenditure, consolidated by payments into the Funds, exceeded the revised statutory expenditure appropriations by HUF 1,838 billion (16.8 per cent). According to the available data, HUF 475 billion of the HUF 515 billion set aside for the sectoral reserve was actually used. Of the HUF 200 billion budgetary amount of the Investment Fund, the budget spent HUF 197 billion, while the government saved almost the entire amount of the reserves set aside for Epidemic expenditure.

In 2023, the wage costs of **budgetary institutions** increased by 5 per cent compared to the base year, reaching nearly HUF 4,300 billion. The institutions' material expenses increased by 11.5 per cent compared to 2022, reaching HUF 2,165 billion. The growth rate was strong despite the fact that base period expenditure was high compared to previous years. In addition to soaring inflation, the increase in material expenses was caused by the impact of higher energy costs for the full year. Other operating expenditure of the institutions increased in 2023 compared to the base year. The institutions spent HUF 384 billion on this type of expenditure, a change of more than 33 per cent compared to 2022. Institutional spending on investment and improvement increased by 30 per cent compared to 2022, to more than HUF 950 billion. So-called other expenditure amounted to HUF 74 billion, HUF 30 billion more than a year earlier.

Based on the preliminary data of the Hungarian State Treasury, the **gross expenditure of the chapter-administered appropriations** amounted to HUF 5,010 billion, HUF 24 billion lower than the gross expenditure of the base year established by the 2022 Act on the Appropriation Accounts. According to preliminary data from the Treasury, the chapter managers spent HUF 3.160 billion on operating aids, almost HUF 40 billion more than in 2022. Expenditure on capital formation also increased, with subsidies paid out increasing from HUF 1,464 billion in 2022 to HUF 1,561 billion in 2022. Expenditure on material expenses has fallen sharply, with a nominal decrease of HUF 151 billion, representing a 36.3 per cent drop in spending compared to 2022. The decrease was due to the full transfer of energy support expenditure to the Utility Protection Fund from the beginning of 2023.

The **EU spending** of HUF 2,812 billion in 2023 was sharply, by nearly HUF 1,000 billion below the target, mainly due to the lower volume of cohesion and RRF expenditures in 2021–2027. Expenditures of just over HUF 360 billion for the 2021–2027 cohesion policy operational programmes were some HUF 540 billion below the revised estimate, while expenditure on RRF funds of HUF 270 billion was HUF 230 billion lower than planned. The lower expenditure outturn for the new cycle is most likely due to the fact that in 2023, Hungary was not able to access the 2021–2027 cohesion and recovery funds allocated to it by the EU bodies. In view of the partial release of the funds at the end of 2023, Hungary could start to draw down cohesion funds for the new cycle in 2024. A total of around HUF 1,370 billion was paid out for the 2014–2020 cohesion programmes in 2023, which is HUF 130 billion less than the amount foreseen. Rural Development Programme expenditures were around HUF 760 billion as planned.

The expenditure appropriation for **support to local governments** was HUF 1.113 billion. The expenditures exceeded the statutory appropriation by HUF 64 billion, or 5.7 per cent. A year earlier, local governments received HUF 1,082 billion in budget support, thus, the increase was 8.8 per cent in the amount of central funds received. The nominal over-expenditure was due to the normal use of part of the special-purpose reserves (e.g. to support the increase in the minimum wage and the guaranteed minimum wage) and to additional accumulation and investment aids (e.g. the expansion of industrial zones) from the reserve margins. In the case of the latter, the government provided additional resources mainly for infrastructure development.

The Budget Act included a total of HUF 977 billion in appropriations for **central reserves**, which were not affected by the amendments to the Budget Act. Overall, HUF 926 billion of central reserves were used during the year. The biggest savings were made in the reserve appropriation for *Provisions*, with a saving of around HUF 48 billion in the reserve appropriation for wage increases.

Other expenditures of the central budget exceeded the statutory appropriations by HUF 462 billion. The difference was largely driven by an overrun in public asset management expenditure. **Expenditure on public asset management** was HUF 1,751 billion, HUF 320 billion more than the budget appropriation as amended by the law. Asset management expenditure in 2023 was HUF 595 billion higher than a year earlier. The overrun is largely explained by the state's acquisition of a stake in Vodafone Hungary Zrt.

Consolidated expenditures of the extra-budgetary funds exceeded the target by HUF 72 billion, resulting in a total HUF 82 billion lower balance of the funds in 2023 compared to the budget target, due to lower revenues. The most heavily weighted expenditure on the National Employment Fund exceeded the statutory appropriation by HUF 7 billion. In addition to these, the Baross Gábor Fund registered higher expenditure of HUF 41 billion, while the National Research, Development and Innovation Fund registered higher expenditure of HUF 10 billion, partly in line with higher revenues.

Expenditure on the Start labour programme was HUF 112 billion instead of the HUF 118 billion foreseen. According to the HCSO, the average annual number of full-time public employees in 2023 was 65,700, a decrease of nearly 9,000 compared to 2022. Of the total expenditure, wage cost accounted for HUF 100 billion, while the share spent on material costs and capital formation amounted to HUF 12 billion.

Consolidated **expenditure of social security funds** amounted to HUF 9,726 billion in 2023, which exceeded the appropriations of the Budget Act by HUF 257 billion. Expenditure higher than the amount of the revised appropriations is mainly explained by the additional pension increase in November due to higher-than-budgeted inflation and an increase in the operating subsidy to health care institutions.

Expenditure of the **Pension Insurance Fund** for 2023 amounted to HUF 5,767 billion, which exceeded the amount foreseen in the amended Budget Act by HUF 213 billion (4 per cent). **Pension benefits** paid from the Fund amounted to HUF 5,760 billion, while **other expenditure** of the Fund amounted to HUF 7 billion. Compared to the 2022 actual figures, the Pension Insurance Fund's expenditure in 2023 increased by HUF 961 billion (20 per cent), almost all of which is related to pension benefits, while the Fund's other expenditure was almost HUF 9 billion lower.

As a result of the inflation indexation mechanism, **pension benefits from previous years** increased by a total of 18.6 per cent in 2023, which according to our calculations contributed to the increase in expenditure from the Pension Insurance Fund by around HUF 840 billion compared to the previous year. In January 2023, **a 15 per cent pension increase** was implemented, in line with the expected rate based on the inflation expectations of the Budget Act, with a budgetary impact estimated at nearly HUF 680 billion. As a result of higher-than-budgeted price increases, the government decided **in November to implement an additional 3.1 per cent pension increase**, which had an estimated HUF 164 billion impact on benefits paid from the Pension Insurance Fund, contributing to the increase in expenditure above the revised target. In addition to the above, the spillover effects of the additional pension increases in 2022 contributed to the increase in expenditure from the Fund by more than HUF 260 billion compared to the previous year.

The increase over and above pension increases is mainly explained by the fact that the **newly established benefits** are on average usually higher than the amount of the previously established pensions, due to the increasing valorisation multiplier resulting from the strong wage dynamics, and the replacement effect also contributes to the increase in benefits. The increase in expenditure was also driven by **a higher average number of pensioners** in 2023 compared to the previous year. The completion of the phased increase in the retirement age in 2022 has gradually ended the sharp decline in the number of beneficiaries of early retirement pensions that was typical of previous years. In contrast, the number of women receiving old-age pensions with 40 years of service has fallen as the retirement age of 65 has been steadily reached. The number of beneficiaries of retirement benefits to relatives has decreased further in 2023, in line with the dynamics of previous years. As a result of these developments, the number of persons receiving pension benefits from the Pension Insurance Fund (old-age and widow's pensions, orphan's pension) in December 2023 increased by nearly 4,200 compared to the last month of the previous year.

Expenditure on **pensions and pension-like benefits** (retirement benefits, early retirement benefits, disability, and rehabilitation benefits) totalled HUF 6,265 billion in 2023, which exceeded the amount of the amended budget appropriations by HUF 219 billion and the expenditure in 2022 by HUF 1,021 billion.

The net expenditure of the **Health Insurance Fund** amounted to HUF 3,959 billion, which exceeded the appropriations of the 2023 Budget Act by about HUF 44 billion. The variance is due to medical and preventive care and drug subsidies, but the higher expenditure was partly offset by the fact that expenditure on cash benefits was lower than the forecast.

Expenditure on **disability and rehabilitation benefits** amounted to HUF 379 billion in 2023, which was HUF 4 billion more than the appropriations of the amended Budget Act. The additional pension increase due to higher-than-expected inflation that underpinned the planning of the 2023 Budget Act also covered disability and rehabilitation benefits, while the reduction in the number of beneficiaries reduced expenditure.

Cash benefits amounted to HUF 686 billion, HUF 48 billion below the amount of appropriations. The difference is mainly due to the fact that at the time of the budgetary planning, higher than actual expenditure was expected for sickness, childcare and adoptive parent allowances. Expenditure on sick pay was HUF 32 billion below target, childcare and adoptive parent allowance expenditure was HUF 13 billion below target, while expenditures related to infant care allowance were HUF 3 billion below target.

Medical and preventive care benefits amounted to HUF 2,410 billion, which is HUF 104 billion more than the 2023 budget. The main reason for this overrun is the increase in operating subsidies paid to the healthcare institutions due to high inflation.

Net expenditure of the drug budget amounted to HUF 352 billion, which is HUF 2 billion below the target. Gross expenditure was HUF 34 billion higher than the amount planned in the Budget Act, while revenues from pharmaceutical manufacturers and distributors were HUF 36 billion higher than the budgeted amount.

Net accrual-based interest expenditure was 3.7 per cent of GDP in 2023, which is the result of gross interest expenditure of 4.7 per cent and interest revenue of 1 per cent of GDP. A significant part of the increase in accrual-based interest expenditure was due to high inflation and the rise in the stock of inflation-linked government securities. The decline in government securities market yields from H2 2023 onwards has reduced the growth rate of interest expenditure. The increase in interest income is mainly related to interest received on government deposits. **Net cash interest expenditure** amounted to HUF 2,321 billion in 2023, HUF 247 billion above the budgeted amount. This is the result of gross interest expenditure being HUF 265 billion higher than the statutory figure, while revenues were HUF 18 billion higher. The higher-than-expected interest expenditure was caused by a significant increase in nominal government debt on the one hand, and higher level of interest rate on the other.

2.4 BUDGET MANAGEMENT OF LOCAL GOVERNMENTS

According to the April 2024 EDP notification, the local government sub-sector ended 2023 with a HUF 20 billion cash surplus. According to the preliminary data, the sub-sector's cash revenues increased by 18.3 per cent compared to the base year, with revenues amounting to HUF 4,310 billion, or 5.7 per cent of GDP. Among the revenues, the growth rate of the so-called local taxes was particularly high, reaching 38 per cent. In particular, the growth dynamics of business tax revenue were high, with revenue collected 42.6 per cent higher than business tax revenue in 2022, due to high inflation and rising profits in 2023. It is also worth mentioning that funds from the European Union increased by 23 per cent, contributing to the creation of a surplus cash balance for local governments. The preliminary EDP notification includes a statistical correction of HUF -136 billion to the EU accounts, reducing the cash surplus by this amount due to the settlement of EU advances.

Based on the data, local government cash expenditure increased by 15.6 per cent compared to the base year, ending the year at around HUF 4,280 billion, or 5.7 per cent of GDP. Among the expenditures, labour costs increased by 12.9 per cent, while the growth rate of material expenses exceeded 23 per cent. The high growth rate of material expenses was largely due to the impact of higher energy costs already affecting expenditure for the full year. Investment spending rose by 8.3 per cent, approaching 1.3 per cent of GDP.

According to HCSO data, the ESA balance of the local government sub-sector shows a deficit of HUF 172 billion in 2023, which represents a HUF 15 billion deterioration compared to the ESA balance in 2022. The HUF 192 billion of statistical corrections relative to the cash surplus is due to accrual accounting for EU funds.

2.5 STATISTICAL CORRECTION (ESA BRIDGE)

The correspondence between cash revenues and expenditures and the resulting cash balances and the ESA balance calculated according to the EU methodology is ensured by statistical corrections (ESA bridges) that complement the cash accounting. Statistical corrections are necessary because the EU approach is to account for some transactions at the time of settlement (accrual accounting), while the Hungarian budgetary accounting rules take transactions into account at the time of cash flow (cash accounting). Moreover, EU rules interpret the concept of public finances (the so-called general government) more broadly than Hungarian law, including certain non-profit institutions, certain state-owned economic organisations, and other entities under state control, as well as certain financial operations (e.g. credit operations). Therefore, the ESA balance calculated according to the methodology used in the European Union is calculated by the HCSO for the general government, and this deficit indicator differs from the general government cash flow (GFS) balance in sectoral coverage.

The 2023 budget bill set the expected balance of statistical corrections (ESA bridge) at -0.2 per cent of assumed GDP (-HUF 137 billion). Thus, this is how much less favourable the ESA-adjusted balance was in the general government balance projection than the general government cash balance target adopted in the Budget Act. According to the April 2024 EDP notification, the actual ESA bridge was HUF -445 billion in 2023, or -0.6 per cent of GDP. The difference is due to a number of factors, the main ones being statistical corrections related to EU accounts and the interest burden on government debt.

A larger amount of statistical corrections was generated by various financial operations of the government, which together resulted in HUF 495 billion of corrections improving the cash balance. Within this, the HCSO recorded an accrual adjustment of HUF -69 billion on swap operations, but this effect was much exceeded by the HUF 326 billion balance-improving adjustments (capital increases, purchases of financial assets) on other financial operations. The largest financial asset purchase in 2023 was the acquisition of the stake in Vodafone Zrt. The balance of loans and loan repayments added a further HUF 217 billion to the statistical correction. Interest settlements related to debt servicing (differences between interest paid and accrued, excluding swap settlements) increased ESA expenditure by HUF 522 billion.

Based on the preliminary calculation of the EU accounts, the HCSO increased the net expenditure of the general government on cash accounting by HUF 835 billion, i.e. by this amount the cash flow balance changed. Within the accounts, the statistical corrections to the RRF (Recovery and Resilience Facility) improved the amount of corrections by HUF 242 billion.

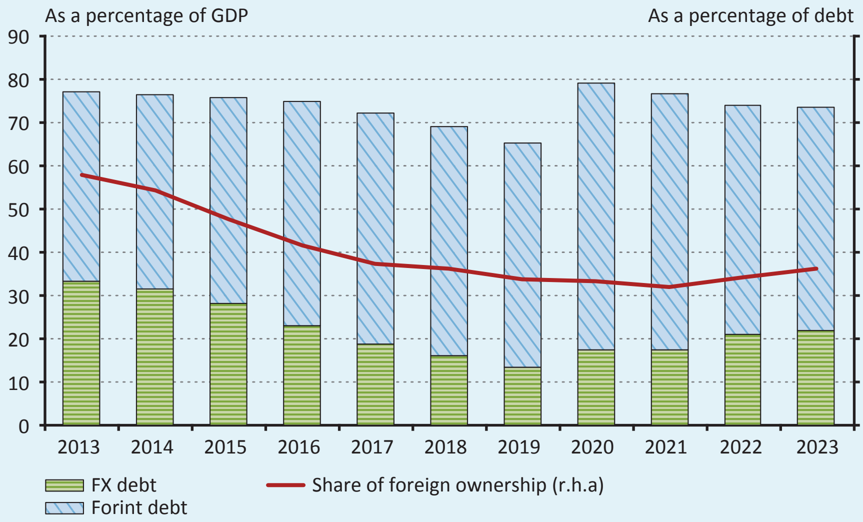
Together, government and non-profit institutions improved the ESA balance of the general government by HUF 418 billion. In total, subsidies received from the central budget and other sub-sectors of the general government, as well as fees and other revenue transfers, exceeded the ESA expenditure of economic organisations and non-profit institutions classified in the general government by this amount.

2.6 DEVELOPMENTS IN GOVERNMENT DEBT

Gross public debt-to-GDP ratio fell to 73.5 per cent at the end of 2023 (Chart 12), a reduction of 0.5 percentage point from 74.1 per cent at the end of 2022. The decline in the public debt ratio was mainly supported by the high GDP deflator, as nominal GDP rose by almost 14 per cent despite the slowdown in the real economy. The decline in the debt ratio was also supported by the appreciation of the forint exchange rate. The increase in government debt was driven by the rise in the debt of classified corporations outside the central debt, mainly Eximbank, and net issuance of around HUF 6,000 billion, which financed the high cash deficit.

By the end of 2023, the FX ratio of central government debt continued to increase and the share of foreign ownership in government debt increased slightly compared to the previous year, due to significant FX bond issuance. In 2023, the Government Debt Management Agency carried out net FX issuance of around HUF 2,850 billion, of which net wholesale FX bond issuance amounted to HUF 1,917 billion. As a result of the FX bond issuance, the FX ratio of the central government debt rose to 26.9 per cent from 25 per cent in 2022. One of the main objectives of the government debt management strategy is to strengthen domestic financing, which has kept the share of foreign ownership low at 36.3 per cent of public debt at the end of 2023.

Chart 12
Developments in gross government debt, forint and FX debt within that and the share of foreign ownership



Source: MNB

3 Expected general government developments in 2024

3.1 EXPECTED ESA BALANCE OF THE GENERAL GOVERNMENT SECTOR IN 2024

According to our forecast, the accrual-based balance of the general government will be in the range of 4.3 to 4.7 per cent of GDP in 2024, thus, in order to achieve the budgetary target, it is required to maintain control over expenditures for the rest of the year. The Budget Act set a deficit target of 2.9 per cent of GDP for 2024 last year, which was revised to 4.5 per cent of GDP in the April EDP notification. Our September 2024 forecast for the general government accrual-based deficit this year was projected to be between 4.3 and 4.7 per cent of GDP (Table 5). With the measures announced this spring and at the beginning of July, the Government increased the budgetary room for manoeuvre by about HUF 1,000 billion. It is supported by declining energy expenditure as a result of the stabilisation of energy prices, the announced deficit-reduction measures, as well as declining government investments, while tax revenues falling short of the budget and high interest expenditures make it difficult to achieve the deficit target for 2024, so it is necessary to maintain control over expenditures for the rest of the year. In our analysis we also cover in detail the budgetary impact of each of the measures announced in July (see Box 2).

According to our forecast, revenues could be HUF 1,844 billion lower than budgeted. Within this, tax and contribution revenues of the central sub-sector could fall short by HUF 851 billion, while revenues from EU subsidies could fall short by HUF 1,255 billion compared to the appropriation. With savings of HUF 306 billion on the primary expenditure side, interest expenditure could be HUF 325 billion higher in 2024 compared to the budgeted level.

Table 5
Balance of the general government in 2024

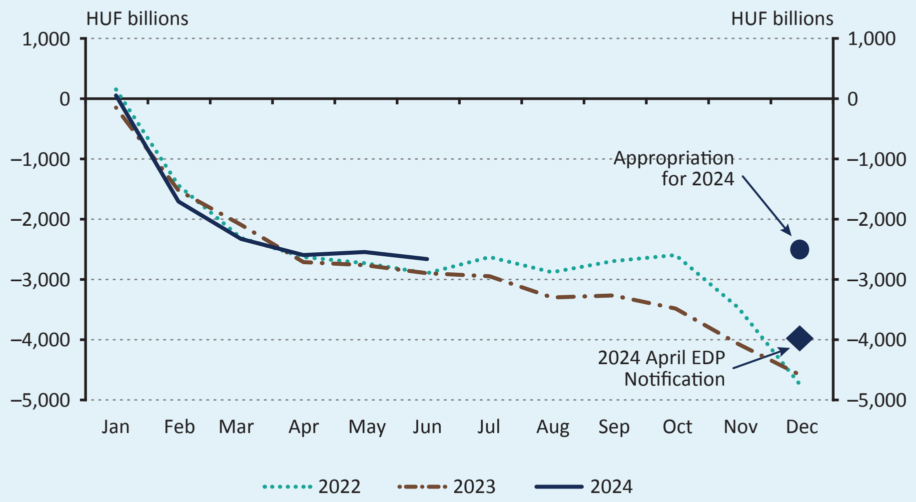
	Statutory appropriation	Expected by the EDP	MNB forecast	Statutory appropriation	Expected by the EDP	MNB forecast	Difference (MNB-EDP)
	HUF billions			percentage of GDP			
1. Balance of the central sub-sector	-2,515	-3,982	(-4,721) - (-4,396)	-2.9	-4.9	(-5.8) - (-5.4)	(-0.9) - (-0.5)
2. Balance of local governments	-165	-109	32	-0.2	-0.1	0.0	0.2
3. Cash-based (GFS) balance of the general gov't (1+2)	**-2,679**	**-4,091**	**(-4,690) - (-4,364)**	**-3.1**	**-5.0**	**(-5.8) - (-5.4)**	**(-0.8) - (-0.4)**
4. ESA bridge	173	441	862	0.2	0.5	1.1	0.5
5. ESA balance of general government (3+4)	**-2,507**	**-3,649**	**(-3,827) - (-3,502)**	**-2.9**	**-4.5**	**(-4.7) - (-4.3)**	**(-0.2) - 0.2**

Note: There can be differences in the table due to rounding. GDP-proportionate values are calculated with the use of different GDP forecasts.
Source: 2024 Budget Act, April 2024 EDP notification, MNB June 2024 Inflation Report

Our forecast is prepared with a lower expected economic growth than the growth rate prognosed in the Budget Act. We expect a shortfall in tax and contribution revenues, especially VAT, due to slower growth this year and last year's underperformance. This year, EU spending may fall short of the plan, which may be offset by higher-than-expected pension expenditure, interest expenditure and expenditure on public asset management. Our expectation for the local government balance is 0.2 per cent of GDP higher, while our forecast for statistical corrections results in an ESA deficit 0.5 per cent of GDP more favourable than in the April 2024 EDP notification, mainly due to state share purchases, which do not increase the ESA deficit.

The cumulative deficit of the central sub-sector at the end of June was HUF 2,656 billion, 106 per cent of the annual appropriation, and 67 per cent of the cash deficit expected in the April EDP notification (Chart 13). Tax and contribution revenue of the central sub-sector was HUF 1,176 billion higher in the first half of the year than in the same period last year, while consolidated expenditure of the central sub-sector was HUF 961 billion higher than in the same period last year, of which interest expenditure was HUF 602 billion. The bulk of the expenditure surplus is related to expenditures on interest, on central budgetary organisations and on pensions, mainly offset by an increase in labour tax and contribution revenues in the first six months of the year. In the first half of the year, cash expenditures related to EU funds amounted to HUF 946 billion, while revenues were HUF 593 billion.

Chart 13
Intra-year cash balance of the central sub-sector (year-to-date cumulated value)

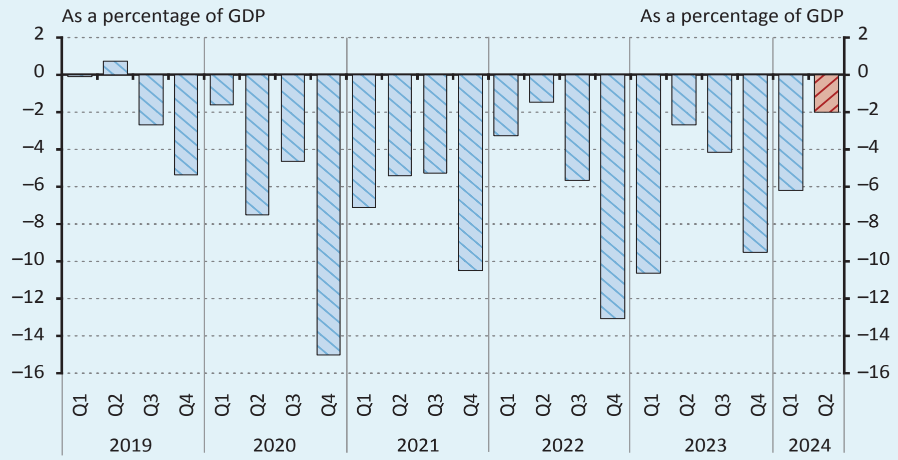


Source: 2024 Budget Act, Hungarian State Treasury, April 2024 EDP notification

In the first half of 2024, the accrual-based deficit was 3.9 per cent of GDP. Quarterly accrual-based deficit in Q1 of 2024 was 6.2 per cent, while in the second quarter it was 2.0 per cent of quarterly GDP (Chart 14). The 2.0 per cent deficit in the second quarter of 2024 was lower than the 2.7 per cent value in the same period of 2023, however, it exceeded the 1.5 per cent second quarter value of 2022.

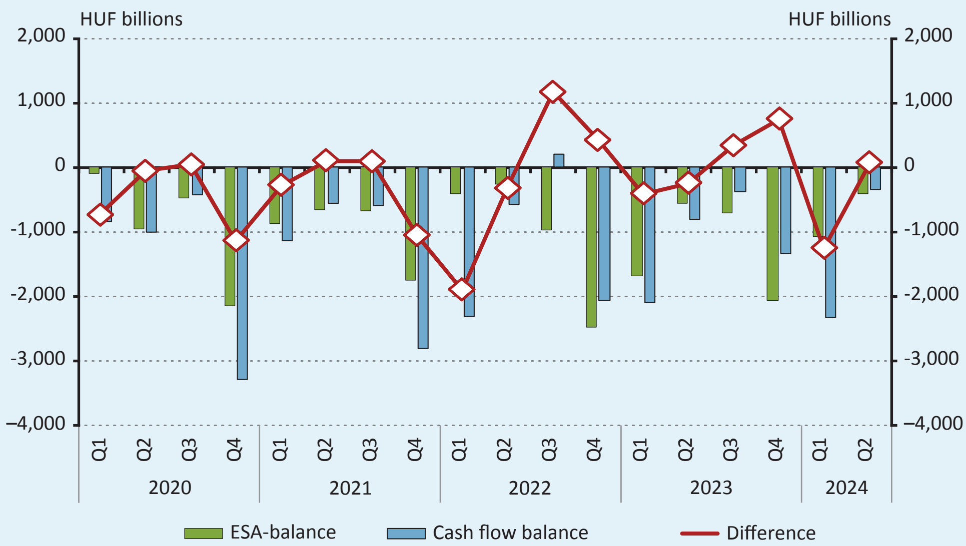
The general government accrual-based half-year deficit in 2024 (HUF 1,470 billion) is HUF 1,186 billion lower than the cash deficit (HUF 2,656 billion) (Chart 15). The difference is mainly related to expenditures in the first quarter. The cash-based expenditure paid for the purchase of Budapest Liszt Ferenc International Airport contributed to the higher cash flow deficit, which did not increase the accrual deficit. In addition, in the case of interest expenditure, the concentration of interest expenditures on retail inflation-linked (Premium Hungarian) government securities in the first quarter of the year significantly increases cash expenditure, while in the case of accrual accounting this amount is spread evenly over the year, which implied a difference of more than HUF 300 billion. On the other hand, the fact that the fine imposed by the legally binding decision of the European Court of Justice was accounted for, resulted in a higher accrual-based deficit, which, however, has not yet appeared as a cash flow expenditure.

Chart 14
Development of accrual balance of the general government



Note: Q2 2024 data based on MNB preliminary financial accounts.
Source: HCSO, MNB

Chart 15
The difference between quarterly accrual (ESA) and the cash flow balances



Source: HCSO, Hungarian State Treasury, MNB preliminary financial accounts (Q2 2024 data)

3.2 MACROECONOMIC PROJECTION UNDERLYING THE BUDGET

The macroeconomic forecast in the 2024 Budget Act is 4.0 per cent, while the MNB's September 2024 forecast projects economic growth of between 1.0 and 1.8 per cent for this year. GDP expanded by 1.5 per cent on an annual basis in Q2 2024. On a quarterly basis, GDP fell by 0.2 per cent, following a rise in the previous quarter, while economic output expanded by 1.3 per cent in the first half of the year compared to H1 2023. The central bank's forecast for 2024 is higher than the fiscal projection for household consumption expenditure and lower for other consumption items. The largest differences are in gross fixed capital formation and foreign trade. In 2024, the expansion of GDP will be supported mainly by household consumption and net exports, while declining investment slows GDP growth. In 2024, as a result of favourable wage and income trends, household consumption might be the support of economic growth, but at the same time, the population remains cautious, as indicated by the historically high savings rate. Low capacity utilization, weak external demand, geopolitical uncertainties, still high price levels and the long shadow of inflation will result in a decrease in investment this year. The moderate European economy will continue to restrain exports in the short term, however, due to the decrease in imports exceeding that of exports, net exports will make a positive contribution to GDP growth.

Table 6
Comparison of the macroeconomic paths included in the 2024 Budget Act and the MNB forecast in the September 2024 Inflation Report (per cent)

	Budget Act	MNB	Difference
GDP	**4.0**	**1.0 - 1.8**	**(-3.0) - (-2.2)**
Consumption expenditure of households	3.2	3.4 - 4.0	0.2 - 0.8
Intermediate consumption	1.1	(-3.2) - (-2.2)	(-4.3) - (-3.3)
Gross fixed capital formation	3.7	(-7.2) - (-5.8)	(-10.9) - (-9.5)
Export	5.9	(-1.5) - (-0.3)	(-7.4) - (-6.2)
Import	4.3	(-3.8) - (-2.6)	(-8.1) - (-6.9)
GDP-deflator	5.6	7.7	2.1
Consumer price index	**6.0**	**3.5 - 3.9**	**(-2.5) - (-2.1)**
Gross wage bill	**10.7**	**13.3 - 13.6**	**2.6 - 2.9**
Average gross earnings	10.3	12.8 - 13.2	2.5 - 2.9
Number of employees	0.4	0.4 - 0.5	0.0 - 0.1

Source: 2024 Budget Act, MNB September 2024 Inflation Report

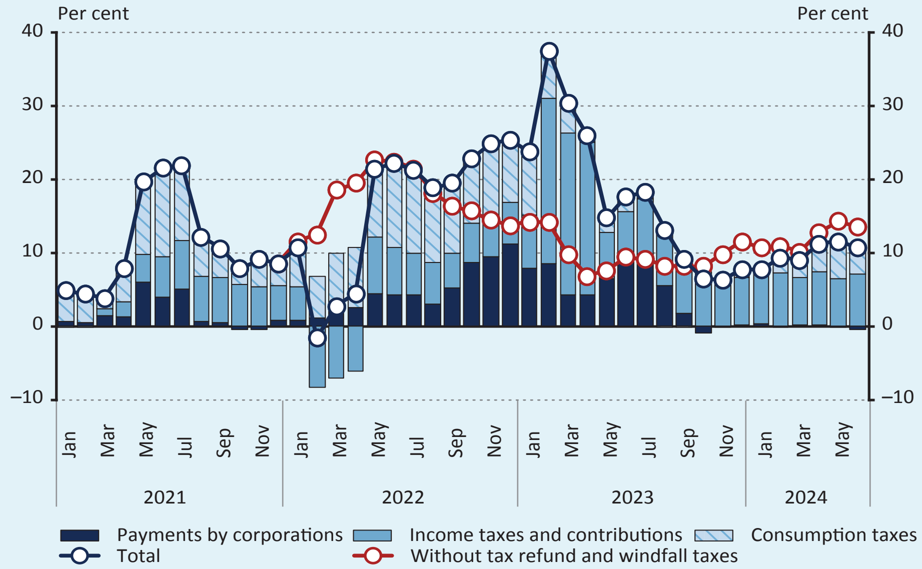
The MNB's forecast expects a similar increase in employment as the Budget Act, but a greater increase in wages. Both the Budget Act and the latest forecast of the MNB expect an employment increase of 0.4 per cent this year. According to the MNB's September forecast, average gross earnings in the national economy are expected to grow by 12.8 to 13.2 per cent, above the budget's expectation (10.3 per cent), so real wages are expected to increase substantially. Wage dynamics in 2024 are primarily determined by the increase in the minimum wage at the end of last year, the easing of labour market tightness and the pace of the easing of inflation expectations.

The 2024 Budget Act is planned with an inflation rate of 6.0 per cent, while the MNB's September Inflation Report expects inflation to be between 3.5 and 3.9 per cent this year. In H1 2024, the rate of price increases ranged between 3.6 and 4.0 per cent. The rapid disinflation that started in early 2023 continued at a slower pace in the first quarter of 2024. In July, the rate of price increase rose temporarily to 4.1 per cent, and then fell back to the tolerance band, to 3.4 per cent in August.

3.3 CASH-BASED REVENUES OF THE CENTRAL SUB-SECTOR

According to our forecast the tax and contribution revenues of the central sub-sector of the budget could fall short of the statutory target by HUF 851 billion, mainly due to lower-than-planned revenue collection from consumption taxes, especially VAT. Based on our forecast, revenues related to the income tax on energy providers and excise duty revenues will also be below the target, so overall the tax- and contribution revenues of the sub-sector could be HUF 851 billion lower than the Budget Act.

Chart 16
Annual change in tax and contribution revenues of the central sub-sector (3-month moving average)



Source: Hungarian State Treasury, MNB

Corporate income tax revenues could fall short of the 2024 budget appropriation by HUF 56 billion. The difference is due to the less favourable macroeconomic developments. In the first six months of the year, corporate income tax revenues were only HUF 5 billion higher than in the same period last year.

Revenues from the **special tax of financial institutions** could exceed the 2024 Budget Act's appropriation by HUF 62 billion. The difference is due to three factors. On the one hand, in addition to the difference in projections for traditional special tax revenues, credit institutions will not be able to deduct one fifth of the special tax related to the 2020 coronavirus crisis from their tax liability in 2024. On the other hand, this tax type continues to be affected by the windfall profit tax part of the fiscal adjustment. During 2024, the windfall profit tax base will be the pre-tax profit of two years earlier, with the first HUF 20 billion of profit subject to a 13 per cent tax rate and the amount above that to a 30 per cent tax rate. Thirdly, tax liability can be reduced by taxpayers if increasing their holdings of medium and long-term government securities, and the rules for this discount have been tightened as part of the consolidation measures. In the first six months of the year, special tax revenues reached HUF 172 billion, HUF 27 billion more than in the first half of the previous year. The revenue from the windfall profit tax was spread over June, October, and December 2023. In 2024, however, the tax relief on the increase in the stock of government securities means that the evolution of windfall profit tax revenue is concentrated in June.

Revenues from **retail tax** could be HUF 28 billion higher than the Budget Act's estimate, mainly due to the high base (as 2023 revenues were only HUF 7 billion lower than the 2024 estimate). In the framework of the amendment implemented in 2023, the tax rate for the part of the tax above HUF 100 billion increased from 4.1 to 4.5 per cent in 2024. By the end of June, taxpayers had paid HUF 31 billion into the treasury, HUF 5 billion less than in the first six months of the previous year. For this tax, the tax liability is concentrated in the second half of the year.

Revenues from **mining royalty** could be HUF 74 billion lower than the Budget Act's estimate. The significant difference is explained by a measure allowing for the application of a reduced rate: from September 2023, taxpayers engaged in the production of oil and gas could enter into an official contract to maintain their 2022 production until the end of 2024 in exchange for a reduced rate. As a result, HUF 57 billion of mining fees were received in the first six months of the year, HUF 85 billion less than the amount paid between January and June 2023.

Revenues from the **income tax on energy providers** may fall HUF 187 billion short of the Budget Act, mainly as a result of global market developments. The rate of the special tax payable by taxpayers producing petroleum products in 2024 on their 2022 turnover was reduced from 2.8 per cent to 1 per cent as a result of a change in 2023. And under measures introduced in July this year, the special 95 per cent tax credit on profits from the difference between Brent and Ural prices was reduced from $7.5 to $5 per barrel, to apply from August 2024. By the end of June, the revenue from this tax amounted to HUF 189 billion. This amount is HUF 91 billion lower than in the same period last year.

Revenues from the **tax on pharmaceutical manufacturers** could be HUF 25 billion higher than the Budget Act's estimate. Compared to the previous year, the rates of the tax have been halved (0.5 per cent for the first HUF 50 billion of net sales, 1.5 per cent between HUF 50 billion and 150 billion, and 4 per cent above HUF 150 billion), and the deductibility of R&D expenditure related to pharmaceuticals from tax liability has been introduced. In six months, HUF 11 billion was paid into the budget under this heading, down HUF 29 billion compared to the first six months of 2023. The shortfall from last year's higher base is also explained by the fact that the 2022 tax liability had to be paid in the first half of the previous year, in addition to the 2023 tax advances.

Revenues from the **carbon dioxide quota tax** could increase revenues by HUF 72 billion compared to the Budget Act, as the tax was introduced into the Hungarian tax system in August 2023, after the adoption of the 2024 Budget Act. By the end of June, the budget had received HUF 38 billion in tax revenue.

Revenues from **road tolls** could exceed the relevant appropriation by HUF 50 billion. The difference is explained by the change to the electronic toll system in 2023, the introduction of the one-day motorway vignette in April 2024 and the base effect. In the first six months of the year, taxpayers paid HUF 298 billion in road toll revenue to the budget through motorway operators, an increase of HUF 99 billion compared to the same period last year.

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

	2024				
	Statutory appropriation	January-June completion	Percent of appropriation	MNB-forecast	Difference: MNB - appropriation
TAX AND CONTR. REV'S OF THE CENTRAL SUB-SECTOR	**28,049**	**13,177**	**47%**	**27,198**	**-851**
Payments by economic organisations	**3,758**	**1,844**	**49%**	**3,715**	**-43**
Corporate income tax	1,153	643	56%	1,097	-56
Special tax of financial institutions	253	172	68%	316	62
Lump sum tax of small entrepreneurs	78	33	43%	67	-10
Tax of small enterprises	228	102	45%	220	-8
Utility tax	41	21	51%	43	1
Eco-tax	5	2	43%	5	-1
Mining royalty	192	57	30%	118	-74
Gambling tax	53	33	62%	64	11
Other taxes and payments	25	20	80%	51	26
Road toll	549	298	54%	599	50
Other centralised revenues	146	65	45%	147	1
Income tax on energy providers	514	189	37%	327	-187
Company car tax	81	40	49%	80	-1
Retail tax	250	31	12%	278	28
Tax on pharmaceutical manufacturers	17	11	64%	42	25
Rehabilitation contribution	174	88	51%	190	16
Carbon dioxide quota tax	0	38	-	72	72
Consumption taxes	**11,041**	**4,742**	**43%**	**10,146**	**-895**
Value added tax	8,574	3,537	41%	7,603	-971
Excise duties	1,678	747	45%	1,583	-95
Motor vehicle registration duty	18	8	44%	21	3
Telecommunication tax	96	81	85%	120	24
Financial transaction levy	348	172	49%	429	80
Insurance tax	234	144	61%	274	40
Airline tax	39	16	42%	35	-4
Tourism development contribution	55	36	66%	82	27
Payments by households	**4,857**	**2,392**	**49%**	**4,875**	**18**
Personal income tax	4,476	2,173	49%	4,515	39
Duties, other taxes	280	127	45%	262	-18
Motor vehicle tax	100	91	90%	98	-2
Tax and contribution rev's of extra-budgetary funds	**574**	**299**	**52%**	**585**	**11**
Tax and contribution rev's of social security funds	**7,818**	**3,900**	**50%**	**7,877**	**58**
Social contribution tax and contributions	7,584	3,777	50%	7,624	40
Other contributions and taxes	234	123	53%	253	19
EU RELATED REVENUES	**2,518**	**593**	**24%**	**1,264**	**-1,255**
OTHER REVENUES	**1,227**	**770**	**63%**	**1,489**	**262**
Revenues related to public asset management	**384**	**180**	**47%**	**493**	**109**
Other revenues of the central budget	**687**	**520**	**76%**	**833**	**146**
Other revenues of social security funds	**45**	**28**	**61%**	**53**	**8**
Other revenues of extra-budgetary funds	**111**	**42**	**38%**	**111**	**0**
TOTAL REVENUES	**31,794**	**14,540**	**46%**	**29,950**	**-1,844**

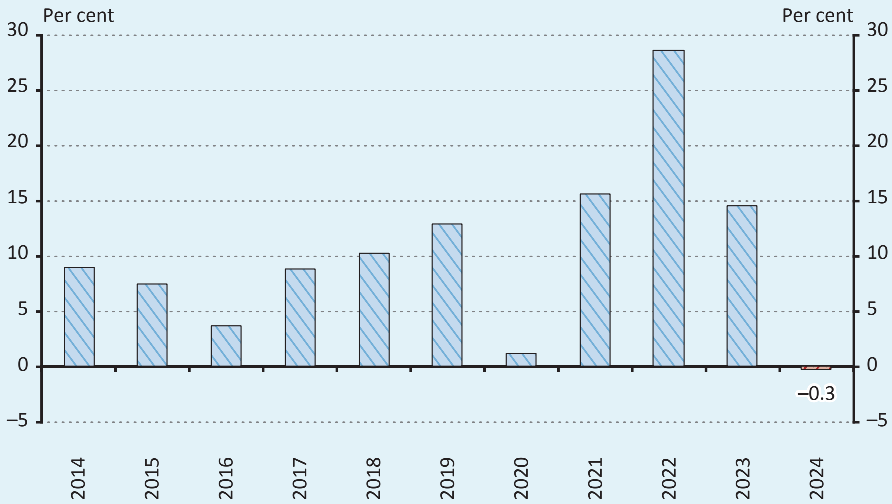
Note: Partially consolidated data: the fiscal impact of the revenues and expenditures within the general government central sub-sector are stated in net terms.

Source: Hungarian State Treasury, 2024 Budget Act, MNB September 2024 Inflation Report

The expected revenues from the **lump sum tax of small entrepreneurs** (KATA) may fall short of the Budget Act's target by HUF 10 billion. The variation may be due to differences in the estimates of the number of taxpayers. During the first six months of the year, the revenue from the lump sum tax of small entrepreneurs amounted to HUF 33 billion, HUF 3 billion less than the first six months of the previous year. In the case of the **tax of small enterprises** (KIVA), revenues are expected to be HUF 8 billion lower than the Budget Act's estimate due to macroeconomic conditions. During the first six months, HUF 102 billion in KIVA revenues were collected, HUF 15 billion more than in H1 2023. Revenues from the **rehabilitation contribution** could be HUF 16 billion higher than the corresponding appropriation in 2024, according to our forecast, as a result of macroeconomic developments that deviate from the Budget Act. In six months, taxpayers paid HUF 88 billion in contributions, HUF 10 billion more than in the same period last year. **Gambling tax** revenues could be HUF 11 billion higher than the appropriation. By the end of June, HUF 33 billion had been received by the budget from this item, exceeding the cumulative revenues for the first six months of 2023 by HUF 6 billion. **Other revenues** from economic organisations could exceed the relevant appropriations by HUF 26 billion, due to a base effect. By the end of June, HUF 20 billion had been paid into the budget under this heading, HUF 5 billion more than in the first six months of the previous year.

Other centralised revenue may develop in accordance with the appropriation. Within this line, the revenue from fines could be HUF 9 billion higher than budgeted. Revenue from product charges could be HUF 6 billion lower than the appropriation. The so-called extended producers' responsibility (EPR) fees introduced from July 2023 reduce product fee payments. Therefore, product fee revenue decreased by HUF 21 billion in H1 2024 compared to the first six months of 2023. Between January and June 2024, HUF 65 billion in revenue from this group of revenues was paid into the Treasury, HUF 11 billion less than in the same period last year.

Chart 17
Growth dynamics of gross VAT revenues in the first six months compared to the same period of the previous year



Source: Hungarian State Treasury

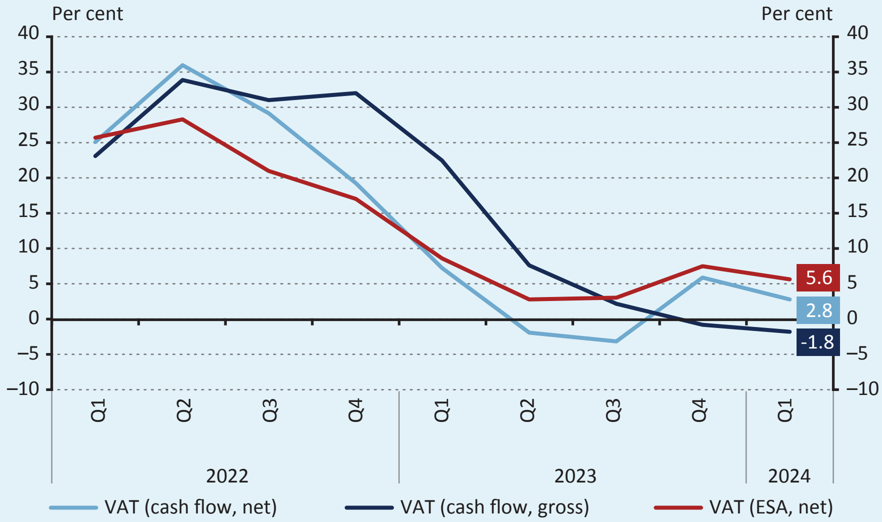
Net cash revenues from **value added tax** are expected to reach HUF 7,603 billion in 2024, HUF 971 billion below the budget adopted last year. **Gross VAT revenues** in the first half of the year fell by an average of 0.3 per cent year-on-year in the first half of the year, the worst first-half dynamics in the last ten years (Chart 17). In the first half of the year, 41 per cent of the target was met, which is expected to lead to a significant under-performance of the annual budgetary target. In the first six months of the year, **net VAT revenues** exceeded 2023 revenues by 6.3 per cent, or HUF 209 billion. The low level of net VAT revenues is partly due to higher-than-expected refunds and partly to stagnation in the growth dynamics of gross revenues.

Box 1
Factors explaining the evolution of VAT revenues in 2023 and Q1 2024

VAT revenue growth fell sharply in 2023 after a dynamic increase in the previous year, and revenues have not recovered in the first half of this year. Last year, high inflation (17.6 per cent) led to a decline in nominal retail sales and in the growth dynamics of consumption, which significantly reduced consumption tax revenues. Net cash revenues from VAT increased by only 2 per cent last year, leaving a revenue shortfall of around HUF 1,000 billion in 2023. The change in the structure of consumption has contributed significantly to this: consumption of products with a high VAT rate (fuel, durable goods) has fallen compared to foodstuffs with a lower effective VAT rate. Public investment as a share of GDP, which also represents part of the VAT base, declined substantially in 2023, while nominal investment expenditure fell in the first half of last year compared with the same period in the year before. The phaseout of the home improvement subsidy until the end of 2022 may have contributed to last year's decline. Net cash-based VAT revenues grew by 6.3 per cent in the first half of this year, which means that the shortfall from the statutory target could be close to HUF 1,000 billion in 2024.

The evolution of VAT revenues in Q1 2024, based on different revenue data, showed a mixed picture. Although gross cash-based revenues from VAT decreased by 1.8 per cent in Q1 2024 compared to the same period last year, net cash-based revenues increased by 2.8 per cent and net accrual-based VAT revenues increased by 5.6 per cent (Chart 18).

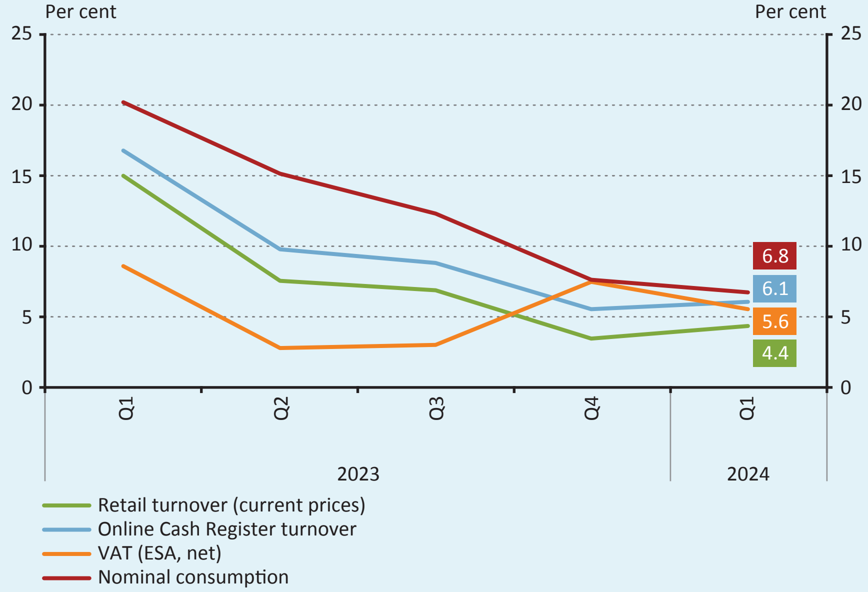
Chart 18
The development of gross and net cash-based VAT revenues and net accrual VAT revenues



Source: Hungarian State Treasury, HCSO

When comparing with macroeconomic trends, the primary focus should be on accrual-based VAT revenues, whose 5.6 per cent increase in Q1 2024 was broadly in line with the 4.4 per cent increase in nominal retail sales, while slightly below the 6.8 per cent nominal increase in household final consumption expenditure (Chart 19). When analysing the divergence, it should be borne in mind that household consumption is not the only source of VAT revenues. Although the vast majority of revenues (80 to 85 per cent) come from VAT paid on household consumption, a smaller share (15 to 18 per cent) comes from investment and consumption of the government and 1 per cent from household investment.

Chart 19
Development of macroeconomic data, net accrual VAT revenues and OCR turnover



Source: Hungarian State Treasury, HCSO

This year, the divergence between the dynamics of VAT revenues and household final consumption expenditure in Hungary may have been driven by declining government expenditure on material and capital expenditure, as well as rising purchases abroad. Public material expenses at current prices fell by 3 per cent and public investment by 7 per cent in Q1 2024 compared with the same period of the previous year, which also reduced VAT revenues. In addition, the first quarter saw a continuation of last year's upward trend, when, according to the HCSO, Hungarians spent HUF 500 billion more on their trips abroad than in 2022. The amount spent on trips specifically to buy goods and services increased by 70 per cent in 2023 compared to the previous year and also increased by 70 per cent in Q1 2024 compared to the same period in the previous year.

Net cash-based VAT revenues grew at a slower pace than accrual-based VAT revenues, by only 2.8 per cent in Q1 2024. The slower growth is due to the fact that accrual VAT revenues take into account VAT revenues and refunds for a given period, while cash VAT revenues show the macroeconomic flows of a period with a time lag due to the timing of payments and refunds. The growth in cash VAT revenues shows the growth in accrual VAT revenues due to the increase in household consumption with some delay. Therefore, the cash data still partly reflect the results of Q4 2023, a period of higher inflation and lower consumption. On the other hand, accrual VAT data are only available 90 days after the end of the quarter.

The worst picture is the 1.8 per cent decline in gross cash-based VAT revenues in the first quarter. This was due to the fact that VAT on intermediate consumption, presumably linked to developments in the energy market, decreased significantly compared to the beginning of 2023. Thus, the amount of tax refunds started to decrease at the beginning of 2024, resulting in a higher net VAT collection dynamic than gross revenues.

Excise duty revenues are expected to reach HUF 1,583 billion in 2024, which is HUF 95 billion below the statutory target 45 per cent of the budget's target has been met by June, so we expect to underperform the annual target in 2024. From 1 January, the excise duty on petrol and diesel increased by HUF 32.55 per litre, so the excise duty content of a litre of petrol is HUF 152.55 and a litre of diesel HUF 142.9. The impact of the HUF 32 per litre increase could increase excise duty and VAT revenues by a total of HUF 150 to 180 billion this year.

Telecommunication tax revenue could reach around HUF 120 billion in 2024, HUF 24 billion above the forecast. Behind the upturn is a higher-than-expected additional windfall profit tax, which will be phased out next year.

Revenues from the **financial transaction levy** are forecast to reach around HUF 429 billion in 2024, some HUF 95 billion above last year's revenues and HUF 80 billion above the statutory appropriation. In the first six months of the year, 49 per cent of the target was met. As part of the consolidation measures announced in July, an accrual income of HUF 92 billion may be received this year, for which the cash revenues may be HUF 15 to 20 billion lower.

Insurance tax revenue is expected to reach HUF 274 billion this year, HUF 40 billion more than the amount planned in the 2024 Budget Act. The difference is due to the over-execution of the surtax introduced in 2022.

Under the **airline tax** revenue heading, HUF 35 billion could be generated in 2024, HUF 4 billion less than budgeted. This tax will be phased out next year.

The **tourism development contribution** revenue is expected to reach HUF 82 billion in 2024, HUF 27 billion more than the amount planned in the Budget Act. In addition to food services, the 4 per cent tax rate was extended to accommodation services from 2020, while its VAT rate was reduced to 5 per cent. 2024 could be the first full year in which these sectors are not exempted from the levy, as accommodation and restaurants were exempted between May 2020 and December 2021 and between October 2022 and March 2023.

We forecast that the budget appropriation for **personal income tax** will be met in 2024. Revenue is expected to be HUF 39 billion higher than the statutory expectation of HUF 4,476 billion, almost half of which was received by the end of June. Gross tax revenues rose by 13.6 per cent in the first six months of the year compared to the first half of last year, while net revenues increased by 13.5 per cent due to a slightly higher dynamic of refunds. This year, the intra-year distribution of personal income tax revenues was affected by the introduction of quarterly tax returns for fringe benefits.

This year, HUF 262 billion is expected from **duties**, which is HUF 18 billion lower than the 2024 budget and HUF 21 billion higher than the 2023 revenue. In the first six months of the year, 45 per cent of the target was met, just HUF 4 billion more than in the same period last year. The subdued housing market in 2023 is expected to reverse this year, but its impact on duty revenues will be delayed.

The combined **tax and contribution revenues of extra-budgetary and social security funds** are projected to exceed the Budget Act's target by around HUF 69 billion. Based on our forecast, social contribution tax revenue is projected to be some HUF 46 billion lower, while the expected amount of employees' social security contributions this year could be HUF 94 billion higher than the statutory appropriation. Social contribution tax revenues increased by 14.5 per cent in the first half of this year, while social security contribution revenues grew by 14.9 per cent compared to the same period last year. This year's social contribution tax revenues will be only minimally affected by the two new measures with regards to the tax allowance concerning labour market entrants with employment contracts starting in August: the eligibility criteria for the allowance will be more stringent, and the duration of the allowance will be halved.

The *public due on simplified employment* and the revenue from *the public health product tax* could exceed the budgeted expectation by around HUF 15 billion. *Payments from pharmaceutical manufacturers and distributors* could be nearly HUF 30 billion higher than the statutory appropriation, partly due to payments from contracted pharmaceutical manufacturers and distributors and partly due to payments from pharmaceutical manufacturers and distributors that ensure the continuous supply of medicines, which will reduce the net expenditure of the pharmaceutical budget.

EU revenues amounted to HUF 593 billion in the first half of the year, down by nearly HUF 180 billion compared to the first six months of last year. Our annual expectation is substantially lower than the forecast, at HUF 1,264 billion by 2024, partly due to the facts and partly due to the constraints and risks that still surround the absorption of EU funds. Of the revenues from first half of the year, around HUF 300 billion was related to the 2021–2027 Cohesion Funds, and more than HUF 120 billion was related to rural development programmes. HUF 53 billion of REPowerEU advances from RRF funding were received in the first half of this year. Just over HUF 90 billion of the revenue is linked to technical revenue from centrally managed appropriations, such as repayments to beneficiaries. Hungary received nearly HUF 15 billion in the first half of the year to reimburse customs collection costs.

Revenues related to public asset management (revenues from real estate, movable property, dividends, other revenues) are forecast to be around HUF 493 billion in 2024, HUF 109 billion higher than the statutory target. In the first six months of the year, 47 per cent of the target was met, which is HUF 157 billion lower than in the same period last year. The expected overachievement is caused by the increase in income related to the exercise of ownership rights.

Box 2
July 2024 budgetary measures and their budgetary impact

The consolidation measures announced in early July could lead to an adjustment of around 0.6 per cent of GDP in 2024 and 0.7 per cent of GDP in 2025, depending on expenditure savings. Together with the measures announced this spring, the government has increased the budget's room for manoeuvre in 2024 by about HUF 1,000 billion as a whole. However, some details of the budgetary measures are not yet known.

This year, in addition to the transfer to the Central Residue Settlement Fund, more revenue measures will be implemented, and in 2025 only the revenue side will be affected by the adjustment. The vast majority of the revenue measures, HUF 150 billion in 2024 and HUF 610 billion in 2025, are linked to tax measures, with additional revenue measures of HUF 20 billion and HUF 70 billion per year respectively (Table 8). In addition to deficit-reducing measures, smaller tax and expenditure reliefs are implemented. These could include the abolition of the airline tax from 2025 and a uniform extension of the deadline for the birth of the first child for families taking out a prenatal baby support loan between July 2019 and June 2021 until 1 July 2026.

In July, an investment of HUF 369 billion has been transferred to the Central Residue Settlement Fund, part of which has already been used in July and August. This measure will lead to an improvement in the deficit if the redeployed funds are not used. There are no known measures on the expenditure side for 2025.

Table 8
Budgetary impact of new revenue and expenditure measures announced in July 2024

Measure	Budgetary impact (HUF billions)	
	2024	2025
Tax revenues	**146**	**606**
Financial transaction levy	92	230
Windfall tax on financial institutions	40	140
Retail tax	0	130
Income tax on energy providers	14	83
Airline tax	0	-37
Insurance tax	0	60
Other revenue measures	**17**	**70**
Inflation adjustment of electronic road toll	0	22
Job Protection Action Plan	2	8
Tax and administrative fines	15	40
Expenditures	**343**	**-53**
Postponement of prenatal baby support deadlines	-26	-53
Rearrangement of expenditures	369	0
Total	**506**	**623**
As a percentage of GDP	**0.6**	**0.7**

Source: Government announcements, MNB calculation

Details of the measures

Tax measures:

1. **The increase in the financial transaction levy rates, which came into force from 1 August, could lead to an additional HUF 85 billion in tax revenues this year and HUF 200 billion in 2025.** The financial transaction levy rates of 0.3 and 0.6 per cent were increased to 0.45 and 0.9 per cent, and the upper limit of the tax was raised from HUF 10,000 to HUF 20,000. For retail transfers, the exemption limit increased from HUF 20,000 to HUF 50,000. The annual fee for credit card purchases remained unchanged, and the fee-free status for retail "Qvik" (QR code and payment request) transfer services will also remain.

2. **The introduction of the additional financial transaction levy on foreign exchange conversion operations from 1 October could raise around HUF 7 billion this year and HUF 30 billion in 2025.** The additional financial transaction levy is 0.45 per cent, capped at HUF 20,000. The additional levy is also payable on transactions made between accounts held with the same service provider if the payer and the payee are the same person.

3. **In the case of the tax of financial institutions, the tax relief on the purchase of government securities has been tightened, which we estimate could generate HUF 40 billion in additional revenue in 2024.** From 1 August 2024, the benefit will only be available if not only does the credit institution's stock of government securities that mature after 1 January 2027, but its total stock of government securities increases between 1 January and 30 November. The extent of the additional revenue is significantly influenced by the reaction of taxpayers to the measure.

4. **In the case of the income tax on energy providers, the rebate on the windfall profit tax on oil price differentials (Brent-Ural) reduced from 1 August, leading to an increase in revenue of HUF 14 billion in 2024 and HUF 43 billion in 2025.** From the summer of 2023 until 1 August 2024, the first $7.50 of the difference was tax-free for each barrel. This rebate will be reduced to $5 per barrel for the last five months of this year and for 2025.

5. **The windfall profit tax originally planned to be phased out for financial institutions, insurance companies, energy provider companies and retail operators will remain in place in 2025.** The extension could increase revenues by HUF 140 billion in 2025 for financial institutions, HUF 60 billion for insurance companies, HUF 40 billion for energy providers and HUF 130 billion for the retail sector.

6. **Tax on airlines is announced to be abolished from January 2025.** The phasing out will reduce revenues by HUF 37 billion in 2025.

Other revenue measures:

7. **From next year, automatic inflation indexing of electronic road tolls will be introduced, which could generate an additional HUF 22 billion in revenue in 2025.** Under the measure, tolls will increase automatically on 1 January each year, in line with the consumer price index for August of the previous year.

8. **For the tax benefits in the Job Protection Action Plan, the allowance for labour market entrants will be tightened and their duration reduced. The measure will have its first significant budgetary impact in the last quarter of 2025, with a full-year impact of around HUF 30 billion in 2026.** Until the change, the allowance was available to those who had been in eligible for social security services for no more than three months out of the previous three quarters. The measure increases the prior period under review to a full year. The duration of the allowance will be reduced from 2+1 years (full exemption up to the minimum wage, then half) to 1+0.5 years for employment contracts established beginning in August 2024.

9. **The increase in tax and administrative fines will mean additional revenue of HUF 15 billion in 2024 and HUF 40 billion in 2025, depending on the fining practices of the tax administration.** In some cases, the maximum rates payable have increased several times over.

Measures on the expenditure side:

1. **For families having taken out a prenatal baby support loan between July 2019 and June 2021, the deadline for the birth of the first child will be extended uniformly until 1 July 2026, which, according to our calculations, could increase the budget deficit by HUF 26 billion in 2024, by up to HUF 53 billion in 2025 and by HUF 37 billion in H1 2026.** The original deadline was 5 years, so for families who received support in 2019, the deadline for having children would expire this year, after which families who did not have children would have to repay the interest subsidy they had received to the state. The impact of the measure has two components: households that do not meet the condition of having children do not have to repay the interest subsidy, while the state continues to pay it on the contracts covered by the measure until the end of the extended period. As the previous rules will apply again after the extended deadline, the effect of the measure is temporary.

2. **In July, an investment of HUF 369 billion has been transferred to the Central Residue Settlement Fund, part of which has already been used in July and August.** The actual balance impact of expenditure-saving measures depends on future action.

3.4 CASH-BASED EXPENDITURES OF THE CENTRAL SUB-SECTOR

Cash expenditure of the central government sub-sector is projected to be in line with the budget in 2024. Expenditure on EU funds is expected to be HUF 1,300 billion below plan. This is partly offset by expected additional expenditure on public asset management and other expenditure, and higher-than-planned interest and pension expenditure. Savings could result from the transfer of investment and capital formation expenditure announced as part of the July consolidation measures to the Central Residue Settlement Fund.

The combined statutory appropriation for the **state transport and utility services** subsidy is HUF 2,074 billion, while our forecast is for HUF 72 billion less. Expenditures reached HUF 1,178 billion by the end of the first half of the year. The full-year statutory appropriation for **public transport services** amounts to HUF 784 billion, which was met pro-rata by the end of June. The budget for **subsidies for public utility services** is HUF 917 billion, while expenditure in the first half of the year was HUF 598 billion, 65 per cent of the statutory allocation. This appropriation is intended to cover the budget subsidy for household utility services. Despite the higher-than-projected expenditure execution, we expect annual savings of HUF 72 billion compared to the target. The savings have two components: on the one hand, we calculate that district heating companies received the full annual compensation from the budget in the first half of the year, so this cost will no longer be charged in the second half of the year, and on the other hand, natural gas prices may be lower than assumed in the budget planning, so we expect a reduced price support in the second half of the year.

We forecast that expenditure **on housing subsidies** could exceed the HUF 182 billion target by HUF 9 billion, mainly due to expenditure related to the new Home Improvement Programme available from 1 July 2024. Under the programme, a total of HUF 6 million in non-refundable subsidies and interest-free loans can be applied for the energy modernisation of houses that received an occupancy permit before 31 December 1990. Within this amount, the loan and the subsidy can be HUF 2.5, 3 or 3.5 million, depending on the level of development of the region and the per capita income of the applicant households. Subsidies related to the HPS and Preferential Settlements could fall below HUF 70 billion again after 2016, while obligation to pay interest on a number of different entitlements could exceed HUF 50 billion, as in the previous year. The value of state support for the already discontinued savings in the form of building society funds (LTP) is steadily decreasing and is expected to fall below HUF 20 billion in 2024. The moderation in expenditure related to mortgage debt cancellation for parents with three or more children is expected to continue in 2024, so we expect expenditure to remain below HUF 20 billion.

The **National Family and Social Policy Fund** expenditure estimates and our expectations are in line for most of the items. The Budget Act set the expenditure of the Fund at HUF 772 billion, of which HUF 400 billion (52 per cent of the appropriation) was paid out in the first half of the year. The expenditure of more than 50 per cent of the appropriations is mainly explained by the fact that expenditures for start-up grants are typically concentrated in the first half of the year. Family allowances account for more than 40 per cent of the expenditure foreseen for the Fund, representing an expenditure of HUF 153 billion (50 per cent of the allocation) in H1 2024. We forecast that expenditure could exceed the target by around HUF 3 billion, mainly due to the spillover effect of the additional increase in early retirement benefits and income support and income supplementary social allowances last November, which was not yet decided when the 2024 budget was adopted.

The net own expenditure of central budgetary organisations and chapters could reach HUF 10,269 billion by the end of the year, which could be HUF 866 billion higher than the statutory appropriations. The net expenditure of the central budgetary bodies amounted to HUF 4,775 billion at the end of the first half of the year, which is 51 per cent of the statutory appropriation. Spending in line with the target shows the government's tight control over expenditures. However, for the second half of the year, we expect expenditure to be above target. The expected overrun is mainly due to the use of a larger part of the reserve appropriations in the institutions and the chapters.

Revenues of budgetary bodies and **payments from budgetary organisations** directly to the central budget amounted to HUF 1,831 billion in the first six months of the year. Thus, the revenue of the chapters, the Central Residue Settlement Fund, and the direct payments from the budget chapters to the central budget were 93 per cent of the annual appropriations. The difference on the revenue side is partly explained by the fact that the Budget Act did not include an appropriation for the revenues of the Central Residue Settlement Fund and the Savings Fund. By the end of June, HUF 144 billion had been paid into the Central Residue Settlement Fund, while no payments had been made to the Savings Fund. The residual amount paid into the funds decreased by HUF 199 billion compared to the same period last year, which indicates that the year-on-year decreasing trend of unobligated appropriations residuals has continued.

The **gross expenditure of budgetary institutions and chapters** in the first half of the year totalled HUF 6,606 billion, reaching 58 per cent of the statutory appropriation. The impact of government measures to curb capital formation spending is already visible in the evolution of investment spending, which has also fallen in nominal terms compared to the base period, a sharp decline in real terms.

Gross expenditure of **budgetary institutions** amounted to HUF 4,194 billion in the first half of the year. The structure of expenditure shows that wage measures are increasing the share of wage costs in expenditure. In the first six months of the year, 57 per cent of total expenditure was spent on wage costs, 24 per cent on material expenses and 11 per cent on other operating expenditure. The share of investment and renovation expenditure also decreased in H1 2024, with institutions spending 7 per cent of their expenditure on such expenditures.

The total expenditure of **chapter-administered appropriations** for the first half of the year was HUF 2,412 billion, 58 per cent of the statutory appropriations. The structure of expenditure shows that the share of expenditures for operating purposes has increased at the expense of subsidies for capital formation purposes. Operating expenditures accounted for more than two-thirds of expenditure by chapter managers, with 68 per cent of total expenditure for this type of purpose. In contrast, expenditures on capital formation fell to 25 per cent. We expect a dynamic increase in the share of capital expenditure in the second half of the year, as the Defence Fund's development appropriations were under-utilised in the first half.

The execution of **central budget appropriations for capital formation and investment**, excluding projects from EU programmes, reached 31 per cent of the adjusted appropriations at the end of the first half of the year. The adopted Budget Act contained an appropriation of HUF 2,549 billion for the central budget for expenditure on capital formation. Following the adoption of the Budget Act, the increase in the cost of certain projects and the government's investment decisions in the meantime have led to an increase in the appropriations for investment and capital formation by HUF 1,003 billion to HUF 3,552 billion by the end of June, excluding projects receiving EU subsidies. The cumulative cash expenditure at the end of June was HUF 1,090 billion. At the end of the first half of the year, own-resource appropriations for capital formation and investment amounted to 4.3 per cent of GDP. Adding to this the EU-funded capital formation expenditure and the expected capital formation expenditure of other sub-sectors of the general government, we expect a higher-than-targeted value as a percentage of GDP.

EU spending closed at HUF 946 billion in the first half of the year, down significantly, by more than HUF 500 billion compared to the same period last year. The HUF 3,606 billion in appropriations is subject to substantial risks due to the withholding of RRF and cohesion funds, and we forecast that expenditures this year could be significantly, by more than HUF 1,300 billion below budget. More than a third of the expenditures, HUF 380 billion, were related to the Cohesion Operational Programmes 2021–2027, while RRF expenditures amounted to HUF 40 billion. Around HUF 330 billion was paid out for rural development and fisheries programmes, but there was also a significant spending of HUF 150 billion on the 2014–2020 Cohesion Operational Programmes.

For the **appropriation for support to local governments**, our forecast foresees the expenditure of HUF 1,270 billion in budget support, which is HUF 137 billion more than the statutory appropriation. The over-expenditure is due to transfers from reserve appropriations, mainly from the appropriations for reserve provisions to cover wage measures. In the first six months of the year, the budget spent HUF 632 billion on subsidies to local governments, which is 56 per cent of the statutory allocation. 50 per cent of our expected annual subsidies was paid by the end of the first half of the year. As subsidies for capital formation typically represent a higher share of the budget support structure in the second half of the year, our forecast includes a small risk of higher support.

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

	2024				
	Statutory appropriation	January-June completion	Percent of appropriation	MNB-forecast	Difference: MNB - appropriation
PRIMARY EXPENDITURES	**31,604**	**15,421**	**49%**	**31,297**	**-306**
State transport and utility services in total	**2,074**	**1,178**	**57%**	**2,002**	**-72**
Public service media service support in total	**126**	**63**	**50%**	**126**	**0**
Housing grants	**182**	**88**	**49%**	**191**	**9**
National Family and Social Policy Fund	**772**	**400**	**52%**	**775**	**3**
Other family benefits (Prenatal baby support, Student loan)	**255**	**114**	**45%**	**234**	**-21**
Net own expenditures of central budgetary organisations and chapters	**9,402**	**4,775**	**51%**	**10,269**	**866**
EU related expenditures	**3,606**	**946**	**26%**	**2,300**	**-1,306**
Support to local governments	**1,133**	**632**	**56%**	**1,270**	**137**
Contribution to the EU budget	**692**	**327**	**47%**	**651**	**-42**
Central reserves	**1,216**	**0**	**0%**	**76**	**-1,140**
Expenditures related to public asset management	**534**	**709**	**133%**	**942**	**408**
Other expenditures	**691**	**381**	**55%**	**1,206**	**514**
Expenditures of extra-budgetary funds	**635**	**293**	**46%**	**646**	**11**
NEF - Passive allowances	130	77	60%	173	43
NEF - Active allowances	125	68	54%	127	2
Other expenditures	380	147	39%	346	-34
Expenditures of social security funds	**10,286**	**5,515**	**54%**	**10,610**	**324**
PIF - Pensions	6,011	3,326	55%	6,205	195
HIF - Disability and rehabilitation benefits	391	215	55%	401	10
HIF - Cash benefits	825	371	45%	779	-46
HIF - Medical and preventive care	2,553	1,353	53%	2,722	169
HIF - Net expenditures of the drug budget	342	179	52%	358	15
Other expenditures	164	72	44%	145	-19
NET INTEREST EXPENDITURES	**2,705**	**1,776**	**66%**	**3,030**	**325**
TOTAL EXPENDITURES	**34,309**	**17,196**	**50%**	**34,327**	**18**
BALANCE	**-2,515**	**-2,656**	**106%**	**-4,377**	**-1,862**

Note: Partially consolidated data: the fiscal impact of the revenues and expenditures within the general government central sub-sector are stated in net terms.
Source: Hungarian State Treasury, 2024 Budget Act, MNB September 2024 Inflation Report

Our current forecast for the **contribution to the EU budget** is HUF 651 billion in expenditure. The statutory appropriation is HUF 692 billion, and the expected saving of HUF 42 billion is due to lower-than-planned GNI growth in 2023. In the first six months of the year, HUF 327 billion was spent on this expenditure item, which is 47 per cent of the appropriations of the Budget Act.

The **central reserve appropriations** of the Budget Act together contain a total reserve of HUF 1,216 billion, of which the government had used HUF 930 billion by the end of June. Of the unused reserve appropriations, HUF 172 billion was set aside in the Investment Fund, and the utilisation of the reserve for extraordinary government measures was close to 40 per cent, in line with the legal obligation. At the same time, expenditures from the top-up reserve provisions set aside for wage measures exceeded the target by HUF 29 billion by the end of June.

Expenditure on public asset management reached HUF 709 billion at the end of June, 133 per cent of the budget. We forecast that by the end of the year, public asset management expenditure could reach HUF 942 billion, HUF 408 billion higher than the statutory target. The over-execution of expenditure is largely due to the acquisition of Budapest Liszt Ferenc International Airport.

The statutory appropriation for **other expenditure** is HUF 697 billion, while our forecast is HUF 1,206 billion. Total expenditure in the first six months of the year was HUF 381 billion, which represents a 55 per cent execution rate. The forecast above the statutory appropriation is mainly due to the expected costs of implementing government measures for economic purposes (subsidies to economic organisations, measures affecting the state investment chapter) taken after the adoption of the Budget Act.

Our projection for the **balance of extra-budgetary funds** consolidated with the central budget is essentially the same as the balance in the Budget Act. **Expenditure on** the **funds** could exceed the budget by around HUF 11 billion. Within this, the National Employment Fund (NFA) passive expenditure (job-seeking benefits) could be some HUF 43 billion higher than the target, while the National Research, Development and Innovation Fund could be under-executed by HUF 20 billion. In the first half of the year, passive expenditure amounted to 60 per cent of the appropriations, but this expenditure is typically concentrated in the second half of the year. The NFA's EU pre-financing and co-financing expenditure reached 21 per cent of the annual appropriation in the first half of the year and could fall short of this by a total of HUF 23 billion in 2024 as a whole. **Fund revenues** in total could exceed the statutory appropriations by HUF 11 billion, mainly can be explained by the almost HUF 21 billion higher amount of central budgetary subsidies.

We expect the central sub-sector's **expenditure on the Start labour programme** to be around HUF 127 billion by the end of the year, in line with the statutory target. In the first half of 2024, spending under the Work Programme was HUF 9 billion higher than in the same period last year.

Consolidated **expenditure of the social security funds** is projected to reach 10,610 billion in 2024, which is HUF 324 billion (3 per cent) higher than the appropriations of the Budget Act for the current year. The bulk of the expenditure over-execution is related to the spillover effect of the 3.1 per cent additional pension increase in November 2023 and the increase in operating subsidies to healthcare institutions. Partially consolidated expenditure of social security funds totalled HUF 5,515 billion by the end of June 2024, which corresponds to 54 per cent of the appropriations for the current year. For pensions and pension-like benefits, the expenditures made reached 55 per cent of the appropriations in June 2024, which was about the same as expected for this period due to the expenditure of the 13th month pensions in February. The balance of the drug budget and expenditure on medical and preventive care benefits was higher than the amount expected over time in the first six months of 2024, while expenditure on cash benefits was below the level expected over time.

Table 10
Developments of the expenditure on pensions and pension-like benefits in the first halves of 2023 and of 2024

	2023	2024	Difference
I. Pension Fund	**2,999**	**3,326**	**327**
1. Old-age pensions	2,303	2,563	260
1.1 Old-age pensions over the retirement age	2,085	2,330	245
1.2 Early retirement benefit for women	217	233	16
2. Retirement provision to relatives	263	284	21
2.1 Orphan's pension	24	26	2
2.2 Widow's pension	239	258	19
3. One-time subsidy	0	0	0
4. Provision for pension premium	0	0	0
5. 13th-month pension	425	471	47
Unaccounted pension expenditure	*8*	*8*	*0*
II. Early retirement benefits	**67**	**69**	**1**
III. Disability and rehabilitation benefits	**200**	**215**	**15**
Total pensions and pension-like benefits	**3,266**	**3,609**	**343**

Source: 2024 Budget Act, Hungarian State Treasury, MNB

Pension benefits paid from the Pension Insurance Fund are projected to be HUF 6,205 billion in 2024, which is HUF 195 billion more than the appropriations. The higher pension expenditure is mainly explained by higher inflation in 2023 than assumed in the budget planning, which led to a 3.1 per cent additional pension increase in November 2023, the impact of which was also incorporated in the base used for the 6 per cent indexation in January 2024. Cumulative expenditure in H1 2024 was HUF 3,326 billion, HUF 327 billion (11 per cent) higher than in the same period last year, mainly due to the pension increases mentioned above (Table 10). The additional expenditure aside from the pension increases is partly explained by the fact that the newly established benefits are on average usually higher than the amount of the previously established pensions, due to the increasing valorisation multiplier resulting from the strong wage dynamics, and the replacement effect also results in the increase in benefits. In addition, the increase in expenditure was driven by a higher average number of pensioners in H1 2024 compared to the same period in the previous year.

No additional pension increases are expected this year, as the 6 per cent indexation in January 2024, based on previous government expectations, is significantly higher than the midpoint of the latest inflation forecast band of the MNB (September 2024 Inflation Report), by about 2.3 percentage points. Presumably, the HUF 20.5 billion **pension premium** planned for this year will not be paid either, because according to our current expectations, the real growth of over 3.5 percent set as a condition for it will not be realised.

Within the benefits paid from the Fund, the expenditure related to **old-age pension benefits** could amount to HUF 4,695 billion, which could exceed the target by nearly HUF 173 billion (more than 3 per cent) in 2024 primarily due to the supplementary pension increase in November 2023. Following the completion of the phased increase in the retirement age in 2022, the number of beneficiaries is again on the rise, with nearly 11,900 more people receiving old-age pension benefits in June 2024 than in the same period of the previous year. In addition, due to the strong wage dynamics in previous years, initial benefits are determined using higher valorisation multipliers, which also contributes to the increase in expenditure. Cumulative expenditure in H1 2024 was HUF 2,330 billion, which is 12 per cent higher than the amount paid in the same period in 2023.

Expenditure on benefits for those retiring with the benefit of the **40-year eligibility period for women** could amount to HUF 465 billion in 2024, which is almost HUF 3 billion (almost 1 per cent) below the forecast. Following the end of the retirement age limit increase in 2022, the number of people receiving preferential benefits started to fall as the 65-year age limit was gradually used again with people reaching the retirement age and was 6,300 lower in June 2024 than in the same month of the previous year. The half-yearly cumulative expenditure on preferential benefits was HUF 233 billion in 2024, an increase of 7 per cent compared to the same period last year.

Expenditure on **retirement provisions to relatives** could amount to HUF 567 billion in 2024, which is nearly HUF 16 billion (3 per cent) more than the appropriations. Within the difference, nearly HUF 15 billion is related to widow's pensions and another more than HUF 1 billion to orphan's pensions. The cumulative amount of expenditure was nearly HUF 384 billion in H1 2024, which is 8 per cent higher than in the same period last year. The number of people receiving widow's benefits was nearly 8,000 fewer in June 2024 than a year earlier, while the number of people receiving orphan's benefits was nearly 800 fewer.

Expenditure on **pension and pension-like benefits** (pension benefits, early retirement benefits, disability, and rehabilitation benefits) is projected to total HUF 6,731 billion in 2024, which could be almost HUF 189 billion higher than the appropriations, mainly due to the spillover effects of the 3.1 per cent additional pension increase in November 2023. Expenditure by June 2024 are HUF 343 billion (11 per cent) higher than the amount paid out in the same period last year.

Consolidated expenditure of the **Health Insurance Fund** could exceed the HUF 4,266 billion budget by HUF 130 billion. Expenditure on cash benefits paid from the Fund may be below the target, which may be linked to lower utilisation than assumed at the time of the expectations on which the budget was based. Net expenditure on medical and preventive care benefits and the drug budget may exceed the appropriations, based on expenditure paid in the first six months. Expenditure reached HUF 2,185 billion at the end of June 2024, which is 50 per cent of the full year's planned expenditure.

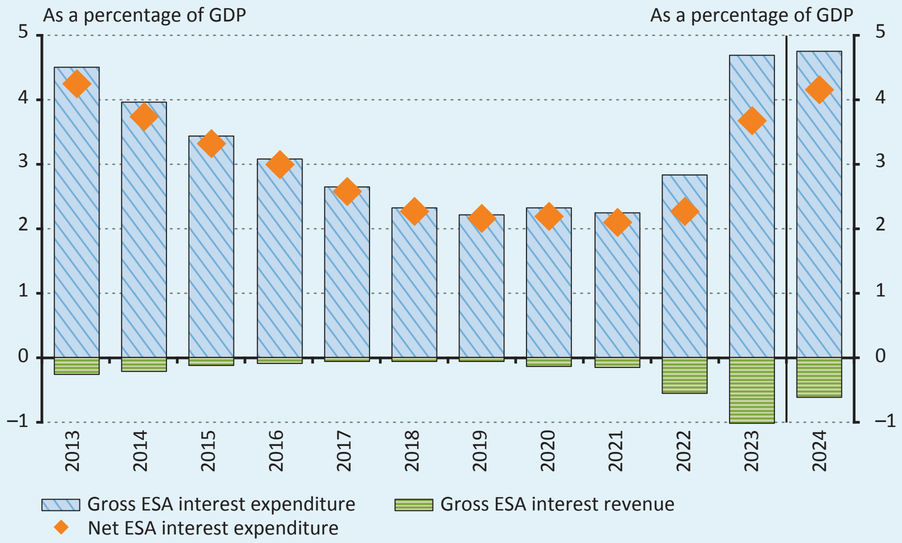
Expenditure on **medical and preventive care benefits** may exceed the 2024 target by HUF 169 billion, mainly as a result of an increase in operating subsidies to health care institutions. Expenditure in the first six months of 2024 amounted to HUF 1,353 billion, 53 per cent of the annual allocation. Medical and preventive care benefits increased significantly in the first half of the year, by HUF 233 billion in 2024 compared to the previous year. In the first six months of the year, the over-expenditure was mainly due to the two-stage salary increases for paramedical staff and healthcare professionals (from 1 July 2023 and 1 March 2024) and the increase in operating subsidies paid to healthcare institutions.

The **net expenditure of the drug budget** could exceed the target by HUF 15 billion, the difference being due to HUF 43 billion higher expenditure and HUF 27 billion higher revenue. The increase in expenditure is due to the assumption of higher annual expenditure than foreseen on the basis of the actual data. The expected revenue over-execution is due to higher revenues from pharmaceutical manufacturers and distributors. The net balance was HUF 179 billion at the end of June 2024, which corresponds to 52 per cent of the forecast.

Expenditure on cash benefits paid from the Health Insurance Fund could be HUF 46 billion below the target. **Infant care allowance** expenditure could be HUF 9 billion lower than planned, **sickness benefit** expenditure HUF 31 billion lower than planned, while **childcare and adoption allowance** expenditure could be HUF 7 billion lower than planned. The differences are mainly due to lower utilisation than assumed at the time of budgeting. Expenditure on cash benefits amounted to HUF 371 billion by June 2024, or 45 per cent of appropriations.

Disability and rehabilitation benefit expenditure is projected to reach HUF 401 billion in 2024, close to HUF 10 billion (2.5 per cent) higher than the target. The higher-than-estimated expenditure is mainly explained by the inclusion of disability and rehabilitation benefits in the additional pension increase implemented in November 2023. However, the impact of the increase in benefits is offset by a 7,900 decrease in the number of beneficiaries in June 2024 compared to the same month of the previous year. The gradual decline in the number of beneficiaries over the years is the consequence of the reclassification of beneficiaries reaching the age limit to the old-age pension and the lower number of new eligible persons. The cumulative amount of expenditure on disability and rehabilitation benefits reached nearly HUF 215 billion in H1 2024, which is HUF 15 billion (8 per cent) higher than the amount for the same period last year.

Chart 20
Development of accrual-based government interest expenditure as a percentage of GDP



Source: HCSO, MNB

Gross accrual-based interest expenditure is projected to rise to 4.8 per cent of GDP at the end of 2024 (Chart 20), well above the statutory target but broadly in line with the value contained in the Convergence Programme. Interest expenditure will remain high this year, mainly due to a high inflationary environment in 2023, and accrual-based interest expenditure is expected to moderate from next year. The interest expenditure on inflation-linked government bonds held by the public declines gradually as inflation falls, with a lag of one year for accrual-based interest expenditure and two years for cash interest expenditure. As in the previous two years, we expect an elevated level of interest revenue, resulting in a moderate increase in net interest expenditures. The increase in interest revenue is realised on the interest revenue of entities classified as government, in addition to the higher interest paid on debt management operations and liquid reserves by the MNB. The cumulative **net cash interest expenditure** from the beginning of the year was two-thirds of the full-year target in H1 2024, so the cumulative interest expenditure at the end of the year could exceed the target due to expected interest expenditure in the remaining half of the year. Our forecast is for net interest expenditure to be materially higher than the statutory appropriation, which is explained by our expectation of higher-than-appropriated revenues and our forecast of significantly higher gross interest expenditure.

3.5 BALANCE OF THE LOCAL GOVERNMENT SUB-SECTOR

The **cash balance of local governments** was planned in the Budget Act at HUF -165 billion, while our forecast foresees a cash surplus of HUF 22 billion by 2024. Compared to the balance assumed when the Budget Act was drafted, the better-than-planned surplus in local tax revenues, on the one hand, and the higher amount of subsidies received from the central budget, on the other, may result in a more favourable cash balance in the sub-sector. According to Q1 data, local governments closed the first three months of the year with a cash surplus of HUF 170 billion. Local government revenue from local business tax increased by more than 21 per cent compared to the same period last year. The weight of local business tax in the sub-sector's tax and tax-like revenues reached 62 per cent in Q1. In the first quarter of the year, local governments' material expenses increased by 5.4 per cent, while expenditure on wages and salaries grew dynamically by 15.1 per cent, while expenditures on investment and capital formation fell by more than 17 per cent compared to the same period last year. The combined effect of these factors resulted in a surplus of over HUF 170 billion by the end of March. We do not expect the low investment activity in the sub-sector to change significantly in H2, supporting a more favourable cash balance than assumed when the Budget Act was drafted.

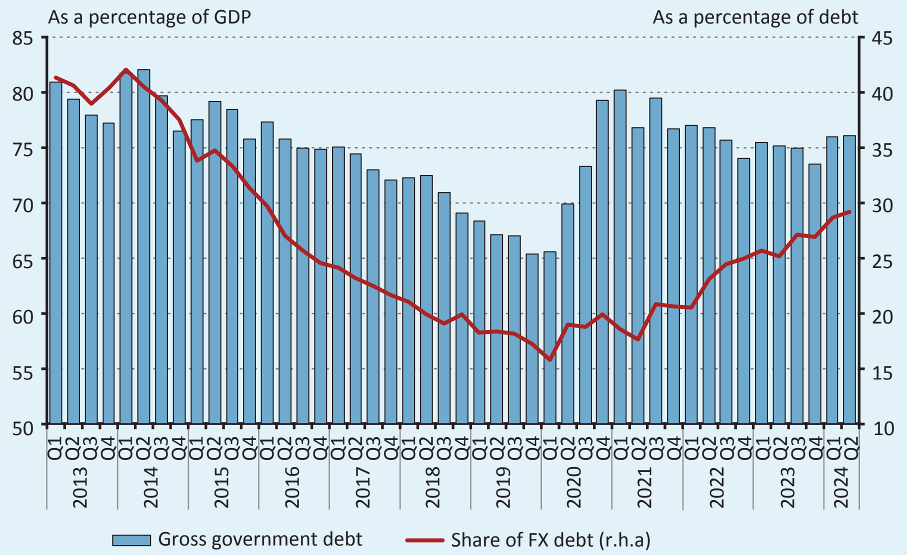
3.6 STATISTICAL CORRECTIONS (ESA BRIDGE)

The 2024 Budget Act set the balance of accrual-based statistical adjustments (ESA bridge) at 0.2 per cent of planned GDP (HUF 173 billion). We expect a statistical correction of 1.1 per cent of GDP by 2024. Compared to the statistical corrections expected when the Budget Act was adopted, the biggest change was in the statistical corrections related to public asset management. Statistical corrections related to advance expenditures for public asset purchases reduced ESA-accounted expenditure by 0.7 per cent of GDP compared to cash expenditure, i.e. the ESA bridge was increased by this amount in H1 2024. The statistical corrections to the EU accounts contribute an additional 0.3 per cent of GDP to the ESA balance to be more favourable than the cash balance. Together, the changes in interest and swap settlements increase net interest expenditure recorded in the accrual-based account by 0.1 per cent of GDP compared to net interest expenditure recorded in the cash account.

3.7 EXPECTED DEVELOPMENTS IN GOVERNMENT DEBT IN 2024

At the end of H1 2024, gross public debt as a percentage of GDP stood at 76.1 per cent (Chart 21). The debt ratio increased by 0.9 percentage points compared to the same period of the previous year and by 2.6 percentage points compared to the end-2023 value. The increase in the public debt was caused by the high net issuance of government securities, based on which the majority of the annual issuance was already fulfilled in the first half of the year. The FX ratio of central government debt rose to 28.7 per cent in Q1 2024 and to 29.2 per cent by the end of Q2, from 26.9 per cent at the end of last year, as a result of FX bond issuance.

Chart 21
Gross government debt as a percentage of GDP and the share of FX debt within the central government debt



Source: GDMA, MNB

We forecast that the gross public debt-to-GDP ratio will fall to 73.2 per cent by the end of 2024 from 73.5 per cent at the end of last year. At the same time, the continued decline of the national debt ratio in 2024 is surrounded by risks. This year, the reduction of the public debt ratio requires the fulfilment of a net output consistent with the cash flow deficit expectation in the April EDP notification, an adequate increase in nominal GDP, and a low level of central and non-central debt issuance in the second half of the year.

We project that in 2024, substantial FX issuance could result in an FX ratio of above 29 per cent of central government debt at the end of the year. Changes in the forint-euro exchange rate affect the debt ratio through the revaluation of foreign currency debt. The lower is the share of FX debt in government debt, the more modest is this effect. At present, a change of HUF 10 in the euro-forint exchange rate changes the government debt-to-GDP ratio by about 0.6 percentage points.

4 Compliance with the fiscal rules

The fiscal rules concerning Hungarian public finances underwent a major overhaul in the period 2023–2024. On the one hand, the temporary exemption until 2023 introduced in the transitional provisions of the Stability Act has been phased out for part of the rules in the Hungarian legal order, and on the other hand, the EU budgetary framework has undergone a substantial transformation (see 5.1 Special topic). The Hungarian fiscal rules still include the 3 per cent deficit criterion, the medium-term budgetary objective (MTO) requirement, and the debt rules of the Fundamental Law and the Stability Law, while the EU rules have made the net expenditure path the most important operational indicator, alongside the Maastricht 3 per cent deficit and 60 per cent debt requirements.

Given the **debt rule of the Fundamental Law**, the domestic debt ratio has always been above 50 per cent of GDP, so the rule requires a reduction in the debt ratio when adopting and implementing the Budget Act.[2] Compliance with the debt rule is a condition for the adoption of the budget, which is examined by the Fiscal Council. The 2023 Budget Act was adopted in 2022 with an expected reduction in the public debt ratio based on the outlook at the time, so compliance with the rule was ensured. However, the escape clauses allow for deviations to be made during the year if there is an enduring and significant downturn in the national economy or if special legal order needs to be introduced.[3] A decline in the real value of gross domestic product of one year or more should be considered an enduring and significant economic downturn, while state of war, state of emergency and state of danger are considered special legal orders.[4] The state of danger imposed by the outbreak of the Russo-Ukrainian war in 2022 triggered the escape clause. The debt ratio still fell by 0.5 percentage point in 2023 and is expected to fall this year, so the rule would be complied with in both years.

Another domestic fiscal rule on public debt is **the debt rule of the Stability Act.** The requirement is for the debt-to-GDP ratio to fall by at least 0.1 percentage point per year, parallel with the enforcement of EU rules.[5] The debt-to-GDP ratio declined by 0.5 percentage point last year and could decline by a further 0.3 percentage point this year, in line with the debt rule under the Stability Act, provided that domestic fiscal developments are consistent with the net expenditure (and debt reduction) path set out in the national medium-term fiscal-structural plan to be prepared in the autumn.

The Maastricht deficit criterion in both the Hungarian and EU fiscal frameworks require that the general government accrual-based deficit should not exceed 3 per cent of GDP.[6] In 2023, the Hungarian budget deficit was projected at 6.7 per cent of GDP, and this year the general government deficit could be 4.5 per cent of GDP. These values are higher than the threshold set in the requirement. In the domestic legal order, the relevant paragraph of the Stability Act was amended so that, under the transitional provision, the rule did not apply in the budget years 2021 to 2023, but the projected budget deficit in 2024 does not meet the criterion. The general escape clause, introduced in the EU in 2020, allowed for temporary deviations from the reference value for the budget balance and from the medium-term budgetary objective and the adjustment path towards it, provided that this does not endanger fiscal sustainability in the medium-term.[7] During the period covered by the escape clause, the EU institutions did not launch an excessive deficit procedure under the rules of the corrective arm of the SGP, including the discretionary decision on the deficit criterion, but limited their action to formulating revised country-specific economic policy recommendations. The EU bodies decided to maintain the general escape clause in 2023, but it has since been phased out. In June 2024, the European Commission prepared its due EDP report on Hungary, among other Member States, due to the high domestic deficit, in which it recommended

[2] Fundamental Law of Hungary, Articles 36 (4)-(5), 37 (2)-(3).
[3] Fundamental Law of Hungary, Articles 36 (6), 37 (3)
[4] Fundamental Law of Hungary, Articles 48-56
[5] Act CXCIV of 2011 on the Economic Stability of Hungary, Section 4 (2a)
[6] Act CXCIV of 2011 on the Economic Stability of Hungary, Section 3/A (2b)
[7] Council Regulation (EC) No 1466/97, Article 5(1), Article 6(3), Article 9(1), Article 10(3); Council Regulation (EC) No 1467/97, Article 3(5), Article 5(2)

to the Council to open an excessive deficit procedure.[8] The European Council is expected to adopt recommendations for tackling the excessive deficit in the autumn, in line with the national medium-term fiscal-structural plans.

Under both the domestic and, until April this year, the EU legal framework for the **medium-term budgetary objective (MTO)**, the general government balance must be set so as to be consistent with the achievement of the MTO.[9] The structural balance, which is the cyclically-adjusted balance net of one-off and other temporary items, is used to measure the path towards the target. The medium-term budgetary objective (MTO) for Hungary in 2023 was -1 per cent of GDP. After the entry into force of the general escape clause in the EU, the Commission did not sanction or investigate compliance with the rules of the preventive arm of the Stability and Growth Pact during its period of application. Thus, Member States are temporarily exempted from the medium-term budgetary objective and the **expenditure benchmark** setting the adjustment path in case of failure to reach it until 2023.

The medium-term budgetary objective (MTO) requirement has been removed from the EU budgetary framework in 2024 and the expenditure rule will no longer be compared to long-term potential GDP, but a country-specific **net expenditure path** will be set for each country in the **national medium-term fiscal-structural plan.** The path in the plan should be consistent with the Member State's expenditures for 4-5 years in the default case and 7 years if structural reforms and investments are implemented. The final content of the net expenditure path will be influenced by the **reference trajectory** from the European Commission and by the **debt and deficit safeguards** that will be introduced as a new element in the framework. Given that the first national fiscal-structural plans will be ready in autumn 2024, compliance cannot be assessed at this stage. The rule on MTO in the domestic legal order was amended, so that under the transitional provision of the Stability Act, this requirement did not have to be complied with between 2021 and 2023. In 2024, the rule on the medium-term budgetary objective cannot be examined because the underlying EU rule has been phased out.

The **EU's debt rule** states that Member States' debt ratios must not exceed 60 per cent of GDP or, if it does, the debt ratio must be reduced at a satisfactory pace. The corresponding reduction of debt until 2024 was quantified by the so-called **debt reduction benchmark**, which required an annual reduction of the debt ratio by approximately one-twentieth of the share of the debt ratio above 60 per cent on average over three years. The European Commission calculated the rate of change in the debt ratio using three different methodologies (forward-looking, backward-looking, cyclically-adjusted) based on its own projections, and if at least one of them achieved the required reduction, the rule was considered to have been met. The gross domestic debt ratio exceeds 60 per cent of GDP in both years under review, so an annual reduction in debt is needed. The general escape clause remained in force in 2023 but has been phased out from this year. Under the new EU rules, the necessary debt reduction will no longer be quantified by the debt reduction benchmark, but by the debt trajectory in **the national medium-term fiscal-structural plan**. To achieve this, domestic fiscal expenditure needs to be in line with the **net expenditure path** in the plan, which will ensure a satisfactory expected reduction in public debt. Actual deviations from the expenditure path are recorded in a **control account**, which is subject to a debt-based excessive deficit procedure if exceeded on an annual or cumulative basis. As the first national medium-term fiscal-structural plan is not yet available, the consistency with the net expenditure path in the plan cannot be assessed.

[8] Report from the Commission – Report prepared in accordance with Article 126(3) of the Treaty on the Functioning of the European Union, European Commission, 19 June 2024, pp. 40-43

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

5 Special topics

5.1 THE REFORM PROCESS OF ECONOMIC GOVERNANCE IN THE EUROPEAN UNION

In April 2024, both the European Parliament and the Council adopted a new regulation on EU economic governance and amendments to previous regulations, so the revised set of fiscal rules entered into force on 30 April. The new fiscal framework applies from this year, with flexible deadlines for the time being. In June, the European Commission gave guidelines to the countries, so Member States had to fulfil their first obligations arising from the new set of rules by September 20, but the framework temporarily gives the opportunity to extend the deadline by a reasonable period. In total, three pieces of legislation were affected: the regulation on **the preventive arm of the SGP** (MTO, expenditure rule, SDP) **was replaced**, the regulation on the **corrective arm** (Maastricht indicators, EDP) **was amended** and the directive on the **requirements for budgetary frameworks of the Member States** (statistical accounts, medium-term planning requirements, budgetary councils) **was** also **amended**.

The reform is primarily aimed at medium-term debt sustainability. The rules are simplified somewhat, but to a lesser extent than originally planned. The changes abolish several indicators and regulations, but also introduce new rules and procedures. As a result of the reform, the debt reduction benchmark, the medium-term budgetary objective (MTO) and the matrix of fiscal adjustment requirements, as well as the significant deviation procedure (SDP) for the preventive arm, will be abolished.

The cornerstone of the changes is the newly submitted national medium-term fiscal-structural plan, **which aims to bring Member States' debt ratios to sustainable levels.** The fiscal-structural plan and the accompanying annual progress report will replace the Stability and Convergence Programmes and National Reform Programmes. The time horizon of the fiscal-structural plan is four or five years by default (depending on the Member State's electoral cycle), but this period can be extended by up to three years by the Member State if it proposes structural and investment reforms to improve the sustainability and resilience of public finances. The national fiscal-structural plans will need to be agreed with civil society organisations, social partners, and other non-governmental stakeholders.

For those Member States with high deficits or high debt, the Commission will prepare a preliminary reference trajectory, while for the others it will only provide technical information. If a country has a budget deficit above 3 per cent of GDP or a debt ratio above 60 per cent of GDP, the fiscal-structural plan to be submitted by the Member State is preceded by a reference trajectory prepared by the Commission, based on the institution's own debt sustainability analysis (DSA). For the other Member States, those with deficits below 3 per cent and debt below 60 per cent, only technical information is provided. A working group with experts from several institutions will be set up to review the DSA methodology. The Commission will engage in a prior dialogue with the Member States concerned, the outcome of which will be included in the fiscal-structural plan to be submitted.

The key indicator for assessing compliance is the net expenditure path. The net expenditure path is the government expenditure net of EU expenditure, interest expenditure, the cyclical element of unemployment benefits and discretionary revenue measures, as well as excluding the impact of one-off and other temporary measures. The actual deviations from the net expenditure path will be monitored in a control account and if the deviations recorded in the account exceed the specified thresholds, it will lead to an Excessive Deficit Procedure (EDP). The threshold for deviations recorded in the control account is 0.3 per cent of GDP annually or 0.6 per cent of GDP cumulatively. If a Member State's net expenditure figures deviate by more than these amounts from the path set in the agreed plan, it is subject to an excessive deficit procedure. Among the rules considered for launching an EDP, the **deficit-based procedure** linked to the 3 per cent Maastricht value will remain unchanged, while the **debt-based EDP** will now be launched following observed deviations in the control account. A minimum annual structural adjustment benchmark of 0.5 per cent of GDP for the budget deficit will be introduced, but the deficit-based excessive deficit procedure remains unchanged. The debt-based EDP will be triggered when the control account thresholds are exceeded on an annual or cumulative basis.

Two new numerical requirements, so-called safeguards, are introduced into the rules. The first of these effectively replaces the debt reduction benchmark and the second the medium-term objective (MTO) for the structural deficit, but in fact they contain minimum requirements linked to setting and achieving the net expenditure path in the national medium-term fiscal-structural plan. The **debt sustainability safeguard** sets a minimum debt reduction requirement of at least 1 percentage point per year for countries with a public debt-to-GDP ratio above 90 per cent, and at least 0.5 percentage point per year for countries with a debt ratio between 60 and 90 per cent. This effectively sets the minimum rate of reduction in the debt ratio instead of the former debt reduction benchmark. In addition to the previous Maastricht threshold of 3 per cent, a **deficit resilience safeguard** will be introduced, under which the Commission's reference trajectory will require an adjustment until the Member State's general government deficit in structural terms is at a safety margin of 1.5 per cent of GDP from the public deficit reference value of 3 per cent of GDP. The minimum annual adjustment is 0.4 percentage point, which is reduced to 0.25 percentage point per year in case of an extension to the fiscal-structural plan (reforms and investments implemented). The minimum annual deficit reduction requirement for Member States under an excessive deficit procedure remains at 0.5 percentage points, which is not affected by this safeguard.

Under the new rules, the increase in both defence and interest expenditure will be taken into account when setting the necessary corrective paths, the former on a permanent, while the latter on a temporary basis. Due to rising geopolitical tensions, the build-up of defence capabilities will receive lasting favourable treatment in the budget deficit assessment, but the procedure is not yet elaborated in detail. The treatment of expenditure growth is not yet well defined and can be assessed by individual Member States on the basis of EU averages, medium-term trends, or other values. The increase in interest expenditure in the years 2025–2027 will be temporary and will be taken into account in the assessment of the EDP adjustment efforts. In light of the changed, elevated interest rate environment, the Commission may adjust the EDP benchmarks in the transition period 2025–2027 with the increase in interest expenditure, provided that the Member State explains how it plans to address the challenges identified in the context of the European Semester.

A fiscal-structural plan is required every 4 to 5 years, or in the event of a change of government, but Member States are required to produce an annual progress report on compliance, replacing the current Stability and Convergence Programmes. Annual reports on progress and reforms undertaken, also in the spring, should take into account common EU objectives and priorities and be consistent with previously agreed recovery and resilience plans, and, at the suggestion of the European Parliament, the budgetary framework will also take into account social convergence. The Macroeconomic Imbalances Procedure (MIP) may be more forward-looking in focus than today, but in legal terms, this procedure is virtually unaffected by the changes. The reforms will allow for a more intensive economic policy dialogue between Member States and the EU in the future, and emerging macroeconomic imbalances can be addressed early on in national medium-term fiscal-structural plans.

The reform will strengthen to some extent, and enshrine in the budgetary framework, the independence, adequate resource capacity and access to information of independent fiscal institutions (IFIs). IFIs, such as national fiscal councils prepare or approve annual and multi-annual macroeconomic analyses, examine compliance with country-specific numerical fiscal rules, assess the consistency and effectiveness of the national budgetary framework, and participate in regular hearings and debates in national parliaments.

The changes to the rules will also change the level of sanctions that can be imposed on euro area Member States. The final sanction for all countries, the suspension of Structural Funds, will remain in place, but it has not been applied to any Member State so far. However, the level of the semi-annual EDP-related financial sanction for euro area Member States will be reduced to 0.05 per cent of GDP, accumulating every six months until effective consolidation measures are taken. The annual rate of financial sanctions for euro area Member States used to be a minimum of 0.2 per cent of GDP, consisting of a fixed and a variable component.

Excessive deficit procedures are launched again this year, involving Hungary. In June, the Commission published the Spring Package for the European Semester, in parallel with EDP reports and a proposal to the Council to launch procedures. An excessive deficit procedure can be launched if the actual or planned government deficit exceeds 3 per cent of GDP. The procedure can be waived only if the Member State's debt ratio does not exceed 60 per cent or, if it does, the deficit is close to 3 per cent of GDP and the excess over it is temporary. Only then can relevant factors be taken into account for the country concerned. In 2024, the Commission reported on 12 Member States, with a total of 7 countries, including Hungary, being subject to an EDP, and the procedure against Romania, which was opened in the first half of 2020, will continue.

The escape clauses used in the fiscal framework will be maintained. The two escape clauses (the country-specific and the general escape clause) will continue to apply to deal with the negative effects of a severe economic downturn on the economy or the budget of a country or the Union as a whole, and the legislative change is only related to the clarification of the activation of these clauses.

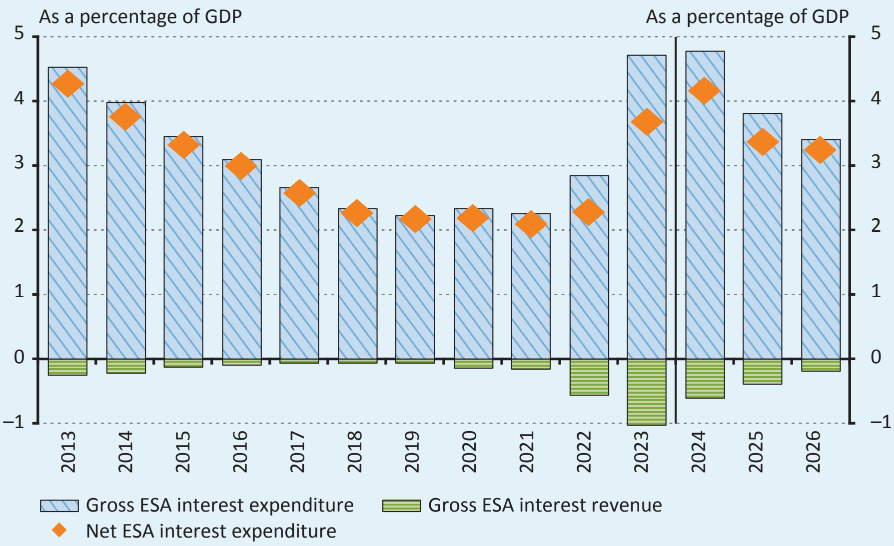
5.2 TRENDS IN GOVERNMENT INTEREST EXPENDITURE

High interest expenditure could continue to be a significant burden on the budget this year

Public interest expenditure, mainly due to high inflation, increased by HUF 1,660 billion to 4.7 per cent of GDP in 2023 and will remain high in 2024 (Chart 22). With high inflation in 2023, we expect accrual-based interest expenditure to rise further to 4.8 per cent of GDP in 2024. Thanks to significant disinflation this year and a moderation in yields, gross interest expenditure could be substantially lower by around 1 percentage point in 2025.

Government net interest expenditure grew less than gross expenditure last year, as interest revenues also increased. Government interest revenues reached 1 per cent of GDP, resulting in a net interest expenditure of 3.7 per cent of GDP. One source of interest revenue is the interest paid by the MNB on the government's deposits with the central bank, which amounted to HUF 170 billion in 2023, or around 0.2 per cent of GDP. This year, with a further slight increase in gross interest expenditure, we expect interest revenues to moderate, so net interest expenditure as a share of GDP could be significantly higher than in 2023, at 4.2 per cent.

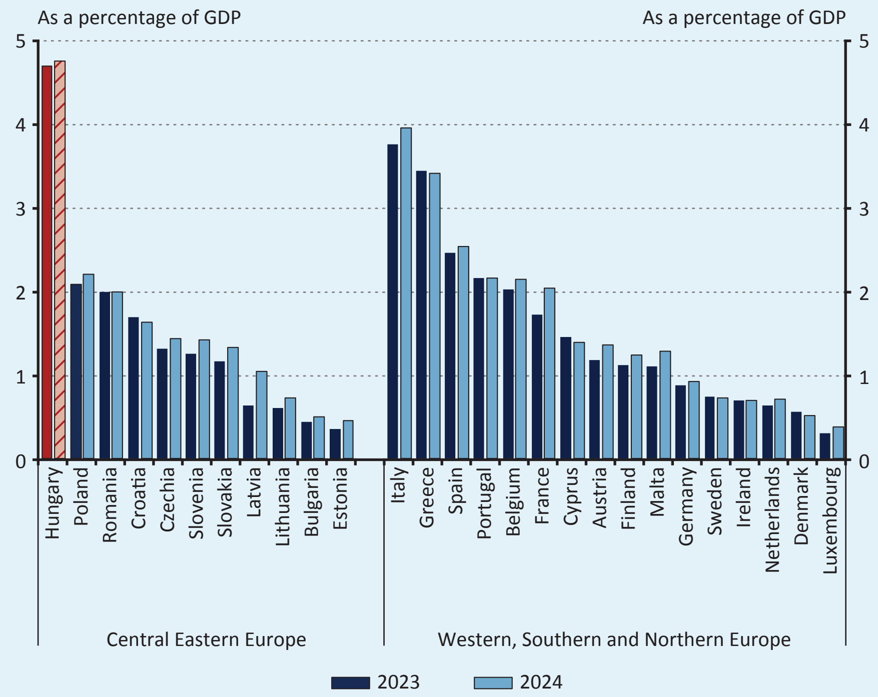
Chart 22
Accrual-based gross and net government interest expenditures



Source: HCSO, MNB

Hungarian interest expenditure is expected to remain the highest as a share of GDP in the European Union, just as in 2023 (Chart 23). After Hungary, Italy spent the most on the cost of financing its public debt in 2023, with an interest expenditure of 3.8 per cent of GDP. The average interest expenditure as a share of GDP in the EU and the region was 1.5 per cent in 2023. In our region, Member States' gross interest expenditure typically does not exceed 2 per cent of GDP.

Chart 23
Gross interest expenditures of EU Member States



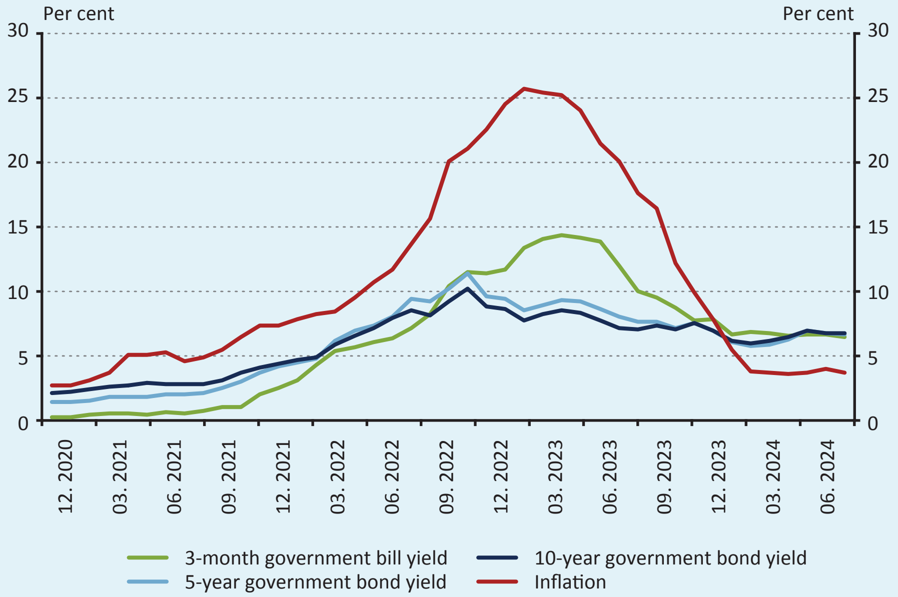
Source: AMECO, MNB

Among the factors affecting interest expenditure, inflation rose the most

In 2023 and 2024, inflation increased interest expenditure significantly, but the fall in yields starting in early 2023 will offset this somewhat. In terms of structure, the cost of public debt is determined by a combination of several factors, including inflation, inflation expectations, country risk perceptions, exchange rate trends and yields in domestic and international government securities markets. Yields on medium- and long-term HUF government securities averaged 7 to 8 per cent per annum in 2023, while the average annual yield on short-term government securities was 11 percent (Chart 24). Both were significantly lower than the 2023 inflation rate, which averaged 17.6 per cent. By the beginning of this year, short-, medium- and long-term HUF yields had fallen persistently to around 6.5 per cent, reflecting the impact of disinflation in 2023 and long-term inflation expectations.

Of the 1.9 percentage point increase in government interest spending in 2023, 0.8 percentage point was caused by an increase in interest spending on inflation-linked government securities (Chart 25). Inflation plays a significant role in the increase in interest expenditure: the high inflation and the rise in the stock of securities caused accrual-based interest expenditure on inflation-linked government securities to rise by HUF 650 billion between 2022 and 2023 to nearly HUF 860 billion, which represents almost half of the increase in total government interest expenditure last year. In 2024, interest expenditure on these securities may exceed HUF 1,200 billion. The increase in expenditure is also boosted by higher demand for inflation-linked household securities on account of high inflation. The stock of Premium Hungarian Government Securities and Baby Bonds has risen from HUF 4,500 billion at the end of 2022 to close to HUF 7,300 billion by the end of 2023. The impact of inflation on interest expenditure is shown by the fact that for these securities, a 1-percentage point decline in inflation means a more than HUF 70 billion reduction in interest expenditure per year.

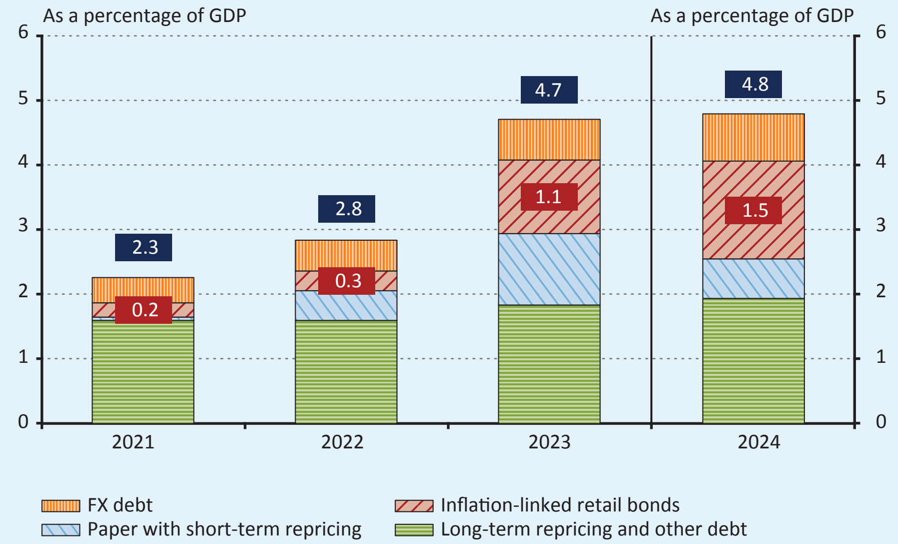
Chart 24
Development of inflation and benchmark government bond yields



Source: GDMA, HCSO

Interest expenditure on short-term government bonds increased by more than HUF 500 billion last year, while in 2024, interest expenditure on short-term bonds could fall significantly by HUF 330 billion. Interest expenditure on government securities with long-term repricing will increase by around HUF 320 billion, while FX interest expenditure rose by HUF 160 billion in 2023. We expect the issuance of securities with long-term repricing to increase by HUF 200 billion in 2024, and FX interest rate outflows by around HUF 120 billion, as a result of a substantial increase in the stock.

Chart 25
Structural decomposition of government interest expenditures



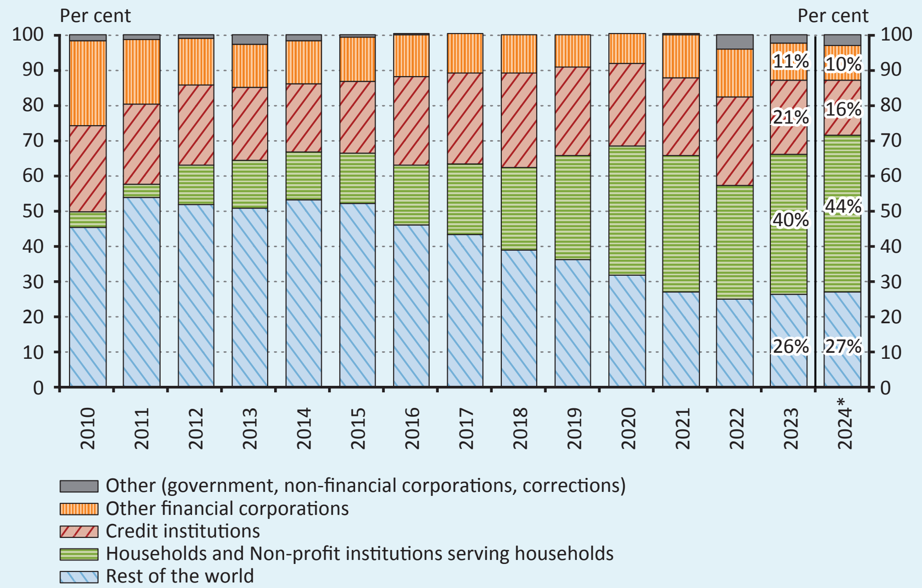
Source: Government Debt Management Agency (GDMA), MNB

Around three quarters of public interest expenditures remain in the country

A significant part of the surplus interest expenditure is transferred domestically, mainly to households. In recent years, one of the key objectives of the public debt management strategy has been to strengthen domestic financing. The share of domestic investors in public interest expenditures has gradually increased in line with the share of domestic ownership in public debt. While only one third of the debt was previously in domestic hands, in 2023 this share rose to nearly two thirds. In 2023, more than a third of total public interest expenditure went to households (1.9 per cent of GDP), around a fifth to credit institutions (1 per cent of GDP) and 11 per cent (0.5 per cent of GDP) to other financial corporations. The share of foreigners in total government interest expenditure increased slightly to 26 per cent (1.2 per cent of GDP) (Chart 26).

In 2024, the interest paid to households will continue to increase. We expect a further significant increase in interest expenditure paid to households this year as inflation-linked government bonds are repriced to higher rates (Chart 26). We forecast that interest paid to credit institutions and other financial companies may decline, while the share of interest paid to the rest of the world may increase moderately, as a result of the large amount of FX debt issuance this year.

Chart 26
Decomposition of government interest expenditure by sector as a share of total



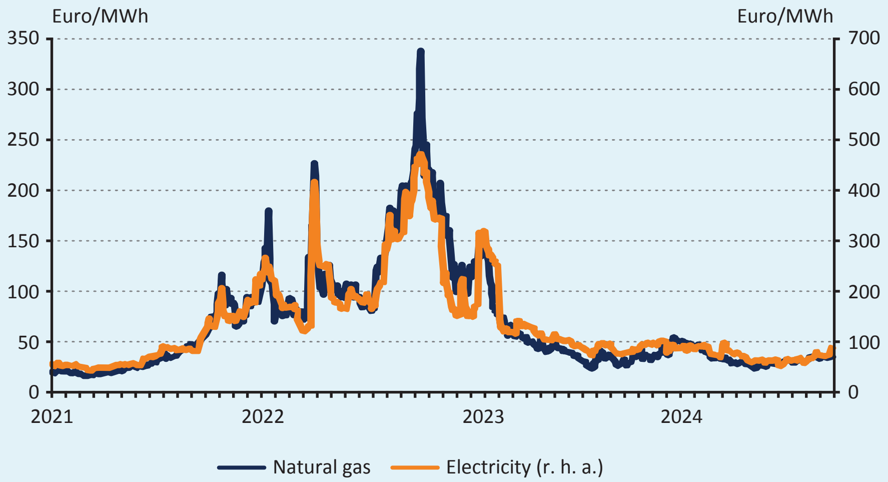
*Note: *MNB forecast*
Source: MNB

Overall, interest expenditure is expected to rise further in 2024, from 4.7 per cent of GDP in 2023 to 4.8 per cent of GDP this year, due to high inflation. In parallel, net interest expenditure could rise from 3.7 per cent to 4.2 per cent of GDP. As a negative fiscal impact of the high inflation environment of recent years, accrual-based government interest expenditure increased by HUF 1,660 billion from 2.8 per cent of GDP in 2022 to around 4.7 per cent of GDP in 2023. A significant part of the increase in accrual-based interest expenditure was due to high inflation and the rise in the stock of inflation-linked government securities. The increase in interest expenditure is partly offset by an increase in government interest revenues, an important part of which is the interest paid by the MNB on government deposits. The negative impact of higher government interest expenditure, due to the high share of government securities held by households, is partly offset by the fact that a large part of it is transferred to households.

5.3 THE BUDGETARY IMPACT OF ENERGY PRICE DEVELOPMENTS

European natural gas and electricity prices rose dramatically between 2021 and 2023, after which they remained higher than before (Chart 27)**.** In the European energy market, before 2021, the price of natural gas was stable at around €15-20, while electricity was around €40-50 per megawatt hour. By the end of 2021, the former had risen to over €100, then to over €300 intermittently in 2022, followed by a subsidence in 2023 and a price level of between €30 and €35 in H1 2024. The price rise from H2 2021 is due to a fall in Russian exports, coupled with rising demand following the economic recovery after the COVID crisis. Then, in February 2022, the Russo-Ukrainian war broke out, and the consequences of this, combined with lower gas stocks across Europe than in previous years, significantly increased the security of supply risks. Following the explosion of the Nord Stream pipeline, Russian gas imports to Europe fell to a quarter of their previous level, which meant that alternative supply channels had to be organised within a short time. The price of energy as perceived by users depended to a large extent on the price of imports in each economy, the contracts signed by wholesalers, and government intervention in the budget, but in general, energy prices in the European Union have risen dramatically. The increase in energy prices has placed a significant burden on companies, families and government budgets and the increase can be regarded as one of the primary causes of the inflationary surge not seen in the past 50 years.

Chart 27
Development of the price of natural gas and electricity on the European energy exchanges

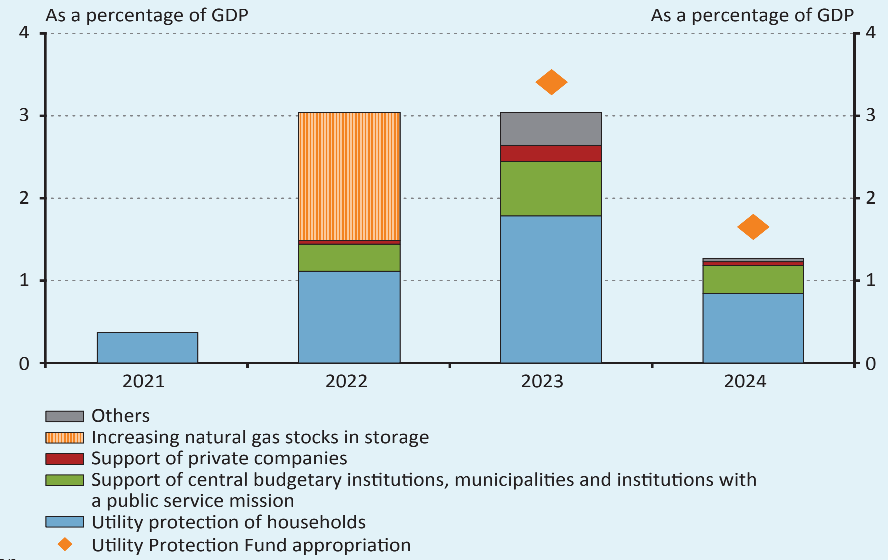


Note: The figure shows the month-ahead settlement prices of the Title Transfer Facility (TTF) natural gas derivative listed on the Dutch gas exchange, which is the leading European benchmark, and in case of electricity the Physical Electricity Index (Phelix) of the German energy exchange.
Source: Bloomberg

The surge in energy prices has increased expenditure in the Hungarian budget through several channels, the most significant of which is the increase in the costs associated with maintaining fixed household energy prices (utility cost reduction). Fixed household energy prices have been unchanged since the implementation of the series of measures from 2013 and have been broadly in line with European energy market prices for the rest of the 2010s. However, from 2021, European energy prices on the exchange, which determine the price of Hungarian imports, increased significantly, leading to a large increase in budget expenditure. The surge in energy prices has not only threatened the maintaining of fixed household prices at previous levels but has also increased the operating costs of budgetary institutions, municipalities, and other institutions with a public service mission, and increased budgetary expenditure on support of private companies.

In 2021, the increase in energy prices in Europe only had a moderate impact on the Hungarian budget. At the end of 2021, the state-owned MVM Group received a capital increase of HUF 208 billion (equivalent to nearly 0.4 per cent of GDP) to provide the necessary resources for the discounted service to households.

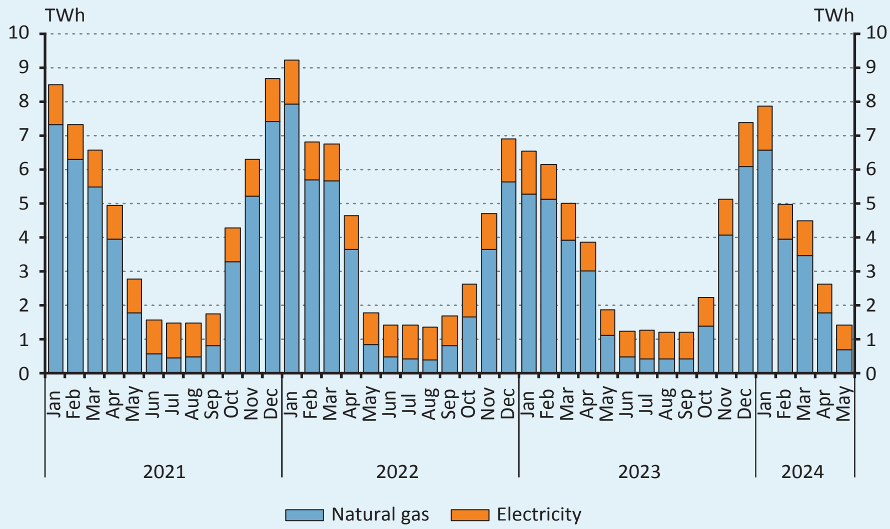
Chart 28
Development of expenditures related to energy market processes



Source: MNB collection

In 2022, public expenditure related to energy market developments increased significantly, reaching nearly 3.1 per cent of GDP (Chart 28). Within this, the maintenance of the utility cost reduction would cost 1.1 per cent of GDP, the support to budgetary institutions, municipalities and other institutions with a public service mission would cost a total of 0.3 per cent of GDP, while the increase in strategic gas stocks cost 2 per cent of GDP in 2022. In order to reduce expenditure, the rationalisation of the utility cost reduction came into force on 1 August, with the introduction of a higher second price level for residential gas and electricity supply, starting from the level of average consumption. Partly as a result of the latter measure and more favourable winter weather, household energy consumption in H2 2022 was already down by more than 20 per cent compared to the same period in the previous year, which also contributes to the reduction in expenditure related to the utility cost reduction (Chart 29). To mitigate security of supply risks, Hungary has significantly increased its strategic gas stocks in 2022. To replenish the security reserve, 310 million m^3 of natural gas was purchased, and to build up a special reserve, Hungary purchased an additional 740 million m^3 of natural gas, for which it secured the necessary funds through a syndicated loan agreement worth €2 billion (around HUF 800 billion).

Chart 29
Development of natural gas and electricity consumption of households



Note: The figure is based on the sales data of retailers and universal service providers to users, so in the case of electricity, it does not include the amount produced and consumed by small household-sized power plants.

Source: HEPURA, MNB calculation

In 2023, the amount of fiscal expenditure related to energy price increases remained at the previous year's level of 3.1 per cent of GDP, slightly below the planned allocation to the Utility Protection Fund. The transparency of expenditure related to energy market developments has been significantly increased by the appearance of the Utility Protection Fund as a separate chapter in the 2023 Budget Act. The 2023 budget of the Utility Protection Fund introduced in August 2022 increased from HUF 670 billion to HUF 2,600 billion, and its actual expenditure is estimated at HUF 2,282 billion. The monitoring of expenditure on utility protection is facilitated by the fact that the resources allocated from the Fund are transferred to the organisations and institutions that actually make the payments by means of transfers of appropriations, and the decisions are published in the form of government decrees. Accordingly, resources used within general government (e.g. compensation of central budgetary organisations) will be included in the own expenditure lines of central budgetary organisations and chapters, while resources used outside general government (e.g. compensation of universal service providers and district heating providers) was included in the special and normative subsidies appropriation in 2023 and in the state transport and utility services appropriation this year. Expenditure is covered by the transfer of certain windfall taxes to the Fund and by a significant amount of central government subsidy (Table 11).

In 2023, HUF 1,347 billion of the Utility Protection Fund was used to maintain the utility cost reduction for households, which was HUF 111 billion (8 per cent) below the target, but almost double the HUF 699 billion paid out for this purpose in 2022. According to our calculations, an additional HUF 314 billion from the Utility Protection Fund has been paid to central budgetary institutions, HUF 92 billion to municipalities, HUF 103 billion to ecclesiastical and civil organisations, HUF 178 billion to state-owned companies, while HUF 249 billion has been paid to the private sector. Within this, we calculate that HUF 298 billion was transferred to other purposes not necessarily related to the protection of utility costs (accounted for in the lines for central budgetary institutions, municipalities, state-owned companies, and support to the private sector). The reason why the level of expenditure on utilities protection was still high in 2023, despite the stabilisation of global energy prices, was that a significant amount of subsidy was carried over from the previous year. The Fund's revenues are largely financed by windfall taxes on sectors benefiting from the rise in energy prices, supplemented by a subsidy from the central budget.

Table 11
The balance of the Utility Protection Fund based on appropriations

	2023		2024	
	Amended appropriation	Actual and MNB estimate	Amended appropriation	MNB estimate
Expenditures	**2,580**	**2,282**	**1,341**	**996**
Utility protection of households	1,458	1,347	917	689
Compensation of central budgetary inst's	400	314	187	120
Compensation of municipalities	145	92	83	65
Support of ecclesiastical and civil org's	150	103	66	39
Support of state-owned companies	178	178	50	46
Support of private companies	249	249	38	38
Revenues	**2,580**	**2,486**	**1,341**	**1,125**
Income tax on energy providers	716	435	514	327
Mining royalty	334	242	192	118
Airline tax	35	35	39	35
Telecommunication tax	96	98	96	120
Tax on pharmaceutical manufacturers	123	91	17	42
Dividend payments of the energy sector*	108	417	-	-
Central support of Utility Protection Fund	1,168	1,168	483	483
Other revenues	-	-	0	0
Balance	**0**	**204**	**0**	**128**

*Note: *HUF 120 billion of the budget line of support of private companies was transferred to the Savings Fund, which was used for the benefit of the Széchenyi Card Programme. Substantial amounts were transferred to other purposes from budget lines of support of central budgetary institutions, municipalities, and institutions with a public service mission.*

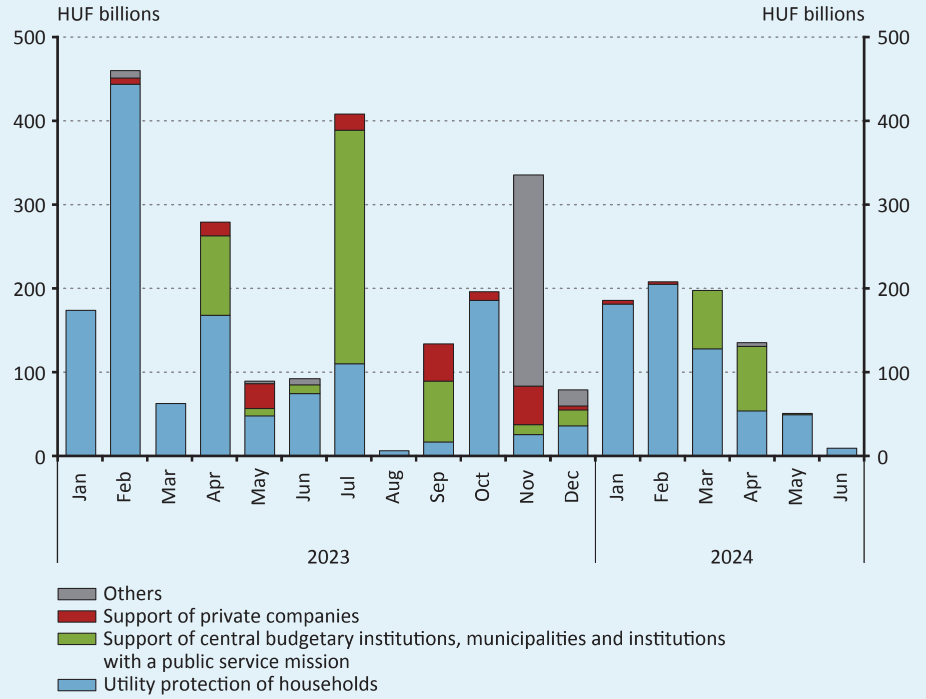
Source: 2023 and 2024 Budget Acts, Hungarian State Treasury, MVM Group reports, MNB

Overall, tax revenue channelled into the Fund was also below the target, while the amount of central subsidy paid was in line with the target. At the same time, the dividend payment from the energy sector resulted in more than HUF 417 billion of income, as the MVM Group paid an additional HUF 309 billion in dividend advances in 2023, on top of the HUF 107.5 billion payment foreseen for 2023, based on its 2022 result. Dividend payments from the energy sector are not included in the 2024 Budget Act as part of the Utility Protection Fund's revenue appropriations, but an additional HUF 15 billion is expected to be paid this year after the MVM Group's 2023 results, and depending on the company group's performance this year, dividend payments may even be made to the budget again.

As a result of the fall in global energy prices, we forecast that the Utility Protection Fund could spend HUF 996 billion (nearly 1.2 per cent of GDP) in 2024, which is HUF 344 billion (26 per cent) below the revised target. We estimate that a total of nearly HUF 786 billion was paid out from the Fund in H1 2024, of which more than HUF 625 billion was for household utilities protection. In addition, HUF 120 billion was paid to support central budgetary institutions, HUF 27 billion to support ecclesiastical and civil organisations and nearly HUF 8 billion to support the private sector (Chart 30). On the basis of government decisions published by 31 July 2024, the government has made an additional HUF 99 billion transfer of appropriations from the Utility Protection Fund, which will be paid in the second half of this year, primarily to support household utility protection, municipalities as well as ecclesiastical and civil organisations. We also forecast that tax revenues, which represent part of the revenue of the Fund, will be below the appropriations, while the central subsidy is expected to be the same as last year. As a result, the balance of the Utility Protection Fund shows a surplus of HUF 128 billion, a significant part of which could be used for other purposes, including non-utility protection purposes.

In addition, the Water Utility Development and Compensation Fund, coming into force on 1 January 2024, will serve the purpose of protecting the utility costs, with nearly HUF 25 billion disbursed in the first half of the year.

Chart 30
Development of expenditures from the Utility Protection Fund by purpose



Source: Hungarian State Treasury, MNB calculation

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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