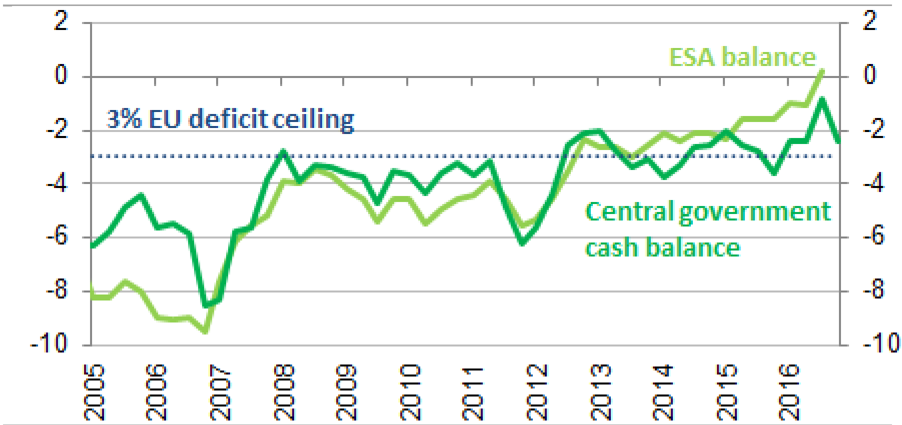
FLASH REPORT

9 January 2017

December spending on one-off items raises 2016 deficit, but the underlying fiscal position remains favourable: similar year-end spending run may come in 2017 as well

- New ESA data until Q3 confirm strong underlying budget position
- Spending rose massively in December as expected: the central government registered a record high 907 bn HUF deficit in the last month of 2016 alone; the full-year cash deficit could be 2.4% of GDP
- Due to expected strong tax revenues at year-end and accounting uncertainties, the ESA deficit could remain below 2% in 2016 (we maintain our expectation of 1.6%)
- Year-end spending in 2016 included mostly one-offs and could have brought forward some spending commitments from 2017; thus the underlying budget position remains favourable in 2017 and we see potential for a similar end-year spending spree in 2017

Chart 1 – Consolidated general government balance (ESA) and central government cash balance
(4Q rolling, as % of GDP)



Sources: KSH, OTP Research

Impressive Q3 budget data

At the end of Q3 2016, Hungary's general government accrual-basis 4Q rolling budget balance stood at +0.2% of GDP, fresh statistics reveal. The cumulated surplus in the first three quarters was as high as 0.6% of GDP; total revenues rose 1.4% YTD while expenditures fell 5.7% YTD. A combination of strong underlying tax collection, one-off revenues and low investment expenditures were responsible for the surplus:

1. Strong wage and consumption growth fuelled tax revenues. Underlying taxes on income and wealth rose 5.9%; social security contributions were up 7% YTD. Even with last year's VAT cuts (pork, new housing), VAT revenues rose 0.6% YTD.
2. One-off revenues under the growth tax credit scheme and income from land sales amounted to ~0.8% of GDP in the four quarters up to Q3.
3. General government expenditures excluding EU-related items remained flat in Q3 YTD. However, public investments fell 46.6% YTD due to the lower absorption of EU funds in the first nine months of 2016.

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The government managed to speed up spending in December

Recognizing the strong underlying position of the budget, and the weakness in public investments, the government decided to speed up public spending at the end of 2016. After a cumulated surplus of 59 bn HUF by November, the central government registered a record high, 907 bn HUF deficit in December. As a result, the cash flow based deficit of the central government reached 2.4% of GDP in 2016.

The year-end spending spree consisted of one-offs, for example handouts to pensioners (48 bn HUF); capital transfers, including debt relief of hospitals (70 bn HUF); a capital injection into Eximbank (47 bn HUF); some asset acquisitions and transfers to NGOs. Pre-financing of EU funds also rose significantly: it totalled 1,460 bn HUF in 2016 (2,100 bn HUF EU funds were distributed in 2016) and over one-third of this expenditure may have been realized in December.

The 2016 ESA deficit could still remain below 2% of GDP

The 2016 ESA deficit could be near 2% of GDP in 2016 according to the Minister for National Economy, Mihály Varga. In our view, it could remain below this level (our forecast is 1.6%), for the following reasons:

1. Accrual-based revenues in December could surprise on the upside. It appears that the economy ended 2016 strongly: tellingly, online retailers and delivery services collapsed under the volume of Christmas orders. The Ministry noted that cash-flow-based revenues exceeded their expectations by 30 bn HUF in December. We think the accrual-based figures could be even stronger.
2. Some central government spending (e.g. transfers to municipalities) may not increase the general government ESA deficit. This might be reflected in the upward revision of the planned surplus of local governments, which was raised by 370 bn HUF in the December forecast of the Ministry compared to the October EDP report.

The underlying fiscal position remains strong in 2017; more one-off spending could come in 17Q4

Whatever the budget outturn in 2016, the underlying fiscal position will remain favourable in 2017. The 2016 deficit target was only approximated through massive end-year spending on one-off items. Furthermore, some expenditure (e.g. capital transfers and EU pre-financing) may have been brought forward from later years. Meanwhile, revenue collection was robust and current spending remained restrained. Thus, even after taking into account 2017 tax cuts, the 2017 deficit could remain as low as 1.1% of GDP.

We maintain our view that there remains room for manoeuvre in the 2017 budget. With 2018 elections on the horizon, it is likely that the government will resort to last-minute spending in 17Q4 again. Thus, the 2017 ESA deficit could eventually turn out near the government target of 2.4% in 2017.

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