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FLASH REPORT

28 May 2020

This year's deficit could be slightly above 4% of GDP, while the 2.9% target in 2021 might be attained if most free reserves are cancelled

- On 26 May, the Finance Ministry submitted the 2021 budget bill to parliament. Although we knew several main points from the Convergence Program already, the details have not been disclosed before.
- Still, we think there are not many important macro news in the document compared to the Convergence Programme, submitted at the beginning of May or to the Fiscal Council's opinion on the budget, published a week before[1].
- Priorities remain the same as discussed also in our previous note:
  - Job preservation: mainly through the kurzarbeit (short-time work) scheme, temporary tax cuts and deferrals in the most affected sectors
  - Job creation: wage support for new employment and subsidized online training, social security contribution and small tax cuts, scaling up public work scheme
  - Infrastructural investment support: government-sponsored infrastructural projects, extra CIT allowances for investments, green and energy saving investment tenders,
  - Key industry support: most affected industries (tourism, health sector, creative industries etc.) could take part in government-sponsored industry support as well as guaranteed and subsidized credit schemes.
  - Credit and liquidity support: Guaranteed loan programs (4.3% of GDP), through the MFB (Hungarian investment Bank) plus additional subsidized funds from the MNB
  - Family support: This is an ongoing priority, given the new stimulus through the family support scheme last year, and now the 13th month pension is gradually introduced (one additional weekly payment per year from 2021 until 2024).
- One important new information is the smaller size of free (unallocated) reserves from 0.8% in 2020 to 0.3% of GDP. The high reserve level this year, unspent until the covid pandemic outbreak, proved particularly useful, as the government had started manoeuvring in March from a nearly balanced budgetary position. Next year this room for manoeuvre is likely to be much narrower.
- There was also some rearrangement in the revenue distribution between the central and local governments: it turned out that revenues from the full vehicle tax remain at the disposal of the central budget still in 2021, and the local government solidarity payments nearly quadrupled (from 0.09% to 0.34% of GDP), which suggests that municipalities will remain financially significantly worse-off. It also turned out that the retail tax will remain in place in 2021.
- One additional, although more technical new information is that the 2021 budget kept and even reinforced the rearranged budget structure from this year. There are two main budgetary policy tools:
  - Health and Epidemic Defence Fund. The former Health Insurance Fund and Epidemic Defence Funds were merged; hence the new fund contains the financing of both 'normal' health care activity as well as the epidemic defence.
  - Economy Protection Fund: the former Employment Fund and targeted infrastructural investment sources are channelled into it.
- Overall, it is not possible to thoroughly assess from the budget document the changes compared to 2020, as no new budget was adopted for this year after the pandemic started; however, both revenue and expenditure figures are obviously overwritten by the change in the macro picture and the savings in ministries in 2020 to partly finance epidemic and economy protection. Still, as the legal document for 2020 remained the same, the 2020 budget appropriation figures in the new budget seem to have been

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taken from the original 2020 budget document. As in case of several items, accrual (ESA based) and cash (budgetary document based) revenue *level* figures can differ significantly, it is hard to assess revenue projections from the current budget document itself. Nevertheless, we can have some idea on the accrual revenues from the macro-assumptions presented in the document and in the Convergence Program summary budgetary figures (these latter are accrual-based).

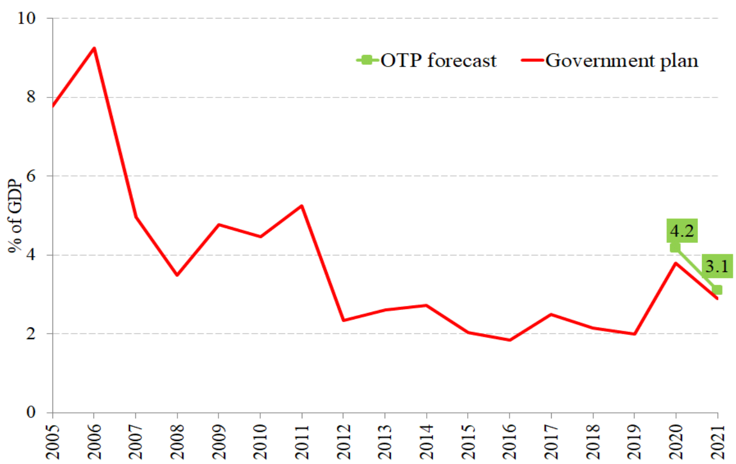
- The main macro figures seem to be unchanged if compared to the Convergence Program, and the GDP growth figure is broadly in line with our assessment (Table 1). Nevertheless, in our view, the numbers seem to be on the optimistic side for the 2020 household consumption figure and the 2021 wage bill figure, both of which are very important in terms of budgetary revenues. This is even more so, as the market consensus seems even more pessimistic than our forecast. Consequently, we see 0.6-0.7% of GDP less revenues in 2020 and 2021, coming mainly from income taxes, indirect taxes, and social security contributions if we compare our forecast to the Convergence Program's accrual revenue figures. However, as we also project slightly less expenditure in government consumption and other expenditures, the final difference on the ESA budget balance is 0.3-0.4% of GDP.
- *Overall, while we think the budgetary plan is solid, we have at least two concerns. First, notwithstanding the huge uncertainty in the economic outlook, we believe that this budgetary revenue planning is a bit optimistic, partly related to the macro assumptions. Second, the 0.3% unallocated reserve seems to be on the low side, especially given the uncertainty.*
- *At this juncture, we think the budget deficit is more likely to end slightly above 4% this year, and next year's deficit could drop below 3% if most free reserves are cancelled. However, the uncertainty in the outlook is huge, and from an economic policy point of view, understandably, growth enhancing should be given priority over deficit reduction.*

Table 1- Macro assumptions: Government, OTP Research, and market consensus

	2020			2021		
Yearly growth, %	Government	OTP	Market expectation	Government	OTP	Market expectation
Real GDP	-3.0	-2.7	-4.3	4.8	4.3	4.7
Real household consumption exp.	0.9	-1.8	-3.7	3.8	3.7	4.9
Nominal GDP	0.6	1.7	-1.3	6.8	5.9	7.5
Consumer prices	2.8	2.8	3.0	3.0	3.0	2.8
Wage bill	3.9	3.3	na	8.5	6.2	na

Minfin, OTP Research, and Focus Economics

Figure 1 – Budgetary Outlook: Government vs. OTP Research



**KSH, Government of Hungary, and OTP Research calculations*

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