FLASH REPORT

30 May 2022

The larger-than-expected fiscal adjustment package puts the government on the safe side in terms of deficit reduction, if it makes a deal on EU funds this year

- After the elections, the incumbent-new government's economy ministers (Mr. Nagy and Mr Varga) both stressed at their parliamentary hearing the government's intention to stick to the original *deficit targets* of 4.9% and 3.5% of GDP for 2022 and 2023. One week after that hearing, just after the first sitting of the government, PM Viktor Orbán announced windfall taxes on certain sectors, to put the budget on track with the initial targets. Details came on Thursday from ministers Nagy and Gulyás, who specified the key figures of the revenue-side measures, and also hinted at a few expenditure-side ones. While the information at this stage is surely incomplete, we try to shed light on the picture.
- For a start, based on our latest calculation *the no-policy change deficit could be near 7.3% and 6.5% of GDP in 2022-2023*, as opposed to the 5.5-6.0% assumption in our previous note. The difference comes partly from energy-related items, which we did not expect, and some other expenditures that popped up in the past two months based on our data collection (Table 1). The list may not be fully complete, but it reflects our current best knowledge. This extra spending is partly counter-acted by stronger-than-expected revenue figures (available until April), as well as by the assumption that the central bank's likely loss for 2022 will not require budgetary capital expenses, given plans to discontinue the funding of foundations originally created by the central bank. This assessment *would put this year's required deficit correction at about 2.4% of GDP (HUF 1,500 bn) and next year's one around 3.0% of GDP (HUF 2,000 bn*). Admittedly, these calculations assume that an agreement on EU funds is reached before the end of this year. In ESA terms, EU-fund-related expenditures and revenues are budgeted in parallel, hence in principle it is still not a problem if the agreement is reached at the end of the year, as based on EU legislation, an agreement on the Recovery and Resilience Facility needs to be reached by the end of this year at the latest, so that the government could withdraw funds from the facility. It is also important that on the revenue side we see upside risks compared to the presented calculation, which could lead to smaller budgetary adjustment need.
- In terms of the *announced package*, as not everything is fully detailed, we made the following assumptions in our calculation. (i) The full-year target revenues from taxes will be collected in 2023. However, public health product and excise duty taxes cannot be collected in full this year. In addition, the revenues from the advertisement tax were only planned from 2023. This brings revenues closer to HUF 850 bn for this year, as opposed to the HUF 915 bn target (ii) Our understanding is that the announced 60-40 ratio of expenditure vs. revenue-side measures (announced by minister Nagy) will be valid for the whole adjustment path of 2022-2023. These two factors mean that the whole package could be near HUF 1,850 bn or 3.1% of GDP this year. We gave our estimate for 2023, but the submitted budget will reveal more details (Table 2).
- In terms of *windfall taxes on certain sectors*, we estimate that by 2022-2023 their total level will reach 2.6% and 2.4% of GDP, which will be higher or similar than in the so far record year of 2013 (2.4%). In terms of *expenditure-side measures, much less is known, but savings were announced on operating expenditures and investment, and probably some layoffs are expected*. As regards operating expenditures, excluding EU funds, they increased by some 1.0 ppts of GDP between 2014 and 2021, so some savings could be expected in this magnitude. In terms of investment, another 1 ppt of GDP, from the 2021 5.9% GDP level seem likely. Not much savings could be foreseen in the short-term from the planned (appr. few hundreds) layoffs, while cuts in other expenditures (capital and current transfers) were not mentioned, but they are still by 2 ppts of GDP above pre-covid levels. So in terms of the latter, savings are also possible.
- The announced measures are in gross terms, so their net effect on the budget could be less, given that spending has an effect on the revenue side as well. Still, we think that *if the announced plans are fully delivered, the government can safely ensure this year's deficit target, in light of surprisingly strong incoming figures on the revenue side. However, all calculations assume an agreement on EU funds still this year.*

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Table 1: The assessment of the current fiscal situation

		BN HUF		% of GDP	
		2022	2023	2022	2023
EU funds are coming	**(A) Government ESA deficit targets**	**2955**	**2337**	**4.9**	**3.5**
	(B) Change in the macro picture (since 2021 autumn)	121	334	0.2	0.5
	(C) MVM loss	240	1000	0.4	1.5
	(D) MNB loss		400		0.6
	(E= A+B+C+D) Our no policy change ESA deficit in the April Flash Note	**3315**	**4071**	**5.5**	**6.1**
	New information since eary April				
	(F) Additional energy related costs (MÁV, Volán, District heating, gas reserves)	640	640	1.1	1.0
	(G) Non-energy related items (Prolonging end 2021 investment decisions, Sberbank, EU financial corrections etc.)	770	350	1.3	0.5
	(H) -MNB loss		-400		-0.6
	(I) -Stronger-than-foreseen revenue data	-300	-300	-0.5	-0.4
	(J=E+F+G+H+I) No policy change ESA deficit	**4425**	**4361**	**7.3**	**6.5**
	(K=J-A) Required deficit correction	**1471**	**2024**	**2.4**	**3.0**
Without EU funds	(L) EU funds at risk	1306	2365	2.2	3.5
	(M=K+L) Required deficit correction if EU funds are not coming	**2776**	**4389**	**4.6**	**6.6**

Table 2: Summary of announced measures

	BN HUF		% of GDP	
	2022	**2023**	**2022**	**2023**
(A) Revenue side	**850**	**915**	**1.4**	**1.3703**
(A1) Total new sectoral levies	*800*	*815*	*1.3*	*1.2*
One-off bank levy	250	250	0.4	0.4
Transaction tax	50	50	0.1	0.1
Insurance tax	50	50	0.1	0.1
Mining tax, energy	300	300	0.5	0.4
Retail tax	60	60	0.1	0.1
Telecom levy	40	40	0.1	0.1
Checkin fee (airlines)	30	30	0.0	0.0
Medical product distributors' levy	20	20	0.0	0.0
Advertisment tax	0	15	0.0	0.0
(A2) Other (chips tax, excise duties)	*50*	*100*	*0.1*	*0.1*
(B) Expenditure side	**1000**	**1600**	**1.7**	**2.4**
(C= A+B) Total measures	**1850**	**2515**	**3.1**	**3.8**

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