

FLASH REPORT

2 October 2024

The 4.5% deficit target this year is reachable but achieving the 3.7% target in 2025 requires adjustments

- **Hungary's ESA-based fiscal deficit** decreased to 5.5% of GDP in 2024Q2, from 5.8% in 2024Q1 on a four-quarter (4Q) rolling basis (Figure 1). This was 0.1 ppts better than the figure published in the financial accounts on the same day. The smaller deficit (compared to Q1) is mainly caused by the lower (-0.5 ppts) expenditure-to-GDP ratio, while the revenue-to-GDP ratio decreased at a smaller rate (-0.3 ppts).
- **Expenditures** on a 4Q basis were affected to the largest extent by declining operating expenses and investments (as the government tried to keep in check both), interest expenses, and (energy) subsidies (as energy prices have normalized). All these expenses were down by 0.2 ppts from the previous quarter. In the longer term, however, the shrinking of operating expenses and investments is hardly sustainable without the significant deterioration of public services. On the other hand, public wages were up by 0.1 ppt because of wage hikes in the public sector, partly financed by EU funds. The remaining expenditure items were unchanged (Figure 3).
- **On the revenue side**, taxes on production were unchanged on a 4Q basis, after the fall in the previous four quarters. The reason for this positive turn was that net VAT revenues increased faster than inflation in H1, due to lower VAT reimbursements. Interest revenues declined by 0.3 ppts after increasing steeply (from 0.5% of GDP at the end of 2021 to 2% of GDP in Q4 2023), due to high inflation and dividend payments by state-owned enterprises (e.g. the large dividend by the state-owned Hungarian electricity and gas company MVM). Other revenues were down by 0.2 ppts, partly due to lower EU transfers. The remaining revenue items (income taxes and social security contributions) were up 0.1 ppt (Figure 4).
- **Our forecast shows that the 4.5% deficit target is reachable in 2024 after the adjustments made by the government.** Since our previous [flash report](#), the government has announced that it would bring down the deficit by HUF 400 billion (-0.5% of GDP), which includes hiking the financial transaction tax, an extra dividend payout from the state-owned Hungarian electricity company (MVM), changing the rules of extra profit taxes on the banking sector, and higher penalties for breaching traffic regulations. This is on top of postponing HUF 675 billion of investments announced this spring, which lowers the deficit by **-0.66% of GDP** this year.
- In the first half of this year, investments and financial transfers were higher than our projection, but operating expenses were lower (on the expenditure side). In the case of revenues, social security contributions and interest revenues were higher, but other incomes were lower. On balance, these effects do not change our view that this year's deficit target is within reach, but risks point to higher deficit, mainly because of the need for steep investment cuts in the second half of the year.
- The EDP notification, published on the same day as the deficit data, has also reinforced the government's 4.5% ESA deficit target for this year, even if the cash-flow-based deficit target was hiked by 0.9 ppts, which could be because of Budapest Airport's acquisition and lower EU funds, which directly affect only the cash-based deficit.
- **Under a no-policy-change scenario, the deficit would be around 4.6% of GDP in 2025, exceeding the target of 3.7%. As parliamentary elections will be held in early 2026, the pressure on the government to ease fiscal policy before the elections, instead of further deficit reduction, is a negative risk.** We assume that the dispute over the penalty between Hungary and the EU Court of Justice will be settled by the end of this year, so it will not affect the budget in 2025. Based on a statement by the Minister for National Economy, we assume that from the HUF 675 billion investment deferred in 2024, HUF 300 billion will be deferred further to 2026 or later. That said, we expect that public investment will increase in 2025 from the very low level in 2024. Interest expenses will be lower (as a percentage of GDP) than this year, as interest payment on inflation-indexed bonds will decline because of lower inflation.

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Higher transaction fees will also be effective for the whole year in 2025, as opposed to 2024, which also reduces the deficit by 0.2% of GDP. On the other hand, taxes on production will be lower as the government promised further cuts to extra-profit taxes, which would add -0.6 pts to the deficit. We expect that taxes on telecoms, pharmaceutical, utility and energy companies, as well as on insurers will decrease, along with the mining royalty. On top of that, family tax allowances will be doubled in two phases next year, which will cost HUF 255 billion in our calculation. Meanwhile, wage hikes in the public sector this year will appear in the base, while further hikes are also in the pipeline. On the other hand, pensions will increase at a slower pace than nominal GDP, which lowers the deficit. (Table 1)

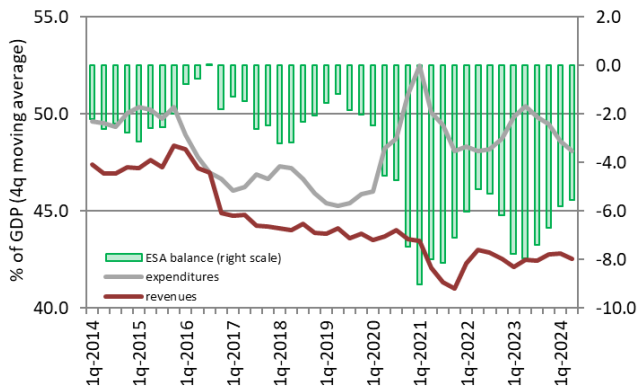
- While the no-policy-change deficit would stabilize near 4.5% in 2024 and 2025 according to our forecast, we suspect that the government will be inclined to create some fiscal space before the general elections in 2026 by tax increases and further postponement of investments.
- **As a result of the new rules of the excessive deficit procedure, there is less pressure on the government to correct the budget.** The EDP against Hungary and several other EU members started this summer, but the EU delayed penalties. According to the rules adopted in February, debt must be on a well-founded downward path only at the end of a four-year budget adjustment period. Moreover, this period can be extended to seven years if the government makes investments that improve the growth potential.
- Our technical assumption is still that Hungary and the EU can reach an agreement with respect to the allocated funds, in accordance with the government's plan in the Convergence Programme; however, the risks to that are becoming higher. On top of that, it is very likely that [EUR 1.1 billion of EU funds will be permanently lost](#) at the end of this year, which will increase the 2022 deficit ex-post. In the case of the RRF funds, the tight schedule is also a risk as all projects must be finished before the end of 2026, otherwise a part of the funds will be lost. As the [Partnership Agreement](#), the operational programmes, and Hungary's [RRF plan](#) were signed at the end of 2022, a delay in the actual payment of EU money does not have an effect on the ESA deficit.

Table 1 - Our deficit forecast*

	% of GDP
2024 deficit (OTP est.)	-4.5%
Partial cut back of extra-profit taxes	-0.6%
Higher financial transaction fees	0.2%
Net interest and dividend	0.9%
Public wages	-0.4%
Part of deferred investments completed	-0.5%
Doubling of family tax allowance in two phases	-0.3%
Dispute with the EU Court of Justice is settled	0.2%
Pensions increase at a lower rate than nominal GDP	0.3%
Other items	0.2%
2025 deficit (OTP est.)	-4.6%

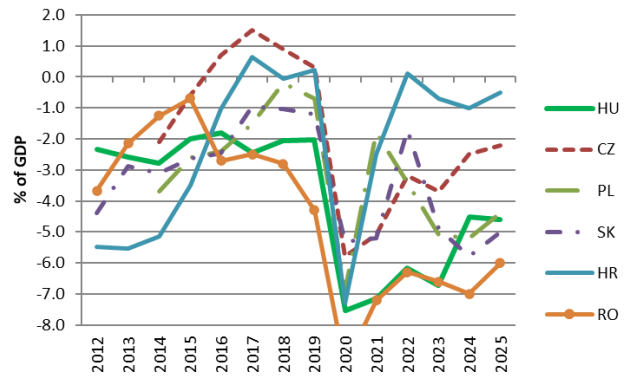
*OTP Research

Figure 1 - Government revenues, expenditures, and ESA



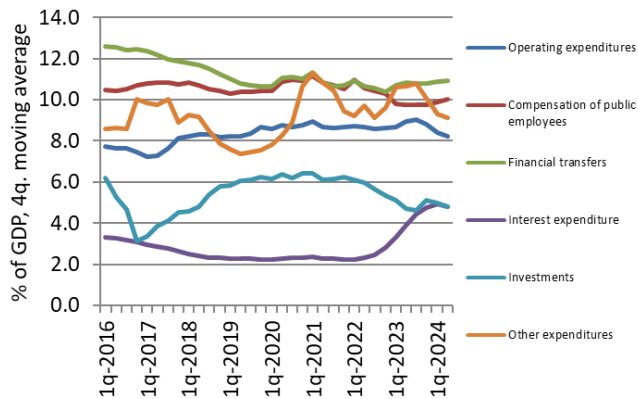
*KSH and OTP Research calculations

Figure 2 - Regional comparison of ESA-based budget balance projections*



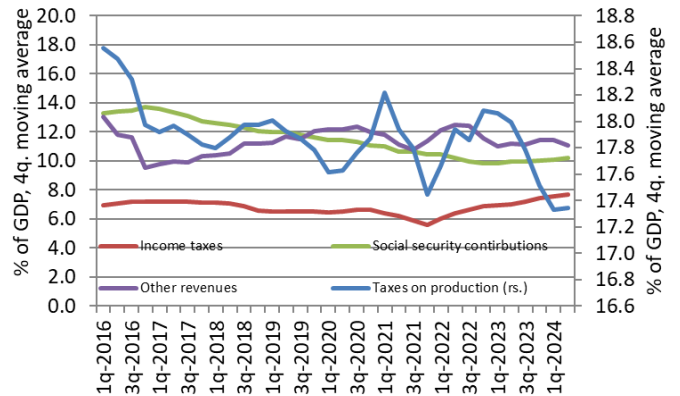
*KSH, OTP Research, Focus Economics

Figure 3 - Government expenditure items (4Q)*



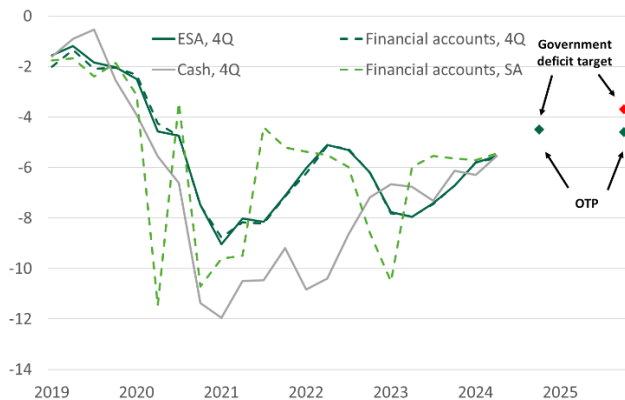
* KSH and OTP Research calculation

Figure 4 - Government revenue items (4Q)*



* KSH and OTP Research calculation

Figure 5 - Deficit indicators*



* KSH, MNB and OTP Research calculation

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