EUROPEAN COMMISSION
DIRECTORATE GENERAL
ECONOMIC AND FINANCIAL AFFAIRS

Brussels, 20 May 2020

Assessment of the 2020 Convergence Programme for

Hungary

(Note prepared by DG ECFIN staff)

CONTENTS

EXECUTIVE SUMMARY

- On 6 April 2020, the Commission provided guidelines to the Economic and Financial Committee on how the format and content of the 2020 Stability and Convergence Programmes can be streamlined in light of the exceptional circumstances related to the Covid-19 pandemic. This assessment takes into account the severe constraints that Member States faced in providing the information usually required in their Programmes. The assessment focuses on the near term in light of the high uncertainty attached to the projections.
- The Hungarian economy grew by 4.9% in 2019. According to the 2020 Convergence Programme, the economy is expected to contract by 3.0% in 2020 and to recover by 4.8% in 2021. Real GDP growth is expected to average at around 4.2% in the following years until 2024. The Commission 2020 spring forecast projects a stronger contraction in 2020, at 7.0%, followed by a recovery of 6.0% in 2021.
- Based on the Convergence Programme, the headline deficit is planned to deteriorate from 2.0% of GDP in 2019 to 3.8% of GDP in 2020. The deficit is expected to decrease to 2.7% in 2021 and to gradually reach 1.0% of GDP by 2024. The Commission projects higher deficits, at 5.2% of GDP and 4.0% of GDP in 2020 and 2021 respectively.
- The policy measures adopted so far to mitigate the economic and social impact of the COVID-19 pandemic are estimated in the Convergence Programme to have a budgetary impact of 2.8% of GDP in 2020. However, these are entirely financed through reallocation of expenditures within the budget, reserves and new taxes. The measures include wage subsidies, tax relief for business and the costs related to the medical emergency expenditure. Additional measures (for a total of 1.8% of GDP) to support the economic recovery and the labour market have been announced but have not yet been specified or adopted. Liquidity measures, with no direct impact on the deficit, are estimated in the Programme to amount to 1.8% of GDP.
- The debt-to-GDP ratio decreased from 70.2% of GDP in 2018 to 66.3% of GDP in 2019, in line with the debt reduction benchmark. The Convergence Programme plans the general government debt to increase to 72.6% of GDP in 2020. In 2021, the debt-to-GDP ratio is expected to decrease to 69.3% and to further decline reaching 59.8% by the end of 2024. These debt projections are below the Commission forecast of 75.0% of GDP and 73.5% of GDP respectively in 2020 and 2021.
- The macroeconomic and fiscal outlook are affected by high uncertainty due to the outbreak of the COVID-19 pandemic.

1. INTRODUCTION

This document assesses the economic and budgetary projections contained in the 2020 Convergence Programme of Hungary covering the period 2019-2024 (hereafter called the Programme), which was submitted on 4 May 2020, after the deadline of 30 April established by the Regulation. The note also assesses Hungary's compliance with the preventive arm of the Stability and Growth Pact in 2019 as well as compliance with the Council Recommendation of 5 December 2019 under the significant deviation procedure.

Hungary is currently subject to the preventive arm of the Stability and Growth Pact. As the debt ratio was 66.3% of GDP in 2019, exceeding the 60% of GDP reference value, Hungary is also subject to the debt reduction benchmark.

On 20 March 2020, the Commission adopted a Communication on the activation of the general escape clause of the Stability and Growth Pact. The clause, as set out in Articles 5(1), 6(3), 9(1) and 10(3) of Regulation (EC) 1466/97 and Articles 3(5) and 5(2) of Regulation (EC) 1467/97, facilitates the coordination of budgetary policies in times of severe economic downturn. In its Communication, the Commission shared with the Council its view that, given the expected severe economic downturn resulting from the COVID-19 outbreak, the current conditions permit the activation of the clause. On 23 March 2020, the Ministers of Finance of the Member States agreed with the assessment of the Commission. The activation of the general escape clause allows for a temporary departure from the adjustment path towards the medium-term budgetary objective, provided that this does not endanger fiscal sustainability in the medium term. For the corrective arm, the Council may also decide, on a recommendation from the Commission, to adopt a revised fiscal trajectory. The general escape clause does not suspend the procedures of the Stability and Growth Pact. It allows Member States to depart from the budgetary requirements that would normally apply while enabling the Commission and the Council to undertake the necessary policy coordination measures within the framework of the Pact.

Hungary is among those Member States who have triggered national escape clauses to suspend budgetary constraints set by their national fiscal rules, as part of the effort to accommodate the budgetary implications of the outbreak.

2. MACROECONOMIC DEVELOPMENTS

The Hungarian economy reached the peak of the economic cycle before the COVID-19 pandemic. Real GDP rose by 4.9% in 2019, fuelled by the robust growth of consumption and investment. The economy maintained strong momentum in the first months of 2020. After the emergence of the first COVID-19 cases in Hungary on 3 March, the government shut down borders, closed schools, restricted shop opening hours and closed certain services as of 16 March, and introduced a partial curfew from 28 March. The curfew and certain restrictions on commercial activities were lifted outside Central Hungary from 4 May.

The macroeconomic scenario underlying the Convergence Programme expects real GDP to decrease by 3% in 2020 due to the pandemic, followed by a rebound of 4.8% in 2021. The 2020 GDP decline is largely driven by falling exports and investment. Private consumption is expected to slow down in line with decreasing employment and lower wage growth. Exports and consumption are projected to drive the recovery in 2021, while investment is expected to remain below its 2019 level until 2022. In

2022-2024, GDP growth is projected to reach an average 4.3% as the economy returns to the pre-COVID-19 growth path.

The projection of the Convergence Programme is based on the assumption that the pandemic is successfully contained across Europe in the second quarter of 2020, and economic activity can recover from the third quarter, albeit with persistently weaker demand in certain sectors (e.g. tourism). If the containment is delayed by one or two quarters, the 2020 GDP decline is estimated in the Programme to be 2.6 or 4.3 percentage points larger, respectively, and the size of the recovery in 2021 is also expected to be slower.

The Commission spring forecast projects a significantly larger, 7% decrease of real GDP in 2020. The recovery is projected to be partial, with real output remaining below its 2019 level in 2021 as well. In particular, the Commission forecast expects a larger decline in private consumption, driven by a sharper labour market reaction and a strong rise in precautionary saving.

Table 1: Comparison of macroeconomic developments and forecasts

	2019		2020		2021		2022	2023	2024
	COM	CP	COM	CP	COM	CP	CP	CP	CP
Real GDP (% change)	4.9	4.9	-7.0	-3.0	6.0	4.8	4.6	4.3	4.2
Private consumption (% change)	5.1	5.0	-6.0	0.9	5.5	3.8	4.6	4.6	4.5
Gross fixed capital formation (% change)	15.3	15.3	-18.7	-8.8	8.9	5.5	4.8	3.4	3.2
Exports of goods and services (% change)	6.0	6.0	-14.0	-8.3	11.2	10.5	7.3	6.5	7.0
Imports of goods and services (% change)	6.9	6.9	-15.0	-6.8	10.1	8.9	6.3	5.6	6.2
Contributions to real GDP growth:									
- Final domestic demand	6.7	6.7	-7.3	-1.8	4.6	3.4	3.6	3.3	3.2
- Change in inventories	-1.3	-1.3	0.0	0.3	0.0	0.0	0.0	0.0	0.0
- Net exports	-0.4	-0.4	0.2	-1.5	1.3	1.4	1.0	1.0	0.9
Output gap[1]	4.1	3.3	-5.2	-3.2	-2.1	-1.9	-0.8	0.2	1.2
Employment (% change)	1.7	1.0	-3.8	-1.8	1.1	1.6	0.8	0.4	0.3
Unemployment rate (%)	3.4	3.4	7.0	5.6	6.1	4.3	3.7	3.5	3.3
Labour productivity (% change)	3.2	3.9	-3.4	-1.2	4.8	3.2	3.8	3.8	3.8
HICP inflation (%)	3.4	3.4	3.0	2.8	2.7	3.0	3.0	3.0	3.0
GDP deflator (% change)	4.5	4.5	4.2	3.7	3.1	3.2	3.3	3.2	3.2
Comp. of employees (per head, % change)	9.4	10.5	5.0	3.9	4.4	6.0	6.1	6.5	6.0
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	0.9	1.0	3.3	1.6	3.4	2.5	2.9	3.4	1.5

Note:

[1]In % of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly

Source :

Commission 2020 spring forecast (COM); Convergence Programme (CP).

3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS

3.1. DEFICIT DEVELOPMENTS AND MEDIUM-TERM STRATEGY AND TARGETS

The budget deficit improved only marginally in 2019, to 2.0% of GDP following 2.1% of GDP in 2018. Revenues continued to be supported by high income and consumption growth. Expenditure items were also dynamic, partly as a result of tightening procedural rules, which limit budgetary institutions' possibility to carry over unused funds to the following fiscal years. Public investment continued growing also on the back of increased EU funds absorption, while capital transfers were boosted by the take-up of the prenatal funding scheme of the 'demography programme'.

The 2019 budgetary outturn was worse than the 1.8% of GDP deficit target set in the 2019 Convergence Programme and confirmed in the Autumn 2019 EDP notification. This was explained by higher-than-expected expenditure, especially at the end of the year. Overall, the higher-than-expected revenues, were offset by higher-than-projected expenditure, especially on intermediate consumption and subsidies. The structural deficit is estimated to have increased to 3.8% of GDP in 2019, from 3.6% in 2018.

For 2020, the Convergence Programme targets a headline deficit of 3.8% of GDP. EU fund absorption is planned to increase marginally (by 0.1 percentage point) compared to the previous year and to reach 2.2% of GDP. As a share of GDP, tax revenues are expected to remain unchanged compared to the previous year. Current expenditure as a share of GDP is planned to increase by 3.1 percentage points, driven by intermediate consumption, other current expenditure and social transfers, following the impact of the measures to contain the pandemic and support the economy. At the same time, the Convergence Programme expects capital expenditure to drop by 1.4% of GDP, despite the impact of loan and investment subsidies in the framework of the 'demography programme' aimed at boosting fertility rates and government guarantees related to subsidized loan programmes. Based on the Convergence Programme, the policy measures adopted so far to mitigate the economic and social impact of the COVID-19 pandemic are estimated to have a budgetary impact of 2.8% of GDP in 2020. However, these are entirely financed through reallocation of expenditures within the budget, reserves and new taxes. The Convergence Programme qualifies part of the COVID-19 measures, notably 2.1% of GDP, as one-off measures in 2020.

In 2021, according to the Convergence Programme, the deficit is expected to decrease to 2.7% of GDP. The recovery in tax revenue is expected to be modest, whereas current expenditure is expected to drop, while public investment is projected to increase sharply, supported also by EU funds.

Over the medium term[1], the Convergence Programme expects the deficit to decrease to 2.2% in 2022 and to gradually reach 1.0% of GDP in 2024. These plans are based on macroeconomic assumptions that assume an average real GDP growth of around 4.4% in the 2022-2024 period. The planned consolidation effort in the Programme is not underpinned by measures.

[1] The Medium-Term Objective reflects the objectives of the Pact.

Table 2: General government budgetary position

(% of GDP)	2019	2020		2021		2022	2023	2024	Change: 2019-2024
	COM	COM	CP	COM	CP	CP	CP	CP	CP
Revenue	**44.0**	**45.1**	**44.0**	**43.6**	**43.2**	**41.3**	**40.3**	**38.8**	**-5.2**
of which:									
- Taxes on production and imports	18.2	18.3	18.2	17.8	18.2	17.7	17.4	17.2	**-1.0**
- Current taxes on income, wealth, etc.	6.7	7.2	7.2	7.0	7.2	7.2	7.1	7.1	**0.4**
- Social contributions	11.9	12.0	11.5	11.5	11.4	10.8	10.3	10.1	**-1.8**
- Other (residual)	7.2	7.7	7.1	7.4	6.4	5.6	5.5	4.4	**-2.8**
Expenditure	**46.1**	**50.3**	**47.8**	**47.7**	**45.9**	**43.5**	**41.9**	**39.8**	**-6.3**
of which:									
- Primary expenditure	43.8	47.8	45.4	45.2	43.6	41.3	39.8	37.8	**-6.0**
of which:									
Compensation of employees+Intermediate	18.4	20.7	19.5	19.5	17.5	16.4	15.9	15.1	**-3.3**
Compensation of employees	10.2	11.2	10.7	10.7	10.0	9.5	9.2	8.7	**-1.5**
Intermediate consumption	8.2	9.4	8.8	8.8	7.5	6.9	6.7	6.5	**-1.7**
Social payments	12.2	13.7	12.9	13.0	12.4	12.0	11.8	11.5	**-0.7**
Subsidies	1.7	1.7	2.0	1.6	1.6	1.5	1.4	1.3	**-0.4**
Gross fixed capital formation	6.0	5.8	5.1	5.7	5.8	5.2	4.5	4.3	**-1.7**
Other (residual)	5.5	5.9	5.8	5.4	6.2	6.3	4.0	3.5	**-2.0**
- Interest expenditure	2.3	2.5	2.4	2.4	2.3	2.2	2.1	2.0	**-0.3**
General government balance (GGB)	**-2.0**	**-5.2**	**-3.8**	**-4.0**	**-2.7**	**-2.2**	**-1.6**	**-1.0**	**1.0**
Primary balance	**0.2**	**-2.6**	**-1.4**	**-1.6**	**-0.4**	**0.0**	**0.6**	**1.0**	**0.8**
One-off and other temporary measures	-0.2	-0.2	-2.1	0.0	0.0	0.0	0.0	0.0	**0.2**
GGB excl. one-offs	**-1.9**	**-5.0**	**-1.7**	**-4.0**	**-2.7**	**-2.2**	**-1.6**	**-1.0**	**0.9**
Output gap[1]	4.1	-5.2	-3.2	-2.1	-1.9	-0.8	0.2	1.2	**-2.1**
Cyclically-adjusted balance[1]	-3.9	-2.8	-2.2	-3.1	-1.8	-1.8	-1.7	-1.6	**2.1**
Structural balance[2]	**-3.8**	**-2.6**	**-0.1**	**-3.1**	**-1.8**	**-1.8**	**-1.7**	**-1.6**	**1.9**
Structural primary balance[2]	-1.5	-0.1	2.3	-0.6	0.5	0.4	0.4	0.4	**1.6**
Gross debt ratio	**66.3**	**75.0**	**72.6**	**73.5**	**69.3**	**66.3**	**63.2**	**59.8**	**-6.5**

Notes:

[1]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission on the basis of the programme scenario using the commonly agreed methodology.

[2]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source :

Convergence Programme (CP); Commission 2020 spring forecasts (COM); Commission calculations.

The Commission 2020 spring forecast, taking into account the impact of automatic stabilisers as well as of sufficiently detailed and adopted or at least credibly announced measures, projects the government deficit at 5.2% of GDP for 2020, which is higher than the authorities' target. The difference is explained by the less optimistic macroeconomic outlook, contributing to a lower growth of current taxes in the Commission forecast, and higher expected growth of government spending, with the Commission forecast projecting a milder drop in capital expenditure. For 2021, the deficit target of 2.7% of GDP set by the authorities is lower than in the Commission forecast, following also the lower base in the previous year.[2]

3.2. MEASURES UNDERPINNING THE PROGRAMME

The Hungarian authorities have announced and implemented measures in several waves since mid-March to mitigate the economic, social and economic impact of the COVID-19 crisis.

The Convergence Programme contains several fiscal policy measures to support the recovery under the so-called Economy Protection Action Plan. The Plan has been indicated to amount to 2.3% of GDP and consists of five programmes, with a view to: retain jobs, create jobs through investments, support pensioners, provide financing for companies and support priority sectors. Of those, so far, only measures in the area of jobs protection (0.4% of GDP) have been adopted; these include a wage subsidy scheme that covers a part of wages lost due to reduced working time, and a wage subsidy scheme for R&D jobs. Also, certain family support benefits that would have ended during the year were extended until end-2020. Tax measures have been adopted, for a total of 0.8% of GDP, to alleviate the tax burden on businesses: these include the bringing forward of the planned 2 pps. cut to employers' social contributions from October to July; some temporary tax cuts in affected sectors including tourism and services; and a tax deferral within the year (from May to September) for annual tax returns, special payment facilities and the acceleration of VAT refunds. Finally, funds for 1.4% of GDP have been allocated and almost entirely spent for the medical emergency and to grant a one-off bonus for healthcare workers in 2020. Overall, the fiscal measures adopted by the government amount to 2.8% of GDP. The Convergence Programme plans additional measures of 1.8% of GDP, which are not sufficiently specified to be assessed. The expansionary measures are largely financed from the reshuffling of existing budgetary chapters and reserves (2.9% of GDP) as well as new taxes on banks and retail companies (0.2% of GDP). Should all the announced but not yet implemented measures be adopted, this could have a deficit increasing impact of 1.4% of GDP.

The authorities have introduced liquidity enhancing measures, notably a payment moratorium for companies and households on loan and financial lease contracts until end-2020, which is not quantified in the Convergence Programme. The government launched credit guarantee programmes and government guaranteed loans for a total of 1.5% of GDP and other programmes (0.3% of GDP) are not yet adopted. The central bank adopted measures to provide unlimited liquidity to the financial sector and to purchase government bonds on the secondary market. Lastly, Hungary submitted several state aid measures for approval for 3.1% of GDP, including grants, subsidised loan, guarantees and the wage subsidy scheme for R&D jobs.

Some of the fiscal measures adopted so far remain limited in time, notably only for 3 or 4 months, and with no clear target, while the crisis could have a widespread and longer impact on the economy. The measures aimed at supporting businesses are

[2] In light of the activation of the general escape clause, the measures taken in response to the coronavirus outbreak in 2020 are not treated as one-off and are thus not excluded from the estimation of the structural budget balance.

not directly targeted at SMEs and large enterprises (including foreign investors) can also benefit from them. In the area of social subsidies, the measures adopted concern only the extension of some limited benefits, while unemployment benefits' duration is the lowest in the EU. The liquidity measures look relatively ambitious but remain largely untargeted, which could reduce their impact.

Overall, the measures taken by Hungary are in line with the guidelines set out in the Commission Communication on a coordinated economic response to the COVID-19 outbreak.[3] The full implementation of those measures, followed by a refocusing of fiscal policies towards achieving prudent medium term fiscal positions when economic conditions allow, will contribute to preserving fiscal sustainability in the medium term. The overall budgetary impact of the fiscal measures reported in the Convergence Programme differs from that included in the Commission 2020 spring forecast. The Commission forecast includes measures with a net deficit-increasing impact of 0.2% of GDP, i.e. only those that were sufficiently specified. The Convergence Programme includes part of the COVID-related measures (2.1% of GDP) as one-offs for 2020, while the Commission forecast includes one-off measures with a deficit-increasing effect amounting to 0.2% of GDP related to a correction of EU funding.

For 2021, and the following years, the Convergence Programme includes the gradual introduction of the 13th month pension, adopted by the government as part of the COVID-measures. The Programme mentions measures adopted in the past and which will have an impact over the projection horizon, without specifying their amount. The Programme also includes a broad list of measures adopted and implemented in recent years in the area of taxation and recalls that tax policy in the coming years will continue to focus on reducing taxes on labour as well as the tax and administrative burden on businesses, increasing the efficiency of tax collection and simplifying the tax system. To this end, the Convergence Programme mentions the extension of the online invoicing system as of July 2020, with the ultimate aim of generating pre-filled VAT declarations for all companies.

[3] https://ec.europa.eu/info/sites/info/files/communication-coordinated-economic-response-covid19-march-2020_en.pdf

Table 3: Discretionary measures adopted/announced in response to COVID-19 outbreak

List of measures	Description	ESA Code (Expenditure/ Revenue component)	Adoption Status	Budgetary impact (% of GDP - change from previous year	
				2020	2021
EXPENDITURES OF PROTECTION AGAINST THE EPIDEMIC				**1.43%**	**0.00%**
Expenditures of protection against the epidemic	Procurement of equipments, investments, other measures	P.2, P.51	Adopted	1.26%	
One-off wage supplementation of healthcare workers by gross 500 000 HUF in 2020.		D.1	Adopted	0.15%	
Prolongation of maternity leave benefits (GYES and GYED)	Those family supports would expire during the crisis will be prolonged	D.62	Adopted	0.02%	
ECONOMY PROTECTION ACTION PLAN			**Partially adopted**	**2.34%**	**1.12%**
Employment protection			**Adopted**	**0.37%**	
	Employment protection wage subsidy (Kurzarbeit). The Hungarian State covers 70% of the amount of net wages lost because of shortened shifts	D.3	Adopted	0.32%	
	Employment protection wage subsidy: 40% wage subsidy for those who work in engineering (research and development) field	D.3	Adopted	0.05%	
Creating employment			**Partially adopted**	**0.50%**	**0.29%**
Thereof					
	Competitiveness-increasing support needed because of the coronavirus pandemic	D.7	Adopted	0.11%	
Relaunching the economy		**D.7, D.9, P.51**	**Pending**	**1.37%**	**0.61%**
Financing of businesses		**D.9**	**Partially adopted**	**0.10%**	**0.22%**
Thereof					
	Guarantee programmes	D.9	Partially adopted	0.06%	0.14%
TAX MEASURES				**0.76%**	**0.54%**
Measures related to Széchenyi Recreational Card (fringe benefits)	Social contribution tax of Széchenyi Recreational Card decreases to 0%	D611C-C08	Adopted	-0.02%	
	The envelope of Széchenyi Recreational Card in 2020 increases from HUF 450 000 to HUF 800 000 in the private sector and from HUF 200 000 to HUF 400 000 in the	D611C-C08	Adopted	-0.02%	

	public sector				
Temporary cancellation of tourism development contribution	Tourism development contribution has not to be paid from 1 March to 30 June	D214H-C04	Adopted	-0.03%	
Decreasing burdens of employers and employees in certain sectors	Employers are exempted from paying contributions, employees are exempted from paying pension insurance contribution and only have to pay the minimal amount of healthcare contribution required by the law until 30 June in certain sectors.	D611C-C08	Adopted	-0.13%	
Exemption from paying rehabilitation contribution tax in certain industries	Exemption from paying rehabilitation contribution tax in certain industries until 30 June	D29C-C01	Adopted	-0.01%	
Exempting beneficiary industries from paying vocational training levy	Exemption of certain industries from paying vocational training levy until 30 June	D29C-C02	Adopted	-0.01%	
Temporary tax holiday for small businesses in certain industries under the simplified, small business oriented tax regime (KATA)	Temporary tax holiday for small businesses in certain industries under the simplified, small business oriented tax regime (KATA) until 30 June	D29C-C05	Adopted	-0.06%	
Tax subsidies will be granted for certain industries in the case of paying KIVA (small business tax)	Industries affected by the epidemic the most are exempted from paying KIVA after personnel costs between March and June	D29C-C06	Adopted	-0.01%	
Excise duty-subsidy in the case of producing disinfectants	As an authorised warehouse keeper with a temporary authorisation for biocidal products, after a simple registration one can produce disinfectants without denaturing free of excise-duty	D214A-C03	Adopted	-0.00%	
Municipalities will be annual VAT declarants	If a municipality is a taxpayer obliged to pay VAT then the tax assessment period for assessing VAT is the calendar year. Annual tax payments affect ca. HUF 80-81 billion VAT liabilities. The pro rata temporis part of these liabilities between March and December in 2020, expecting a proportional distribution within the year, would cause a loss of ca. HUF 60 billion for the central budget.	D211-C01	Adopted	-0.13%	0.12%

Another decrease of Social contribution tax by 2 percentage points from Q3 of 2020	Tax rate decreases by 2 percentage points from 17,5% to 15,5% from 1 July 2020	D611C-C01	Adopted	-0.34%	-0.64%
KIVA (small business tax) is going to decrease by 1 percentage point	Rate of KIVA (small business tax) will be decreased from 12 to 11 % from 2021	D29C-C06	Adopted		-0.02%
TOTAL MEASURES				**4.55%**	**1.68%**
of which: Adopted				**2.75%**	**0.78%**
FUNDRAISING MEASURES					
Reallocating from budgetary heading to the Economy Protection Fund	The Government as the source of economy protection measures reallocated the funding of institutions as the smaller part and as the greater part the funding of those programmes can be postponed	P.51, P.2, D.7, D.9	Adopted	-1.96%	
Central Reserve of the Protection Against the Epidemic	Using the Country Protection Fund for the protection against the epidemic	P.2	Adopted	-0.80%	
Decreasing the funding of political parties	Reallocating 50% of the funding of political parties	D.7	Adopted	-0.003%	
Budgetary transfers	Budgetary transfers	P.2	Adopted	-0.10%	
Introduction of retail tax	Introduction of special retail tax from 1 May 2020	D.29	Adopted	0.08%	0.11%
Shifting motor-vehicle tax into the central budget	Shifting motor-vehicle tax into the central budget	D.29, D.59	Adopted	0.07%	
Contribution of the banking sector	The top rate of the bank tax imposed on financial institutions is going to increase by 0.19 percentage points in 2020. The higher amount of tax payed as a result of the increase will support the Protection Fund Against the Epidemic. Financial institutions will be able to deduct this surcharge from their tax liabilities of the next five years in equal instalments.	D214I-C06	Adopted	0.12%	-0.02%
TOTAL FUNDRAISING MEASURES				**3.13%**	**0.08%**

Source: Convergence Programme.

Table 4: Guarantees adopted/announced in response to COVID-19 outbreak

List of measures	Description	Adoption Status	Maximum amount of contingent liability* (% of GDP)	
MFB Vis Maior Guarantee Programme	Loan repayment guarantee provided by MFB (Hungarian Development Bank) for SMEs and big enterprises, the Hungarian State grants irrevocable collateral surety up to 90% of the guarantee.	Adopted by government decision		0.11%
Garantiqa Krízis Garanciaprogram / Garantiqa Crisis Guarantee Programme	Tackling financial difficulties and liquidity problems of companies caused by the spread of COVID-19. For the guarantees granted to restore and maintain the operability of firms, the Hungarian State grants counter sureties up to 90% of the guarantee with subsidising the fee of the guarantor as well.	Adopted by government decision		1.06%
Increase the available amount of the surety for Guarantiqa counter guarantee provided by the Hungarian state	In line with the conditions previously introduced, granting state counter surety for the guarantee granted, with also subsidising the fee of the guarantor up to as much as 85% of the guarantee.	Adopted by government decision		0.28%
AVHGA Krízis Agrárgaranciaprogram /AVHGA Crisis Agrarian Guarantee Programme	Tackling financial difficulties and liquidity problems of agricultural companies caused by the spread of COVID-19. For the guarantees granted to restore and maintain the operability of agricultural firms the Hungarian State grants counter sureties up to 90% of the guarantee with subsidising the fee of the guarantor as well.	Work is in progress		0.21%
EXIM Kárenyhítő Garanciaprogram/ EXIM Compensation Guarantee Programme	Providing guarantees with state background for business loans provided by financial institutions in order to overcome liquidity difficulties caused by the COVID-19 epidemic and to assure the continuous economic activity of enterprises, providing state surety for these guarantees up to 100% of the guarantee.	Work is in progress		0.11%
			Total	**1.76%**

***** Any possible budgetary impact related to the call of those guarantees should be provided in Table 3.
Source: Convergence Programme.

3.3. DEBT DEVELOPMENTS

In 2019, the general government debt-to-GDP ratio continued declining, from 70.2% in 2018 to 66.3%. The reduction was driven by the high nominal GDP growth, which more than compensated the small debt-increasing impact of stock-flow adjustments.

The Convergence Programme projects an increase of the debt ratio to 72.6% of GDP in 2020. The projected increase is due to the increase in the headline primary deficit, the low nominal GDP growth and sizable debt-increasing stock-flow adjustments. The debt-to-GDP ratio is projected to decline to 69.3% by the end of 2021. It is then planned to decline to 59.8% by the end of 2024, corresponding to an average annual reduction of 3.2 percentage points over the 2022-2024 period. The decrease in the debt-to-GDP ratio is strongly supported by a favourable snowball effect, although to a declining extent over the forecast horizon. This is due to a projected high nominal GDP growth and continuing decreases in interest spending. The improvement in the primary balance is also increasingly contributing to the debt-reduction path. The stock-flow adjustment is expected to be favourable in 2021 and 2022.

The Commission 2020 spring forecast projects a higher debt-to-GDP ratio for 2020 and 2021 than the Convergence Programme. The debt-to-GDP ratio is expected to increase to 75.0% in 2020 and to decline to 73.5% by the end of 2021. The difference is explained by lower nominal GDP growth and higher primary deficits, while over the two years taken together, the debt-increasing impact of the stock-flow adjustment is broadly similar.

Table 5: Debt developments

(% of GDP)	Average 2014-2018	2019	2020		2021		2022	2023	2024
			COM	CP	COM	CP	CP	CP	CP
Gross debt ratio[1]	**74.3**	**66.3**	**75.0**	**72.6**	**73.5**	**69.3**	**66.3**	**63.2**	**59.8**
Change in the ratio	-1.4	-3.9	8.7	6.3	-1.5	-3.3	-3.0	-3.1	-3.4
Contributions [2]*:*									
1. Primary balance	**-0.9**	**-0.2**	**2.6**	**1.4**	**1.6**	**0.4**	**0.0**	**-0.6**	**-1.0**
2. "Snow-ball" effect	**-1.8**	**-3.8**	**4.5**	**2.0**	**-3.8**	**-3.1**	**-2.8**	**-2.5**	**-2.3**
Of which:									
Interest expenditure	3.1	2.3	2.5	2.4	2.4	2.3	2.2	2.1	2.0
Growth effect	-2.8	-3.2	4.8	2.0	-4.1	-3.2	-3.0	-2.6	-2.5
Inflation effect	-2.1	-2.9	-2.9	-2.4	-2.1	-2.2	-2.1	-2.0	-1.9
3. Stock-flow adjustment	**1.3**	**0.3**	**1.4**	**2.8**	**0.8**	**-0.5**	**-0.1**	**0.0**	**0.0**

Notes:

[1] End of period.

[2] The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

Source :

Commission 2020 spring forecast (COM); Convergence Programme (CP), Comission calculations.

3.4. RISK ASSESSMENT

The macroeconomic and fiscal outlook are affected by high uncertainty due to the outbreak of the COVID-19 pandemic. The pandemic could become more severe and last longer than assumed, requiring more stringent and longer lasting containment measures. This would result in worse economic and fiscal outcomes. It could also require further fiscal policy measures. That would result in worse fiscal outcomes but help to mitigate the economic impact. An additional risk stems from the considerable size of public guarantees issued in response to the crisis.

The risk scenarios of the Convergence Programme also point towards lower GDP growth and a higher budget deficit.

Over the last four years, recurrent end-year spending of higher-than-budgeted revenues and reserves seems to have become a way of financing systematically underbudgeted expenditure items. This suggests that not all reserves in the budget can be freely disposed of to cover pandemic-related expenditure. The deficit projections seem also to rely on some revenue buoyancy, as the projected increase in tax revenues does not appear to be fully explained by the underlying macroeconomic scenario, nor is it underpinned by measures. This points to potentially lower-than-projected revenues.

The risks to the planned debt trajectory are largely similar to those affecting the deficit target. However, macroeconomic risks can affect debt-to-GDP ratios in an amplified manner, simultaneously through a higher-than-planned deficit and a lower denominator (i.e. a less favourable “snow-ball”) effect. Additional risks stem from the sensitivity of the debt level to exchange rate movements, as currently around 17% of government debt is denominated in foreign currency. The debt trajectory of the programme is also shaped by the cash-flow effects of EU transfers. A slower-than-planned implementation of EU funded projects would imply a slower debt reduction than anticipated.

4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT

4.1. Compliance with the deficit criterion

According to the Convergence Programme, Hungary’s general government deficit is expected to reach 3.8% of GDP in 2020, thereby exceeding the Treaty reference value of 3% of GDP. This provides prima facie evidence of the existence of an excessive deficit in Hungary for the purposes of the Treaty and the Stability and Growth Pact. The Commission has therefore prepared a report under Article 126(3) TFEU, which analyses Hungary’s compliance with the deficit criterion of the Treaty. Overall, the analysis suggests that the deficit criterion as defined in the Treaty and in Regulation (EC) No 1467/1997 is not fulfilled.

4.2. Compliance with the debt criterion

As the debt ratio exceeds the 60% of GDP reference value, Hungary is subject to the debt reduction benchmark of the Stability and Growth Pact.

In 2019, Hungary complied with the debt reduction benchmark, with a gap of more than 5% of GDP. Based on the Commission 2020 spring forecast, the debt reduction benchmark is expected not to be met in 2020, and to be respected in 2021.

According to information provided in the Convergence Programme, Hungary is expected to meet the debt reduction benchmark in 2020 and in 2021, since the debt-to-GDP ratio is planned to remain below the debt reduction benchmark.

4.3. Compliance with the required adjustment path towards the MTO

On 14 June 2019, the Council recommended Hungary to take the necessary measures to ensure that the nominal growth rate of net primary government expenditure does not exceed 3.3% in 2019 and 4.7% in 2020, corresponding to an annual structural adjustment of 1% of GDP in 2019 and 0.75% of GDP in 2020. On 5 December 2019, the Council decided that Hungary had not taken effective action in response to its Recommendation of 14 June 2019, and issued a revised recommendation. In the Recommendation of 5 December 2019, the Council asked Hungary to take the necessary measures to ensure that the nominal growth rate of net primary government expenditure does not exceed 4.7% in 2020, corresponding to an annual structural adjustment of 0.75% of GDP in 2020.

According to outturn data and the Commission 2020 spring forecast, in 2019 both pillars point to a significant deviation from the required adjustment towards the medium-term budgetary objective. The growth of nominal primary government expenditure, net of discretionary revenue measures and one-offs, was well above the expenditure benchmark of 3.3% in 2019, pointing to a significant deviation (deviation of 2.3% of GDP). The structural balance worsened from 3.6% of GDP in 2018 to 3.8% of GDP in 2019, thus also pointing to a significant deviation from the recommended structural adjustment (deviation of 1.2% of GDP). The compliance with the expenditure benchmark is negatively impacted by the lower GDP deflator underlying that indicator compared to the current estimates, and by the smoothing of nationally financed investment. The structural balance, in turn, is positively impacted by the higher potential growth estimate underlying that indicator but negatively impacted by revenue shortfalls. Taking into account these factors, the overall assessment confirms a significant deviation from the adjustment path towards the medium-term budgetary objective in 2019. This assessment is also in line with the earlier conclusion of 5 December 2019, when the Council found that Hungary had not taken effective action in response to the Council Recommendation of 14 June 2019. The conclusion of a significant deviation is confirmed when looking at 2018 and 2019 taken together.

In 2020, based on the Commission 2020 spring forecast, including the fiscal measures adopted until the cut-off date, the nominal growth rate of net primary government expenditure is expected to exceed the applicable expenditure benchmark of 4.7%, leading to a deviation of 1.5% of GDP from the requirement set in the Council Recommendation for 2020. The structural balance is expected to improve by 1.1% of GDP. This improvement is above the effort of 0.75% of GDP recommended by the Council by 0.4% of GDP. Therefore, the expenditure benchmark points to a risk of a deviation from the required adjustment while the structural balance points to compliance, with a relatively large discrepancy. The expenditure benchmark is negatively impacted by the use of a lower GDP deflator compared to current estimates and by the smoothing of investment. At the same time, the structural balance is positively influenced by revenue windfalls and negatively influenced by a lower point estimate of potential GDP growth (2.1%) underlying its calculation compared to the medium-term average (3.0%) underlying the expenditure benchmark. Overall, and in light of the activation of the general escape clause for 2020, which allows for a temporary departure from the adjustment path towards the medium-term budgetary objective, Hungary can be considered to have complied with the Council Recommendation of 5 December 2019.[4]

[4] The possible retroactive impact on output gap estimates as a result of the recession induced by the COVID-19 outbreak and the possibility of abnormal responses of government revenues to major swings in economic activity underline that compared to the structural balance the expenditure benchmark is likely to provide a more reliable and predictable indicator in times of severe economic downturn.

Table 6: Compliance with the requirements under the preventive arm

	(% of GDP)	2019	2020		2021	
	Background budgetary indicators[1]					
(1)	Medium-term objective (MTO)	-1.5	-1.0		-1.0	
(2)	Structural balance[2] (COM)	-3.8	-2.6		-3.1	
	Setting the required adjustment to the MTO					
(3)	Structural balance based on freezing (COM)	-3.3				
(4) = (1) - (3)	Position vis-a -vis the MTO[3]	Not at MTO				
(5)	Required adjustment[4]	1.0				
(6)	Required adjustment corrected[5]	1.0				
(8)	Corresponding expenditure benchmark[6]	3.3				
	Compliance with the required adjustment to the MTO					
		COM	**COM**	**CP**	**COM**	**CP**
	Structural balance pillar					
(8) = Δ (2)	Change in structural balance[7]	-0.2				
(9) = (8) - (6)	*One-year deviation from the required adjustment*[8]	-1.2				
	Two-year average deviation from the required adjustment[8]	-1.3				
	Expenditure benchmark pillar					
(10)	Net public expenditure annual growth corrected for one-offs[9]	9.5				
(11) = (10) - (8)	One-year deviation adjusted for one-offs[10]	-2.3				
	Two-year deviation adjusted for one-offs[10]	-1.8				
	Finding of the overall assessment	**Significant deviation**				
	Compliance with the debt criterion					
	Transition period					
	Required structural adjustment (MLSA)[11]					
	Structural adjustment[12]					
	After transistion period					
	Gap to the debt benchmark [13,14]	-5.2	2.0	-6.2	-1.1	0.0

Legend

'*Compliance*' - the recommended structural adjustment or a higher adjustment is being observed.

'*Some deviation*' - a deviation from the recommended structural adjustment is being observed, but it is below the threshold for a significant deviation.

'*Significant deviation*' - a deviation which has reached or breached the threshold for a significant deviation (i.e. 0.5% of GDP over one year, 0.25% of GDP over two years on average).

Notes

[1] The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage points (p.p.) is allowed in order to be evaluated as having reached the MTO.

[2] Structural balance = cyclically-adjusted government balance excluding one-off measures.

[3] Based on the relevant structural balance at year t-1.

[4] Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page 38.).

[5] Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

[6] Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A corrected rate applies as long as the country is adjusting towards its MTO, including in year t.

[7] Change in the structural balance compared to year t-1. Ex post assessment (for 2019) is carried out on the basis of Commission 2020 spring forecast.

[8] The difference of the change in the structural balance and the corrected required adjustment.

[9] Net public expenditure annual growth (in %) corrected for discretionary revenue measures, revenue measures mandated by law and one-offs (nominal)

[10] Deviation of the growth rate of public expenditure net of discretionary revenue measures, revenue increases mandated by law and one-offs from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

[11] Defines the remaining annual structural adjustment over the transition period which ensures that - if followed – Member State will comply with the debt reduction benchmark at the end of the transition period, assuming that COM (S/CP) budgetary projections for the previous years are achieved.

[12] Applicable only during the transition period of three years from the correction of the excessive deficit for EDP that were ongoing in November 2011.

[13] Not relevant for Member Sates that were subject to an EDP procedure in November 2011 and for a period of three years following the correction of the excessive deficit.

[14] Shows the difference between the debt-to-GDP ratio and the debt benchmark. If positive, projected gross debt-to-GDP ratio does not comply with the debt reduction benchmark.

Source:
Convergence Programme (CP); Commission 2020 spring forecast (COM); Commission calculations.