Opinion of the Fiscal Council

on the interim situation of the implementation of Act LV of 2023 on the Central Budget of Hungary for 2024 and on the expected development of public debt

I.

Background, legal basis and publicity of the preparation of the Opinion

The Fiscal Council (hereinafter referred to as the Council, Fiscal Council, FC) shall, in accordance with Section 23 (1) (c) of Act CXCIV of 2011 on the Economic Stability of Hungary (hereinafter referred to as the Stability Act, Stab. Act), issue an opinion on the state of implementation of the Central Budget Act and the expected development of public debt on a semi-annual basis.

On this basis, the Council reviewed the implementation of Act LV of 2023 on the 2024 Central Budget of Hungary (hereinafter: the 2024 Budget Act, hereinafter: the "2024 Budget Act") and the development of public debt in the first half of the year, the budgetary process, considering in some places the data for July-August, and the expected implementation of the Act.

In its Opinion on this issue, the Council, following its practice and working methodology, took note of the following background in the preparation of the 2024 central budget law.

- In its Opinion **(Resolution No. 4/2023.05.23. on the draft bill on the 2024 central budget of Hungary)** the Council stated that "the draft budget bill foresees economic growth of 4.0 percent in 2024, higher than the average of known domestic and international forecasts, supported by household consumption growth, a renewed dynamic increase in gross fixed capital formation and a growth rate of exports exceeding imports." It also indicated that it "considers that the economic growth projected by the government could materialize if external and domestic conditions are favourable, but that it is subject to a number of risks." Among these, the FC highlighted Russia's aggression against Ukraine and its response (sanctions), Europe's energy security problems, and the delay in negotiations on the disbursement of funds from the European Union to Hungary, which will continue to negatively affect the Hungarian economy in 2024.

  The Council has already previously considered it necessary "to bring the government sector deficit below 3 percent of GDP in order to balance the Hungarian economy and budget." This time, the FC concluded that the "draft budget bill is consistent with this: in 2024, the general government sector deficit on an accrual basis (ESA) will fall below the Maastricht criterion by 1.0 percentage point compared to 2023 to 2.9 percent, while the cash deficit of the central government subsystem will be reduced by 1.5 percentage points to 2.9 percent." It also pointed out that [...] "there are risks to the achievement of these targets. One is that the expected economic growth will not materialize, which would reduce budget revenues. As regards the outturn of revenues in 2024, there is a risk that some revenues, mainly related to consumption, are expected to underperform in 2023, which will worsen the base of these appropriations." Moreover, the Council "sees a serious risk that the appropriations for the budget bodies in kind, including energy compensation, will be significantly below the rate of price increases realized in 2022 and expected in 2023 and 2024." The Council pointed out that "the other operating appropriations of the budget headings of several institutions not under the control of the Government will decrease by up to 10 percent compared to the 2023 appropriations, which will lead to a very significant decrease in real terms for these institutions." The FC considered that "without targeted austerity and rationalization measures, there is a risk that the maintenance of the viability of the budgetary bodies will require large unplanned expenditures in 2024. All these, in the Council's view, also entail operational and service quality risks, which should be mitigated in the budget."

In its Opinion, the Council welcomed that "in line with the provisions of the Fundamental Law, the downward trend in the government debt ratio will continue and the draft budget bill envisages a reduction from 69.7% at the end of 2023 to 66.7% at the end of 2024. In view of the planned 3 percentage point reduction, the Council considered the reduction of the debt ratio to be achievable, despite the macroeconomic and budgetary risks described" and on this basis concluded that "the draft 2024 budget bill complies with the debt rule of the Fundamental Law and the provision of Article 4(2a) of the Stab.

The Council objected that the "draft bill does not include the expected necessary loss compensation of the Magyar Nemzeti Bank, thus it is not in line with Article 166 (3) of Act CXXXIX of 2013 on the Magyar Nemzeti Bank, which provides that "if the amount of equity capital falls below the subscribed capital at the end of the year under review, the difference shall be reimbursed by the central budget in equal annual instalments (...) within 5 years directly to the profit and loss reserve." Since the Central Bank's results have been largely negatively affected by the overall stimulus measures implemented in the context of the handling of the crisis and the subsequent interest rate increases necessary to bring down inflation, the Council considers it necessary that the draft law should take account of this expected legal obligation so that the deficit target and the debt rule continue to be met.

Finally, the Council concluded that it was necessary to draw attention to "the current limits to the predictability of macroeconomic conditions for budgetary planning, which leave the predictability of external developments surrounding the Hungarian economy in 2024 subject to large uncertainties." He also stressed that "the associated risks may require re-planning, which limits the role of the budget as an economic compass."

- In its Decision **(Resolution No. 5/2023.07.06., giving its preliminary consent to the final vote on the 2024 central budget bill)**, the Fiscal Council stated that "the public debt indicator planned for 31 December 2024 should be adjusted to the level of the 2024 budget of Hungary. T/4181/471 on the Central Budget of 2024 for the year 2024 [...] has been determined in accordance with the provisions of the Stability Act, in line with the macroeconomic and public finance developments underlying the bill. Since the value of the debt indicator calculated for the end of 2024 in the bill is 3 percentage points lower than the value of the indicator expected for the end of 2023, the requirement of Article 36(5) of the Fundamental Law is also fulfilled."

  However, the Council maintained "the bulk of its comments on the draft budget law, given that neither economic conditions nor the budget law have changed to such an extent that the risks indicated have been eliminated." Thus, it pointed out that "the prolonged war between Russia and Ukraine, the sanctions imposed in response to it and the sharp fluctuations in world energy prices, which affect both the expenditure and revenue sides of the budget, are creating greater than usual macroeconomic risks." It also stressed that "some elements of the economic developments in 2023 point to negative risks around the macroeconomic path underpinning the budget (lower-than-expected household consumption and higher-than-projected inflation), while other factors have been favourable in recent months (energy prices and the balance of payments)" and that "in several cases, the changes have a direct budgetary impact in 2024." The KT also indicated that "without targeted austerity and task rationalisation measures, there is a risk that maintaining the viability of budgetary bodies may require large unplanned expenditures in 2024."

  Even before the amendment, the Council welcomed the Government's initiative to amend the Act on the Magyar Nemzeti Bank in 2023, according to which "the negative capital of the central bank must be compensated primarily by the positive results expected in later years". In its decision, the FC indicated that the "budget takes into account the cohesion and recovery funds of the EU budget cycle 2021-2027, so the implementation of the budget is conditional on their receipt in the planned amount and time." The Council welcomed the fact that "the planned 3 percentage point reduction in the government debt ratio provides a significant margin to ensure that the risks indicated do not fundamentally jeopardize the reduction of the government debt ratio" and gave its consent to the final vote on the single budget bill T/4181/471.

- In its Opinion **(Resolution No. 4/2024.04.16 on the implementation of the Act on the Central Budget of Hungary for 2023 and the development of public debt)**, based on full-year trends, the Council concluded that "the domestic economy's performance declined by 0.9 percent, below the projections underlying the budget planning." It also pointed out that "the main reasons for the decline in GDP were the fall in domestic demand due to high inflation, geopolitical conflicts and the weak cyclical situation of our main external trading partners (above all Germany)." It also pointed out that both the fiscal and the accrual deficits were significantly higher than planned [...], "the actual cash deficit was 35.1 percent (HUF 1 193.2 billion) higher at HUF 4 493.4 billion. The ESA deficit was originally planned at 3.5 percent of GDP, which was increased to 3.9 percent of GDP in the revised budget. The actual deficit for 2023 was 6.7 percent of GDP, significantly higher than the government's expectation of 5.2 percent in autumn 2023."
According to the KT assessment „high inflation and lower-than-planned economic performance have had a significant negative impact on the budgetary position. Consumption-related tax revenues were significantly below target due to a fall in consumption because of high inflation', and interest expenditure was significantly higher than planned in the context of higher-than-planned government debt, higher inflation and government bond yields."

The Council also pointed out that "the cash deficit was increased by the fact that the government was forced to advance EU funding for the developments planned to be implemented under the 2021-2027 Cohesion Operational Programmes and the Recovery Plan due to the delay in the approval of the disbursement of EU funds to Hungary." However, the FC welcomed the fact that "the competent bodies of the European Union approved the Hungarian Recovery Plan at the end of 2023 and the judicial reform, so that Hungary could start receiving cohesion funds in December..."

The Council welcomed the fact that "the government debt indicator has been reduced from 74.1 percent at the end of 2022 to 73.5 percent at the end of 2023." [...] However, the FC pointed out that "the reduction fell short of the 2.3 percentage points targeted in the original budget and the 3.8 percentage points envisaged in the revised budget." In its opinion, the Council pointed out that "the 0.6 percentage point reduction in the debt ratio is the result of a significant nominal increase in GDP, with a higher-than-planned deficit and a decline in real GDP."

In addition, the FC Opinion drew attention to the forecasting constraints in the spring-summer budgeting process, supporting "the planning and submission of the budget closer to the current year in case of greater uncertainty in the macroeconomic path". Furthermore, "it considers it a forward-looking practice that if macroeconomic developments deviate significantly from the forecast used as a basis for budget planning, and the deficit and debt ratios are worse than the target, the Government will initiate an amendment to the Budget Law."

The Fiscal Council adopted its **Three-year outlook on macroeconomic and budgetary developments by Resolution No. 2/2024.01.05.** Notable among these are its main findings for 2024:

Regarding economic development, the Council considered that "Based on the still only slight growth of the economy in the second half of 2023, the 4 percent growth in 2024 assumed in the Convergence Programme will only be achieved under very favourable conditions, with a more realistic GDP growth of around 3 percent[1] ." Furthermore, "2024 will be a post-energy and post-inflation crisis year in which economic growth will depend on the speed of recovery, in particular the recovery of consumption and investment."

According to the Council, the debt rule "will only be met if the volume of GDP grows faster than the increase in public debt resulting from the government sector deficit and the revaluation of foreign currency debt. Consequently, a significant increase in real GDP and/or a significant reduction in the government sector deficit as a share of GDP is needed to meet the debt rule."

[1] The Three-Year Outlook took into account the Convergence Programme 2023-2027. Since then, the Convergence Programme for 2024-2028 has been published, which foresees economic growth of only 2.5% in 2024.

> To achieve the latter, the Council considers that "a significant improvement in the primary balance, a positive primary balance, is needed". This is because government sector interest expenditure as a share of GDP "is projected to rise to 4.1 per cent of GDP by 2024 according to the Convergence Programme[2] . Thus, a primary surplus of 1.2 percent of GDP [...] is needed to achieve the deficit target of 2.9 percent of GDP in 2024."

The Fiscal Council based its semi-annual assessment on the written analyses of the State Audit Office and the National Bank of Hungary on the budgetary processes of the first half of 2024, on the information provided by the Ministry of Finance and the Central Statistical Office on the situation of the economy in the first half of the year and of the central subsystem of the state budget at the end of June, as well as on the economic analyses and assessments of domestic research and analytical institutes, some major international organisations (OECD, IMF, World Bank, European Commission) and other domestic market analysts commissioned by the Fiscal Council's Secretariat. The Council also considered the findings of Hungary's Convergence Programme 2024-2028.

The Council shall inform the Speaker of the National Assembly and the Government of its Opinion and publish its assessment on the website of the National Assembly.

II.

Opinion of the Council

At its meeting on 26 September 2024, the Council reviewed the main processes and the background of the implementation of Act LV of 2023 on the Central Budget of Hungary for 2024 in the first half of the year, based on Article 23(1)(c) of the Stability Act. It has formulated the following Opinion on these.

1) The Council notes that the domestic economic situation and that in Europe will continue to be negatively affected in 2024 by the ongoing war between Russia and Ukraine, the generally tense geopolitical situation and the slowdown in European industrial production. These factors will continue to weigh heavily on the Hungarian economy, resulting in a 1.3 percent contraction in economic output in the first half of 2024 compared to the first half of 2023.

[2] Here again, the Three-Year Outlook is based on the Convergence Programme 2023-2027. In the new Convergence Programme for 2024-2028, interest expenditure as a share of GDP is projected to rise from 4.7% in 2023 to 4.9% in 2024, while the ESA deficit is planned to fall from 6.7% in 2023 to 4.5% in 2024. On this basis, the expectation for 2024 is for a positive primary balance of 0.4 percent, a smaller share than previously calculated.

2) The Council estimates that real economic growth this year will be significantly below the 4% planned in the Budget Law and is forecast to be below 2%. Economic growth will be supported by the expansion of household consumption through a dynamic rise in real wages, as well as favourable developments in net exports. Compared to the forecast underlying the budget law, the largest shortfall is expected in gross fixed capital formation. The domestic economy, and investment in particular, will be adversely affected by the delay in the negotiations on the disbursement of funds from the European Union.

3) The Fiscal Council assessed the fiscal developments in the light of the Government's increase in the ESA-based deficit target for 2024 to 4.5% of GDP from 2.9% in the Budget Law. However, the increased budget deficit target, like the expenditure measures announced in April 2024 and the revenue measures taken in July 2024, was not transposed in the Budget Law, so that the Council could only assess the implementation of individual appropriations against the original revenue and expenditure appropriations, which did not reflect the increased deficit target.

4) The Council considers that the risks it identified in its 2024 budget planning opinion, as detailed in Chapter I, have materialized. The deficit of the central sub-system of general government in the first half of the year amounted to HUF 2,656.4 billion, 105.6 percent of the annual appropriation set in the Budget Act. This is two-thirds of the general government cash deficit target of HUF 3,982 billion, which was increased in proportion to the revised ESA deficit. With the high cash deficit concentrated in the first half of the year, the accrual deficit in the first half of 2024 amounted to 3.9 percent of half-year GDP, according to the MNB's preliminary financial accounts. The main factors behind the higher-than-planned cash deficit were:

   a) On the revenue side, the high level of appropriations, which does not reflect last year's low execution, mainly results in lower than expected payments of general sales tax and excise duties, as well as, for specific reasons, of the energy sector.

   b) On the expenditure side, interest payments related to the financing of public debt, budgetary bodies and professional headings, expenditure on public assets and payments related to pensions were higher than planned.

   c) Budget revenues from the European Union were nearly HUF 370 billion below the expenditure of EU programmes.

5) The Council considers that the fiscal measures announced in April 2024, as well as those announced in early July, support the achievement of the new deficit target. Achieving the deficit target will require a consistent implementation of the measures and close monitoring and control of public expenditure towards the end of the year.

6) When drawing up its opinion in previous years, the Council considered the fact that EU budgetary rules, including the deficit requirement, were suspended during the Covid epidemic. The rules were reintroduced in 2024 and, because of a budget deficit above 3% of GDP both in the past and in the present, the Council of the European Union decided, on a proposal from the European Commission, to open an excessive deficit procedure for Hungary in July 2024.

7) The Fundamental Law provides for a reduction of the debt ratio if the debt ratio exceeds 50%, but the special emergency legislation introduced this year allows for derogations from the debt rule. The Stability Law requires that the government debt ratio should be reduced by at least 0.1 percentage points, while respecting EU rules on debt reduction. Compliance with the debt rule of the Stability Law would be exempted by a fall in gross domestic product.

8) The Council notes that the government debt-to-GDP ratio increased from 73.5 percent at the end of 2023 to 76.1 percent at the end of the first half of the year, due to the high cash deficit and the completion of a large part of the government debt issuance to finance the full-year deficit. The planned 3 percentage point reduction in the government debt ratio in the Budget Law is significantly moderated by the increased ESA deficit target for the cash deficit and lower-than-planned nominal GDP growth due to lower real GDP growth. This year's lower-than-expected debt reduction in the budget law is also reflected in the end-year debt indicator of 73.2 percent set in the government's EDP notification. The projected small decline in the debt ratio will necessarily require the achievement of the revised accrual and cash deficit target and a subdued second half of the year debt issuance by central and non-central governments. In addition, the Council notes that the exchange rate sensitivity of the debt has also increased as a result of the rising foreign exchange component of government debt.

III.

Justification

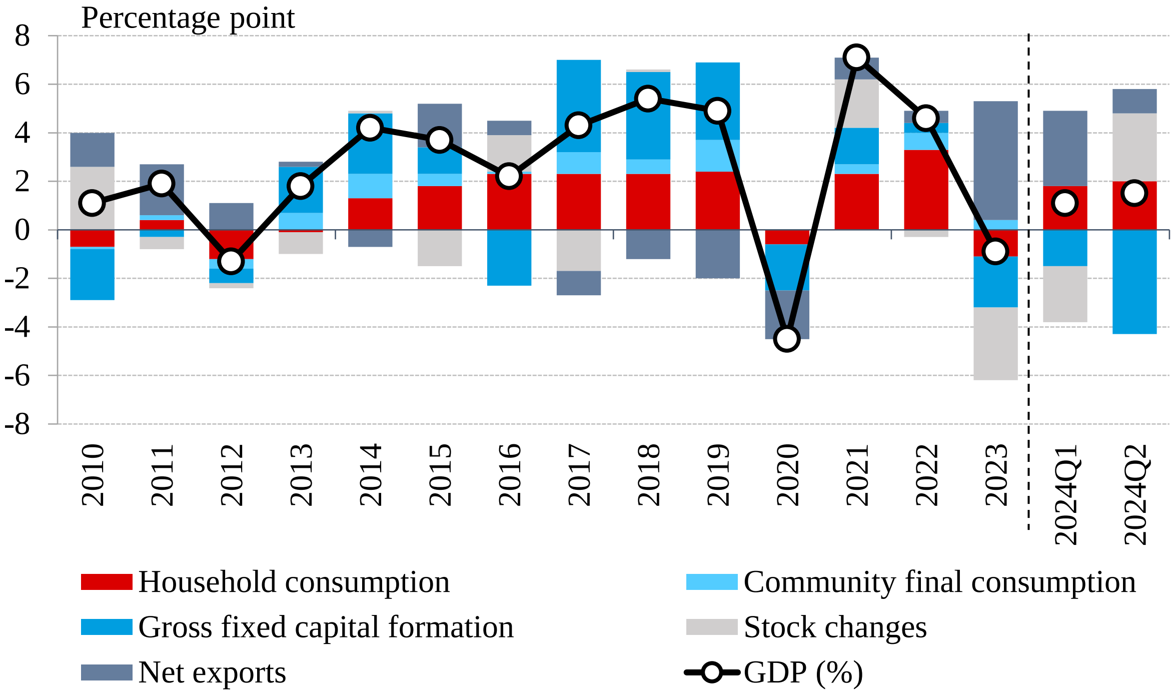
1. Macroeconomic conditions

In terms of the external environment, the ongoing Russian-Ukrainian war, the generally tense geopolitical situation and the decline in European industrial production have created a prolonged negative environment for the Hungarian economy. In the first half of 2024, GDP growth was more subdued in the European Union and higher in China and the United States. GDP grew by 3.0 percent in the United States and by 5.0 percent in China, reflecting the impact of demand stimulus measures in China. In the European Union, GDP grew by 0.7 percent in the first half of 2024. The IMF, the World Bank, the OECD and the European Commission also assess the global economy as being in a fragile phase and expect more subdued growth in 2024. The OECD's May forecast suggests global GDP could grow by 3.1 percent in 2024. The US is forecast to grow by 2.6 percent and China by 4.9 percent. The ECB's latest forecast for the euro area, published in June, is for a slightly higher expansion of 0.9 percent than last year.

In the first half of 2024, the output of the domestic economy grew by 1.3% on an annual basis. Gross domestic product rose by 1.1 per cent in the first quarter of 2024, followed by 1.5 per cent year-on-year growth in the second quarter. On a quarterly basis, economic output expanded by 0.7 percent in the first quarter, followed by a 0.2 percent decline in the second quarter.

On the consumption side, household consumption (+1.9 percentage points) and net exports (+2.1 percentage points) supported economic growth in the first half of the year, while investment performance (-2.9 percentage points) held back growth. The change in inventories contributed 0.3 percentage points to GDP growth. On the production side, among the main branches of the economy, services (+1.6 percentage points) supported economic growth in the first half of the year, while the performance of industry (-0.7 percentage points) held back growth (Graph 1).

1. Figure: Consumption-side decomposition of annual GDP change



Note: Community final consumption includes social benefits in kind received from government and non-profit institutions in addition to community consumption.
The change in stocks also includes the balance of acquisitions and disposals of valuables.
Source: HCSO, MNB

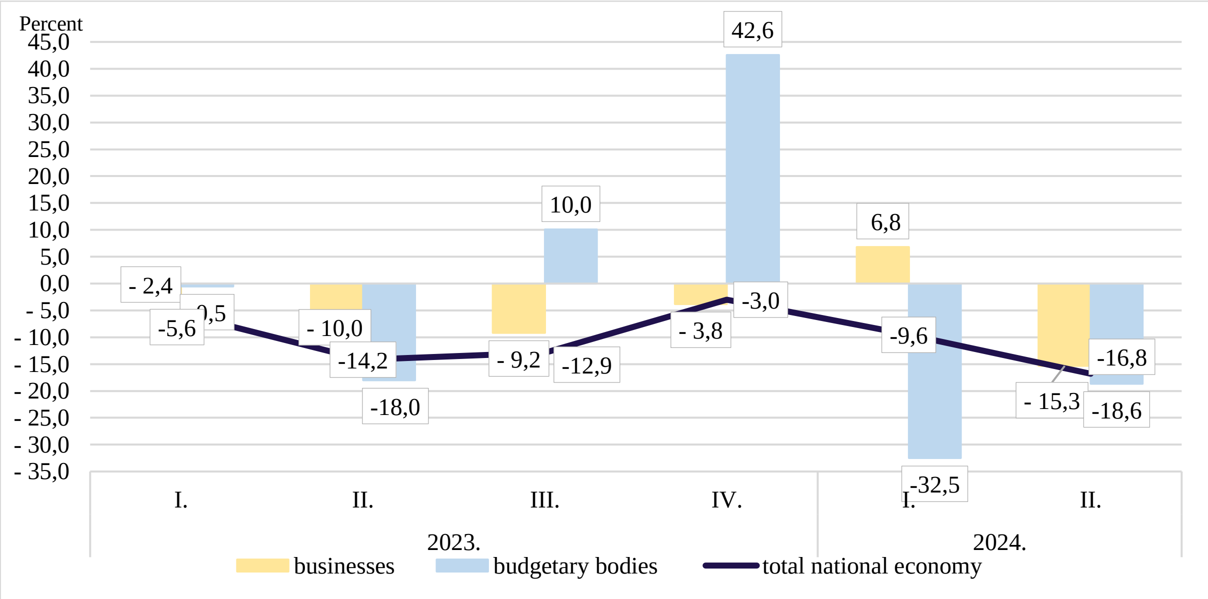
Industrial production contracted by 3.3% year-on-year in the first half of the year, driven by weak international markets and weak domestic demand. Output fell in ten of the thirteen manufacturing sub-sectors, with the largest decline of 12.5 per cent in electrical equipment. Output in the manufacture of transport equipment fell by 5.8 per cent. In the first half of the year, the volume of sales to foreign markets fell by 4.9 per cent and domestic sales by 2.7 per cent.

Despite low foreign sales, the trade surplus in goods was €7.7 billion between January and June 2024, €3.4 billion higher than in the first half of 2023. This is due to a larger fall in imports than exports. The value of exports in Euros was 5.8 percent lower in the first half of this year compared to the same period last year, while imports were 10.8 percent lower. The fall in imports is mainly due to low investment demand.

Investment in the national economy fell by 13.5 percent in the first half of the year compared with the same period a year earlier. Construction investment decreased by 6.6 percent and machinery and equipment by 21.7 percent year-on-year in the first half of 2024. Investment in sectors producing for the external market fell by an average of 18.7 percent and that of domestically active sectors by 2.9 percent. Among the sectors of the economy, only investment in the narrowly defined public sector recorded an increase, averaging 10.5 percent. Investment in sectors indirectly related to general government (quasi-fiscal) fell by 16.0% on average in the first half of the year.

Breaking down investment into corporate and budgetary sources, at the end of 2023 there was a surge in the public sector, linked to the use of resources from the previous EU budget cycle (Figure 2). As Hungary's access to EU funds is currently limited and some of the developments covered by domestic spending have been postponed, investment by public bodies has fallen to a low level.

2. Figure: Volume change in investment by business and government, 2023-2024 (same period of previous year = 100.0%)



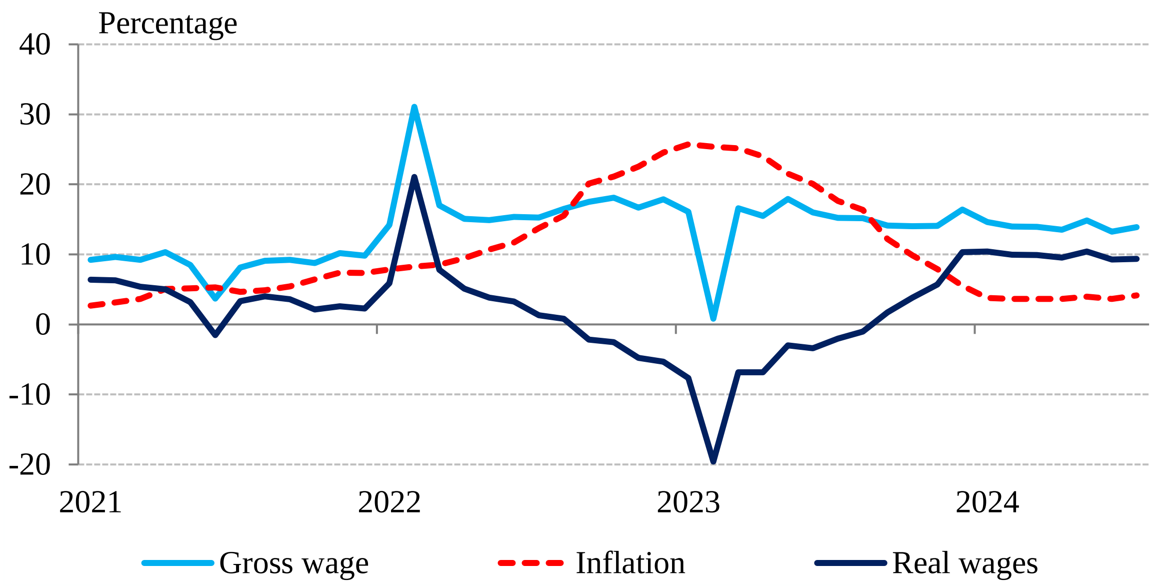
Source: based on KSH STADAT 3.2.1.5., edited by SAO

Investment in the residential real estate activities sector contracted by 8.7% on an annual basis. Construction output volume expanded by 5.1 percent between January and June 2024. In the first half of the year, 6.0 thousand new dwellings were built, 18 percent less than the same period of the previous year. The number of building permits issued was 9.0 thousand in Q1-2 2024, 17.5 percent lower than in the same period of the previous year.

Overall, the fall in investment is linked to the weak economic cycle. Capacity expansion by firms producing for export is being held back by weak external markets and low confidence, while in the domestic market, the slowdown is being driven by the postponement of public investment, a lack of EU funds and limited domestic demand.

Nominal wage dynamics remained high, with real wage dynamics turning positive since September 2023, due to falling inflation, and this continued in 2024 (Figure 3). Household consumption expanded by 4.1% year-on-year in the first half of 2024, seasonally and calendar-adjusted, on the back of dynamic wage growth. Retail sales rose by 2.7 percent in the first half of this year, on a calendar-adjusted basis. The unwinding of household caution remains slow, with households allocating an increasing share of their disposable income to savings. The labour market is stable, with employment growing by 0.5 per cent on an annual basis in the first half of 2024, amid subdued economic output growth. On a seasonally adjusted basis, employment grew by 0.3 percent compared to 31 December 2023. Labour market tensions have eased in recent quarters, suggesting an adjustment to the changing business cycle. As labour market activity has expanded, the number of unemployed has risen, with an unemployment rate of 4.2 percent in July 2024, which remains low by EU standards.

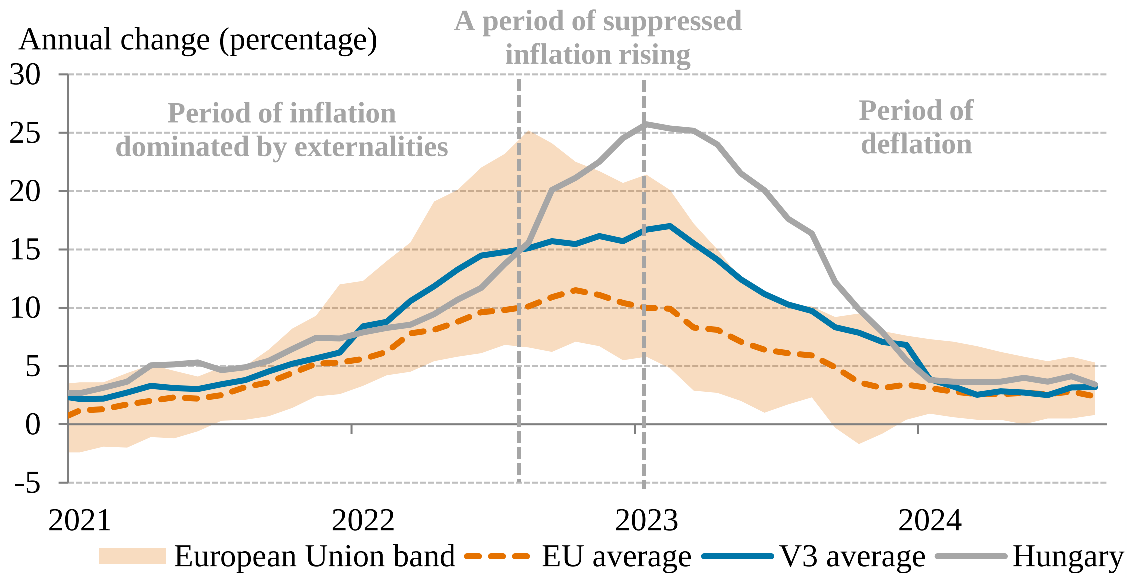
3. Figure: Wage dynamics in the economy (annual change)



Source.

Domestic inflation averaged 3.7% in the first half of 2024, within the central bank's tolerance band (Figure 4). The rapid pace of disinflation slowed across Europe by the first half of 2024. In 8 of the 27 EU Member States, inflation was flat or rising from January to June, while euro area inflation, which had moderated to 2.4 percent by November 2023, rose to 2.5 percent in June this year. In Hungary, inflation returned to the tolerance band in August 2024 after 4.1 percent in July, with consumer prices rising by 3.4 percent year-on-year. The largest contributor to the decline in the annualized consumer price index, by 0.5 percentage point, was the moderation in fuel price dynamics, mainly due to base effects and the decline in world oil prices.

4. Figure: Inflation trends in Hungary, the region and the European Union



Note: Based on the HCBS methodology for Hungary and the Harmonized Index of Consumer Prices (HICP) for the rest of the world.
Source.

2. Revenues of the central subsystem

In the first half of the year 2024, the central sub-system of general government - taken together - generated revenue of HUF 18,897.4 billion, which is 49.4 percent of the annual appropriation. This is HUF 1106.6 billion - 6.2 percent - higher compared to the same period of the previous year (also referred to as the base period). Labour tax revenues contributed most to the surplus, while consumption tax revenues increased less.

Within the central sub-system, the revenue of the **central budget** is HUF 13,002.1 billion, which is 48.2 percent of the annual appropriations (hereinafter referred to as "annual appropriations/appropriations"). The evolution of tax revenues in the first half of 2024 was mainly determined by a more modest improvement in the performance of the economy.

Payments by economic operators amounted to HUF 1 844.1 billion, which is 49.1 percent of the annual appropriations.

Corporate tax is the main source of this revenue. This accounted for HUF 643.3 billion (55.8 percent of the annual estimate), which was only HUF 5.2 billion more than in the same period last year. The 5.8 percentage points higher than budgeted execution in the first half of the year was due to higher cash flows related to the May settlements and higher levels of advances than in the previous year, as well as payments related to individual and different tax year settlements.

Payments from financial institutions amounted to HUF 171.8 billion (67.8% of the annual appropriations), which was HUF 27.5 billion higher than in the base period. This is due to the higher tax liability imposed based on tax return data (during 2024, the extra profit tax base became the pre-tax profit of two years earlier, with a tax rate of 13% for the first HUF 20 billion and 30% for the amount above this).

Revenue **from the itemized tax on small taxpayers** amounted to HUF 33.4 billion, which is 42.9% of the estimate and HUF 2.9 billion less than in the same period last year. The main factor behind the decrease is the steady decline in the number of active taxpayers opting for this tax category. **Small business tax** revenue amounted to HUF 102.5 billion, 45.0 percent of which was collected, HUF 15.3 billion more than in the same period last year.

From 2024 onwards, **the toll revenue** will be shown in a separate balance sheet line, including the sum of the revenues from the electronic toll system and the time-based toll. By the end of the first half of 2024, revenue from tolls amounted to HUF 298.4 billion, 54.4 percent of the target and HUF 98.7 billion higher than in the base period. The increase is due to the increase in toll revenue items and changes in the legal framework of the toll system.

Other centralized revenue amounted to HUF 65.3 billion in the first half of the year, 44.9 percent of the target. In this revenue group, the outstanding revenue item is the collection of fines, which amounted to HUF 39.9 billion.

The revenue from **mining royalties** amounted to HUF 56.8 billion (29.6% of the annual target), down HUF 84.8 billion from the same period of the previous year. Under a law in force from September 2023, taxpayers in certain industries who have entered an extraction obligation under an official contract and maintain their 2022 production until the end of 2024 will benefit from a reduced tax rate.

Payments in the energy sector received HUF 189.3 billion (36.9% of the estimate), which is HUF 91.1 billion less than in the same period last year. This is mainly due to developments on the world market and to the measure reducing the rate of the special tax on turnover payable by taxable persons producing petroleum products from 2.8 to 1.0 percent.

The pharmaceutical tax generated HUF 10.8 billion, 63.8 percent of the appropriation. The extra profit tax on pharmaceuticals has been introduced from 2024, which has not yet been accounted for in the appropriation, so tax revenue may exceed the legal expectation.

Rehabilitation contribution revenue amounted to HUF 88.0 billion, 50.6% of the annual appropriation (HUF 9.9 billion more than in the previous year), due to the increase in the minimum wage and thus the tax rate.

HUF 37.9 billion was received for the **carbon dioxide quota tax**, HUF 39.5 billion for the **company car tax** (48.9 percent of the annual appropriation), HUF 21.1 billion for **the utilities tax** (51.0 percent of the annual appropriation) and HUF 32.6 billion for the **gambling tax** (61.8 percent of the appropriation).

In the first six months of the year, the budget received HUF 4,742.0 billion in revenue **from consumption-related taxes**, 42.9% of the annual estimate, while it exceeded the previous year's figure by HUF 388.9 billion. The two dominant elements in the revenue structure are taxes on consumption: general sales tax and excise duties.

VAT revenue amounted to HUF 3,536.9 billion, 41.3 percent of the annual target, up HUF 208.9 billion, 6.3 percent above the low level of the base period. In the first half of 2024, the share of VAT refunds was lower compared to 2023 (43.9 percent this year compared to 47.4 percent last year). Due to the decrease in refunds, the value of VAT revenue increased compared to 2023. An apparent acceleration in domestic demand for the rest of the year and a consequent further strengthening in retail sales should improve the performance. The change in the consumption structure, which implies a dynamic expansion of foreign purchases, will worsen the evolution of the budget VAT revenue (this change in the consumption structure will also have an indirect negative impact on other tax revenues).

Revenue from **excise duties** amounted to HUF 747.5 billion (44.6 percent of the estimate), which is HUF 99.3 billion (15.3 percent) higher than in the same period of the previous year. The increase in fuel revenues is explained by the increased tax rates effective from 1 January 2024: from 1 January, the excise duty on petrol and diesel increased by HUF 32.55 per litre, so that a litre of petrol contains HUF 152.55 and a litre of diesel HUF 142.9 of excise duty. The development of tobacco revenues is due to the market reaction to the January 2023 tax rate increase, the base year stock effect. For spirits and other products, the revenue increase is underpinned by turnover.

The amount collected under the **financial transaction tax** heading amounted to HUF 172.4 billion (49.5% of the estimate), HUF 5.9 billion more than the amount collected in the base period. The revenue development was related to payments for credit card transactions. **Registration tax collection** amounted to HUF 7.7 billion (43.8 percent of the target, slightly higher than the same period of the previous year). **Telecommunication tax** collection (HUF 81.4 billion) was 85.1 percent, HUF 20.3 billion higher than the base period. Most taxpayers increased their service charges by the rate of inflation. **Insurance tax** receipts amounted to HUF 143.8 billion (61.4 percent of the target), HUF 25.8 billion more than the previous year (with a significant contribution from the January 2024 settlement of the 2023 insurance surtax liability). **Airline contributions** received HUF 16.4 billion, 41.8 percent of the annual target. The **contribution for tourism development** amounted to HUF 35.8 billion (65.7 percent of the estimate). In addition to the increase in turnover, this is because 2024 could be the first full year in which these sectors are not exempted from paying the tax, as accommodation and dining establishments were exempted from paying the 4% tax between May 2020 and December 2021 and between October 2022 and March 2023.

In the first half of the year, the total amount of **retail payments** was HUF 2,391.6 billion, which is 49.2 percent of the target. The largest share of this revenue line is **personal income tax**, which amounted to HUF 2 173.4 billion (48.6 percent of the target). Overall, HUF 257.8 billion more revenue was received than in the same period of the previous year, due to an increase in the wage bill. Gross receipts in the first six months of the year were 13.5 percent higher than in the first half of last year, and the intra-year timing of personal income tax payments in the first half of this year was affected by the introduction of a quarterly filing system for fringe benefits. **Levy payments** accounted for 45.5% of the annual target (HUF 127.4 billion), which is only HUF 4 billion more than in the same period last year. This is due to the weak macroeconomic performance and the impact of the subdued housing market last year, which is reversing this year, but whose impact on levy receipts will be delayed. **Motor vehicle tax** revenues amounted to HUF 90.8 billion (89.7% of the annual target), up HUF 27.1 billion on the base period.

Payments on state property amounted to HUF 180.4 billion in the first half of the year, 47.0 percent of the annual estimate. The highest amount was **achieved in revenues related to the exercise of property rights**, well above the budgeted amount of 67.7 percent (HUF 148.8 billion), of which HUF 76.6 billion was generated from the sale of quotas. However, revenues **from the sale of immovable property** and from **the national land fund were** significantly below the forecast.

Local authorities are expected to **pay** a solidarity contribution of HUF 307.6 billion - some 30 percent more than the previous year's allocation - to be **paid by** municipalities with a high per capita tax capacity. In the first six months of the year, revenue was 55.1 percent of the target, at HUF 169.5 billion.

Revenue from EU programmes amounted to HUF 578.2 billion in the first half of this year, which is 23.3% of the annual allocation (HUF 2 479.8 billion). The significantly lower than expected execution was due to the underperformance of the Cohesion Policy Operational Programmes and the Recovery and Resilience Instrument (RRF). Just over HUF 90 billion of this revenue related to technical revenue from centrally managed appropriations, such as reimbursements to beneficiaries. The call on the annual appropriations remains subject to constraints and risks. For the Cohesion Operational Programmes for 2021-2027, HUF 298.0 billion (27.3 percent) of the appropriations were implemented. The bulk of this is used to finance the career development model for teachers. As regards the RRF, only the advance payment for RePowerEU was received out of the available envelope, the second part of which (HUF 53.2 billion) was budgeted. Hungary will continue to have no access to the rest of the envelope until it has satisfactorily implemented all 27 "super-milestones"[3] . For the 2014-2020 period, Hungary's total allocation under the Cohesion Operational Programmes was €27.2 billion[4] , of which Hungary had drawn down around 98% by the end of June.

Debt servicing cash revenue (interest) amounted to HUF 233.9 billion, 58.8 percent of the annual estimate.

The reimbursement of customs collection costs is shown under **Other EU revenue**. This amounted to HUF 14.7 billion in the first half of the year, 38.0 percent of the statutory appropriation (HUF 2.5 billion below the base period performance).

In the first half of the year, 53.4 percent (HUF 451.8 billion) of the combined revenue target for **the Separate State Funds** was met. The **National Employment Fund (NFA)** accounted for the largest share of the total, with 45.8 percent of the annual allocation (HUF 213.6 billion). The bulk of the Fund's resources came from the NFA's share of social security contributions, which reached 50.5% (HUF 198.1 billion) as a result of the increase in contributory income. **The National Fund for Research, Development and Innovation** generated 55.1 per cent of

[3] The 27 "super-milestones" are the conditionality linked to the protection of the Union's financial interests and the strengthening of judicial independence.
[4] Together with Rural Development Programme

the appropriations (HUF 94.1 billion). The main contributor to this was the innovation levy (54.9% of the total). The **Central Nuclear Financial Fund (CNF)** accounted for 61.7% of the total (HUF 78.7 billion), the **National Cultural Fund for** 56.6% (HUF 8.8 billion) and the **Bethlen Gábor Fund for** 84.5% (HUF 56.5 billion).

The revenue target of the **social security funds** (HUF 10,443.9 billion) was 52.1 percent met in the first half of the year. Within this, the Pension Insurance Fund's revenue of HUF 3,213.0 billion accounted for 53.4% of the target, as the bulk of the state subsidy was transferred to finance the 13th month pension at the beginning of the year. The Health Insurance Fund's revenue of HUF 2,230.5 billion was 50.4% of the target.

The social contribution tax payable to **the Pension Insurance Fund** (HUF 1 343.3 billion) exceeded the revenue collected in the same period of the previous year by HUF 401.0 billion. **Social security contributions** and **pension contributions** accounted for here amounted to HUF 1,349.7 billion, exceeding the revenue collected in the same period of the previous year by HUF 175.2 billion (14.9%). This is due to an increase in the Fund's share of social contribution tax, as well as to an increase in employment and in contributory income.

The 2024 budget for the Pension Insurance Fund includes **a central budget contribution of** HUF 531.4 billion to support benefit expenditure, which will help to ensure the balance of this fund. By the end of the half-year, 479.9 billion forints had been transferred (of which 449.0 billion forints were transferred in February to support the payment of the 13th month pension).

The social contribution tax for **the Health Insurance Fund** (HUF 163.6 billion) is HUF 209.6 billion less than in the same period of the previous year. This decrease is explained by the combined effect of the increase in taxable income and the decrease in the Fund's share of the social contribution tax. **The share of social security contributions payable to the Health Insurance Fund and the health insurance contribution** amounted to HUF 920.6 billion in the half-year, HUF 119.0 billion (14.8%) higher than in the same period of the previous year, due to an increase in earnings and contributory income.

Budget contributions to balance the **Health Insurance Fund** amounted to HUF 945.5 billion. This is HUF 309.4 billion higher than in the same period last year.

3. Expenditure of the central subsystem

In the first half of the year 2024, **expenditure in the central sub-system of general government** amounted to HUF 21,553.8 billion, using 52.9% of the appropriations, which is 4.2% more than in the same period of the previous year. While in the same period of 2023, the overrun of the target was observed in the amounts paid for housing protection and housing subsidies, in the first half of 2024 it was mainly in the expenditure related to interest, pensions and state property.

In the central budget, payments reached HUF 15 642.3 billion, 52.8 percent of the appropriations, only 1.4 percent more than the previous year. Within this, the main expenditure items were as follows.

Expenditure on **public transport and utilities** amounted to HUF 1 178.5 billion, 56.8% of the target, 23.1% less than in the base period. *Road network availability charges* and *public transport reimbursements and subsidies* were around the budgeted amount, while the execution of the *subsidies for public utility services* was significantly higher. The latter includes expenditures for the residential energy redundancy service, the residential electricity system charges subsidy, and the redundancy stockholding service and compensation for district heating suppliers. The higher-than-projected outturn is mainly due to the payment of subsidies for the protection of public utilities, with a new element of HUF 24.8 billion for the Water Utilities Development and Compensation Fund.

Spending **on housing subsidies** was 48.5 percent of the target at HUF 88.2 billion by the end of June. Compared to the same period in 2023, this is HUF 242.4 billion less, in line with the end of the home renovation subsidy and the related loan at the end of 2022 (with a carry-over effect to 2023) and the launch of the Family Home Loan (CSOK) on new terms from 1 January 2024. The change in the conditions of the CSOK has had the effect of reducing the amount of housing subsidies compared to 2023.

Expenditure from the **National Family and Social Policy Fund was** 3.7 percent higher than in the base half-year, at 51.8 percent of the allocation, or HUF 400.1 billion.

Most of this, HUF 212.9 billion, was paid out **in family allowances**. Of this, HUF 153.0 billion was used *for family allowances, which* is 49.8 percent of the appropriation, slightly less than in the base period, in line with the decrease in the number of children. The additional family allowances were used for various *purposes related to child rearing, childcare and the start of life.*

HUF 106.4 billion, or 51.4% of the allocation (10.8% more than in the same period of the previous year), was used **for social assistance to supplement or substitute incomes**. The increase in spending was mainly because some benefits increased in line with the higher minimum wage from January 2024, while others followed inflation and paid a 13th month benefit, similar to pensions. In addition, the number of beneficiaries has also increased.

For under-age benefits, HUF 68.4 billion, or 52.1% of the allocation, was paid, applying both the 13th month amount and inflation tracking, as for pensions.

More than 42% of central budget expenditure was accounted for **by central government bodies and headquarters' appropriations,** amounting to HUF 6605.7 billion. Most of this was used **for spending by budget bodies,** which accounted for 57.9% of the total, or HUF 4 193.8 billion, or 22.1% more than in the previous year. Of this expenditure, HUF 2,369.0 billion was spent on personal allowances and employer contributions, the share of which increased compared with the same period last year due to the impact of wage measures. At the same time, the share of expenditure on non-payments and on capital formation decreased. Expenditure was boosted by the fact that the government provided health service providers and clinical centers with a total of some HUF 104 billion in subsidies to settle their debts. Under a rule introduced seven years ago, the institutions paid 144 billion forints into the Central Residuals Settlement Fund under the heading of unencumbered appropriations.

Expenditure on professional headings was HUF 2,411.9 billion, 58.3 percent of the appropriations, but 9.9 percent below the base period. The lower expenditure is largely because part of the previous headings (e.g. transport improvements) will be accounted for in a separate budget balance line under the 'public investment heading' from the beginning of 2024. Most of the payments are for normative funding of various public and non-public human services, economic development programmes, regional development tasks, tourism programmes, investment promotion, cultural value-added investments. Here too, there was a tendency for expenditure to take a back seat to accumulation.

In line with the very slow receipt of EU programme receipts**, implementation of EU programmes** continued at a subdued pace**.** In the first half of the year, payments amounted to HUF 945.7 billion, which is 26.2 percent of the appropriations and 35.3 percent below the base period. The under-execution was due to low spending on the 2021-27 Cohesion Policy

Operational Programmes and the Recovery and Resilience Facility (RRF). Within the Cohesion Operational Programmes 2021-2027, the highest disbursement was made by the Operational Programme Human Resources Development (EFOP) Plus (HUF 238.1 billion, 65.4 percent of the allocation). The high disbursement is mainly related to the Teacher Career Model Programme, which accounts for the bulk of the funding for the teacher salary increase. Only 5.2 percent of the RRF expenditure of HUF 766.8 billion was implemented. Expenditure on the 2014-2020 cohesion programmes amounted to HUF 150.9 billion.

631.9 billion forints was allocated **to support local governments**, 55.8 percent of the 83 billion forints of the budget from the Pension Protection Fund, 9.4 percent more than a year earlier. The bulk of the aid (91.4 percent) was a normative contribution to general operations and sectoral tasks (certain public education, social, child welfare, childcare and culture). The higher performance here was due to support for the increase in the minimum wage and guaranteed minimum wage, as well as the increase in teachers' salaries.

The contribution to the EU budget amounted to 47.3 percent of the appropriations, or HUF 327.2 billion. The saving is due to the calculation method based on lower than expected economic growth in 2023.

Expenditure on state property amounted to HUF 708.8 billion, 132.7 percent of the appropriation, and 18 percent higher than in the base period. Almost four-fifths of the amount was spent on capital increases in state-owned majority-owned companies, and 112.2 billion forints was spent on state real estate and movable property. Almost four-fifths of the amount was spent on capital increases in state-owned majority-owned companies, the largest share of which was related to the purchase of the airport.

Expenditure under the **public investment heading** amounted to HUF 152.4 billion, 7.9 percentage points more than the current rate (this expenditure line was not included in the 2023 appropriations).

Interest expenditure amounted to HUF 2009.5 billion, up 47.7 percent on the base period, or 64.8 percent of the target. The increase in interest expenditure is mainly due to the impact of high inflation in 2022 on interest expenditure in 2024. For inflation-tracking government bonds subscribed by the public, the moderation in inflation in cash interest payments will be felt after two years. On the positive side, an increasing share of the interest paid will be paid to the public.

In the first half of the year, more than four-fifths of the HUF 1 215.8 billion **central reserve** allocation was used, in line with transfers due to wage increases. Within this, 779.2 billion forints **of the Provisions** were used, exceeding the target by 36.1 billion forints . 45.7 percent of the appropriation was for teachers' salaries, almost all of which was transferred to the relevant headings and to local governments. No further transfers are expected for this purpose. It should be noted, however, that the appropriations for the provisions are open-ended, and consequently transfers in excess of the appropriations for other purposes pose a direct risk to the deficit target. In the first half of the year, HUF 84.5 billion, or 38.4 percent of the appropriation, was reallocated to **Exceptional government measures**. Thus, the requirement of the General Budget Act was met, as the first half of the year's utilization did not exceed the limit of 40 percent of the appropriation.[5.] Among the expenditure of the half-year, the increase in the budget for the Irinyi Plan Food Supplier Development Programme (HUF 27.0 billion to develop the capacity of domestic food producers and to increase the competitiveness of enterprises in the food supply sector), the financing of the Hungaroring Sport Zrt. Strategic Development Programme (HUF 10.0 billion) and transfers necessary for the tasks of the Presidency of the Council of the European Union (HUF 5.2 billion).

Expenditure on **separate public funds** amounted to 306.2 billion forints, 3.8 percentage points below the target, but 2.5 percent higher than the previous year. The largest amount, HUF 192.0 billion, was spent on the **National Employment Fund**. Of this, HUF 77.5 billion was spent on *passive expenditure and job-search subsidies*, 26.3% more than in the base half, and 9.6 percentage points above the time-elapsed target. There was also significant spending on the **National Research, Development and Innovation Fund** (HUF 61.9 billion, 40.2 percent of the allocation) and the **Bethlen Gábor Fund** (HUF 36.4 billion, 54.1 percent of the allocation).

Expenditure of **social security funds** amounted to HUF 5,605.4 billion, 13.0% above the previous year's amount and 3.7 percentage points above the time-proportional value.

Within the financial funds of social security, the **Pension Insurance Fund** stands out in terms of size, with a half-year execution of HUF 3 330.5 billion, 10.9% above the base period, while 55.3% of the target was met. This year again, the higher-than-projected first-half performance was due to the payment of the 13th month's pension in February. Other expenditure accounted for only HUF 4.5 billion of the total expenditure up to June 2024, so the bulk was for **pension**

[5] Act CXCV of 2011 on Public Finances, Section 21 (3). The approval of Parliament is required for any use of more than this amount.

benefits. The 10.9 percent increase in these from the previous year was due to the carry-over effect of the supplementary pension increase in November 2023 and the impact of the forward increase in January 2024. In February, for the third time since 2022, pensioners and survivors' benefit recipients received a full monthly amount for the 13th month of pension entitlement after 2022, totaling 2.1 million. The increase in the retirement age was completed by 2022, which meant that the number of beneficiaries continued to rise in 2024: 11.9 thousand more people (0.6%) received an early retirement pension in June 2024 compared to June of the previous year. By contrast, the number of people receiving a pension with the benefit of the 40-year eligibility period for women continued to fall as the retirement age was reached and was 6.3 thousand (4.2 per cent) lower in June 2024 than in the same period in 2023. The average monthly amount of old-age pensions in June 2024 was HUF 232.6 thousand, 10.8 percent higher than a year earlier. The Fund's budget for 2024, approved in July 2023 and not amended since then, did not include any provision for the impact of the 3.1 per cent pension increase of 1 November 2023 on the increase of 1 January 2024. According to the MNB's September forecast, annual inflation is expected to be between 3.5 and 3.9 percent. Based on actual inflation data to date and the inflation expectations of the Ministry of Finance and the MNB, no additional pension increase is expected in November, as inflation is not expected to reach the 6 percent rate taken into account for the pension increase on 1 January 2024. No pension premium is expected to be paid in November either, as the 3.5% GDP growth rate that is a precondition for the pension premium is not expected to be reached, based on the forecasts and the HCSO data. Thus, its target (HUF 20.5 billion) is expected to reduce the Fund's deficit.

From the Health Insurance Fund, HUF 2274.9 billion was used, 51.4% of the annual allocation, 16.2% more than the previous year. **Expenditure on preventive medical care,** which accounted for the largest share of HUF 1 352.7 billion up to the half-year, was higher both compared with the base period (20.8 percent) and the period-on-period (3 percentage points). The increase over the previous year is mainly related to the wage increases for health professionals and health care workers that started on 1 July 2023 and continued 1 March 2024. Expenditure also includes a further HUF 63.4 billion in subsidies to publicly funded state, municipal and church-owned health care providers providing outpatient and inpatient care, as well as to clinical centres of medical universities, to finance their outstanding debt stock until end-April 2024, and a further HUF 41.0 billion transferred until end-June 2024. **For pharmaceutical subsidies**, HUF 269.2 billion was spent, 3.8 percentage points more than the time-elapsed rate and 10.8 percentage points more than the base period. 25.7 percent of the

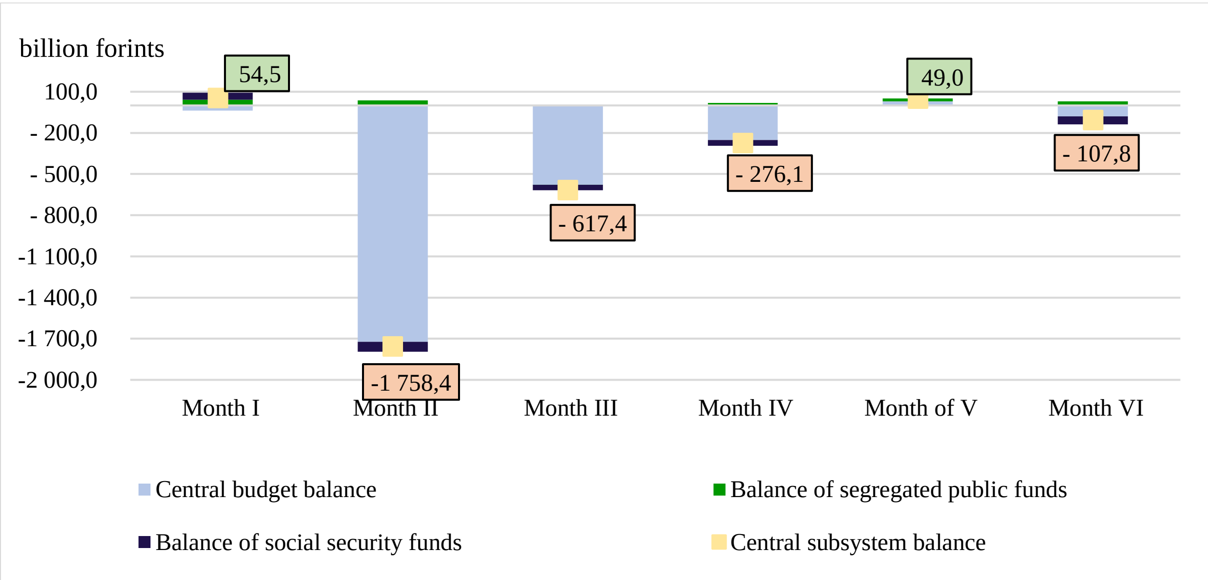
Health Insurance Fund, up 10.2 percent on the previous year, and 48.2 percent of the annual allocation, HUF 585.7 billion, was used **for cash benefits.**

4. The feasibility of meeting the deficit target

The deficit of the central sub-system of general government in the first half of the year amounted to HUF 2,656.4 billion, 105.6 percent of the budgeted appropriations. This is two-thirds of the annual cash deficit target of HUF 3,982 billion, which is part of the revised (ESA) deficit target of 4.5 percent from 2.9 percent . However, the increased budget deficit target has not been transposed in the Budget Law, so the appropriations still give guidance on the original deficit target. The fiscal measures announced over July 2024 support the achievement of the new deficit target, but these measures have not been reflected in the appropriations of the Budget Law either.

The balance of the central subsystem at the end of the first half of 2024 consisted of a deficit of HUF 2 640.1 billion in the central budget, a surplus of HUF 145.7 billion in the earmarked state funds and a deficit of HUF 161.9 billion in the social security funds. The monthly evolution of the central subsystem balance is shown in Chart 5.

5. Figure: Monthly balance of the central subsystem (months I-VI 2024, in billion HUF)



Source: total VAT of the Hungarian State Treasury based on month 06.2024, edited by the SAO (the figures show the balance of the central subsystem)

The data in Figure 5 show that in the first half of 2024, the central subsystem recorded a deficit in all months except January and May, with a significant amount in February. The large deficit in February was caused by the lower-than-projected VAT payments on the one hand, and the 13th month pension paid in February and the interest payment on the Premium Hungarian Government Bond in February on the other. On the revenue side, the deficit in Q1-2 2024 is mainly driven by lower-than-expected payments in Q1-2 2024 of general sales tax and excise duties within consumption-related tax revenues and of energy sector payments within payments by business entities, while on the expenditure side, it is mainly driven by lower-than-expected payments in Q1-2 2024 of budgetary appropriations and professional appropriations, interest payments related to the financing of public debt, expenditure on public assets and large payments related to pension benefits. This is also because the EU received 578.2 billion forints, while expenditure on EU programmes amounted to 945.7 billion forints.

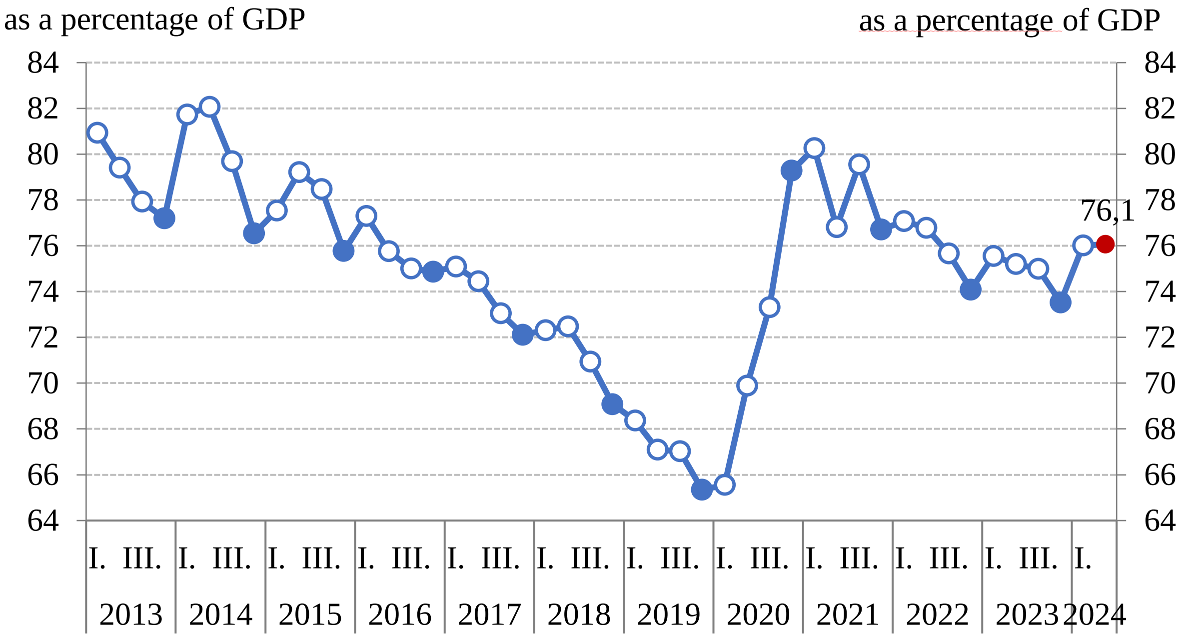
The government's decision to reschedule HUF 675 billion of public investment in April helped to counteract the significant increase in the deficit. To meet the deficit target for 2024, a further package of measures was announced in July 2024. The bulk of the measures concern the revenue side: the key rates of the financial transaction levy have been increased as of 1 August 2024, as well as the ceiling of the levy and the ceiling of the retail exemption from the levy. Also from 1 August, tax and administrative fines have been increased, the conditions for tax relief for the purchase of government securities have been tightened for the bank tax, and the relief for the extra profit tax on oil price differentials (Brent-Ural) for the income tax on energy suppliers has been reduced. From 1 October, an additional transaction tax will be introduced on currency conversion operations. In the context of an expenditure-saving measure, direct investment and capital expenditure have been transferred to the Central Residual Settlement Fund. The actual balance impact of the expenditure saving measures will depend on the expenditure measures implemented during the rest of the year and on the maintenance of control on the expenditure side. As a measure to help families, the deadline for the birth of the first child for families taking out a baby loan between July 2019 and June 2021 has been extended uniformly until 1 July 2026. The shortfall was reduced by the one-off (larger) payment of several tax receipts in the April-May period due to tax payment rules.

Based on the revised deficit target and projected developments, Hungary's ESA-based budget deficit continues to exceed the 3% of GDP deficit criterion set by EU rules. In similar cases in recent years, the EU has not opened an excessive deficit procedure for Hungary, due to the existing escape clause. This relief was phased out from 2024, so in July this year the Council of the European Union opened the procedure.

6. Enforcement of public debt rules

At the end of 2023, the ratio of nominal government debt of HUF 55,134.4 billion to nominal GDP of HUF 74,992.0 billion was 73.5 percent. Based on the EDP report, the projected value of the debt ratio at the end of 2024 is 73.2 percent, i.e. the projected reduction in the debt ratio has been reduced to 0.3 percentage point from the 3 percentage points projected in the original budget law. The increase in the deficit target and the lower-than-expected pace of economic growth also played a role. Compared to the end of 2023, the debt-to-GDP ratio increased by 2.6 percentage points to 76.1 percent by the end of the first half of 2024, from 73.5 percent. The increase in the debt ratio was driven by the deficit of the central sub-system, which was significantly higher than its time-proportion at the end of the first half of 2024.

6 Figure: Quarterly gross public debt to GDP ratio



Source: ÁKK, MNB

To reach the EDP-reported end-year debt ratio of 73.2%, the half-year data suggest an improvement of 2.9 percentage points, which is above the second-half decline in recent years (see Figure 6).

According to data from the Public Debt Management Centre, the bulk of the central debt outstanding at the end of the first half of the year was in forint, accounting for 70.5% of total debt. The stock increased by HUF 1,822.5 billion in nominal terms over the half-year, mainly due to an increase in holdings of government bonds, discount Treasury bills and retail government securities. Central foreign currency debt as a share of total debt stood at 29.2 percent at the end of H1 2024, up 2.3 percentage points from the share at the end of H2 2023. Here, the stock increased by HUF 2,328.3 bn in nominal terms, mainly driven by the international bond issuances (dollar bond and euro bond) in January and the project finance foreign currency loan drawdown in April.[6] Between end-2023 and end-1H2024, the HUF exchange rate movements increased the HUF carrying value of foreign currency debt by HUF 504.1 billion. Because of the increasing foreign currency share of public debt, the exchange rate sensitivity of the debt has also increased.

The developments in the first half of the year, the increased deficit target and lower-than-expected economic growth increase the risks to the moderation of the debt ratio. In addition to the achievement of the deficit target, the decline in the debt ratio could be supported by more dynamic GDP growth, more subdued debt issuance in the second half of the year according to the debt manager's issuance plan and no change in non-central government debt.

The Fundamental Law provides for the reduction of the public debt ratio in the case of a debt ratio above 50 percent[7] , but this year, too, derogations from the debt rule are possible under the special emergency legislation, which allows derogations to be made to the extent necessary to mitigate the consequences of the circumstances that triggered the emergency (or, in the case of a sustained and significant downturn in the national economy, to the extent necessary to restore the balance of the national economy). The requirement of the Stability Law is a reduction of the government debt ratio by at least 0.1 percentage points, subject to EU rules on debt reduction[8] . Compliance with the debt rule of the Stability Law would be exempted by a fall in gross domestic product.

The **EU debt rule** states that Member States' debt ratios must not exceed 60% of GDP or, if they do, that a satisfactory reduction in the debt ratio is needed. Adequate debt reduction was quantified by the so-called one-twentieth debt rule until 2024, which required an annual reduction of the debt ratio by approximately one-twentieth of the share of the debt ratio above

[6] Over the same period, the stock of other liabilities decreased by HUF 145.2 billion in nominal terms, from 0.6% to 0.3% of total debt.
[7] Fundamental Law of Hungary, Articles 36-37
[8] Act CXCIV of 2011 on the Economic Stability of Hungary, § 4 (2a)

60 percent averaged over three years. Under the new EU rules, the required debt reduction will no longer be quantified by the one-twentieth rule, but by the debt path in the national medium-term budgetary structure plan. To achieve this, domestic fiscal expenditure will need to be in line with the net expenditure path in the plan, which will ensure a satisfactory reduction in public debt. Actual annual or cumulative deviations from the expenditure path above the thresholds trigger a debt-based excessive deficit procedure. The first domestic fiscal structural plan is expected to be available in the autumn.

Budapest. 26 September 2024.

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