Resolution No. 6/2024.11.07.

Opinion of the Fiscal Council
on the draft bill on the 2025 central budget of Hungary

I.

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

The Fiscal Council (hereinafter referred to as the Council, Fiscal Council, FC), in accordance with Article 24 of Act CXCIV of 2011 on the Economic Stability of Hungary (hereinafter referred to as the Stability Act, Stab. Act), and in line with Article 44 (2) of the Fundamental Law, hereby gives its opinion on the draft Act on the Central Budget. In its Opinion, the Council may comment on the draft and, if it has fundamental objections to the draft as to its credibility or enforceability, may express its disagreement with the draft.

On 31 October 2024, Minister of Finance Mihály Varga sent the draft bill on the 2025 central budget of Hungary (hereinafter: the draft), which was discussed and approved by the Government, to the President of the Fiscal Council as an annex to his opinion request letter PM/8012/3/2024.

The Council's assessment of the draft was also informed by the following background.

- **In its Opinion 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." Among the risks, the Council 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 due to Hungary from the European Union, 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 may 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."

  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 Stability Act.

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 a re-planning, which limits the role of the budget as an economic compass."

- **In its Decision No 5/2023.07.06.**, **giving its preliminary consent to the final vote on the 2024 central budget bill**, the JPC 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." It stressed that "some elements of the economic developments in 2023 around the macroeconomic path underpinning the budget point to negative risks (lower-than-expected household consumption and higher-than-projected inflation), while other factors have evolved favorably in recent months (energy prices and the balance of payments)" and that "in several cases, the changes have a direct budgetary impact in 2024."

Even before the amendment, the Council welcomed the Government's initiative to amend the Law on the Magyar Nemzeti Bank in 2023, which states that "the negative capital of the central bank should be compensated primarily by the positive results expected in later years". With the adoption of the amendment, the budget was no longer under an obligation to reimburse the Bank when the 2024 Budget Law entered into force. In its decision, the Fiscal Council indicated that the "budget takes into account the cohesion and recovery funds for the EU budget cycle 2021-2027, so that the implementation of the budget is conditional on their receipt on time and in the amounts foreseen." The Council welcomed the fact that "the planned 3 percentage points 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 assent to the final vote on the single budget bill T/4181/471.

- The Council, having reviewed **the main mid-year processes of the implementation of Act LV of 2023 on the 2024 Central Budget of Hungary,** made the following main findings in **its Opinion No 5/2024.09.26.**

  The adverse external factors "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." "In the Council's view, real economic growth this year will be significantly below the 4 percent projected in the Budget Law and is forecast to be below 2 percent. Economic growth will be supported by an expansion in household consumption through a dynamic rise in real wages, as well as favorable developments in net exports." "The domestic economy, and investment in particular, will be adversely affected by the delay in negotiations on the disbursement of funds from the European Union to Hungary."

The Council assessed the fiscal developments in the light of the fact that "the Government has raised its ESA-based deficit target for 2024 to 4.5 percent of GDP from 2.9 percent in the Budget Law." It noted that "the increased budget deficit target, however, like the expenditure side measures announced in April 2024 and the revenue side measures taken in July 2024, was not transposed in the Budget Law, so that the Council could only assess the implementation of each appropriation against the original revenue and expenditure appropriations, which did not reflect the increased deficit target."

The Council considered that "the risks it had indicated in its opinion on the 2024 budget planning have materialized. The deficit of the central sub-system of the 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 Law. 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 a 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." "On the revenue side, mainly due to the high appropriation, which does not reflect last year's low execution, the execution of the general sales tax and excise duties and, for specific reasons, the payments of the energy sector, was lower than expected in relation to time." "On the expenditure side, interest payments related to the financing of the public debt, as well as appropriations for budgetary bodies and professional headings, expenditure on public property and payments related to pensions were higher than budgeted." "Budget revenue from the European Union was almost HUF 370 billion below the expenditure on EU programmes."

"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 fiscal deficit target will require consistent implementation of the measures and close monitoring and control of public expenditure towards the end of the year."

The Council also took note that "as a consequence of a budget deficit above 3% of GDP, the Council of the European Union decided to open an excessive deficit procedure for Hungary in July 2024, following a proposal from the European Commission."

The FC noted that "the general 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 large share of 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 slight decline in the debt ratio will necessarily imply the achievement of a deficit below the revised accrual and cash deficit target and a subdued second half of the year in central and extra-central debt issuance."

...

In formulating its Opinion on the draft bill on the 2025 central budget of Hungary, the Fiscal Council - following its previous practice - based its Opinion on the written analyses and findings of the State Audit Office of Hungary and the National Bank of Hungary on the budget processes. In addition, it reviewed the economic forecasts of domestic research and analysis institutes commissioned by the FC Secretariat, as well as those of international organizations (European Commission, OECD, IMF, World Bank) and other authoritative market analysts. In addition, the Council took into account the medium-term fiscal structural plan of Hungary 2024.

The Council examined the draft bill on the 2025 central budget of Hungary and its macroeconomic background as a whole: it analysed the details, revenues and expenditures of the draft from the point of view of the balance of payments and compliance with the public debt rule. As in the past, the Council did not take a position on distributional and supply policy issues, in line with its mandate under the Fundamental Law and the Stability Law.

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

II.

Opinion of the Council

On 7 November 2024, the Council discussed the draft bill on Hungary's 2025 central budget, pursuant to Article 24 (2) of the Stab. Act, and on this basis - by unanimous decision - formulated the following opinion.

1) The Council has no fundamental objections to the credibility and enforceability of the draft bill on the 2025 Hungarian central budget that would justify a statement of disagreement with the draft. However, following its practice so far, the Council feels obliged to draw the attention of the Government to a number of risks to the achievement of the planned objectives.

2) The FC notes that the draft budget bill projects economic growth of 3.4 percent for 2025, at the upper end of the 2.5-3.8 percent forecast range of international forecasts and the domestic institutions that prepare their analysis for the Fiscal Council. This is projected to be supported by both an increase in household consumption and a renewed rise in gross fixed capital formation. The Council considers that the economic growth forecast by the government could be achieved, but that there are risks to it. The spill-over effects of the Russian-Ukrainian war and the resulting sanctions will continue to negatively affect the Hungarian economy beyond 2024 and into 2025. Europe's energy security problems, while alleviated, have not disappeared. In addition, negotiations on the disbursement of funds from the European Union to Hungary continue to drag on. There is also the risk of escalation of the war in the Middle East, as well as global trade conflicts. As a result, the main risks are related to the positive investment trend reversal needed to achieve the planned economic path.

3) The Council continues to consider it necessary to bring the government sector deficit below 3% of GDP in order to balance the Hungarian economy and budget. The draft budget bill sets the government sector deficit on an accrual basis (ESA) at 3.7 percent of GDP in 2025. This exceeds this limit and the criterion set by the EU's founding treaty. Domestic legislation temporarily allowed the deficit to remain above 3 percent, but the suspension has ended, so the current set of rules sets the deficit criterion at 3 percent next year. According to the Ministry of Finance, the Government will initiate an amendment to this rule with a view to its adoption by Parliament before the entry into force of the Budget Law.

4) The Council considers that there are risks to the achievement of the 2025 deficit target. On the revenue side, there is a risk that economic growth in 2025 will be lower than expected, which would reduce budget revenues. On the other hand, the Council sees a risk in the projected inflow of EU funds, as the uncertainty surrounding the availability of EU funds persists, which would increase the cash deficit if revenues from the Recovery and Resilience Fund and cohesion funds for 2021-2027 are not received, with unchanged expenditure. Managing risks is hampered by the fact that the contingency reserve of HUF 100 billion in the Exceptional Government Measures appropriation is not only below the current rules, which require a 0.5 percent (HUF 220 billion) reserve

as a share of the expenditure headline, but also low compared to the risks identified. According to the Ministry of Finance, the Government will also take the initiative to amend this rule, with a view to its adoption by Parliament before the entry into force of the Budget Law. In view of the risks surrounding the implementation of the budget, the Council does not consider it advisable to amend the law in such a way as to reduce the obligation to set aside reserves to deal with these risks.

5) The projected reduction in the budget deficit in 2024 compared to the projected level is mainly due to a reduction in high interest expenditure as inflation falls. Interest expenditure on gross accrual basis as a share of GDP is projected to fall from 4.8 percent in 2024 to 3.8 percent in 2025, mainly due to the repricing of inflation-linked government bonds to lower interest rates. In addition, the reduction in the deficit will be helped by a number of tax measures and a total savings obligation of HUF 350 billion for budgetary bodies under the supervision of the government.

6) The Fiscal Council concludes that, in line with the provisions of the Fundamental Law, the public debt indicator[1] is projected to decline over the course of 2025. According to the draft budget bill, it will decline from 73.2 percent at the end of 2024 to 72.6 percent at the end of 2025. The Council considers the reduction in the debt ratio to be realistic. On this basis, the Council concludes that the draft budget bill 2025 complies with the debt rule of the Fundamental Law and the provision of Article 4(2a) of the Stab. Act. However, the Council indicates that on the basis of currently known circumstances, the debt ratio in 2024 could be higher than projected in the draft bill, which would not affect the reduction next year per se, but would result in a higher debt trajectory. In the Council's view, an increasing risk to this path is that the foreign exchange ratio of central government debt has been gradually increasing over the recent period, approaching 30 percent, materially increasing the exchange rate sensitivity of the debt.

7) The Council welcomes the targets beyond 2025, which include a gradually declining deficit and debt trajectory. The national medium-term fiscal structural plan presented to the European Union aims at reducing the budget deficit and, if met, the government sector deficit will be reduced to 2.9% already in 2026. Under this plan, the debt-to-GDP ratio could fall below 70 percent by the end of 2027. Achieving all this will require disciplined fiscal policy.

8) The Council examined whether the provision of budgetary compensation in 2025 is necessary in order to ensure the adequacy of the capital of the Magyar Nemzeti Bank (MNB), as provided for in Article 23(1)(ac) of the Stability Act. Based on the development of the MNB's own funds in 2024, the forecast approved and submitted by the MNB's Board of Directors in April and a review of international experience, the

[1] Public debt indicator: the ratio [...] to be taken into account in the implementation of Article 36 (4) to (5) and Article 37 (2) to (3) of the Fundamental Law, expressed as a percentage, rounded up to one decimal place, the numerator of which is the value of the public debt, the denominator of which is the value of the gross domestic product, calculated in accordance with the Council Regulation on the European system of national and regional accounts in the Community, as defined in this Act (Art. 2 of the Stab. Act).

Council concluded that, based on the current regulatory framework, there is currently no need for recapitalization of the MNB.

9) Recognizing also the benefits of spring budgeting, the Council welcomes the autumn budgeting of 2025, which reduces the predictability constraints on the macroeconomic conditions for budgetary planning and thus helps the budget to fulfil its role as an economic compass.

10) The Council authorizes its Chair to make public his Opinion on the draft and to present it to the plenary session of the National Assembly, taking into account its relation to the submitted bill.

III.

Justification

1) Credibility and enforceability of the draft

Pursuant to Section 24 (2) of the Stab. Act, the Council may comment on the draft budget bill or, if it has fundamental objections to the draft, its credibility or enforceability, it may express its disagreement with the draft.

2) Budget targets and conditions for 2025

2.1. Macroeconomic indicators on which the planning is based

Macroeconomic developments in 2024 are significantly less favorable than projected by domestic and international workshops and the government macroeconomic forecast underlying the 2024 budget.

The draft already takes into account the fact that economic activity in the third quarter of 2024 was materially below expectations, mainly due to weak external demand, falling investment and a drop in agricultural output due to drought. The slowdown in the European economy has hit Hungary harder than other countries in the region, and this negative impact has been exacerbated by weak agricultural yields. The draft forecasts GDP growth of 0.8 percent in 2024, which, based on the data for the first three quarters of the year, requires a pick-up in economic activity in the last three months of the year on a quarterly basis.

The draft budget for 2025 projects GDP growth of 3.4%. On the consumption side, growth is supported mainly by a 3.9 percent increase in household consumption and a 5.1 percent expansion in gross fixed capital formation, while the contribution of net exports is slightly negative (-0.1 percentage point).

The most critical factor for the realization of the forecast is the external environment, in particular the performance of the European (German) automotive value chains. The German economy is a major contributor to domestic exports. All these factors have a significant impact on business sentiment and prospects. Weak external market activity is therefore not only holding back exports, but also significantly reducing investment (gross fixed capital formation). Even so, exports are still projected to expand by 3.4% next year, while gross fixed capital formation is expected to expand by 5.1%, which will require at least a partial replacement of deferred investment and the continuation of announced large investments. If the large investments under way are on track to become productive, this should provide sufficient impetus for export expansion, provided that demand is sufficient. As a result, the main risks are related to the realization of the positive investment trend reversal needed to support the projected economic path.

International organizations’ projections for 2025 assume a more subdued GFCF accumulation and typically a more negative net export contribution. Overall, the macro trajectory of the draft

GDP is at the upper end of the 2.5-3.8 percent forecast range of international projections and the domestic institutions that prepare the analysis for the Fiscal Council.

The pick-up in consumption is supported by stable employment and strong real wage growth, while the population remains cautious, as indicated by the increased savings rate. Employment is expected to grow slightly by 0.1% in 2025. The increase in employment is entirely driven by developments in the competitive sector, with no change in the public sector. The tight labour market is projected to maintain the wage dynamics that have been high for several years, with average gross earnings set to rise by 8.7 percent, coupled with a 5.3 percent increase in real net wages in 2025, while inflation is projected to be 3.2 percent. The value of purchased consumption at current prices will increase by 7.8 per cent, which could lead to a substantial increase in the tax base for VAT, a key tax for the budget.

2.2. Revenues of the central subsystem

The total - non-consolidated - **revenue** estimate of the **central subsystem** for 2025 is HUF 39,042.9 billion, which is HUF 802.5 billion more than the 2024 estimate, while the September notification report's expected outturn for 2024 is 2.7 percent (HUF 1,021.8 billion) higher. In what follows, the 2025 appropriations are compared to the expected value of the 2024 notification report published in September (hereafter: expected execution).

Planning practice shows that, in relative terms, **tax and contribution revenues** account for the largest share of revenue sources.

The Council has assessed the reasonableness of the tax revenue estimates on the basis of information from the Ministry of Finance on the tax changes the Government plans to introduce in 2025 (including the taxes covered by the Emergency Government Order) and the revenue changes it expects. Thus, the revenue estimates require the planned tax changes to come into effect on 1 January 2025 in order to be met.

In 2025, registration tax, motor vehicle tax, transfer duty and excise duty (on fuel and alcohol) will increase in line with the change in the consumer price index for the month of July of the previous year, as published by the Central Statistical Office, compared to the same period of the previous year, and from 2026, company car tax and tobacco excise duty will also increase.

The target for **payments by economic operators** is HUF 3 9,927.5 billion, which is 8.3 percent (HUF 302.5 billion) higher than the expected outturn in 2024. The increase compared to the base year is also due to changes in the rules for the mining levy, the extension of the carbon dioxide quota tax and the additional revenue from the global minimum tax advance. **Corporate tax** traditionally dominates the revenue group of payments by business entities, with an appropriation of HUF 1,285.5 billion, up by 19.4 percent (HUF 208.5 billion) compared to the expected outturn in 2024. The estimate for **payments by financial institutions** is HUF 253.1 billion, compared to the expected HUF 294.5 billion in 2024.

The target for **the specific tax on small taxpayers** is HUF 66.7 billion, HUF 0.4 billion less than expected in 2024, reflecting the expected moderate decrease in the number of businesses in this group. **The small business tax** is estimated at HUF 257.8 billion, which could increase by 14.9% compared to the expected outturn for 2024 (HUF 224.3 billion), reflecting an increase in the number of taxpayers and a stronger economy.

The energy sector is projected to **pay** HUF 296.7 billion, HUF 13.3 billion less than expected in 2024. The **mining levy** is budgeted at HUF 129.0 billion, 17.6 percent above the base year expectation, partly due to the rule change.

Tolls are budgeted at HUF 663.0 billion, which is 7.1 percent (HUF 44.1 billion) more than expected this year.

The retail sales tax target is HUF 295.3 billion, 11.7 percent (HUF 30.9 billion) higher than this year's expected implementation.

The **rehabilitation contribution** is HUF 204.6 billion, 9.2 percent (HUF 17.3 billion) more than expected.

A carbon tax of 75 billion forints could enter the budget.

Consumption-related taxes are budgeted at HUF 10,952.5 billion, accounting for 28% of the resources of the central subsystem. This revenue group is 7.5 percent (HUF 762 billion) more than expected for this year. These payments are materially affected by the return of the economy to growth, rising average earnings, rising household consumption and lower inflation.

The **general sales tax** budget is HUF 8,277.2 billion, which is 8.1 percent (HUF 617.4 billion) more than the 2024 target. The availability of the appropriation is supported by a further 8.7 percent increase in earnings and a 3.9 percent increase in household consumption. The forecast for general sales tax revenues is in line with the macroeconomic expectations of the budget and the expected outturn in 2024. However, there are risks if the 2024 base year outturn and macroeconomic developments turn out worse than expected.

The **excise tax** budget is HUF 1,702.9 billion, 7.0 percent (HUF 112.1 billion) more than the 2024 budget. Contributing to the increase in tax revenue, the excise duty rate on tobacco will rise by 8 percent, while the excise duty on fuel and other (including spirits) will rise by the rate of inflation in July of the previous year.

The **registration tax** budget is HUF 25.7 billion, which is HUF 11.3 billion more than the expected base in 2024, due to the introduction of a higher tax rate for less environmentally friendly vehicles and the introduction of an annual inflation-linked tax increase from 2025.

The financial transaction tax is budgeted at HUF 589.3 billion, which is HUF 171.9 billion more than expected for this year. The significant increase is due to the increased or extended bank transaction tax rate in 2024.

The insurance tax budget is HUF 213.1 billion, which is HUF 68.4 billion below the expected outturn for 2024. This is due both to the change in tax rates and to allow taxpayers to reduce their tax liability by purchasing government securities.

The **tourism development contribution** is foreseen at HUF 90.2 billion, compared to the HUF 83.7 billion expected in 2024.

The total amount of **payments per capita** is HUF 5,283.5 billion, 7.9 percent (HUF 387 billion) higher than the expected 2024 total. **Personal income tax** dominates this revenue group, with HUF 4,905.4 billion of the total, 8.2 percent (HUF 371 billion) higher than the expected outturn. This is mainly due to high wage outflows and the increase in average earnings, while the second half of the year will see a reduction of around HUF 80-85 billion in revenues due to the 50 percent increase in family allowances.

The target for **levy revenues** is HUF 275.4 billion, which is HUF 13 billion (5 percent) more than expected this year. A significant shift in revenues is expected as a result of a pick-up in real estate sales, while the transfer tax on the ownership of motor vehicles and trailers will rise in line with inflation.

The motor vehicle tax budget is HUF 102.7 billion, which is 4.1 percent more than the 2024 target (HUF 98.7 billion).

The central sub-system's revenue estimate **from social contribution taxes and contributions** is HUF 8,824.1 billion, 9.3 percent higher than expected in 2024. Of this, the Pension Insurance Fund will receive HUF 5,912.8 billion, the Health Insurance Fund HUF 2,473.9 billion and the National Employment Fund HUF 437.4 billion.

The revenue plans for EU funds amount to HUF 2268 billion. The bulk of this, HUF 2129 billion, will come from the Commission for Cohesion (1300 billion), Recovery (630 billion) and Rural Development (165 billion). Other, typically technical, revenue (such as refunds to beneficiaries) amounts to HUF 107 billion, while the Government plans to reimburse the cost of customs duties collection to the tune of HUF 32 billion. At the time of writing, recovery funds are still unavailable, so there are significant risks to the achievement of the Recovery and Resilience Fund (RRF) revenues of over HUF 600 billion.

2.3. Expenditures of the central subsystem

According to the draft, the **total** non-consolidated **expenditure appropriations of** the central sub-system of general government amount to HUF 43,165.8 billion, 5.9% more than the 2024 appropriations and only 0.8% more than the expected 2024 outturn.

From the draft provided to the Council, it was not yet possible to know the breakdown of income and expenditure between the three main categories: operating (current), domestic accumulation and operating and development expenditure, which also receives EU funding.

On the basis of the data received later as additional information, and without assessing them in detail, it can be concluded that 85.3% of the total expenditure appropriations are **for current (operational) purposes.** The share is 1.3 percentage points higher than the one calculated from the 2024 appropriations, thus continuing the trend of these expenditures. **Domestic sources** are projected to account for 7.7 percent of total spending on **capital** expenditure, 0.4 percentage point more than in 2024. In contrast, there is a significant decrease of 1.7 percentage points in appropriations for **EU-funded operational and development purposes**, which account for 7 percent of total expenditure.

Under the plan, **support for families will** continue in 2025, with energy price protection and energy efficiency being a key tool to offset the rise in global energy prices. The **Public Utility Defense Fund** will be abolished from 2025, so the maintenance of household energy protection will be transferred to the Ministry of Energy and the planned expenditure will be HUF 880 billion compared to the HUF 917 billion in 2024. Support for the energy costs of public transport services will be allocated to the Ministry of Construction and Transport, while the compensation of public institutions for public service costs will be allocated to the Ministry of Finance, with a planned expenditure of HUF 253 billion. The Government will continue to decide on the use of the appropriations for the protection of public finances by individual decision. In addition, HUF 121 billion of the Water Utility Development and Compensation Fund, which will apply from 1 January 2024, will be allocated to the Ministry of Energy chapter. The planned expenditure for 2025 on water protection is close to the appropriations for 2024.

The National Defense Fund will also be abolished, and the planned **defense expenditure** in the Ministry of Defense section of the central budget will still reach 2 percent of GDP in 2025.

In order to improve the balance of public finances, the central budget chapters and separate state funds under the control of the Government are required to pay a total of HUF 350 billion to the central budget by 31 March 2025, for which a plan of measures must be submitted to the Government by 1 March 2025. At the same time, the fact that the 2024 year-over-year surpluses of budgetary bodies have been partially incorporated in the 2025 budget appropriations increases the soundness and enforceability of the budget, and is thus some HUF 2,000 billion higher than the 2024 appropriations. However, in line with the austerity objectives, this amount is below the expected expenditure for 2024. The moderate increase in expenditure is also supported by the implementation of the Government's investment moderation programme.

The draft contains an appropriation to guarantee the resources needed to implement the planned additional wage measures for certain categories of public servants (additional salary increases for teachers and vocational trainers, wage increases for water workers, increases in the minimum wage and the guaranteed minimum wage, etc.). The budget plans in line with the legislation **by preserving the value of pensions** and by paying the 13th month pension for the fourth year in a row.

The statutory appropriation for **Exceptional Government Measures** provides for a reserve of HUF 100 billion. This is not in line with the current Public Finance Act, which provides for a reserve of 0.5% of the total expenditure (which would correspond to an appropriation of HUF 220 billion), and is low compared to the potential risks. The Ministry of Finance has informed the Council that it will propose an amendment to the rule to enter into force before the 2025 budget. Reducing the size of the reserves increases the risk to feasibility.

According to the draft, **public health institutions** will receive an extra HUF 150 billion in funding. At the same time, the 2025 budget for spending on preventive medical care (HUF 2,766.1 billion) is HUF 213.1 billion higher than the 2024 budget. In 2025, HUF 45 billion is expected to be allocated for the subsidization of equitable medicines and medical aids.

The planned **spending on EU programmes of** HUF 3023.8 billion would be 50 percent more than the expected outturn in 2024 (the latter is only 56 percent of the then estimate). Based on the planned spending structure, the Government plans to pay out more than HUF 1600 billion for the operational programmes 2021-2027 and more than HUF 400 billion for the RRF programmes. Given that barely a tenth of the 2024 RRF disbursement envelope has been met in the first 9 months, and that there is still no sign of significant progress in meeting the conditions for the release of funds, there are significant risks to the 2025 plans for recovery funds.

Public **interest expenditure** will continue to be a high budgetary cost in 2025**.** In 2025, the amount of interest expenditure on **current payments** could reach HUF 3,836.1 billion, or 4.4 percent of GDP, significantly exceeding the expected HUF 3,572.0 billion in 2024. At the same time, the gross **accrued** interest expenditure as a share of GDP could reach 3.8 percent, according to the draft law. Accrual interest expenditure would thus fall by about 1 percentage point compared to 2024, mainly due to the repricing of inflation-linked government bonds to lower interest rates. The difference between cash and accrual interest expenditure is mainly due to the fact that for inflation-tracking government bonds, the higher interest payments after inflation in 2023 are paid in 2025, while in accrual terms, a significant part of these interest payments is already taken into account in 2024. A shift in the forint-euro exchange rate implies a risk not only for the evolution of government debt but also for interest expenditure, which increases as the foreign currency share of government debt increases.

A new regulatory element is the deduction and redistribution of the municipalities' surplus of business tax to the regional development fund within the district. Behind the surplus revenue abstracted, the municipalities concerned may have commitments, the non-fulfilment of which may be a risk factor in the management of the municipalities.

As regards expenditure appropriations, the Council identified the following risks:

The amount of the appropriation **for the financing of high-value medicines** (HUF 180.0 billion) planned for 2025 under the Medicines and Preventive Care sub-heading of the Health Insurance Fund is 38.8 percent higher than the 2024 appropriation. However, the outturn of the 2024 appropriation is expected to exceed HUF 200 billion, so without further action, the increased 2025 appropriation may not be sufficient to fully cover the medical tasks financed by this appropriation.

In the draft Budget Act 2025, the Government increased the amount of appropriations open from above by HUF 1,397 billion compared to the 2024 budget. This increased the ratio of the amount of top-up appropriations to the total expenditure of the central sub-system of general government from 50.0 percent to 50.4 percent.

2.4. Capital adequacy of the Magyar Nemzeti Bank

In preparing its opinion, the Council took into account in particular the following considerations:

As a result of the crisis management measures taken after the outbreak of the coronavirus epidemic, which increased the central bank's balance sheet, and the monetary policy designed to suppress inflation, the MNB's own equity turned negative in 2023, amounting to - HUF 1,855 billion. It is important to stress, however, that while the positive impact of monetary policy measures was felt by all agents in the economy, the cost of these measures was concentrated at the central bank.

The central bank's performance is gradually improving thanks to interest rate cuts. Despite the loss in the first half of the year, the MNB's own funds improved by nearly HUF 90 billion by the end of June 2024, helped by the shift in gold and foreign exchange rates.

In the near future, the balance sheet contractionary effect of the phasing out of previous programmes could lead to a significant improvement in the MNB's profit and equity. In addition to monetary policy developments, a number of other variables, both domestic and foreign, could have a significant impact on the MNB's equity. According to the forecast provided by the MNB in April, the future path of equity could exceed the level of subscribed capital in the longer term under several possible scenarios. These would require a reduction in the country's risk premium, which can be supported by successful disinflation, disciplined fiscal policy and an increase in competitiveness.

The Council, in cooperation with the MNB, held an international online conference on the role of central bank capital on 12 September. One of the key findings of this conference was that a central bank can effectively perform its statutory tasks even with negative capital. There are several central banks that have had negative equity for a long time, yet have been able to operate smoothly and efficiently and successfully achieve price stability. Moreover, experts consider that the use of profits from later years for this purpose is an accepted way of replenishing central bank capital.

The Council finds it acceptable that the draft bill on the 2025 central budget does not include a reimbursement from the budget to improve the MNB's capital position.

2.5. General government deficit

The deficit of the government sector on an accrual basis (ESA) is projected to be 3.7 percent of GDP in 2025. This will continue the decline in the deficit ratio from 6.7 percent in 2023 to 4.5 percent of GDP in 2024. The latter deficit target, which was increased mid-year, was considered achievable by the Council in paragraph 5 of its Opinion 5/2024.26.09.2024 on the mid-year assessment of the implementation of the 2024 central budget, provided that the fiscal measures taken are implemented consistently in 2024 and that public expenditure is kept under tight monitoring and control towards the end of the year.

The 3.7% deficit target remains above the criterion set by the EU Treaty, and also above the 3% target set by the domestic rule. The domestic rules temporarily allowed the deficit to remain above 3 percent, but the suspension has ended, so the current set of rules now requires the 3 percent deficit to be reached in 2025. According to the Ministry of Finance, an amendment to this rule will be initiated before the entry into force of the Budget Law.

At the same time, it is welcome that Hungary's medium-term fiscal structural plan could bring the ESA deficit below 3.0% of GDP in 2026, albeit marginally.

Contributing to the reduction in the fiscal deficit in 2025 is the reduction in gross accrued interest expenditure as a share of GDP from 4.8 percent in 2024 to 3.8 percent in 2025, according to the draft law, which is mainly caused by the repricing (reduction in interest rates) of inflation-linked government securities. In addition, under the draft, the reduction in the budget deficit will be helped by an increase in tax revenues, as well as by a number of tax measures and expenditure measures that impose a total of HUF 350 billion in savings on budget headings and on earmarked public funds. The budget foresees a high level of expenditure on public expenditure on energy and on energy protection, which could provide a buffer against falling world energy prices, but a substantial increase in energy prices would lead to higher expenditure.

However, the deficit target could be made more difficult to achieve by the under-execution of some revenues in 2024, mainly related to consumption, which, as in 2023, would worsen the base of these appropriations. In addition, if the economic growth expected for 2025 is not achieved, as in 2024, this would also reduce the revenues of the budget. There appears to be a risk that the inflows of EU funds under the draft plan will materialize, as the uncertainty surrounding their availability persists, increasing the risk of loss of resources for RRF funds and for Cohesion funds in 2021-2027.

2.6. Public debt

The public debt-to-GDP ratio (the public debt ratio) has been falling year on year since 2021, and the draft bill envisages that the decline will continue in 2024, as the debt ratio could fall from 73.4 percent at the end of 2023 to 73.2 percent. According to the draft, the expected debt ratio of 73.2 percent at the end of 2024 could fall to 72.6 percent by the end of 2025, supported by a reduction in the general government deficit and economic growth, as well as a reduction in non-central subsystem debt.

Based on the currently known circumstances, the debt ratio in 2024 could be higher than projected in the draft bill, which does not in itself affect the reduction next year, but results in a higher debt trajectory. The Council, in its mid-year assessment of the implementation of the 2024 central budget, pointed out in paragraph 8 of its Opinion No 5/2024.26.09.2024 that the achievement of the revised accrual and cash deficit targets is also essential for the planned small reduction in the debt ratio.

The debt reduction of 0.6 percentage points in the draft budget bill is achievable with nominal GDP growth in line with the macroeconomic path of the budget and a reduction in the stock of non-central debt of 0.5 percentage points of GDP in the draft. However, the lower-than-expected economic performance, the slower pace of non-central debt reduction and the increasing exchange rate risk due to a rising foreign exchange rate ratio of central government debt close to 30 percent would make it substantially more difficult to achieve the planned debt reduction. Changes in the forint-euro exchange rate affect the debt ratio through the revaluation of foreign currency debt. This impact is smaller the lower the share of foreign debt in government debt. Currently, a change in the forint-euro exchange rate of 10 forints changes the government debt-to-GDP ratio by about 0.6 percentage points. The draft assumes a euro exchange rate of 397.5 forints.

The Fundamental Law provides for a reduction of the debt ratio if the debt ratio is above 50 percent, in order to adopt and implement the budget law. The requirement of the Stability Law is that the government debt ratio must be reduced by at least 0.1 percentage points, in compliance with EU rules on debt reduction[2]. The requirement of the Stability Law is fulfilled in the draft.

The EU debt rule states that Member States' debt ratios should 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 60 percent on average 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 government expenditure will need to be in line with the net expenditure path in the plan, which will ensure a satisfactory reduction in government debt. With an initial debt ratio between 60 and 90 percent of GDP, the ratio should decline by at least 0.5 percentage point per year on average. (Actual annual or cumulative deviations from the expenditure path above the thresholds will trigger a debt-based excessive deficit procedure for the offending Member State.)

According to Hungary's medium-term fiscal structural plan, the debt-to-GDP ratio could fall below 70% by the end of 2027. The achievement of the medium-term debt trajectory is, as in

[2] Act CXCIV of 2011 on the Economic Stability of Hungary, § 4 (2a)

the year, dependent on, inter alia, economic growth, the budget deficit and, increasingly, exchange rate developments due to the increased foreign exchange ratio of central government debt.

Budapest. 7 November 2024.

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