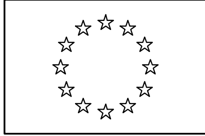

EUROPEAN COMMISSION

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Recommendation for a

COUNCIL OPINION

on the updated convergence programme of Hungary, 2009-2012

EXPLANATORY MEMORANDUM

1. GENERAL BACKGROUND

The Stability and Growth Pact is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation. The 2005 reform of the Pact sought to strengthen its effectiveness and economic underpinnings as well as to safeguard the sustainability of the public finances in the long run.

Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[1], which is part of the Stability and Growth Pact, stipulates that each Member State has to submit, to the Council and the Commission, a stability or convergence programme and annual updates thereof. Member States that have already adopted the single currency submit (updated) stability programmes and Member States that have not yet adopted it submit (updated) convergence programmes.

In accordance with the Regulation, the Council delivered an opinion on the first convergence programme of Hungary on 8 July 2004 on the basis of a recommendation from the Commission and after having consulted the Economic and Financial Committee. As regards updated stability and convergence programmes, the Regulation foresees that these are assessed by the Commission and examined by the Committee mentioned above and, following the same procedure as set out above, the updated programmes may be examined by the Council.

2. BACKGROUND FOR THE ASSESSMENT OF THE UPDATED PROGRAMME

The Commission has examined the most recent update of the convergence programme of Hungary, submitted on 29 January 2010, and has adopted a recommendation for a Council Opinion on it.

In order to set the scene against which the budgetary strategy in the updated convergence programme is assessed, the following paragraphs summarise:

(1) the Commission Communication of 26 November 2008 ("A European Economic Recovery Plan");

(2) the conclusions of the Economic and Financial Affairs Council of 20 October 2009 on the "Exit strategy";

(3) the country's position under the corrective arm of the Stability and Growth Pact (excessive deficit procedure);

(4) the most recent assessment of the country's position under the preventive arm of the Stability and Growth Pact (summary of the Council Opinion on the previous update of the convergence programme).

[1] OJ L 209, 2.8.1997, p. 1. The documents referred to in this text are available at: http://ec.europa.eu/economy_finance/sgp/index_en.htm.

2.1. The Commission Communication of 26 November 2008 ("A European Economic Recovery Plan")

In view of the unprecedented scale of the global crisis that hit financial markets and the world economy in 2008-2009, the European Commission called for a European Economic Recovery Plan (EERP)[2]. The plan proposed a co-ordinated counter-cyclical macro-economic response to the crisis in the form of an ambitious set of actions to support the economy consisting of (i) an immediate budgetary impulse amounting to € 200 bn. (1.5% of EU GDP), made up of a budgetary expansion by Member States of € 170 bn. (around 1.2% of EU GDP) and EU funding in support of immediate actions of the order of € 30 bn. (around 0.3 % of EU GDP); and (ii) a number of priority actions grounded in the Lisbon Strategy and designed to adapt our economies to long-term challenges, continuing to implement structural reforms aimed at raising potential growth. The plan called for the fiscal stimulus to be differentiated across Member States in accordance with their positions in terms of sustainability (or room for manoeuvre) of government finances and competitive positions. In particular, for Member States outside the euro area with significant external and internal imbalances, budgetary policy should essentially aim at correcting such imbalances. The plan was agreed by the European Council on 11 December 2008.

2.2. The conclusions of the Economic and Financial Affairs Council of 20 October 2009 on the "Exit strategy"

Following the halt of the sharp decline in economic activity and first signs of a recovery from the crisis, the stabilisation of financial markets and the improvement in confidence, the Council concluded on 20 October 2009 that, while in view of the fragility of the recovery it was not yet time to withdraw the support governments provided to the economy and the financial sector, preparing a coordinated strategy for exiting from the broad-based policies of stimulus was needed. Such a strategy should strike a balance between stabilisation and sustainability concerns, take into account the interaction between the different policy instruments, as well as the discussion at global level. Early design and communication of such a strategy would contribute to underpinning confidence in medium-term policies and anchor expectations. Beyond the withdrawal of the stimulus measures of the European Economic Recovery Plan, substantial fiscal consolidation was required in order to halt and eventually reverse the increase in debt and restore sound fiscal positions. Increasing the efficiency and effectiveness of public finances and the intensification of structural reform were desirable even in the short term as they would contribute to fostering potential output growth and debt reductions.

The Council agreed on the following principles of the fiscal exit strategy: (i) the strategy should be coordinated across countries in the framework of a consistent implementation of the Stability and Growth Pact; (ii) taking country-specific circumstances into account, timely withdrawal of fiscal stimulus was needed; provided that the Commission forecasts continued to indicate that the recovery was strengthening and becoming self-sustaining, fiscal consolidation in all EU Member States should start in 2011 at the latest; (iii) in view of the challenges, the pace of consolidation should be ambitious, in most countries going well beyond the benchmark of 0.5% of GDP per annum in structural terms; and (iv) important flanking policies to the fiscal exit would include strengthened national budgetary frameworks for underpinning the credibility of consolidation strategies and measures to support long-term

[2] Communication from the Commission to the European Council of 26 November 2008.

fiscal sustainability; in addition, structural reform efforts should be strengthened to enhance productivity and to support long-term investment. The Council agreed that these elements should be reflected in the stability and convergence programmes, to be transmitted by Member States to the Commission by the end of January 2010.

2.3. The excessive deficit procedure for Hungary

On 5 July 2004, the Council decided that an excessive deficit existed in Hungary in accordance with Article 104(6) TEC. Subsequently, several Council Recommendations under Article 104(7) TEC were adopted, the most recent one on 7 July 2009, establishing a deadline for taking effective action by 7 January 2010.

The Council recommended to Hungary to put an end to the existing excessive deficit as rapidly as possible and by 2011 at the latest. In particular, deficits in 2009 and 2010 should respect the limits of 3.9% of GDP and 3.8% of GDP, respectively. Budgetary measures should ensure an improvement in the structural balance of at least a cumulative 0.5 percentage points over the two years of 2010 and 2011 taken together. The recently adopted fiscal responsibility law should be fully implemented. Finally, the government debt to GDP ratio should be brought onto a firm downward trajectory, if possible before 2011.

The Council continues to welcome the commitment of the Hungarian authorities announced originally in the adjusted convergence programme update of 1 September 2006 to submit reports to the Commission and the Council examining progress made in complying with this recommendation on a six-monthly basis. Moreover, it invites the Hungarian authorities to report on progress made in the implementation of these recommendations in a separate chapter in the updates of the convergence programmes until the excessive deficit is corrected.

On 16 February 2010 the Council concluded that it appeared that Hungary had taken action representing adequate progress towards the correction of the excessive deficit within the time limits set by the Council. However, it was also noted that there were considerable risks attached to the 2010 deficit target, both on the revenue and the expenditure side. Against that background and in view of already agreed non-compensated tax cuts in 2011, the required cumulative 0.5% of GDP structural adjustment necessary to bring the deficit below 3% in 2011 could not be considered yet as ensured.

2.4. The assessment in the Council Opinion on the previous update

In its opinion of 10 March 2009, the Council summarised its assessment of the previous update of the convergence programme, covering the period 2008-2011, as follows. The Council considered that, "in spite of distinct improvements in its high imbalances, including the reduction in the budget deficit from 9.3 % of GDP in 2006 to below 3.5 of GDP in 2008, Hungary has been particularly exposed to the financial crisis and thus had to limit the financing need of the government rather than stimulate the economy during the economic downturn. In this context, it adopted a policy of further fiscal adjustments and tighter deficit targets to restore investor confidence. This strategy has been backed by international financial assistance from the EU, the IMF and the World Bank. The programme foresees a continuation of the front-loaded consolidation strategy, with another important adjustment in 2009 to 2.6 % of GDP, and followed by a more moderate adjustment path towards a budget deficit of 2.2 % of GDP by 2011. However, this deficit reduction path is subject to risks, especially since the macro-economic assumptions underlying the programme have in the meantime become markedly favourable. This risk would be substantially reduced by the corrective measures adopted and structural steps recently announced by the Government together with the revision

of the 2009 deficit target slightly upwards to 2.7-2.9 % of GDP. Moreover, the adoption of the law on fiscal responsibility is an important step towards establishing prudent fiscal policy and, if implemented with determination, should contribute to the durability of the fiscal consolidation. Nevertheless, the sustainability of public finances also hinges on the continuation of structural reforms, to the extent that they increase long-term growth, help meet budgetary targets, and reduce the country's vulnerabilities".

In view of this assessment, the Council invited Hungary to "(i) in view of the risks, maintain adequate buffers, take the necessary measures to bring the budget deficit below the 3% of GDP threshold in 2009, and ensure that adequate progress in budgetary consolidation towards the MTO is made thereafter, thereby setting the debt-to-GDP ratio on a declining path towards the 60 % of GDP threshold; (ii) ensure full implementation of the fiscal responsibility law, continue expenditure moderation through further reforming of public administration, healthcare, and education systems, as announced, and strengthen financial market regulation and supervision; (iii) in view of the level of debt and the increase in age-related expenditure, further improve the long-term sustainability of public finances; continue to reform the pension system after the steps already taken in 2006-2008".

Recommendation for a

COUNCIL OPINION

on the updated convergence programme of Hungary, 2009-2012

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[3], and in particular Article 9(3) thereof,

Having regard to the recommendation of the Commission,

After consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

(1) On [22 April 2010] the Council examined the updated convergence programme of Hungary, which covers the period 2009 to 2012.

(2) Hungary was in a fragile economic condition when the financial crisis broke out in autumn 2008. The mid-2006 fiscal policy reversal, which was aimed at correcting the existing economic imbalances and restraining the accumulation of the public debt, successfully reduced the budget deficit to 3.8% of GDP by 2008 (compared to 9.3% of GDP in 2006) but the adjustment was incomplete when the global financial crisis hit. Moreover, the share of foreign-exchange-denominated debt was relatively high. Gross financing needs became more difficult to meet, reflecting investors' concerns about the sustainability of the budgetary position, the country's high external debt, and the drop in potential growth. Taken together, these factors required a stronger economic policy response, measures to support the banking sector, and significant external assistance from international institutions of EUR 20 billion, including EUR 6.5 bn from the EU (of which EUR 5.5 billion have been disbursed). Since the second half of March 2009, against the background of strong stabilisation and adjustment efforts, access to market-based financing has been regained. Moreover, due to the significant contraction in domestic demand in 2009, a dramatic improvement was registered in the current account, mostly through the trade balance. The exchange rate remained broadly stable since July 2009 and the central bank was able to cut the main policy rate by cumulative 375 basis points between mid-2009 and early 2010. Given the lack of fiscal space and investors' concerns, the Government has continued to implement its fiscal consolidation policy and only

[3] OJ L 209, 2.8.1997, p. 1. The documents referred to in this text can be found at the following website: http://ec.europa.eu/economy_finance/sgp/index_en.htm.

adopted budgetary neutral measures to support the economic recovery. Continuing fiscal consolidation to bring the debt on a declining path and further improve the long-term sustainability of public finances remains a key challenge for Hungary.

(3) Although much of the observed decline in actual GDP in the context of the crisis is cyclical, in the case of Hungary, it came on top of already steadily declining potential growth; thus, growth in potential output will resume from a lower starting point. In addition, the crisis may also affect potential growth in the medium term through lower investment, constraints in credit availability and increasing structural unemployment. Moreover, the impact of the economic crisis will coincide with the negative effects of demographic ageing on potential output and the sustainability of public finances. Against this background it will be essential to accelerate the pace of structural reforms with the aim of supporting potential growth. In particular, for Hungary it is important to undertake reforms aimed at increasing labour force participation and to rebuild its ability to attract FDI.

(4) The macroeconomic scenario underlying the programme envisages that, after a contraction of 6.7% in 2009, real GDP will decline further by 0.3% in 2010 to resume growing by 3¾% in 2011 and 2012. This is slightly more optimistic than the Commission services' autumn 2009 forecast, according to which annual GDP growth would decline by 0.5% in 2010 and grow by 3.1% in 2011. However, in view of recent information, including the better-than-expected preliminary 2009 GDP figure of -6.3% of GDP, the projection for 2010 appears plausible, while the scenario remains slightly favourable in the outer years. According to the programme, growth is expected to rely primarily on the rebound of net exports, with private consumption still contracting in 2010 by around 2½%, which according to the most recent information, could be slightly worse. Domestic demand projections look broadly plausible, but the forecast for imports and investment appears to be optimistic. On balance, the macroeconomic scenario seems to be plausible in 2010 and slightly favourable in 2011 and 2012. The nominal path of the reference scenario is driven by the congruous cyclical position of labour and product markets. Specifically, while the significant negative output gap asserts downward pressure on prices, the high unemployment implies the deceleration of wages. Overall, inflation figures appear plausible in 2010 and slightly on the low side thereafter. The programme's macroeconomic scenario is consistent with the underlying monetary and exchange rate assumptions.

(5) The programme estimates the general government deficit in 2009 at 3.9% of GDP in 2009, after 3.8% in 2008. The headline deficit has been broadly stabilised in spite of the strong economic deterioration associated with the global economic downturn and its large unfavourable budgetary effects. This was achieved thanks to the implementation of expenditure cuts, partly of a structural nature and in particular in public wages, pensions, and social benefits. As a result, there was a significant improvement in the structural balance by nearly 3% of GDP. In addition, a broadly deficit neutral tax reshuffling was implemented to boost the competitiveness of the economy by lowering the tax burden on labour and increase the weight of consumption taxes. Given the high public debt level and the stress in financial markets, the authorities have been in a position to support the economic recovery only by taking measures that did not have a budgetary impact. In line with the exit strategy advocated by the Council, and with a view to correcting the excessive deficit

by 2011, taking also into account the high public debt-to-GDP ratio, the restrictive fiscal stance in 2009 is planned to be continued over the period 2010-2011.

(6) The budget target for 2010 in the programme is a deficit of 3.8% of GDP, in line with the Council recommendation under Article 104(7) TEC of 7 July 2009 and with the 2010 budget adopted on 30 November 2009. The programme projects revenue to stabilise in nominal terms in 2010, which implies both a further decrease in real terms and a lowering revenue ratio (from 45.9% in 2009 to 45% in 2010). On top of the continued widening of the negative output gap, growth composition effects associated with the increasing weight of net exports in the economy and the concomitant lowering share of domestic demand largely explain the decrease of the revenue ratio. In order to offset the fall of the revenue ratio and improve the budgetary balance at the same time, the programme aims at decreasing the expenditure ratio (from 49.8% in 2009 to 48.8% in 2010). It mainly relies on structural reforms and specific saving measures (including the pension system, social benefits, public wages and transfers to the local governments as well as to the long distance public transport) amounting to 2% of GDP, adopted in 2009 and with a budgetary impact in 2010. Although these measures in total should exceed 2 pp. of GDP in 2010, the structural deficit as recalculated by the Commission services according to the commonly agreed methodology based on the programme data is expected to improve by less than ¼ pp of GDP. The implementation of a significant part of the saving measures was necessary just to counterbalance the underlying upward trend of certain expenditures. In addition, the revenue ratio is expected to decline more than it would have resulted from the use of standard elasticities given both the slight deficit increasing nature of the tax reshuffling measures in 2010 as well as the advance purchases of tobacco stamps ahead of the excise duty increase as of 2010.

(7) The main goal of the programme's medium-term strategy is to reduce the general government deficit from 3.8% of GDP in 2010 to below 3% by 2011 (2.8%) and then further to 2.5% in 2012. The 2011 and 2012 deficit targets result in a recalculated structural deficit of 1½% and 2½% of GDP, respectively. It means that a structural improvement by around 3 pp of GDP in 2009 is projected to be followed by a 0.1% of GDP improvement in the period 2010-2011 (compared to an almost 1% of GDP deterioration in the Commission services Autumn 2009 forecast). In 2012, the structural balance would even deteriorate by 1% of GDP. Regarding 2011, despite the recovery of the economy, the revenue ratio is expected to further decline in view of (i) the increasing weight of net exports which makes growth less tax reach, (ii) the lagged effect of the contraction of the economy, and (iii) the adoption in 2009 of a reduction of the overall tax burden linked to the personal income tax as of 2011. The acceleration of the absorption of the EU funds may only partly offset these developments, leaving an overall decline in the revenue ratio by 0.8% of GDP. The convergence programme broadly lists a number of possible measures on the expenditure side that would more than offset the fall of the revenue ratio and bring the deficit to 2.8% of GDP. They refer mainly to a further real wage decrease in the public sector, an additional decline of social benefits in real terms and strict discipline of the management at the budget chapters. However, these measures have not been specified in detail. The medium-term objective (MTO) is a structural

balance of -1.5% of GDP, which in view of the new methodology[4] and the most recent projections and debt levels reflects the objectives of the Pact. While the programme aims at complying with the MTO in 2012, according to the structural balance recalculated by the Commission services according to the commonly agreed methodology (-2.5% of GDP), it does not and there would be a structural deterioration. Moreover, the measures backing the 2012 target are also largely unspecified.

(8) The budgetary outcomes could be worse than projected in the programme. In 2010, revenue could turn out lower than expected of ¼% of GDP, in particular since in view of the earlier cut-off date the programme did not take into account the Constitutional Court's decision of revoking the general value-based property tax adopted by the Parliament. On the expenditure side, some overruns are expected due to the costs linked to the re-nationalizing of the airline company MALEV and the fact that the planned reduction of the subsidy for the long distance public transport system is not fully underpinned by structural measures. The programme also foresees an additional saving at the budget chapters due to the recently established system of treasures, but this is not ensured as it is not backed by specific measures. Finally, the one-off revenue of ¼% of GDP in 2010 from the shift of the eligible employees and pensioners from the private pillar into the public of the pension system still has to be confirmed in the context of the notification procedure. On the other hand, there are budgetary reserves of around ½% of GDP that could be frozen and contingency expenditure cuts of 0.2% of GDP that could be made to compensate for adverse developments. Regarding 2011 and 2012, slippages compared to the programme can be expected both on the revenue and the expenditure side, on top of the base effects including from the elimination of the property tax. The speed of the recovery of the economy and the share of the private consumption expenditure in 2011 and beyond in the programme is slightly more optimistic than in the Commission services' projection, which implies that the tax revenues in the programme might be on the high side. Regarding expenditure, the savings measures foreseen in the programme to counterbalance the continuous fall of the revenue ratio are not yet underpinned by concrete decisions. Moreover, the programme does not take into account the central bank losses, which are expected to increase the deficit by 0.1-0.2% of GDP in 2011 and 0.3-0.4% in 2012 based on current estimations. Finally, expenditure could turn out to be higher linked to losses of state-owned companies. At the same time, budgetary reserves to compensate against slippages are only around 0.2% of GDP in 2011 and 0.4% in 2012, which compares with 0.8% in 2010. Although in the recent years the targeted budget deficits have been met, the risks associated with Hungary's track record are in light of the substantial slippages in earlier years, and particularly in elections years such as 2010, at best neutral. Therefore, there are considerable risks that the deficit outcomes may be worse than planned in the programme.

(9) Government gross debt is estimated at 78% of GDP in 2009, up from around 73% in the year before. This increase is explained by the general government deficit and the negative nominal GDP growth. According to the programme, the debt ratio is

[4] The country-specific MTOs should take into account three components: i) the debt-stabilising balance for a debt ratio equal to the (60% of GDP) reference value (dependent on long-term potential growth), implying room for budgetary manoeuvre for Member States with relatively low debt; ii) a supplementary debt-reduction effort for Member States with a debt ratio in excess of the (60% of GDP)

projected to remain over the Treaty reference value throughout the programme period. A further rise to 79% of GDP in 2010 is projected before it would start declining to 77% and 73½% in 2011 and 2012, respectively. The expected improvement in macroeconomic conditions and the start of the amortisation of the international economic assistance from 2011 are the main factors behind such positive developments. In view of the negative risks to the budgetary targets and the possible stock flow adjustments, the evolution of the debt ratio could be considerably less favourable than projected in the programme, especially as from 2011. From 2010 onwards, the debt ratio diminishes sufficiently towards the reference value.

(10) Pension reforms implemented in 2009 are estimated to reduce the increase in future age-related expenditure, which after this reform is projected to be clearly below the EU average. The budgetary position in 2009 as estimated in the programme improved from the starting position of the previous programme. Thus, the budgetary impact of population ageing on the sustainability gap has been largely mitigated. Ensuring high primary surpluses over the medium term and implementing the pension reform rigorously, as already foreseen in the programme, will reduce the long-term sustainability risks of public finances, which were assessed in the Commission 2009 Sustainability Report[5] as medium. Medium-term debt projections until 2020 that assume GDP growth rates will only gradually recover to the values projected before the crisis and tax ratios will return to pre-crisis levels show that the budgetary development envisaged in the programme, taken at face value, would be enough to stabilise the debt ratio by 2020.

(11) Regarding the institutional features of public finances, one of the most important recent developments is the implementation of the new fiscal framework, which relies on the fiscal responsibility law (FRL) and the amendment of the organic law adopted in November 2008. Overall, the new fiscal framework is expected to contribute to improving transparency and sustainability of public finances. The FRL stipulates that as a general rule the determination of the future primary balances in a medium-term framework should be consistent with a real debt rule. Based on the FRL, an independent Fiscal Council has been established and started its operation. The 2010 budget has already been prepared broadly in line with the new fiscal framework and the 2011 budget will need to be fully in compliance with all the elements of the fiscal framework. Concerning the budgetary framework, another key development is the adoption of the Act on the legal status and financial management of budgetary institutions by the Parliament in December 2009. The new legislation complements the existing rules with a number of new elements, including detailed operational and financial management rules for the various budgetary institutions and by providing a uniform framework with respect to the use of both Hungarian and EU funds. However, it is too early to assess the effectiveness of the new framework in terms of ensuring an improved budgetary execution and sound fiscal policy.

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[5] In the Council conclusions from 10 November 2009 on sustainability of public finances "the Council calls on Member States to focus attention to sustainability-oriented strategies in their upcoming stability and convergence programmes" and further "invites the Commission, together with the Economic Policy Committee and the Economic and Financial Committee, to further develop methodologies for assessing the long-term sustainability of public finances in time for the next Sustainability report", which is foreseen in 2012.

(12) Hungary is characterised by a high overall tax burden in combination with a high level of government spending. The government has taken several measures to reform the tax system broadly in a budget neutral way, aiming at boosting the competitiveness of the economy by shifting the tax burden from labour to consumption taxes. However, recent rulings of the Constitutional Court and the income tax cut planned for 2011 imply revenue losses, which have not yet been covered by measures, although a resubmission of an amended property tax cannot be discarded either. On the expenditure side, primary expenditure growth has outpaced nominal GDP growth in the period 2000-2009. A major challenge for public expenditure reduction is the anticipated rise in public expenditure related to ageing. Past reforms of the pension system, in particular in May 2009, should lead to a slower increase in pension costs and also favour labour supply, thereby supporting potential growth. In the future, increasing the statutory retirement age in line with life expectancy would help improve the quality of public finances. The reduction of the size of government and an increase in the efficiency of public administration, e.g. in the area of education and health care, could also bring about large welfare gains and eventually make room for further tax cuts on labour.

(13) Overall, in 2010 the budgetary strategy set out in the programme seems to be broadly consistent with the Council Recommendations under Article 104(7) TEC as the considerable risks associated to the outcome are at least partly matched by the possibility to freeze budgetary reserves and to adopt contingency expenditure cuts. From 2011, taking into account the risks, the budgetary strategy may not be consistent with the Council recommendations and the structural effort of a cumulative 0.5% of GDP over 2010-2011 is not yet ensured. In particular, the expenditure saving measures underpinning the target for 2011 are only partly specified and not yet adopted, and not specified at all in 2012. Moreover, the tax revenues forecast for both years might turn out to be on the high side. At the same time, budgetary reserves are relatively limited compared to 2010, which suggests that the deficit outcome may turn out substantially worse and the excessive deficit may not be corrected on time unless further consolidation measures are taken. In view of these risks attached to the budgetary targets, the strategy may not be sufficient either to ensure that the government gross debt ratio is brought back onto a firm downward trajectory. To address those risks and to correct the expansionary policy stance in 2012 which is not in line with the Pact, the strategy needs to be backed up by fully specified measures as from 2011 and the consolidation efforts needs to be strengthened, especially in the outer years.

(14) As regards the data requirements specified in the code of conduct for stability and convergence programmes, the programme has some gaps in the required and optional data[6]. In its recommendations under Article 104(7) of 7 July 2009 with a view to bring the excessive deficit situation to an end, the Council also invited Hungary to report on progress made in the implementation of the Council's recommendations in a separate chapter in the updates of the convergence programmes. Hungary complied with this recommendation.

[6] In particular, the compulsory information on the nominal effective exchange rate is missing as well as optional data including on general government expenditure by function and the breakdown of stock-flow adjustments.

The overall conclusion is that despite the sharp economic contraction in 2009 in the context of the financial crisis, the budget deficit was stabilised. Following the strongly restrictive fiscal stance in 2009 and the previous two years, the budgetary stance in Hungary turns broadly neutral in 2010 and 2011 and expansionary in 2012. According to the programme, this should lead to a correction of the excessive deficit by 2011. The government gross debt-to-GDP ratio is expected to continue its upward movement up to 2010 and start declining again in 2011, bringing the debt back on a downward path. However, the budgetary path only foresees a small structural improvement in 2010, none in 2011, and a deterioration in 2012. Moreover, this path is subject to considerable downside risks, especially in the outer years. In 2010, the elimination of the property tax and the downward risks notably linked to the additional financing need of the public transport could be compensated to some extent by the freezing of budgetary reserves and contingency expenditure cuts of 0.2% of GDP. Regarding the outer years, risks are linked to the fact the macroeconomic scenario presented in the programme is on the high side and that the measures underlying the budgetary path are largely unspecified and not adopted. Against this background, the correction of the excessive deficit in 2011 in line with the recommendation of 7 July 2009 under Article 104(7) of the TEC and the subsequent further consolidation is not ensured and it will be necessary to specify the savings measures and strengthen the consolidation efforts from 2011. While the programme announces a number of improvements to the fiscal framework, more needs to be done.

In view of the above assessment and also in the light of the recommendation under Article 104(7) TCE on 7 July 2009, Hungary is invited to:

(i) ensure that the 3.8% of GDP deficit target for 2010 is achieved through tight expenditure control as well as through a possible freezing of budgetary reserves and the implementation of contingency expenditure cuts if needed;

(ii) specify the measures underlying the budgetary targets from 2011 onwards and stand ready to strengthen the fiscal effort in case risks related to the fact that the programme scenario is more favourable than the scenario underpinning the Article 104(7) TEC Recommendation materialise to ensure that the deficit is brought below 3% of GDP in 2011; and considerably strengthen the strategy for 2012 to ensure an adjustment towards the MTO in line with the requirements of Stability and Growth Pact;

(iii) improve the quality of public finances by preparing and adopting a 2011 budget in full compliance with the fiscal framework and by supporting expenditure moderation through a further reform of public administration and by addressing the situation of loss-making enterprises through structural reforms.

Comparison of key macro economic and budgetary projections

		2008	2009	2010	2011	2012
Real GDP (% change)	**CP Jan 2010**	**0.6**	**-6.7**	**-0.3**	**3.7**	**3.8**
	COM Nov 2009	0.6	-6.5	-0.5	3.1	n.a.
	CP Dec 2008	*1.3*	*-0.9*	*1.6*	*2.5*	*n.a.*
HICP inflation (%)	**CP Jan 2010**	**6.1**	**4.2**	**4.1**	**2.3**	**2.6**
	COM Nov 2009	6.0	4.3	4.0	2.5	n.a.
	CP Dec 2008	*6.2*	*4.5*	*3.2*	*3.0*	*n.a.*
Output gap[1] (% of potential GDP)	**CP Jan 2010**	**2.6**	**-4.8**	**-5.6**	**-2.8**	**-0.1**
	COM Nov 2009[2]	2.9	-4.0	-4.7	-2.0	n.a.
	CP Dec 2008	*2.3*	*-0.1*	*0.4*	*n.a.*	*n.a.*
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	**CP Jan 2010**	**-6.2**	**2.2**	**1.6**	**1.5**	**1.4**
	COM Nov 2009	-5.6	0.5	0.3	0.4	n.a.
	CP Dec 2008	*-5.1*	*-3.7*	*-2.5*	*-1.6*	*n.a.*
General government revenue (% of GDP)	**CP Jan 2010**	**45.5**	**45.9**	**45.0**	**44.2**	**43.3**
	COM Nov 2009	45.5	45.9	45.1	45.1	n.a.
	CP Dec 2008	*45.2*	*45.8*	*46.0*	*45.8*	*n.a.*
General government expenditure (% of GDP)	**CP Jan 2010**	**49.3**	**49.8**	**48.8**	**47.0**	**45.8**
	COM Nov 2009	49.3	50.0	49.4	49.0	n.a.
	CP Dec 2008	*48.6*	*48.4*	*48.5*	*48.0*	*n.a.*
General government balance (% of GDP)	**CP Jan 2010**	**-3.8**	**-3.9**	**-3.8**	**-2.8**	**-2.5**
	COM Nov 2009	-3.8	-4.1	-4.2	-3.9	n.a.
	CP Dec 2008	*-3.4*	*-2.6*	*-2.5*	*-2.2*	*n.a.*
Primary balance (% of GDP)	**CP Jan 2010**	**0.4**	**0.5**	**0.5**	**1.0**	**1.2**
	COM Nov 2009	0.4	0.2	-0.1	-0.2	n.a.
	CP Dec 2008	*0.6*	*1.9*	*2.0*	*2.2*	*n.a.*
Cyclically-adjusted balance[1] (% of GDP)	**CP Jan 2010**	**-5.0**	**-1.7**	**-1.3**	**-1.5**	**-2.5**
	COM Nov 2009	-5.1	-2.2	-2.1	-3.0	n.a.
	CP Dec 2008	*-4.3*	*-2.8*	*-3.2*	*n.a.*	*n.a.*
Structural balance[3] (% of GDP)	**CP Jan 2010**	**-4.6**	**-1.6**	**-1.5**	**-1.5**	**-2.5**
	COM Nov 2009	-4.8	-2.1	-2.1	-3.0	n.a.
	CP Dec 2008	*-4.0*	*-2.8*	*-3.2*	*n.a.*	*n.a.*
Government gross debt (% of GDP)	**CP Jan 2010**	**72.9**	**78.0**	**79.0**	**76.9**	**73.6**
	COM Nov 2009	72.9	79.1	79.8	79.1	n.a.
	CP Dec 2008	*71.1*	*72.5*	*72.2*	*69.0*	*n.a.*

Notes:

[1] Output gaps and cyclically-adjusted balances according to the programmes as recalculated by Commission services on the basis of the information in the programmes.

[2] Based on estimated potential growth of 0.8%, 0.3%, 0.2% and 0.3% respectively in the period 2008-2011.

[3] Cyclically-adjusted balance excluding one-off and other temporary measures. One-off and other temporary measures are 0.4% of GDP in 2008, 0.1% in 2009 both deficit-reducing and 0.2% of GDP in 2010 deficit increasing according to the most recent programme and 0.3% of GDP in 2008 and 0.1% in 2009, all deficit-reducing, in the Commission services' November 2009 forecast.

Source:

Convergence programme (CP); Commission services' November 2009 forecasts (COM); Commission services' calculations