An extraordinary deficit figure for 2011

The Hungarian budget ended the year of 2011 with a surplus of 4.3 percent which is an outstanding achievement both from an international and a long term Hungarian perspective and also unprecedented since the regime change. The deficit figure calculated according to the EU methodology, however, includes a number of known one-off items which complicate long term comparisons. Therefore, the Ministry for National Economy considers it a priority to share with the public the deficit data excluding one-off items.

On the basis of data excluding unplanned one-off items, the calculation of which this analysis includes, the government budget of Hungary (the compound balance of the central budget, state funds as well as local governments) registered **only 2.43 percent deficit as of GDP** compared to the assumed 2.94 percent.

Two key factors had contributed to this result:

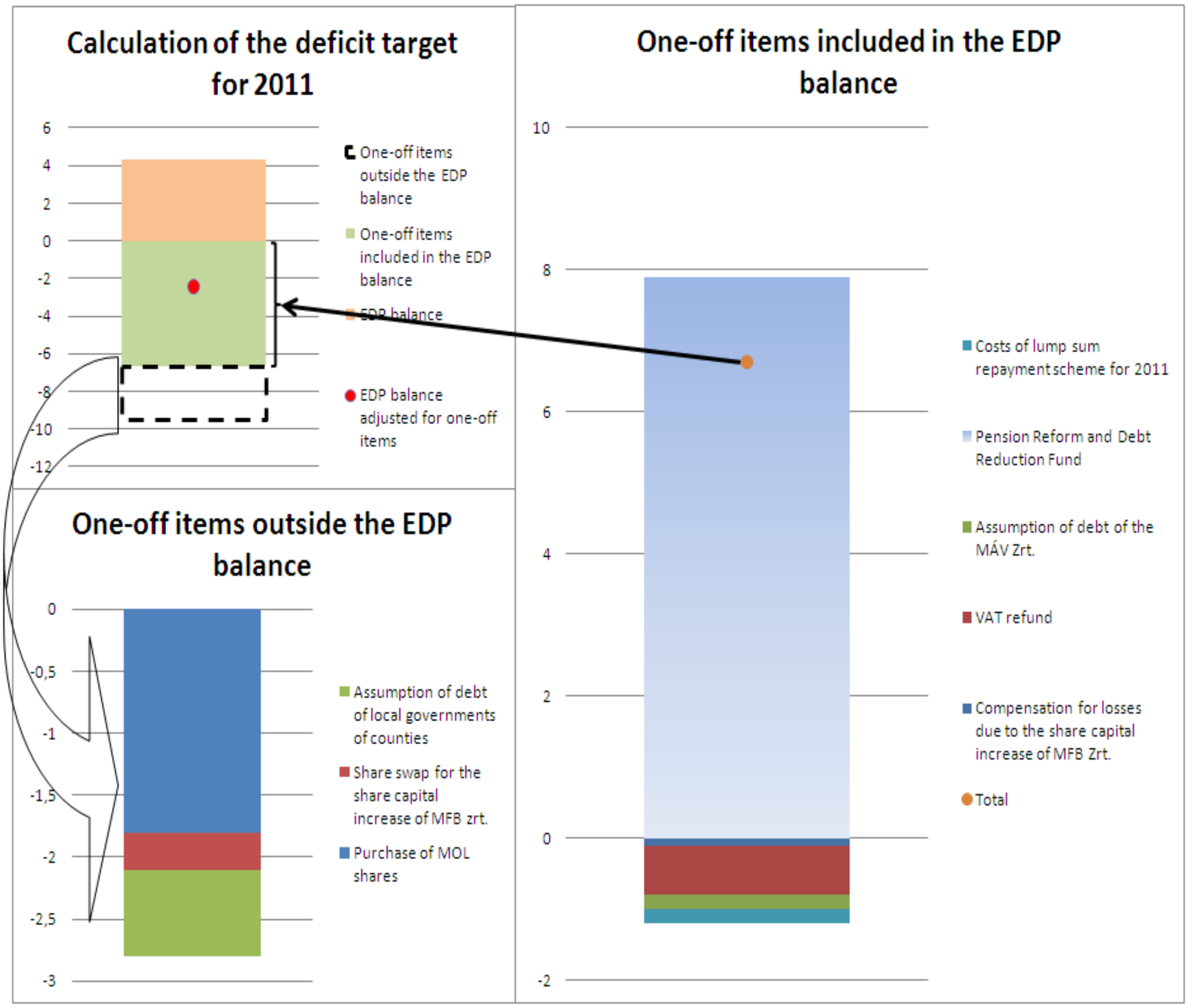
- The efforts aimed at a more efficient collection of revenues due to the state, the successful implementation of expenditure guidelines in the central sub system of the state budget and the efforts aimed at a more rigorous fiscal management have **yielded results** of which the Ministry reported already in January in its cash flow outlook study.
- The **cash flow balance of local governments** has turned out to be more favourable than it had been expected and we analyze this development in this report below.

Local governments

Currently no final data are available yet about the cash flow deficit of the local government system. It is obvious already, however, that the cash flow balance of local governments has taken a substantially more positive turn than it had been anticipated. According to preliminary data for 2011 it appears that **after the significant accumulation of deficits in the past couple of years, expenditures were about on a par with revenues this year**, therefore the system was almost balanced. On the basis of preliminary data we can conclude that the **improvement in the balance was a consequence of lower than expected expenditures**. Within that, the non-personnel costs and accrued charges came in below the estimate, while financing costs (credit repayment) have increased substantially.

The impact of one-off items on the budget

Several one-off items – which could not be taken into account by the government during the budgetary planning process - have also impacted the final reading of the deficit figure. Due to the transformation of the pension system, the greatest of all items originated from the transfer of private pension fund assets. As a result, the revenue side of the budget registered a surplus of 7.9 percent of GDP compared to the planned one. On the expenditure side there were several one-off items, of which some influenced the EDP balance but some others appear only in the cash flow balance. The calculation of the final figure is demonstrated by the below illustration:

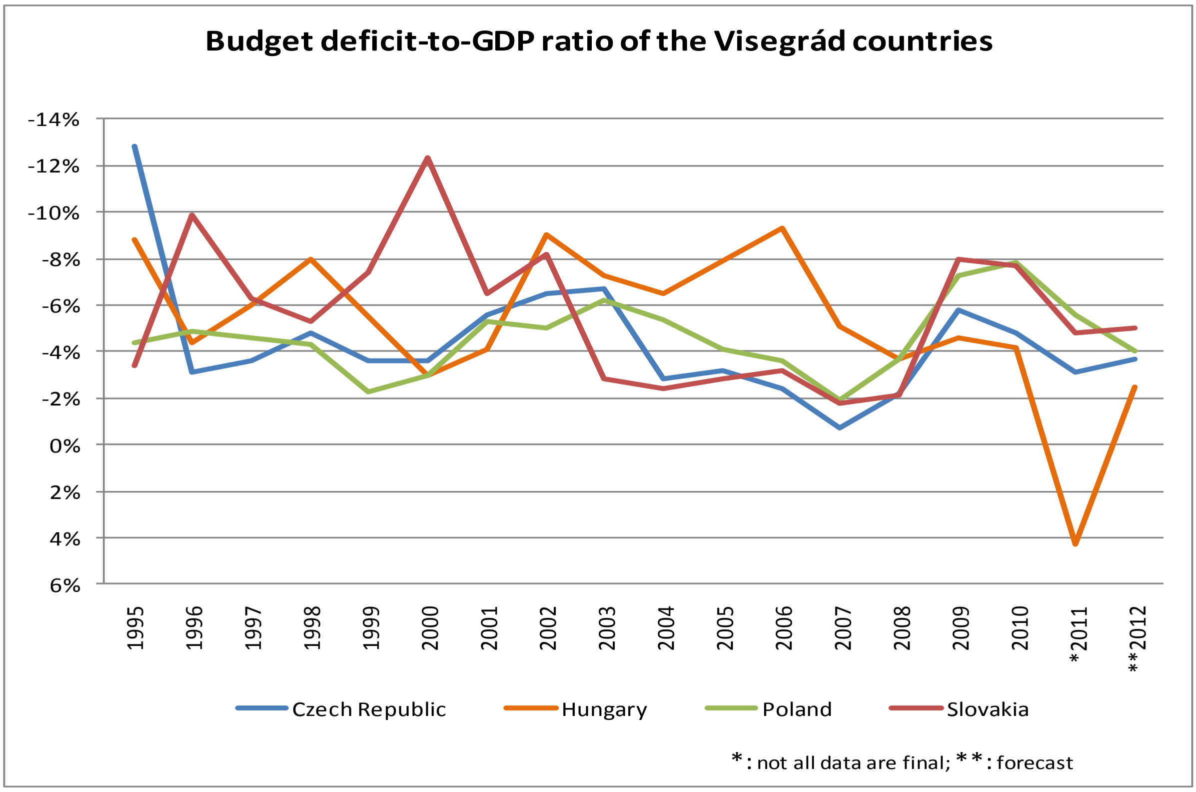


The sum total of items which impact the EDP balance amounts to the 6.7 percent of GDP. This amount is made up on the revenue side by the private pension fund assets and on the expenditure side by the **VAT refund carried out due to the verdict of the European Commission, the assumption of debt of MÁV Zrt., the compensation for losses incurred due to the share capital increase of the MFB and the costs of lump sum repayment**

scheme for 2011 (right hand side graph). The items **outside the EDP balance** as a whole amount to the 2.8 percent of GDP. The **greatest one-off item was the purchase of MOL shares which cost the 1.8 percent of GDP** (lower left hand side graph). Another **significant expenditure item was the assumption of debt of local governments of counties and the share swap for the share capital increase of the MFB**. The surplus of 4.3 percent of GDP minus the 6.7 percent of GDP from the total of the items included in the EDP balance equals the 2.43 percent deficit figure which is comparable to prior deficit data (upper left hand side graph).

International comparison

The state budget balances of the Visegrád countries were hugely diverse in the past one-and-a half decades which were strongly influenced by political cycles. This trend used to be also typical in Hungary in the past, but after the change of government in 2010 for the first time after several years a responsible and credible economic policy could prevail which resulted in a diminishing Hungarian state budget deficit that will also continue on a sustainable course.



Source: Eurostat, Ameco, NGM

From a regional perspective, after the change of government in 2010 as a consequence of the economic stabilization process **Hungary now has the lowest budget deficit**. On the basis of data for 2011 it was only Hungary that could meet the 3 percent deficit target expected by the EU. Moreover, via **the deficit of 2.43 percent of GDP we could even surpass** the 2.94 percent estimate which had been initially assumed. The graph also aptly shows that in 2002-2008 Hungary had by the far the highest deficit course, whereas now we are the leaders in the region.

Analyzing the state budget balances as GDP ratios of the past two years it is also apparent that **after the change of government in 2010**, due to the measures aimed at structural stability which were in the meanwhile implemented, for the first time since our accession to the EU the budget deficit was below the 3 percent threshold. In a challenging international economic environment only ten out of the 27 EU member countries could deliver this extraordinarily favourable result in 2011.

Budget deficit-to-GDP ratios of EU countries*

	2010	2011**
Austria	-4.40%	-2.60%
Belgium	-4.10%	-3.70%
Bulgaria	-3.10%	-2.10%
Cyprus	-5.30%	-6.00%
Czech Republic	-4.80%	-3.09%
Denmark	-2.60%	-1.84%
Estonia	0.20%	1.00%
Finland	-2.50%	-0.50%
France	-7.10%	-5.30%
Germany	-4.30%	-1.00%
Greece	-10.60%	-9.25%
Hungary	**-4.20%**	**4.30%**
Ireland	-31.30%	-9.90%
Italy	-4.60%	-3.90%
Latvia	-8.30%	-4.00%
Lithuania***	-7.00%	
Luxembourg	-1.10%	-1.10%
Malta	-3.60%	-2.80%
Netherlands	-5.10%	-4.70%
Poland	-7.80%	-5.60%

Portugal	-9.80%	-4.20%
Romania	-6.90%	-4.35%
Slovakia	-7.70%	-4.80%
Slovenia	-5.80%	-6.40%
Spain	-9.30%	-8.50%
Sweden	0.20%	0.30%
United Kingdom	-10.30%	-8.30%

*: the 3 percent deficit threshold is not achieved; green: the deficit criteria is met

**: not all data are final

***: no data is available for 2011

Source: Eurostat, NGM

Summary

There was not a single government in Hungary since the regime change which would have managed to conclude a fiscal year with a budget surplus. Therefore, the fact that **in 2011 the government could conclude the budget with a surplus is an outstanding situation**, even if we consider the significant impact of one-off measures.

It has to be noted, that **the deficit figure of 2.43 percent has also been an unprecedented achievement since the regime change**. The figure which is much more favourable than formerly estimated is partly a consequence of a favourable performance in the local government system and the substantial economic policy measures of the government have been yielding results as well. As a result of the proportionate, flat-rate tax system, **for the first time in several years household spending stopped deteriorating**, which is also due to better employment data and an almost 6 percent rise in real wages. The lower, 10 percent corporate tax for SMEs has also contributed to higher spending.

The budget deficit figure of 2.43 percent for 2011 is therefore a crucial signal that **the Hungarian government is committed to a tight, disciplined fiscal policy** and it will meet the 2.5 percent deficit target for 2012 and the 2.2 percent deficit target for 2013.