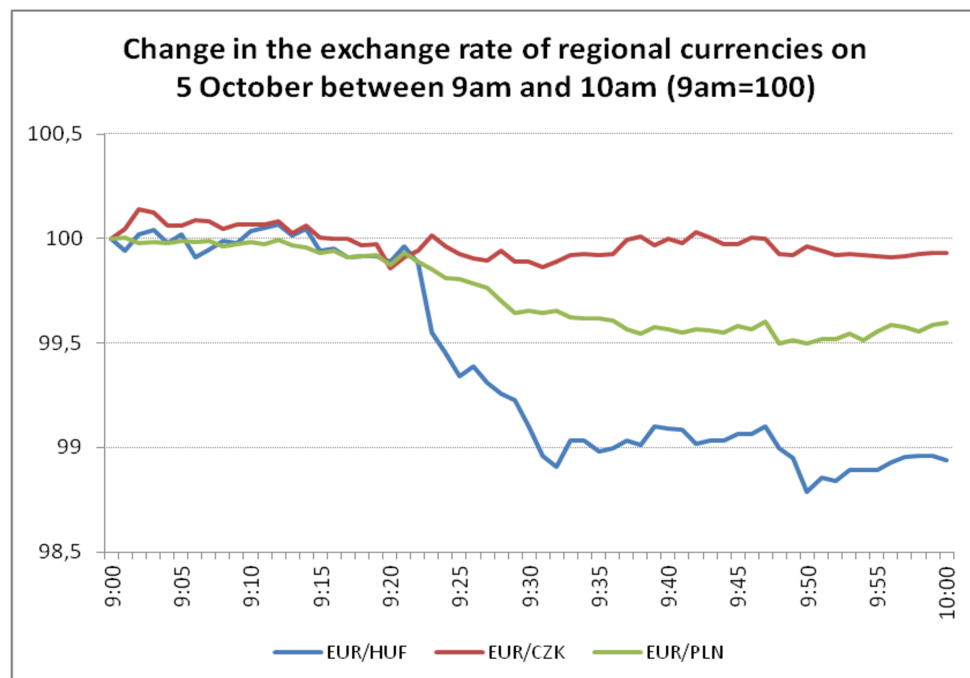
New government measures

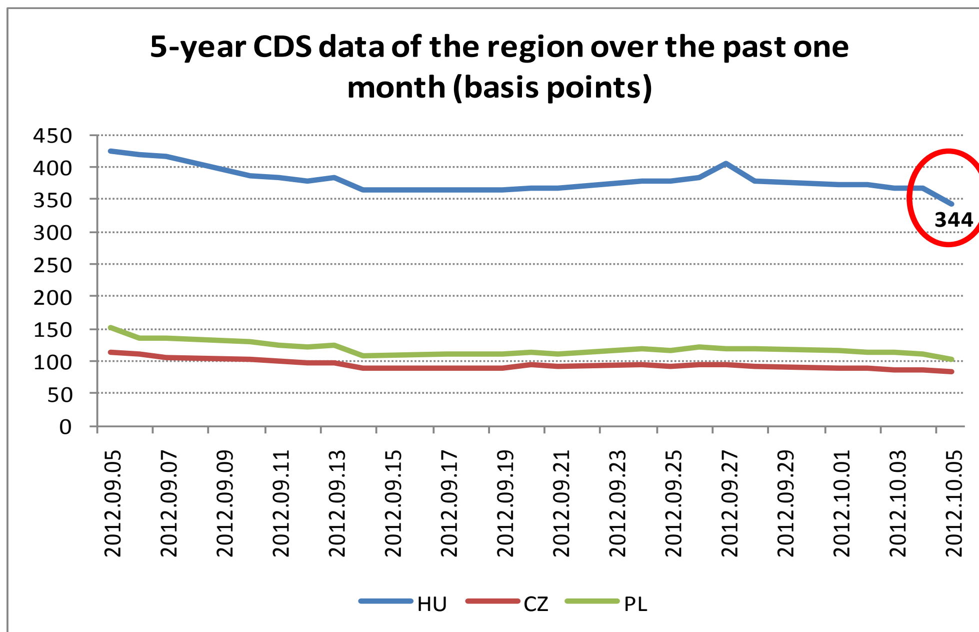
The Government is committed to taking action in order to get the excessive deficit procedure lifted

On Friday 5 October 2012 the Government of Hungary published its latest package of draft measures, formerly introduced measures as well as the updated macro economic outlook which takes into consideration the aforementioned measures and a different economic growth prospect in its Progress Report in order to fulfill recommendations proposed by the EU Economic and Financial Affairs Council. Markets welcomed the Report which was reflected in prompt forint appreciation and a lower Hungarian CDS spread. After the announcement at 9am the forint exchange rate gained almost 1 percent against the euro thereby outperforming regional currencies.



Source: Reuters

Credit risk premia hedging against Hungarian sovereign default (5-year CDS) declined by almost 22 basis points by the end of the day to 344 basis points (according to Reuters data).



Source: Reuters

First the European Commission and after that the Council of Europe have both confirmed that Hungary had introduced effective measures in order to eliminate excessive deficit. The current Report emphasizes yet again that the Government continues to be committed to keeping fiscal deficit below 3 percent of GDP in the next couple of years and general government debt on a steadily declining path. To this end, it has decided to introduce further measures which will impact both 2012 and 2013. To meet the original deficit targets a fiscal adjustment larger than this would have been necessary, but that would have resulted in such demand contraction that would have curbed growth for a prolonged period and that would hinder sustainable deficit reduction. Therefore deficit targets have been revised upward. Deficit is expected to be 2.7 percent in 2012 and 2013 and estimated at 2.2 percent in 2014. Consequently, deficits will remain below 3 percent, thus the key requirement for lifting the excessive deficit procedure can and will be met and as a result Hungary will not lose EU resources.

Below is an overview of measures for 2012, 2013 and 2014 announced lately or introduced formerly along with their anticipated impacts as well as the structural reforms aimed at underpinning a favourable deficit and debt path by the Government.

1. Fiscal situation

a. in 2012

By conservative estimation the deficit target for 2012 will be 2.7 percent which is slightly higher than the formerly anticipated 2.5 percent. The following measures have influenced the deficit so far:

	Revenue	Expenditure
Increasing	- hiking excise tax on tobacco products - introducing reverse charge VAT aimed at boosting revenues in certain agricultural sectors - introducing telecom tax - asset transfer related to step-back of private pension fund members this year	- buy-out of PPP projects - increasing EU Own Resource Fund
Decreasing	- one-off revenue from the sale of telecommunication frequencies not realized yet in 2012 - methodological change of recording EU transfers	- freezes on the expenditure appropriations of central budgetary institutions and chapter administered appropriations

At their 4 October session the Government decided to take further measures aimed at improving the fiscal balance which amount to 0.4 percent of GDP, which are as follows:

Measure	Positive fiscal effect (billion HUF)
Freezes on the expenditure appropriations of central budgetary institutions and chapter administered appropriations	**49**
Freeze on part of the general reserve for covering costs of extraordinary government measures	20
Freezes on PPP and EU Own Resource Fund appropriations	**23**
Savings on expenditures at State Property chapter and National Land Fund	5
Balance improvement at National Employment Fund	**16**
Balance improvement at the National Cultural Fund and the Research and Technological Innovation Fund	4
Bringing forward the date of excise tax hike on tobacco products to 1 December	**2**
Changes in innovation contribution rules	15
Total	**133**

The implementation of these measures can result in a deficit of 2.7 percent, but if a more optimistic scenario comes true the former target of 2.5 percent can also be attained.

b. in 2013

The former Budget Bill for 2013 had been based upon a GDP growth projection of 1.6 percent in light of which a deficit target of 2.2 percent appeared achievable. The growth estimate has been modified to 1 percent with a deficit target of 2.7 percent. In the current, worse than previously estimated macro-economic environment adhering to a deficit well below 3 percent necessitated the adoption of further balance-improving measures. The gross fiscal effect of the new steps announced recently total 397bn HUF (1.3 percent of GDP) which will secure a deficit well below 3 percent in 2013 as well.

Measure	Gross effect (billion HUF)
1. Increasing the EU co-financing rate of projects	**55**
2. Reduction of bureaucracy	30
3. More efficient wage controls in the public sector	**73**
4. Improved targeting of social benefits	8
5. Eliminating regressing rates for social security contributions	**51**
6. Financial transaction duty	60
a. Increased payment obligation of the State Treasury	**30**
b. 0,3% financial transaction duty on cash withdrawal	30
7. Increasing transparency in the economy	**120**
a. Combating tax avoidance: extending reverse charge VAT to swine trade	10
b. Combating tax avoidance: connecting cash registers to NAV (National Tax and Customs Administration)	**95**
c. Altering regulation of small business tax	15
Total	**397**

These additional measures aimed at improving the balance ensure that the state budget deficit will be well below the 3 percent threshold also in 2013.

The main items influencing the 2013 deficit are as follows (in percent of GDP):

Item	% of GDP
Balance in the Convergence Programme and the submitted Budget Bill	-2,2
Wage adjustment in healthcare	**-0,2**
Funding for wage adjustment in healthcare (excise tax, public health tax on unhealthy products)	0,2
Job Protection Action Plan	**-0,9**
Reduced interest payments as a result of the agreement	0,3
Increasing efficiency of tax collection, others	**0,6**
Reduction of tax revenues (macro path, elimination of risks, MNB transaction duty)	-1,2
Surplus from primary expenditures (macro path, elimination of risks)	**-0,4**
Revenue from frequency sale originally planned for 2012	0,1
Cancellation of extra reserves (Country Protection Fund)	**0,3**
Without balance-improving measures and the Country Protection Fund	-3,4
Net effect of additional measures	**1,2**
Restoring and increasing extra reserves (Country Protection Fund)	-0,5
Balance of 2013	**-2,7**

2. Structural reforms

The Government facilitates deficit and debt reduction via structural reforms in the long term. Priorities concerning the above focus on making the economy more transparent and facilitating job creation. In order to achieve the latter goal the key objective is to increase indirect taxes on consumption and excise goods and reduce taxes on labour force. Another string of measures impacts local governments. Further significant changes will take place in the pharmaceutical subsidy system and public transport financing; moreover a usage-based electronic toll system (e-toll) will be introduced from 1 July 2013 at the latest.

The 2013 fiscal impact of measures regarding taxation	Effect (billion HUF)
Revenue-increasing measures	
Hiking of financial transaction duty (except for the MNB)	80
Electronic connection of cash registers with the NAV	95
Introducing reverse charge VAT in swine sector	10
Hiking of excise taxes	30
Abolition of social security contribution ceiling	51
Total	**266**
Measures resulting in lower revenues	
Introduction of Job Protection Action Plan	-255
Total	**-255**
Balance	**11**