MINISTRY
FOR NATIONAL ECONOMY

The budget deficit will substantially decrease even this year

By 2014 the debt as of GDP will decrease below 70%

Focus

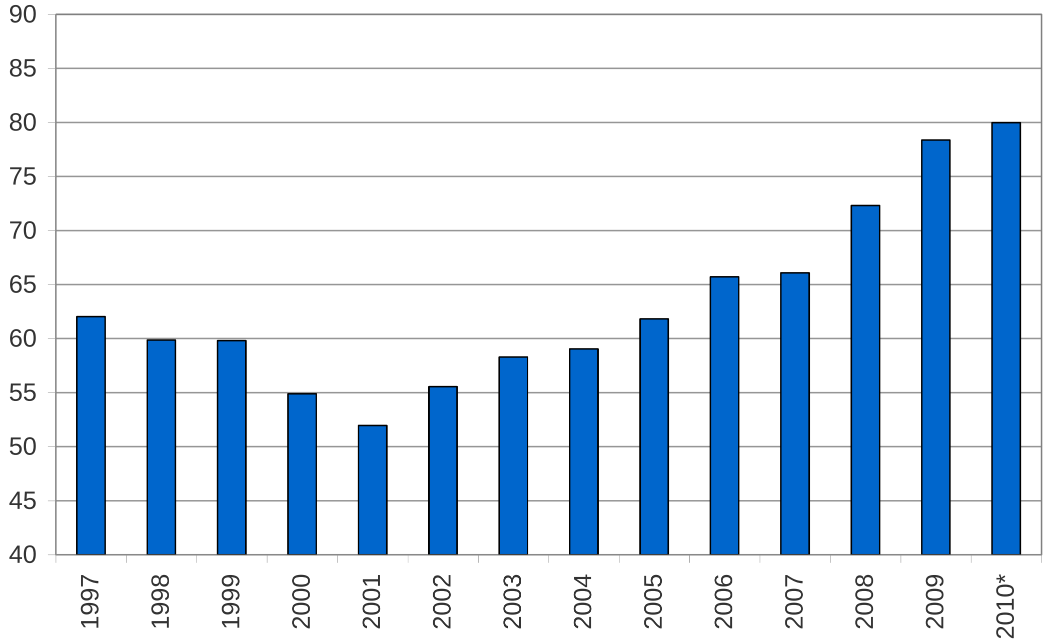
Hungary has been committed to a strict budget policy. In accordance with the convergence programme, the government will gradually reduce budget deficit from 3.8% as of GDP in 2010 to 2.9% in 2011. Parallel to this, they will contribute to jumpstarting an economic growth with measures aimed at job creation. As a result, the level of public debt will fall from 80% as of GDP in 2010 to 70% by 2014.

Background

Due to the policy of the last eight years that was based on overspending, high budget deficit and increasing public debt, the financial crisis, which struck in the autumn of 2008, pushed the country to the brink of sovereign default which could only be avoided with the help of international loans. In 2001 the level of public debt amounted only to 52% as of GDP. After the political change in 2002, the level of indebtedness was rising every year and the debt-to-GDP ratio was 78.4% by 2009 and reached almost 80% by 2010.

The interest payable on service public debt has been a great burden; in 2010 the amount to be paid comprised about 57% of personal income tax revenues. Additionally, the high level of debt (and the high proportion of foreign currency-denominated loans within that) makes the country more vulnerable and less prepared to withstand global financial shocks.

Fig.: Public deficit of Hungary, in % as of GPD *Source: Eurostat*



**Estimated by the Ministry for National Economy*

‘Cornerstones’

The primary reason for the high level of public debt has been the long-standing budget deficit which is high from both a domestic and an international point of view. After Hungary joined the EU in 2004, the Hungarian budget deficit has never been below 3% as of GPD, therefore the country has been in the excessive deficit procedure for six years now. In addition, as the period since 2002 was characterized by an economic growth well below the region’s average, it has also fuelled the rise of the debt-to-GDP ratio.

Hungary has once already won the battle against indebtedness; the first Orbán government reduced the level of public debt from 62% as of GDP to 53% (marking the public debt at the end of 1997 and 2001, respectively), which is below the figure required by the Treaty of Maastricht.

A turn in economic policy

Having recognized the perils that public debt poses, the government which entered office in 2010 was committed to its reduction. Through the measures which were announced as part of the first and second action plans the government will cut the level of public debt in a **predictable and steady manner**. The measures implemented so far will reduce the debt-to-GDP ratio in three ways. The pension reform will cut the level of public debt in the short and long term together with a budget deficit, which will be low in even historic terms and with the growth-oriented measures of the action plans that will create the extra economic performance required to work off the debt.

The impact of the pension reform on reducing debt

The wealth of private pension fund members who had returned to the state pension system cut the level of debt by 7-8%. About half of this amount will have an immediate impact on the level of gross debt as the government securities, which have been channelled to the Pension Reform and Debt Reduction Fund, will be withdrawn right away.

The impact of a conservative deficit policy

A disciplined budgetary policy is an essential condition for solving debt anomalies. In 2010 Hungary managed to achieve the lowest budget deficit in the EU. 2011 will be the first year since our accession to the EU when Hungary meets the below-3% requirement set by the Treaty of Maastricht.

Afterwards deficit reduction will continue, the debt-to-GDP ratio will decrease gradually until 2014. The measures on budget deficit will result in an average annual reduction of 1.5% of public debt.

As a result, the government will cut the debt-to-GDP ratio from 80% in 2010 to 70% by 2014. Hungary has been obviously undergoing a profound transformation with regard to balancing the budget and cutting public debt.

The impact of lower financing costs

The costs of financing public debt will decrease substantially. On the one hand, there will be less interest payable on less debt, and on the other hand, the rate of interest charged will also be significantly lower. Indeed, investors regard a lower amount of debt less risky and are willing to finance the country with fewer risks involved. Furthermore, the commitment to meet the targets set in the budget provides an additional "credibility bonus" which will further reduce the costs through improving investor confidence.

The impact of pro-growth measures

During the next couple years the acceleration of economic growth will considerably contribute to the reduction of the debt-to-GPD ratio. The government has implemented a number of measures so far in order to assist job creation and economic recovery. As a part of the structural reform package of 2011, the cabinet will implement a series of further measures aimed at improving labour market activity and helping sustainable economic growth simultaneously.

Conclusion

As a result of the disciplined budgetary and the growth-oriented economic policy of the government, the debt-to-GDP ratio will permanently decrease in Hungary in the next couple of years and will fall below the level of 70% by 2014. A lower level of public debt will significantly cut the costs of debt and instead of debt repayment the government can spend tax revenues on performing classical administrative tasks in a more efficient way.

Budapest, 16 February 2011.

Ministry for National Economy