Hungary's August deficit points to economic warning signs

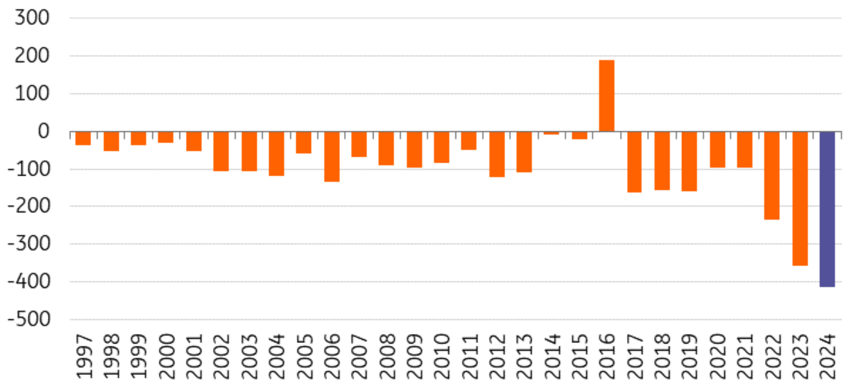
After an improvement in the previous month, August brought a sharp reversal in fiscal developments for Hungary. While expenditure is likely to be tightly controlled, economic activity may remain the main culprit. We see some upside risks to our 4.5-5.0% deficit forecast

We should no longer be talking about achieving 1.5% GDP growth in Hungary, but rather be cheering for 0.5%

Revenue shortfall may be the main reason for August deficit

Hungary's monthly budget deficit was HUF 414bn in August, bringing the year-to-date general government cash flow deficit to HUF 2.86tr. This means that the shortfall sits at 72% of the Government Debt Management Agency's planned financing needs for 2024. August's deficit was the highest monthly shortfall we've seen for the same month in 28 years. While we are reluctant to see this as a flashing red light, one or two more weak high-frequency data points and we should consider a gloomier near-term economic outlook.

The monthly general government balance in August (cash-flow, HUFbn)

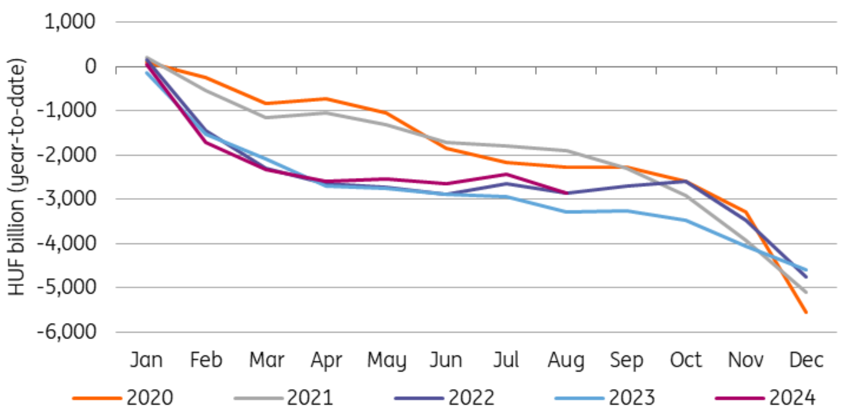


Source: Ministry of Finance, ING

The Ministry of Finance's statement provided little clarity on the unusually high monthly deficit. However, the first paragraph of the statement is something new. In our view, it attempts to downplay the recent weak data point by referring to previously announced fiscal measures to improve the fiscal balance. It also highlights the seasonality of the August data and promises that the government is prepared to keep the deficit on a moderate path.

However, the key sentence is that "the government will monitor developments in fiscal indicators and, if necessary, take additional measures to maintain the deficit target". This is a new addition to the statement compared to previous months and clearly underscores the upside risks to the 4.5% deficit target that we have been highlighting for some time.

Cash-flow based year-to-date central budget balance



Source: Ministry of Finance, ING

Reading through the details, we would like to highlight three important developments:

- While the government highlights debt servicing costs as a major item in the year-to-date deficit, this hardly explains the exceptionally high deficit in August. On a monthly basis,

interest expenditure amounted to HUF 200bn, roughly the same as in July.
- In contrast to the July statement, this time the Ministry of Finance included some figures related to EU funds. While expenditure on EU projects increased by about HUF 141bn in the last two months, the income flow was only HUF 96bn. The lack of EU funds is clearly one of the key fiscal stories of the year.
- The previous press releases from time to time reflected the revenue side with some positive comments, stating that the year-to-date revenue increase is 9.9% compared to a year ago (as of July). The August press release didn't provide any information, and an additional reference to weak VAT revenues in the statement leads us to believe that revenues are once again falling behind schedule, possibly due to weak economic activity.

Deficit situation is not out of control, but it is not comfortable either

We have long argued that there is a slippage risk in the 2024 budget, which we have previously calculated at around 0.0-0.5ppt of GDP. While the government's measures may be able to cover the slippage risk we originally calculated for 2024, there is an old/new risk in town: economic activity. The recent disappointing second quarter GDP data and the weak start to the third quarter (in retail and in industry) signal that economic activity remains weak, posing a downside risk to the inflow of indirect tax revenues, the main pillar on which the revenue side of the budget rests.

We maintain our call for a deficit of 4.5-5.0% of GDP in 2024, with a preference for the higher end. The recent reference to further measures clearly supports our view of a renewed chance of slippage. And with weaker high-frequency data in the coming months, our GDP growth forecast of 1.5% will be subject to a clear downside risk, possibly triggering a downward revision of the achievement of the fiscal target.

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