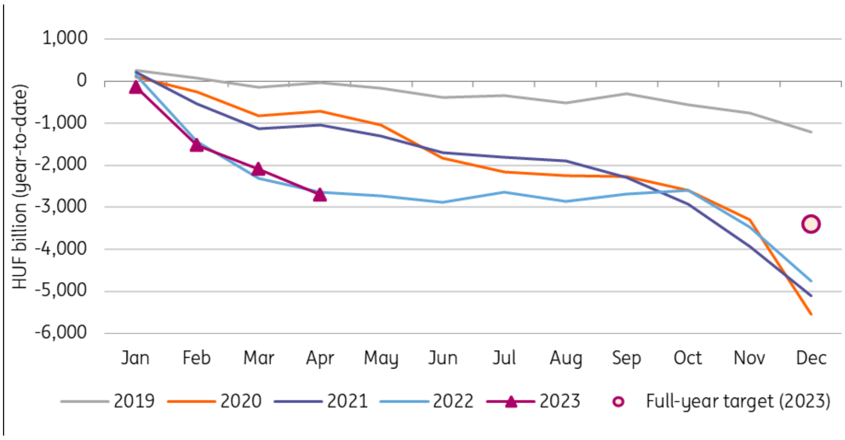
Hungarian budget posts biggest April deficit on record

Hungary's budget follows last year's trajectory as deteriorating economic activity puts pressure on the revenue side. The expenditure side also looks challenging with sky-high inflation at the forefront

With the monthly deficit generated in April equaling to HUF 620bn, a new record has been made. In terms of overall budgetary trajectory, this year looks very similar to 2022, with the year-to-date deficit accumulation being pushed to HUF 2,709.7bn. We believe that despite 80% of the full-year deficit target having been met by April, the budget situation looks manageable, although it provides some challenges down the road for policymakers.

Budget performance (year-to-date, HUFbn)



Source: Ministry of Finance, ING

Inflation is a double-edged sword, which at this point of the cycle is rather wounding the budget by boosting expenditures, rather than propping up the revenue side. Towards the end of last year, as domestic demand was still strong, significant sums flowed into the general budget via VAT and excise duty, which boosted the revenue side. But the volume of retail sales was down by 13.1% year-on-year in March, which points to less inflow via indirect taxes. As far as fuel retailing is concerned, the yearly-based drop equals almost 30%, which suggests that revenues through excise duty have taken a big hit. However, the subdued consumption dynamics should not surprise anyone given real wages have been dropping for the last six consecutive months. In our view, domestic demand will not rebound in the coming months, which will put further pressure on the revenue side. We expect a turnaround in consumption dynamics only in the second half of the year, which in turn will help generate more revenue via indirect taxes.

As for the expenditure side, costs have been relentlessly rising compared to previous years, with key challenges still remaining ahead of us. The Ministry of Finance pointed out in its press release that the regulated utility price scheme for households cost the budget HUF 848.5bn by the end of April. In our view, this year the government changed its approach regarding the recapitalisation of state-owned firms. While in the past the recapitalisation was settled towards the end of the year, this year we believe that recapitalisation costs are spread out monthly in smaller chunks, hence putting more pressure on the budget in the first half of the year. At the same time, this likely means that we won't see a large deficit accumulation at the end of the year.

Nevertheless, on the expenditure side, the regulated utility scheme was not the only costly element. In fact, on the backdrop of inflation, both pension outflows and debt servicing costs are markedly elevated compared to last year. Even though the National Bank of Hungary is preparing for the start of the rate-cutting cycle, from a debt servicing cost perspective the picture will remain broadly unchanged. For this year the budget will be weighed down by the burden of high interest rates. The Ministry of Finance noted that HUF 2,136.2bn was spent on pension payments year-to-date, with the government still calculating with 15% average inflation for 2023. In our view, the full-year average inflation will more likely come in around 19%, which by law will trigger a total HUF 200-300bn adjustment need in pensions.

When it comes to challenges on the revenue side, we believe that we might be nearing the bottom from an indirect tax inflow perspective. However, as real wages will likely recover only in the fourth quarter of this year, the tax boost from the rebound in consumption might be a little late. On the expenditure side, with the heating season officially over, we expect the regulated utility scheme-related spending to significantly shrink, but from an efficiency and sustainability standpoint, more work has to be done. In this regard, the modernisation of the water supply network is a good step to alleviate some of the financing costs related to the government scheme.

Besides all of these internal challenges, one external challenge stands out, namely the fate of the EU funds. For this year, the government is calculating a 2,245bn HUF (€6bn) inflow from EU programmes, where the vast majority is related to the Common Agriculture Policy and the 2014-20 Multiannual Financial Framework related transfer. Here, we calculate a HUF 500-600bn risk tied to the 2021-27 programming period, should the government fail to secure the deal with the EU. However, this is not our base case. On 3 May, the Hungarian Parliament adopted the judicial reform, which is the first step in unlocking a part of the EU funds, namely €13bn from the Cohesion Fund, where the remaining €9bn will remain blocked until the government no longer ticks all the boxes related to other milestones. As soon as the European Commission investigates and approves the judicial reforms (review starts on 1 June with a 90-day review period), advance payments of the unblocked funds could start to flow.

Author

Peter Virovacz
Senior Economist, Hungary
peter.virovacz@ing.com

Disclaimer