

## Hungary: Unexpectedly tight budget in 2020

The details of the 2020 draft budget contain some surprises. The macro projection looks a bit optimistic, while the stricter-than-expected budget will give more room for manoeuvre to the monetary policy



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### The deficit figures

The government surprised everybody with its 2020 draft budget, because it plans a 1% Maastricht deficit, while it presented a 1.5% deficit in the latest Convergence Programme submitted to the European Commission. Moreover, the planned deficit-to-GDP ratio is significantly lower than the actual data in 2018 (2.2%) and the plan in 2019 (1.8%). The stricter fiscal policy will be more than welcomed by the European decision makers. However the 1.1% structural deficit is still higher than the medium-term objective (MTO), which was set by the European Commission at 1% for Hungary, but we hardly see it as a huge problem.

The last important deficit figure is the cash-flow based deficit, which is much more essential than the accrual-based Maastricht deficit when it comes to the state's financing need. In 2019, the government planned a 2.7% cash-flow based deficit, while it is planned at 0.9% in 2020. It means significantly less financing needs and a further decrease in the FX debt ratio (to 14.4%).

## The macro projection behind the budget

The government sees 4.0% GDP growth mainly due to domestic factors as it forecasts a 1.3% increase in employment and an 8.3% wage growth. This macro path seems a bit optimistic compared to market expectations and ING forecasts. However, that's what we said when we saw the macro projections of the government in the 2018 and in the 2019 draft budgets and yet the Hungarian economy has been outperforming all expectations.

|                         | 2020 draft budget | ING forecast |
|-------------------------|-------------------|--------------|
| Deficit-to-GDP          | 1.0%              | 1.5%         |
| GDP growth (YoY)        | 4.0%              | 3.0%         |
| CPI (YoY)               | 2.8%              | 3.1%         |
| Gross wage growth (YoY) | 8.3%              | 7.0%         |

The main drivers of economic growth remain consumption and investments, despite that the government is planning on less government spending and public investment for 2020. This is basically the main source of the strong improvement in the 2020 deficit. At the same time, tax revenues are expected to keep increasing driven by growing wages and consumption and also by the retreat of the shadow economy. The government calculates with growing net exports, mainly arising from the utilisation of new export capacities, which also suggests that the government is not necessarily sold on the global 'doom and gloom' scenario.

So even despite having an optimistic macro projection with a not so cloudy external outlook, we see the 1% budget deficit achievable. The main reason behind this is the highest ever reserves (emergency budget fund) built in the budget. The government created a budget reserve that roughly sums to 1% of GDP. The amount of the Country Protection Fund is HUF378bn, while the amount of the general reserves (the targeted reserve for extraordinary government measures) is HUF110bn. The total amount (HUF488bn) is HUF260bn higher than the reserve in 2019. If the external outlook worsens, the government will still have a lot of room for manoeuvre.

All things considered, the draft budget indicates that the government is ready to tighten the fiscal policy, mostly on the expenditure side. In the meantime, it will be also helpful for the monetary policy, as with a stricter fiscal policy, the National Bank of Hungary might get what it wants: more flexibility in its decision making. A tighter budget can replace possible rate hikes going forward to cool down inflation pressure, so the interest rate environment might remain supportive for longer or at least until the end of 2020. The final vote on the budget is expected on 12 July.

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