Maintaining the Hungarian deficit target is becoming more challenging

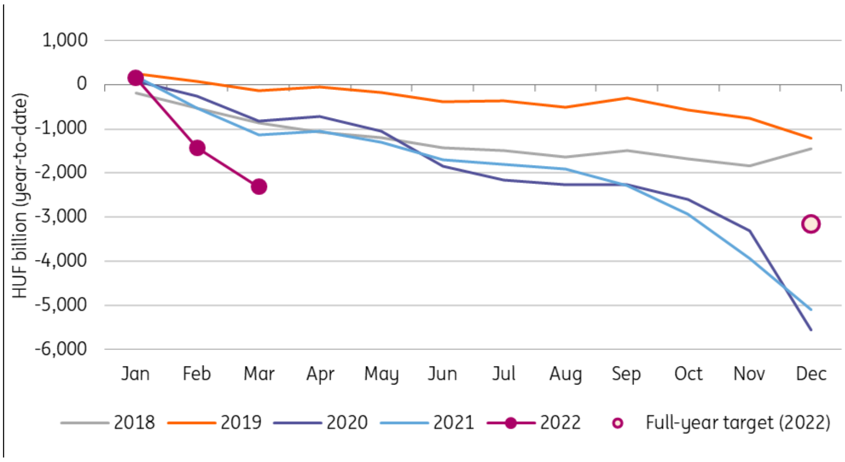
After an extraordinary monthly deficit in February, March didn't bring any relief. With the cash-flow based deficit sitting at 73% of the full-year target, the government needs to review the budget

The Ministry of Finance has emphasised that households should not bear the burden of the war

The Hungarian budget posted a HUF 875.5bn deficit in the month of March. With that, the year-to-date deficit accumulation hits HUF 2.309bn. This equates to 73% of the full-year cash-flow based deficit target, which is unusually high even if we know that the revenues and incomes are not evenly distributed throughout the year.

Given the many extreme circumstances it is not overly surprising to see this type of slippage in the budget. The government planned frontloaded budget spending; handing out a significant amount of transfers to households in February. On top of that came the war in Ukraine which has created further pressure on the expenditure side.

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

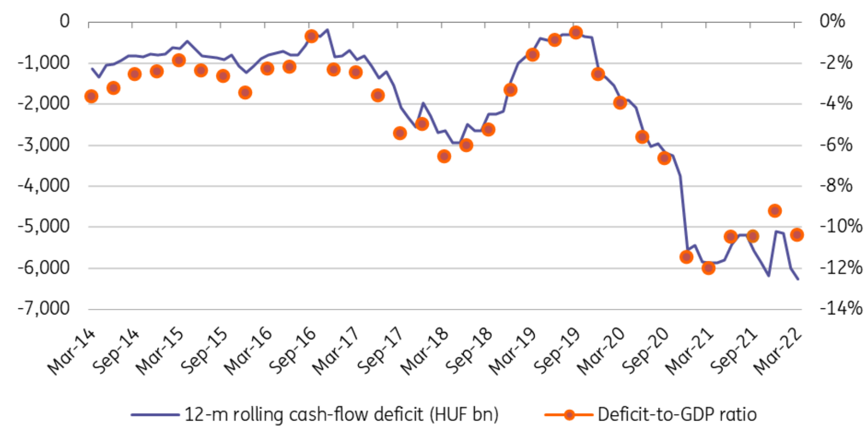


Source: Ministry of Finance, ING

The Ministry of Finance's statement reiterates this, highlighting the increasing costs of border defence and assistance for refugees. Besides this, it also emphasises that it is ready to defend households so that they don't bear the burden of the war. The budgetary performance is affected by family support and tax reduction measures.

What to do next is the main question here. We see two different paths in front of policymakers. The easiest path would be to let the original deficit target (4.9% of GDP) go and amend the budget to reflect the new situation. The tricky part here is the debt accumulation, although with better-than-expected 2021 debt-to-GDP data at 76.8% there is more room for manoeuvre. It is questionable how the rating agencies would react to an altered and increased deficit and debt target knowing that a significant part of this year's deficit is stemming from extraordinary transfers to households not related to the war or the pandemic, but rather to the election. With upwardly revised fiscal targets, we see an increased chance for a negative outlook regarding the Hungarian sovereign credit ratings, while we don't think that an immediate downgrade is in the cards.

12-month rolling cash-flow deficit



Source: Ministry of Finance, ING

The March 2022 deficit-to-GDP ratio is an estimation based on ING's GDP forecast.

The other path would be to carry out austerity measures reflecting the budget slippage. As for now, it is really hard to make a calculation or even an educated guess about the adjustment needed. As a rough estimation, we see it at HUF 500bn or roughly 1% of GDP. This could be achievable via cuts in public spending related to investment projects. Should we see a bigger recalibration needed, then the government could levy/increase taxes to boost revenues. We wouldn't expect measures affecting the tax burden on labour but rather some sectoral taxes (banking, telecommunication and/or retail sectors). The caveat with these could be that companies will pass on the costs to households which would strengthen inflation further.

In this volatile and fragile situation, we don't expect the government to rush into any decision whether it is an austerity measure or a change of the deficit target. Especially in a situation where the newly-elected government will be inaugurated in May. In this respect, we see the government and the debt management agency operating in a "business as usual" mode in the coming months. But in case of need, we see the debt agency raising extra funding via a new round of Eurobond issuance.

This makes the situation a bit more complicated (if that's possible) as the government needs to present its latest Convergence Programme to the EU by the end of April containing its budget forecasts for the coming years. Thus we might have a sneak peek of what we can expect in 2023. A year ago, the 2023 deficit target was forecast at 3.9% by the Hungarian government which seems increasingly unsustainable without any austerity measures.

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