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COMMISSION STAFF WORKING DOCUMENT
Accompanying the documents

Recommendation for a Council decision establishing that no effective action has been taken by Hungary in response to the Council recommendation of 22 June 2018

Recommendation for a Council Recommendation with a view to correcting the significant observed deviation from the adjustment path toward the medium-term budgetary objective in Hungary

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1. INTRODUCTION

Since 2013, Hungary has been subject to the preventive arm of the Stability and Growth Pact, which requires sufficient progress towards the medium-term budgetary objective (MTO). Hungary is also subject to the debt rule as its general government debt remains above 60% of GDP.

On 22 June 2018 the Council decided in accordance with Article 121(4) of the Treaty on the Functioning of the European Union ("TFEU") that a significant observed deviation from the MTO occurred in Hungary in 2017.[1] In view of the established significant deviation, the Council issued a recommendation for Hungary to take the necessary measures to ensure that the nominal growth rate of net primary government expenditure[2] does not exceed 2.8% in 2018, corresponding to an annual structural adjustment of 1.0% of GDP. It also recommended Hungary to use any windfall gains for deficit reduction, while budgetary consolidation measures should ensure a lasting improvement in the general government structural balance in a growth-friendly manner. The Council established a deadline of 15 October 2018 for Hungary to report on action taken in response to the recommendation. The Hungarian authorities delivered their report in response to the Council Recommendation (hereafter: "the report") within that deadline. On 18-19 September 2018, the Commission undertook an enhanced surveillance mission in Hungary for the purpose of on-site monitoring under the Article -11(2) of Regulation (EC) No 1466/97. The findings of the enhanced fiscal surveillance were subsequently made public.

Section 2 of this document discusses macroeconomic developments and outlook in 2018 and 2019. Section 3 presents the updated budgetary projections for 2018 and 2019. Section 4 assesses compliance with the Council Recommendation of 22 June 2018, while Section 5 proposes an adjustment path for 2019. Section 6 concludes.

2. MACROECONOMIC DEVELOPMENTS AND OUTLOOK 2018-2019

Hungarian economic growth accelerated to 4.7% in the first half of 2018. GDP growth was broad-based, supported by all main domestic demand components and exports. Private consumption benefited from strong real wage growth owing to the tight labour market and administrative wage measures, including the 8% rise in the minimum wage and salary

[1] Council Recommendation of 22 June 2018 with a view to correcting the significant observed deviation from the adjustment path toward the medium-term budgetary objective in Hungary (OJ C 223, 27.6.2018, p. 1)

[2] Net primary government expenditure is comprised of total government expenditure excluding interest expenditure, expenditure on Union programmes fully matched by Union funds revenue and non-discretionary changes in unemployment benefit expenditure. Nationally financed gross fixed capital formation is smoothed over a four-year period. Discretionary revenue measures or revenue increases mandated by law are factored in. One-off measures on both the revenue and expenditure sides are netted out.

increases in the public sector. Private investment was supported by strong demand and favourable financing conditions, while government fixed capital formation grew dynamically also on the back of increased EU-fund absorption.

Table 1: Macroeconomic developments and forecast

	2017	2018		2019	
	Outturn	CP	COM	CP	COM
Real GDP (% change)	4.1	4.3	4.3	4.1	3.4
Private consumption (% change)	4.8	5.2	5.2	4.8	3.3
Gross fixed capital formation (% change)	18.2	12.8	12.5	7.5	9.4
Exports of goods and services (% change)	4.7	7.2	7.1	6.9	6.0
Imports of goods and services (% change)	7.7	9.2	9.0	7.4	7.1
Contributions to real GDP growth:					
- Final domestic demand	6.2	5.5	5.7	4.2	4.0
- Change in inventories	-0.2	0.0	-0.3	0.0	0.0
- Net exports	-1.9	-1.1	-1.1	0.0	-0.6
Output gap[1]	1.7	1.7	2.8	1.5	2.9
Employment (% change)	2.0	1.5	0.9	1.5	0.5
Unemployment rate (%)	4.2	3.4	3.6	2.7	3.3
Labour productivity (% change)	2.1	2.8	3.4	2.6	3.0
HICP inflation (%)	2.4	2.5	3.0	2.7	3.3
GDP deflator (% change)	3.8	2.7	3.7	3.1	3.3
Comp. of employees (per head, % change)	6.2	9.1	8.1	7.9	6.6
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	4.3	5.9	3.2	5.9	2.4

Note:

[1]In % of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the

Source :

Commission 2018 autumn forecast (COM); 2018 Convergence Programme (CP).

According to the Commission 2018 autumn forecast, GDP growth in 2018 as a whole is expected at 4.3% (see Table 1). This marks the peak of the domestic business cycle, as growth is set to decelerate to 3.4% in 2019 and to 2.6% in 2020. The expected slowdown is due to the fading effect of administrative wage increases, the moderation of investment dynamics, and the expected weakening of main export markets.

Strong demand growth and capacity constraints have begun to raise costs and prices. Unemployment fell to a record low, contributing to strong labour cost growth, which is only partly offset by cuts of employer social contributions. A broad set of indicators point to rising inflationary pressure: the GDP deflator is forecast to rise by 3.7% in 2018, construction costs increased by 9.8% y-o-y in August 2018, while the aggregate house price index rose 12.1% y-o-y in the first quarter of 2018. HICP inflation is set to rise to 3.3% in 2019 on the back of unprocessed food and energy prices, but the underlying momentum will keep inflation at 3% in 2020, after cost shocks fade.

The Commission GDP growth forecast for 2018 was revised up since the spring, from 4.0% to 4.3%. The Commission 2018 autumn forecast estimates also a higher GDP deflator in 2018 than in the spring, resulting in a higher nominal path of the economy. The Hungarian Ministry of Finance has not published a comprehensive update of their macroeconomic projections since the 2018 Convergence Programme. Nonetheless, the authorities revised their 2018 real GDP growth forecast marginally upwards, while they increased their nominal path markedly with an elevated GDP deflator as reflected in the 2018 autumn EDP notification. This results in a significant denominator effect on the government revenue and expenditure-to-GDP ratios in the updated budgetary projection for 2018. While the 2018 growth expectation of the Commission is similar to the authorities' assessment, the 2019 projection remains more conservative compared to the macroeconomic scenario presented in the 2018 Convergence Programme. The Commission forecast expects that capacity constraints exert a stronger effect on prices, which in turn limits real GDP growth.

Based on the Commission 2018 autumn forecast and the commonly agreed methodology for calculating the cyclical position of the economy, the positive output gap is projected to widen further in 2018 and to broadly stabilise in 2019. In 2020, GDP growth slows below potential, narrowing the output gap.

3. FISCAL DEVELOPMENTS AND OUTLOOK 2018-2019

On 18-19 September 2018 the Commission undertook an enhanced surveillance mission in Hungary for the purpose of on-site monitoring under Article -11(2) of Regulation (EC) No 1466/97. The Commission report on the mission finds that the Hungarian authorities do not plan to act upon the Council Recommendation of 22 June 2018 this year. At the same time, they expressed their commitment to improve the budgetary position as of 2019. The 2019 budget, which was already adopted by the Hungarian Parliament in July 2018, aims to bring down the general government deficit by 0.6% of GDP next year, in line with the plans set out in the 2018 Convergence Programme. However, the Council recommendation does not cover 2019.

Updated budgetary projection for 2018 and reported action

In their report on action taken[3], the authorities maintain the general government deficit target from the 2018 Convergence programme of 2.4% of GDP in 2018. The report highlights that the unchanged 2018 deficit target is accompanied by significant changes in the revenue and expenditure sides of the budget. Compared to the 2018 Convergence Programme, the authorities expect substantially higher tax revenues and reduced co-financing costs of EU-funded projects due to a lower-than-initially-planned EU fund absorption. However, the deficit-improvement resulting from these developments (amounting altogether to some 1% of GDP) is projected to be fully absorbed by extra spending, mainly on nationally financed investments and public wages.

The authorities provide a list of discretionary measures they have taken or planned, without providing their estimated impact. Moreover, the list includes only measures with a positive impact on the budget. Table 2 presents those measures listed in the report, which were adopted or announced following the Council recommendation of 22 June 2018 and thus had not been reported yet in the 2018 Convergence Programme. The estimates of the fiscal impact in the Table 2 come from subsequent exchanges with the authorities. Based on these

[3] https://ec.europa.eu/info/files/hungary-report-council-recommendations-under-significant-deviation-procedure_en

estimates, the reported new discretionary measures have no notable impact on the budget execution in 2018, but rather contribute to the planned deficit reduction in 2019 (i.e. the increase of certain consumption taxes and the rationalisation of staffing public administration starting at the end of 2018). The report also refers to ongoing efforts aimed at enhancing tax collection efficiency, most notably the phasing-in of an online invoicing system for inter-company transactions in 2018. That measure is not included in Table 2 as it was already adopted when the 2018 Convergence Programme was published. The estimated budgetary effect of it has been incorporated in the Commission 2018 autumn forecast (see Table 3).

Table 2: Discretionary fiscal measures listed in the report (fiscal impact in % of GDP)

	2018	2019
Revenues		
Excise duties: Increasing the tobacco duties in three steps (September 2018, January and July 2019)	0.01%	0.04%
Extra levy on unhealthy foodstuff ("chips tax"): increasing the tax rate and broadening the tax base		0.03%
Corporate income tax: capping the deductibilty of interest liabilities (part of transposition of EU Anti-Tax Avoidance Directives)		0.02%
Expenditure		
Rationalisation of personnel in central public administration[1]	0.02%	-0.1%

Note:
[1] Preliminary estimate. The positive value in 2018 reflects planned severance payments.
[2]The budgetary impact in the table as estimated by the authorities. A positive sign implies that revenue /expenditure increases as a consequence of this measure.

Table 3: Discretionary revenue measures included in the Commission 2018 forecast (fiscal impact in % of GDP)

Measure	2018	2019
Reduction of employer's social security contribution (SSC) rate (rate reduction from 22% to 19.5% in 2018 and to 17.5% from 1st July 2019)	-0.7%	-0.3%
Extra payroll tax/SSC revenues due to minimum wage increases – direct, static effect (general wage minimum: 8% rise in 2018; skilled workers: 12% rise in 2018)	0.2%	
Selective VAT rate cuts (2018: fish and pork liver from 27% to 5%; restaurant meals and internet from 18% to 5%; 2019: preserved milk from 27% to 5%)	-0.2%	-0.1%
Measures to increase tax collection efficiency (extension of online cashiers and phasing-in online invoicing between companies)	0.1%	
Revamping SSC allowances (phasing-out the previous age related benefits, while making old age pensioners exmept of all social contributions)		-0.1%
Residual (all other smaller measures taken together)	-0.1%	0.1%
TOTAL	**-0.7%**	**-0.4%**

Note:
The budgetary impact in the table as included in the Commission 2018 autumn forecast. A positive sign implies that revenue increases as a consequence of this measure. The table presents spearately only measures with a fiscal impact of at least 0.1% of GDP over the examined period.

Based on the Commission 2018 autumn forecast, which takes into account the above discussed budgetary developments and measures, the general government deficit is projected at 2.4% of GDP in 2018, in line with the authorities' current target (see Table 4). Compared to the updated budgetary outturn in 2017, the headline deficit is expected to increase by 0.2% of GDP, while the general government deficit excluding the effect of one-offs is set to improve by a similar magnitude.[4] As the positive output gap is projected to continue widening, the Commission projects a deterioration of the structural balance by 0.4% of GDP, from -3.4% in 2017 to -3.8% in 2018.

Regarding key factors shaping the 2018 deficit forecast, the fall-out of one-off receipts (i.e. income from land sales) and temporary tax proceeds (i.e. a corporate income tax revenue windfall), which benefited the budget in the previous year, significantly contribute to the increasing headline deficit. Revenues have also been reduced by tax measures, including a 2.5 percentage-point decrease in the employer social contribution rate, the effect of which on the tax-to-GDP ratio is projected to be largely dampened due to a rapid growth of major tax bases. While the revenue outlook improved considerably since the spring, it is set to be matched by extra spending reflecting information provided in the updated budgetary plans of the authorities. Nonetheless, the growth of primary expenditure, excluding increased spending from EU funds, is forecast to slow compared to 2017 and to remain well below the forecast high GDP growth.[5] This projected moderation of spending growth coupled with a continued decline of interest outlays reduces the impact of the above-mentioned deficit-increasing developments.

Updated budgetary projection for 2019

According to the Commission 2018 autumn forecast, the headline deficit is expected to decrease to 1.9% of GDP in 2019, just slightly above the budgetary target of 1.8%, declining by around 0.5 percentage points compared to 2018. The impact of fiscal expansion seen since 2017 on the budgetary position is projected to be partly reversed with the structural balance estimated to improve by some 0.5% of GDP to -3.3% of GDP in 2019 (see Table 4).

The Commission 2018 autumn forecast incorporates an additional 2 percentage-point cut in social contributions, which is planned by the authorities as of July 2019. The remaining elements of the 2019 tax package are estimated to be broadly revenue-neutral overall (see Table 3). Taking into account the budgeted appropriations, total primary expenditure, excluding spending from EU funds, is expected to increase rather moderately relative to the GDP, which is the key driver of the forecast deficit-reduction.[6] The projected expenditure restraint affects the main spending items at a varying degree. While the public wage bill is foreseen to increase well below inflation and social payments are also set to decline in real terms, spending on government investment is forecast to expand even as a percentage of GDP.

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[4] The 2017 budgetary outturn figures were revised in the 2018 autumn EDP notification resulting in a deterioration of the general government deficit recorded for 2017 by around 0.3% of GDP compared to the spring data.

[5] In 2017, primary expenditure, filtering out the effect of one-offs and EU funds, rose above the rate of GDP growth, by 9.5% in nominal terms and 5.5% in real terms as measured relative to the GDP deflator. In 2018, primary expenditure, netting out the same factors, is projected to increase only by 5.7% relative to a nominal GDP growth of 8.1%, which corresponds to a real growth of 2.0%. This results in 1 percentage point reduction in the expenditure-to-GDP ratio.

[6] In 2019, total primary expenditure, excluding spending from EU funds, is projected to increase by 4.4% relative to a forecast nominal GDP growth of 6.9%, which corresponds to a real growth of 1.0%.

Table 4: Composition of the budgetary adjustment

(% of GDP)	2017	2018			2019		
	Outturn	CP	Update October[3]	COM	CP	Budget July[3]	COM
Revenue	**44.7**	**45.5**	**45.1**	**44.9**	**45.1**	**45.5**	**44.7**
of which:							
- Taxes on production and imports	18.0	18.1	18.4	18.3	17.9	18.1	18.2
- Current taxes on income, wealth, etc.	7.4	6.9	6.9	6.9	7.0	7.1	6.9
- Social contributions	12.8	12.7	12.5	12.4	12.6	12.7	12.2
- Other (residual)	6.5	7.8	7.3	7.3	7.6	7.6	7.4
Expenditure	**46.9**	**47.9**	**47.5**	**47.3**	**46.9**	**47.3**	**46.6**
of which:							
- Primary expenditure	44.1	45.3	44.9	44.7	44.5	44.9	44.2
of which:							
Compensation of employees	10.9	10.5	10.8	10.8	9.9	9.9	10.1
Intermediate consumption	7.9	7.3	7.6	7.6	7.1	8.0	7.8
Social payments	13.9	13.8	13.4	13.4	13.1	13.0	12.9
Subsidies	1.4	1.4	1.4	1.4	1.4	1.3	1.3
Gross fixed capital formation	4.5	6.0	6.0	5.8	7.0	6.6	6.3
Other (residual)	5.5	6.3	5.7	5.7	6.0	6.0	5.7
- Interest expenditure	2.8	2.6	2.5	2.5	2.4	2.4	2.4
General government balance (GGB)	**-2.2**	**-2.4**	**-2.4**	**-2.4**	**-1.8**	**-1.8**	**-1.9**
Primary balance	**0.6**	**0.2**	**0.1**	**0.1**	**0.6**	**0.6**	**0.5**
One-off and other temporary measures	*0.4*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
GGB excl. one-offs	**-2.6**	**-2.4**	**-2.4**	**-2.4**	**-1.8**	**-1.8**	**-1.9**
Output gap[1]	1.7	1.7	n.a.	2.8	1.5	n.a.	2.9
Cyclically-adjusted balance[1]	-3.1	-3.2	n.a.	-3.8	-2.6	n.a.	-3.3
Structural balance[2]	**-3.4**	**-3.2**	n.a.	**-3.8**	**-2.6**	n.a.	**-3.3**
Structural primary balance[2]	-0.7	-0.6	n.a.	-1.3	-0.2	n.a.	-0.9

Notes:

[1]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the CP is recalculated by Commission on the basis of the programme scenario using the commonly agreed methodology.

[2]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

[3]The figures of October update and the 2019 budget also reflect statistical revisions and thus are not fully comparable with the 2018 CP. The 2019 budget was adpoted before the budgetary projections for 2018 were updated by the authorities in October 2018.

Source :

2018 Convergence programme (CP), 2018 autumn EDP notification, Hungarian Ministry of Finance (Update October), 2019 budget approved on 20 July 2018, Hungarian Ministry of Finance (Budget July), and the Commission 2018 autumn forecast (COM)

Public debt developments

In 2017, the general government debt-to-GDP ratio reached 73.3%, decreasing overall by some 7 percentage points from its peak in 2011. The Commission 2018 autumn forecast projects a marked slowdown in debt reduction in 2018 despite the forecast nominal GDP growth above 8%: the debt ratio is expected to decrease only to 72.9% (see Table 5). This stoppage results from a sizeable adverse stock-flow-adjustment effect largely due to the increased pre-financing needs of EU-funded projects and the weakening of the exchange rate. In 2019, the debt ratio is expected to decline faster, falling to 70.3% by the end of the year thanks to the improving budgetary position and the persisting high nominal GDP growth.

In 2017, Hungary complied with the debt rule as the government debt-to-GDP ratio remained below the debt-reduction benchmark. A similar conclusion is reached for 2018 and 2019 on the basis of the Commission 2018 autumn forecast.

Table 5: Debt developments

(% of GDP)	2017		2018		2019	
	CP	Outturn	CP	COM	CP	COM
Gross debt ratio[1]	**73.6**	**73.3**	**73.2**	**72.9**	**69.6**	**70.3**
Change in the ratio	-2.4	-2.6	-0.4	-0.3	-3.6	-2.6
Contributions [2] *:*						
1. Primary balance	**-0.8**	**-0.6**	**-0.2**	**-0.1**	**-0.6**	**-0.5**
2. "Snow-ball" effect	**-2.6**	**-2.9**	**-2.2**	**-3.0**	**-2.7**	**-2.3**
Of which:						
Interest expenditure	2.8	2.8	2.6	2.5	2.4	2.4
Growth effect	-2.8	-2.9	-3.0	-2.9	-2.8	-2.3
Inflation effect	-2.6	-2.7	-1.8	-2.5	-2.1	-2.3
3. Stock-flow adjustment	**1.1**	**0.9**	**2.1**	**2.8**	**-0.3**	**0.2**

Notes:

[1] End of period.

[2] The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

Source :

2018 Convergence programme (CP) and Commission 2018 autumn forecast (COM), Commission calculations

4. COMPLIANCE WITH THE COUNCIL RECOMMENDATION FOR 2018

On 22 June 2018, the Council recommended Hungary to take the necessary measures to ensure that the nominal growth rate of net primary government expenditure does not exceed 2.8% in 2018, corresponding to an annual structural adjustment of 1.0% of GDP.

In 2018, based on the Commission 2018 autumn forecast, the growth of government expenditure, net of discretionary revenue measures and one-offs, is projected at 7.0%, well above the recommended reference rate of growth (deviation of 1.6% of GDP, see Table 6). The structural balance is set to deteriorate by 0.4 % of GDP pointing to the opposite direction of the recommended structural improvement of 1.0% GDP (deviation of 1.4% of GDP).

The overall assessment indicates that the expenditure benchmark is negatively affected by three factors. First, the medium-term potential GDP growth arising from the Commission 2017 spring forecast applied as a benchmark is impacted by very low potential growth estimates in the aftermath of the crisis. As a result of data revisions and the subsequently estimated recovery of the growth potential, the currently calculated average potential growth rate for the same reference period of 2012-2021 is considerably higher (2.3% vs. 1.8%). Second, the GDP deflator underlying the expenditure benchmark (which is based on the projection of the Commission 2017 spring forecast) does not seem to account properly for the increased cost pressures affecting government spending. Third, the expenditure benchmark appears to underestimate the fiscal effort because it does not take into account the indirect revenue effect of certain measures. In particular, this concerns the structural increase in tax revenues generated by the ripple effect of significant minimum wage increases on earnings above the statutory minimum as well as by the pass-through of the employer social contribution rate cut into higher wages. After adjusting for these factors, the expenditure benchmark appears to adequately reflect the fiscal effort and still points to a deviation by a wide margin. The assessment of the structural balance leads to a similar result. The size of deviation indicated by the structural balance pillar is negatively affected by a revenue

shortfall[7], but this is partly offset by the effect of a higher point estimate for potential GDP growth compared to the medium-term average underlying the expenditure benchmark.

Therefore the overall assessment confirms the deviation from the recommended adjustment.

Table 6: Hungary under the preventive arm of the SGP – Compliance with the Council Recommendation of 22 June 2018

(% of GDP)	2017	2018
Initial position[1]		
Medium-term objective (MTO)	-1.5	-1.5
Structural balance[2]	-3.4	-3.8
Structural balance based on freezing	-3.2	-3.6
Position vis-a -vis the MTO[3]	Not at MTO	Not at MTO
Structural balance pillar		
Required adjustment[4]	0.3	1.0
Required adjustment corrected[5]	0.0	1.0
Change in structural balance[6]	-1.4	-0.4
One-year deviation from the required adjustment [7]	-1.4	-1.4
Two-year average deviation from the required adjustment [7]	-0.7	-1.4
Expenditure benchmark pillar		
Applicable reference rate[8]	1.5	2.8
One-year deviation adjusted for one-offs[9]	-2.4	-1.6
Two-year deviation adjusted for one-offs[9]	-1.9	-2.0
Conclusion		
Conclusion over one year	Significant deviation	Significant deviation
Conclusion over two years	Significant deviation	Significant deviation

Notes

[1] The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage points (p.p.) is allowed in order to be evaluated as having reached the MTO.

[2] Structural balance = cyclically-adjusted government balance excluding one-off measures.

[3] Based on the relevant structural balance at year t-1.

[4] Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page 38.).

[5] Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

[6] Change in the structural balance compared to year t-1. Ex post assessment (for 2017) is carried out on the basis of Commission 2018 spring forecast.

[7] The difference of the change in the structural balance and the corrected required adjustment.

[8] Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A corrected rate applies as long as the country is adjusting towards its MTO, including in year t.

[9] Deviation of the growth rate of public expenditure (net of discretionary revenue measures, revenue increases mandated by law and one-offs) from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

Source : Commission 2018 autumn forecast (COM); Commission calculations.

[7] The revenue shortfall reflects the phase-out of the extraordinary corporate income tax revenue discussed above.

5. PROPOSED ADJUSTMENT PATH FOR 2019

On 13 July 2018, the Council addressed recommendations to Hungary within the context of the European Semester. In the area of public finances, for 2019 the Council recommended Hungary to ensure that the nominal growth rate of net primary government expenditure does not exceed 3.9 %, corresponding to an annual structural adjustment of 0.75 % of GDP.[8] The Council recommendation for 2019 was set in line with the minimum requirement as determined by Regulation (EC) No 1466/97 and the commonly agreed adjustment matrix[9], which factors in the prevailing economic circumstances and possible sustainability concerns, taking into account the Commission 2018 spring forecast.

Based on the Commission 2018 autumn forecast, Hungary's structural deficit increased by 1.7% of GDP in 2017 and it is projected to deteriorate further by 0.4% of GDP reaching 3.8% in 2018. As a result, the structural deficit is estimated to be 2.3% of GDP away from the MTO in 2018. In order to correct for the cumulated deviations and to bring Hungary back on an appropriate adjustment path following past slippages, an additional and persistent effort should complement the adjustment target for 2019 recommended by the Council on 13 July 2018. An additional effort of 0.25% of GDP seems appropriate given the magnitude of the observed significant deviation from the required fiscal adjustment. It would accelerate the adjustment back towards the MTO.

Based on the Commission 2018 autumn forecast, that target of 1.0% of GDP structural adjustment is consistent with a nominal growth rate of net primary government expenditure of 3.3% in 2019, compared to the growth rate of 5.3% currently projected by the Commission.

The structural improvement of 1.0% of GDP in 2019 translates into a need to adopt measures of a total yield of 0.5% of GDP in structural terms as compared to the current 2019 baseline of the Commission 2018 autumn forecast, given projected improvement of the structural balance in 2019.

6. CONCLUSION

On 22 June 2018, the Council recommended Hungary to take the necessary measures to ensure that the nominal growth rate of net primary government expenditure does not exceed 2.8% in 2018, corresponding to an annual structural adjustment of 1.0% of GDP.

In the report on action taken in response to the recommendation, the authorities retain their initial general government deficit target of 2.4% of GDP for 2018. Compared to the spring 2018, the authorities expect significantly higher tax revenues and savings due to the decreased co-financing costs of EU-funded projects. However, the deficit-reducing effect of these developments is planned to be fully offset by additional spending. The reported new discretionary measures have no significant net fiscal impact on the budget outcome in 2018, thus falling short of the structural effort recommended by the Council.

The Commission 2018 autumn forecast projects a general government deficit for 2018 in line with the authorities' current target. This implies a worsening of both the nominal and structural deficits compared to 2017. In 2018, based on the Commission 2018 autumn forecast, both the expenditure benchmark and the structural balance pillars point to a

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[8] OJ C 320, 10.09.2018, p. 72

[9] "Commonly agreed position on Flexibility within the SGP", formally endorsed by ECOFIN Council on 12 February 2016, available at: http://data.consilium.europa.eu/doc/document/ST-14345-2015-INIT/en/pdf

deviation from the fiscal effort recommended by the Council on 22 June 2018. An overall assessment confirms this conclusion.

In light of an insufficient response to the Council Recommendation of 22 June 2018 and the cumulated high deviation from the required adjustment path toward the MTO, it is appropriate to address to Hungary a revised recommendation on the necessary measures to be taken. A revised recommendation to improve Hungary's structural balance by 1.0% of GDP in 2019 relative to 2018 would accelerate Hungary's adjustment back towards the MTO.