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From:	Secretary-General of the European Commission, signed by Mr Jordi AYET PUIGARNAU, Director
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To:	Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of the European Union
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Subject:	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

Delegations will find attached document COM(2019) 534 final.

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Brussels, 5.6.2019
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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

{SWD(2019) 534 final}

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

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 121(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[1], and in particular the second subparagraph of Article 10(2) thereof,

Having regard to the recommendation from the European Commission,

Whereas:

(1) In accordance with Article 121 of the Treaty, Member States are to promote sound public finances over the medium term through the coordination of economic policies and multilateral surveillance in order to avoid the occurrence of excessive government deficits.

(2) The Stability and Growth Pact (SGP) is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation.

(3) On 22 June 2018, the Council found in accordance with Article 121(4) of the Treaty that a significant observed deviation from the medium-term budgetary objective of a general government deficit of 1,0 % of GDP in structural terms occurred in Hungary in 2017. In view of that established significant deviation, on 22 June 2018, the Council recommended Hungary[2] to take the necessary measures to ensure that the nominal growth rate of net primary government expenditure[3] does not exceed 2.8 % in 2018, corresponding to an annual structural adjustment of 1.0 % of GDP. It also recommended that Hungary uses any windfall gains for deficit reduction, thereby putting the country on an appropriate adjustment path toward the medium-term budgetary objective. On 4 December 2018, the Council concluded that Hungary had

[1] OJ L 209, 2.8.1997, p. 1.
[2] OJ C 223, 27.6.2018, p. 1.
[3] 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.

not taken effective action in response to the Council Recommendation of 22 June 2018. On that basis, on 4 December 2018 the Council issued a revised recommendation for Hungary to take the necessary measures to ensure that the nominal growth rate of net primary government expenditure does not exceed 3.3 % in 2019, corresponding to an annual structural adjustment of 1.0 % of GDP.

(4) In 2018, based on the Commission 2019 spring forecast and the 2018 outturn data validated by Eurostat, the growth of net primary government expenditure was well above the expenditure benchmark, pointing to a significant deviation (deviation of 1.3 % of GDP). The structural balance deteriorated to -3.7 % of GDP from -3.4 % of GDP in 2017, also pointing to a significant deviation from the recommended structural adjustment (deviation of 1.3 % of GDP). The size of the deviation indicated by the structural balance is negatively impacted by substantial revenue shortfalls as well as higher investment expenditures amidst an overheating economy, while it is estimated to have marginally benefitted from falling interest expenditure. The expenditure benchmark is strongly negatively impacted by the medium-term potential GDP growth applied in its calculation, which includes very low potential GDP growth in the aftermath of the crisis. In addition, the GDP deflator underlying the expenditure benchmark does not seem to account properly for the increased cost pressures affecting government spending. After adjusting for these factors, the expenditure benchmark appears to adequately reflect the fiscal effort and still points to a significant deviation. Taking into account these factors, both indicators confirm a significant deviation from the requirements of the preventive arm of the SGP in 2018.

(5) On 5 June 2019, following an overall assessment, the Commission considered that a significant observed deviation from the adjustment path toward the medium-term budgetary objective exists in Hungary and issued a warning to Hungary in accordance with Article 121(4) of the Treaty and the first subparagraph of Article 10(2) of Regulation (EC) No 1466/97.

(6) In accordance with the second subparagraph of Article 10(2) of Regulation (EC) No 1466/97, within one month of the date of the adoption of the warning, the Council is to address a recommendation to the Member State concerned to take the necessary policy measures. Regulation (EC) No 1466/97 provides that the recommendation will set a deadline of no more than five months for the Member State to address the deviation. On that basis a deadline of 15 October 2019 for Hungary to address the deviation appears appropriate. Within that deadline, Hungary should report on action taken in response to this Recommendation.

(7) Based on the output gap projections of the Commission 2019 spring forecast, Hungary will remain in good economic times in 2019 and 2020. While in 2019, real GDP is estimated to grow in line with potential GDP (at 3.7 %), in 2020, real GDP growth (at 2.8 %) is forecast to be lower than the growth potential (at 3.6 %). Hungary’s general government debt ratio is above the 60 %-of-GDP threshold. Hence, the minimum required structural effort prescribed by Regulation (EC) No 1466/97 and the commonly agreed adjustment matrix under the preventive arm of the SGP, which factors in the prevailing economic circumstances and possible sustainability concerns, amounts to at least 0.75 % of GDP for both 2019 and 2020.

(8) Hungary's structural deficit has increased by 1.4 % of GDP in 2017 and by 0.3 % of GDP in 2018, to 3.7 % of GDP in 2018. It is projected in the Commission 2019 spring forecast to decrease as of 2019. An additional effort, necessary to correct for the cumulated deviations and to bring Hungary back on an appropriate consolidation path

following the slippages since 2017, should complement the minimum adjustment requirement in 2019. An additional effort compared to that resulting from the commonly agreeed adjustment matrix under the preventive arm of the SGP of 0.25 % of GDP in 2019 seems appropriate given the magnitude of the observed significant deviation from the recommended adjustment path towards the medium-term objective and it will accelerate adjustment back towards the medium-term budgetary objective. The required effort for 2019 is in line with the adjustment recommended by the Council on 4 December 2018. For 2020, the minimum adjustment requirement of 0.75 % of GDP seems appropriate, contingent on compliance with the requested adjustment in 2019.

(9) The required improvement in the structural balance by 1.0 % of GDP in 2019 and 0.75 % of GDP in 2020 is consistent with a nominal growth rate of net primary government expenditure not exceeding 3.3 % in 2019 and 4.7 % in 2020.

(10) The Commission 2019 spring forecast projects an improvement in the structural balance by 0.4 % of GDP in 2019 and by a further 0.6 % of GDP in 2020. Therefore, a structural improvement of 1.0 % of GDP in 2019 and 0.75 % of GDP in 2020 translates into the need to adopt measures of a total structural yield of 0.6 % of GDP in 2019 and additonal measures of a structural yield of 0.2 % of GDP in 2020 compared to the current baseline in the Commission 2019 spring forecast.

(11) The failure to act upon earlier recommendations to correct the observed significant deviation call for urgent action to put Hungary's fiscal policy back on a prudent path.

(12) In order to achieve the recommended budgetary targets, it is crucial that Hungary adopts and strictly implements the necessary measures and monitors the development of current expenditure closely.

(13) Hungary should report to the Council on action taken in response to this Recommendation by 15 October 2019.

(14) It is appropriate that this Recommendation be made public,

HEREBY RECOMMENDS THAT HUNGARY:

(1) take the necessary measures to ensure that the nominal growth rate of net primary government expenditure does not exceed 3.3 % in 2019 and 4.7 % in 2020, corresponding to an annual structural adjustment of 1.0 % of GDP in 2019 and 0.75 % of GDP in 2020, thereby putting the Member State on an appropriate adjustment path toward the medium-term budgetary objective;

(2) use any windfall gains for deficit reduction; budgetary consolidation measures should secure a lasting improvement in the general government structural balance in a growth-friendly manner;

(3) report to the Council by 15 October 2019 on action taken in response to this Recommendation; the report should provide sufficiently specified and credibly announced measures with a view to complying with the required adjustment path, including budgetary impact of each of them, as well as updated and detailed budgetary projections for 2019-2020.

This recommendation is addressed to Hungary.

Done at Brussels,

For the Council
The President