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## COVER NOTE

From:	Secretary-General of the European Commission, signed by Mr Jordi AYET PUIGARNAU, Director
date of receipt:	5 June 2019
To:	Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of the European Union
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Subject:	COMMISSION RECOMMENDATION of 5.6.2019 with a view to giving warning on the existence of a significant observed deviation from the adjustment path toward the medium-term budgetary objective to Hungary

Delegations will find attached document C(2019) 5002 final.

Encl.: C(2019) 5002 final

Brussels, 5.6.2019  
C(2019) 5002 final

**COMMISSION RECOMMENDATION**

**of 5.6.2019**

**with a view to giving warning on the existence of a significant observed deviation from  
the adjustment path toward the medium-term budgetary objective**

**to Hungary**

## COMMISSION RECOMMENDATION

of 5.6.2019

**with a view to giving warning on the existence of a significant observed deviation from the adjustment path toward the medium-term budgetary objective**

**to Hungary**

THE EUROPEAN COMMISSION,

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 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies<sup>1</sup>, and in particular the first subparagraph of Article 10(2) thereof,

Whereas :

- (1) Article 121 of the Treaty sets the framework of the preventive arm of the Stability and Growth Pact (SGP) whose objective is to promote sound public finances over the medium term through the coordination of economic policies and multilateral surveillance. The operation of the preventive arm is further specified in Regulation (EC) No 1466/97 and in the Code of Conduct of the SGP<sup>2</sup>.
- (2) In order to ensure sustainable public finances and to avoid the occurrence of excessive budget deficits, Member States should achieve a country-specific medium-term budgetary objective for their budgetary position set in structural terms, and maintain it over the economic cycle. For Member States that are not at their medium-term budgetary objective, an appropriate adjustment path towards the medium-term budgetary objective is defined.
- (3) Within the framework of the European Semester, the Council annually addresses guidance to the Member States making full use of the legal instruments provided under Articles 121 and 148 of the Treaty, and under Regulations (EC) No 1466/97 and (EU) No 1176/2011<sup>3</sup>.
- (4) Based on Article 10 of Regulation (EC) No 1466/97, the Commission conducts an ex-post assessment of progress towards the medium-term budgetary objective for the previous year by comparing fiscal outturn data with the required pace of adjustment towards the medium-term budgetary objective with a view to identifying actual significant divergences of the budgetary position from the medium-term budgetary objective, or from the appropriate adjustment path towards it as recommended by the Council.

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<sup>1</sup> OJ L 209, 2.8.1997, p. 1.

<sup>2</sup> "Specifications on the implementation of the Stability and Growth Pact and Guidelines on the format and content of Stability and Convergence Programmes", 5 July 2016,  
[http://ec.europa.eu/economy\\_finance/economic\\_governance/sgp/pdf/coc/code\\_of\\_conduct\\_en.pdf](http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/coc/code_of_conduct_en.pdf)

<sup>3</sup> Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances (OJ L 306, 23.11.2011, p. 25).

- (5) Based on Article 10 of Regulation (EC) No 1466/97, the Commission evaluates progress towards the medium-term budgetary objective on the basis of an overall assessment with expenditure, net of discretionary revenue measures and one-offs as the reference, including an analysis of the structural balance.
- (6) Pursuant to Article 10(3) of Regulation (EC) No 1466/97, the overall assessment of whether a deviation from the medium-term budgetary objective or the adjustment path towards it is significant includes, in particular, two criteria. One, which is applicable in assessing expenditure developments, net of discretionary revenue measures and one-offs, is whether the deviation has a total impact on the government balance of at least 0.5% of GDP in a single year or cumulatively in two consecutive years. The other, which is applicable in assessing the change in the structural balance, is whether the deviation in the structural balance is of at least 0.5% of GDP in a single year or at least 0.25% of GDP on average per year in two consecutive years.
- (7) In the case of a significant observed deviation from the adequate adjustment path towards the medium-term budgetary objective, the Commission is to address a warning to the Member State concerned in accordance with Article 121(4) of the Treaty.
- (8) 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<sup>4</sup> does not exceed 2.8 % in 2018, corresponding to an annual structural adjustment of 1.0 % of GDP, thereby putting the Member State on an appropriate adjustment path toward the medium-term budgetary objective<sup>5</sup>. On 4 December 2018 the Council decided that Hungary has not taken effective action in response to the Council Recommendation of 22 June 2018<sup>6</sup>. 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<sup>7</sup>.
- (9) Based on the 2018 outturn data validated by Eurostat and the Commission 2019 spring forecast, the observed deviation from the recommended path towards the medium-term budgetary objective based on the structural balance in 2018 was above the threshold for significance of 0.5 % of potential GDP. In addition, expenditure growth net of discretionary revenue and one-off measures was also above the rate which ensures compliance with the recommended adjustment path toward the medium-term budgetary objective.
- (10) An overall assessment is required in line with Article 10(3) of Regulation (EC) No 1466/97. In 2018, 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 a position of -3.4 % of GDP in 2017, also pointing to a significant deviation from the recommended

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<sup>4</sup> 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.

<sup>5</sup> OJ C 223, 27.6.2018, p. 1.

<sup>6</sup> OJ L 325, 20.12.2018, p. 29.

<sup>7</sup> OJ C 460, 21.12.2018, p. 4.

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 those factors, the expenditure benchmark appears to adequately reflect the fiscal effort but it still points to a significant deviation.

- (11) Taking into account those factors, the overall assessment leads to the conclusion that the observed deviation in 2018 from the requirements of the preventive arm of the SGP as set out in the Council Recommendation of 22 June 2018 is significant,

HAS ADOPTED THIS RECOMMENDATION:

The Commission hereby warns Hungary that a significant deviation from the adjustment path towards the medium-term budgetary objective was observed in 2018.

Done at Brussels, 5.6.2019

*For the Commission  
Pierre MOSCOVICI  
Member of the Commission*