EUROPEAN
COMMISSION

Brussels, 23.5.2018
COM(2018) 431 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

{SWD(2018) 368 final}

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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 10(2), second sub-paragraph, thereof,

Having regard to the recommendation of the Commission,

Whereas:

(1) According to Article 121 of the Treaty on the Functioning of the European Union, Member States shall 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 12 July 2016, the Council recommended Hungary to achieve a fiscal adjustment of 0.6% of GDP in 2017 unless the medium-term objective was respected with a lower effort.

(4) Based on the Commission 2018 spring forecast and the 2017 outturn data validated by Eurostat, the growth of government expenditure, net of discretionary revenue measures and one-offs, was well above the applicable expenditure benchmark rate in 2017, pointing to a significant deviation from the required structural adjustment (deviation of 2.4% of GDP). In 2017, from a position of -1.8% of potential GDP in 2016, the structural balance deteriorated to -3.1% of GDP, also pointing to a significant deviation (deviation of 1.4% of GDP). The overall assessment indicated that the expenditure benchmark was negatively affected by three elements, including a too low medium-term potential growth rate and GDP deflator underlying the expenditure benchmark as well as a permanent revenue effect. After correcting for these factors, the expenditure benchmark appears to adequately reflect the fiscal effort and points to a significant deviation. This conclusion is confirmed by the assessment of the structural balance pillar, which after taking into account the impacts of

[1] OJ L 209, 2.8.1997, p. 1.

decreasing interest expenditure, investment volatility and a revenue windfall, still points to a significant deviation. The overall assessment therefore leads to the conclusion that the observed deviation from the medium-term budgetary objective in 2017 is significant.

(5) On [23 May] 2018, following an overall assessment, the Commission considered that a significant observed deviation from the medium-term budgetary objective exists in Hungary and issued a warning to Hungary in accordance with Article 121(4) TFEU and 10(2), first-sub-paragraph, of Regulation (EC) No 1466/97.

(6) According to Article 10(2), second sub-paragraph, of Regulation (EC) No 1466/97, within one month of the date of the adoption of the warning, the Council should address a recommendation to the Member State concerned to take the necessary policy measures. The regulation foresees 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 2018 for Hungary to address the deviation appears appropriate. Within that deadline, Hungary should report on action taken in response to this recommendation.

(7) Hungary's structural balance in 2017 is estimated to have been 1.6% of GDP away from its medium-term budgetary objective of a structural deficit of -1.5% of GDP. Based on the output gap projections of the Commission 2018 spring forecast, Hungary is in good economic times in 2018. Hungary's general government debt ratio is above the 60% of GDP threshold. The minimum required structural effort prescribed by Regulation (EC) No 1466/97 and the matrix of requirements, which factors in the prevailing economic circumstances and sustainability concerns, amounts to at least 1% of GDP for 2018. The Commission 2018 spring forecast projects a further deterioration of the structural balance by 0.5% of GDP in 2018. Therefore, a minimum structural improvement of 1% of GDP in 2018 translates into a need to adopt measures of a total yield of 1.5% of GDP compared to the current baseline from the Commission spring 2018 forecast. Given the significant size of the required structural consolidation effort resulting from the minimum adjustment requirement, it is appropriate not to require any additional required adjustment on top of the minimum 1% of GDP requirement.

(8) The required improvement of the structural balance by 1% of GDP in 2018 is consistent with the nominal growth rate of net primary government expenditure not exceeding 2.8% in 2018.

(9) It is appropriate that this recommendation should be made public.

(10) 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,

HEREBY RECOMMENDS:

(1) Hungary should 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% of GDP, thereby putting the country on an appropriate adjustment path towards the medium-term budgetary objective.

(2) Hungary should 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) Hungary should report to the Council by 15 October 2018 on action taken in response to this recommendation.The report should provide sufficiently specified and credibly announced measures, including budgetary impact of each of them, as well as updated and detailed budgetary projections for 2018.

This recommendation is addressed to Hungary.

Done at Brussels,

For the Council
The President