**About government budget deficit**

*Figyelő, December 15, 2009*

The IMF shows a more permissive tone regarding the consolidation of big SOEs.

What should be done to the debt of huge SOEs (e.g. MAV and BKV) accumulated in recent years and to the related liabilities taken by the government? – this is one of the base questions of next year's budget. There is a practice evolved in previous years that the new government consolidate these enterprises after the elections, as they got into such a bad condition by the end of the previous political cycle that banks are not willing to lend them with the aim of financing their operation even with state guarantee.

Fidesz which is likely to win the elections has already indicated that government budget deficit may reach even 7% instead of official target of 3.8%. The difference of 3 percentage points comprises the planned necessary consolidation of the company. The IMF and the EU seems to insist on the target of 3.8% so far – at least in their official communication. At the same time, there is a rumor in money markets that international organizations tend to accept the view that huge public service providers like MAV and BKV cannot be left to go bankrupt (at the time of the deadline of our newspaper we received the news that the government helps BKV with additional transfers of HUF 23 bn). One can say that it is a political question. One can also argue that these companies need a structural reform, but their debt should be paid back even in this case.

The Resident Representative of the IMF, Iryna Ivaschenko told us that one should divide between the costs/losses that arose thanks to the decisions of the government (e.g. due to the state subsidy of passenger transport) and other losses which are the result of the inefficient operation of the company. . Losses stemming from the former factor should be covered by the state. At the same time, the restructuring of the company and the abolition of the loss-generating structure are the appropriate answer to the latter type of losses.

The statement made by Ms Ivaschenko seems to be a change in tone compared to the earlier standpoint. If we assume that the IMF thinks that restructuring and efficiency improvement should be reached at huge SOEs, this means that they also acknowledge the one-off expenditure items needed to meet these goals. As a result, these items will also be contained by the government budget balance, thereby increasing the deficit.

*Government budget outlook*

- Budget deficit target contained by the 2010 budget law: 3.8%
- Deficit expectation based on Reuters consensus: 4.3%
- Debt to be consolidated by the next government: 2.7%
- Deficit with consolidation (if target is met): 6.5%

- Analyst forecast (incl. consolidation): 7.0%

Of course, the IMF is not likely to be happy because of the increase in the planned deficit. The Resident Representative told us that they are still not willing to support a fiscal policy that endangers budget discipline. Current base scenario – also included in the budget – targets government budget deficit of 3.8% of GDP in 2010 and a deficit below 3% in 2011. According to the IMF's calculations, as the Hungarian economy recovers from the crisis, the public debt as % of GDP will fall relatively quickly. It can moderate to 70% from current level of 80% within 5 years.

On the other hand, the IMF also acknowledges that there are substantial risks in the 2010 budget. "According to us, the MoF calculated the base scenario of the budget on the basis of a realistic macro framework. On the other hand, I would like to note that our projections regarding budget revenues are 0.3% of GDP lower than the budget law's projection." – Ms Ivaschenko argued.

According to the IMF, the most important risk factor is the corporate tax. Amid the crises, it is quite difficult to forecast tax revenues stemming from the corporate sector. "We perceive in other countries as well that during recoveries following substantial economic contraction there are large swings in the CIT payments. This may be true in Hungary too." – the ResRep of the IMF emphasized. This is the reason why the Hungarian authorities built an unusually high level of reserves (0.8% of GDP or roughly HUF 200 bn) into the budget. According to the IMF, it may be enough to offset revenue shortfall, if needed.