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Subject:	COUNCIL RECOMMENDATION on the 2023 National Reform Programme of Hungary and delivering a Council opinion on the 2023 Convergence Programme of Hungary

Delegations will find attached the above-mentioned draft Council Recommendation, as discussed by the Council and European Council, based on the Commission Recommendation COM(2023) 617 final.

COUNCIL RECOMMENDATION

of …

on the 2023 National Reform Programme of Hungary and delivering a Council opinion on the 2023 Convergence Programme of Hungary

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 121(2) and Article 148(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 Article 9(2) thereof,

Having regard to 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[2], and in particular Article 6(1) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

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1 OJ L 209, 2.8.1997, p. 1.
2 OJ L 306, 23.11.2011, p. 25.

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) Regulation (EU) 2021/241 of the European Parliament and of the Council[3], which established the Recovery and Resilience Facility ('the Facility'), entered into force on 19 February 2021. The Facility provides financial support to the Member States for the implementation of reforms and investments, entailing a fiscal impulse financed by the Union. In line with the priorities of the European Semester, the Facility contributes to economic and inclusive recovery and to the implementation of sustainable and growth-enhancing reforms and investments, in particular reforms and investments to promote the green and digital transitions and to make the Member States' economies more resilient. It also helps strengthen public finances and boost growth and job creation in the medium and long term, improve territorial cohesion within the Union and support the continued implementation of the European Pillar of Social Rights. The maximum financial contribution per Member State under the Facility was updated on 30 June 2022, in accordance with Article 11(2) of Regulation (EU) 2021/241.

3 Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility (OJ L 57, 18.2.2021, p. 17).

(2) On 22 November 2022, the Commission adopted the 2023 Annual Sustainable Growth Survey, marking the start of the 2023 European Semester for economic policy coordination. On 23 March 2023, the European Council endorsed the priorities of the 2023 Annual Sustainable Growth Survey, which are centred around the four dimensions of competitive sustainability. On 22 November 2022, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the 2023 Alert Mechanism Report, in which it identified Hungary as one of the Member States that may be affected or may be at risk of being affected by imbalances. As such, an in-depth review would be needed. The Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area and a proposal for the 2023 Joint Employment Report, which analyses the implementation of the Employment Guidelines and the principles of the European Pillar of Social Rights. The Council adopted the Recommendation on the economic policy of the euro area[4] ('2023 Recommendation on the euro area') on 16 May 2023 and the Joint Employment Report on 13 March 2023.

(3) While the Union's economies are showing remarkable resilience, the geopolitical context continues to have a negative impact. As the Union stands firmly with Ukraine, the Union's economic and social policy agenda is focused on reducing the negative impact of energy shocks on both vulnerable households and firms in the short term, and on keeping up efforts to deliver on the green and digital transitions, support sustainable and inclusive growth, safeguard macroeconomic stability and increase resilience in the medium term. It also focuses heavily on increasing the Union's competitiveness and productivity.

4 Council Recommendation of 16 May 2023 on the economic policy of the euro area (OJ C 180, 23.5.2023, p. 1).

(4) On 1 February 2023, the Commission issued a communication entitled 'A Green Deal Industrial Plan for the Net-Zero Age' ('the Green Deal Industrial Plan'). The aim of the Green Deal Industrial Plan is to boost the competitiveness of the Union's net-zero industry and support the fast transition to climate neutrality. It complements ongoing efforts under the European Green Deal and REPowerEU. It also aims to provide a more supportive environment for scaling up the Union's manufacturing capacity for the net-zero technologies and products required to meet the Union's ambitious climate targets, and to ensure access to relevant critical raw materials, including by diversifying sourcing, properly exploiting geological resources in Member States and maximising the recycling of raw materials. The Green Deal Industrial Plan is based on four pillars: a predictable and simplified regulatory environment, faster access to finance, the enhancement of skills, and open trade for resilient supply chains. On 16 March 2023, the Commission issued a further communication entitled 'Long-term competitiveness of the EU: looking beyond 2030', structured along nine mutually reinforcing drivers with the objective of working towards a growth-enhancing regulatory framework. It sets policy priorities aimed at actively ensuring structural improvements, well-focused investment and regulatory measures for the long-term competitiveness of the Union and its Member States. The recommendations below help address those priorities.

(5) In 2023, the European Semester for economic policy coordination continues to evolve in line with the implementation of the Facility. The full implementation of the recovery and resilience plans remains essential for delivering the policy priorities under the European Semester, as the plans address all or a significant subset of the relevant country-specific recommendations issued in recent years. The 2019, 2020 and 2022 country-specific recommendations remain equally relevant for the recovery and resilience plans revised, updated or amended in accordance with Articles 14, 18 and 21 of Regulation (EU) 2021/241.

(6) Regulation (EU) 2023/435 of the European Parliament and of the Council[5] (the 'REPowerEU Regulation'), which was adopted on 27 February 2023, aims to rapidly phase out the Union's dependence on Russian fossil-fuel imports. This will contribute to energy security and the diversification of the Union's energy supply, while increasing the uptake of renewables, energy storage capacities and energy efficiency. The REPowerEU Regulation enables Member States to add a new REPowerEU chapter to their national recovery and resilience plans in order to finance key reforms and investments that will help achieve the REPowerEU objectives. Those reforms and investments will also help boost the competitiveness of the Union's net-zero industry as outlined in the Green Deal Industrial Plan and address the energy-related country-specific recommendations issued to the Member States in 2022 and, where applicable, in 2023. The REPowerEU Regulation introduces a new category of non-repayable financial support, made available to Member States in order to finance new energy-related reforms and investments under their recovery and resilience plans.

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5 Regulation (EU) 2023/435 of the European Parliament and of the Council of 27 February 2023 amending Regulation (EU) 2021/241 as regards REPowerEU chapters in recovery and resilience plans and amending Regulations (EU) No 1303/2013, (EU) 2021/1060 and (EU) 2021/1755, and Directive 2003/87/EC (OJ L 63, 28.2.2023, p. 1).

(7) On 8 March 2023, the Commission adopted a communication providing fiscal policy guidance for 2024 ('the communication of 8 March 2023'). It aims to support the preparation of Member States' stability and convergence programmes and thereby strengthen policy coordination. The Commission recalled that the general escape clause of the Stability and Growth Pact will be deactivated at the end of 2023. It called for fiscal policies in 2023–2024 that ensure medium-term debt sustainability and raise potential growth in a sustainable manner and invited Member States to set out in their 2023 stability and convergence programmes how their fiscal plans will ensure that the Treaty reference value of 3 % of gross domestic product (GDP) is adhered to and ensure plausible and continuous debt reduction, or for debt to be kept at prudent levels in the medium term. The Commission also invited Member States to phase out national fiscal measures introduced to protect households and firms from the energy price shock, starting with the least targeted ones. It indicated that, if support measures needed to be extended because of renewed energy price pressures, Member States should better target such measures at vulnerable households and firms. The Commission stated that the fiscal recommendations would be quantified and differentiated. Moreover, as proposed in its communication of 9 November 2022 on orientations for a reform of the EU economic governance framework, the fiscal recommendations would be formulated on the basis of net primary expenditure. It recommended that all Member States continue to protect nationally financed investment and ensure the effective use of the Facility and other Union funds, in particular in light of the green and digital transitions and resilience objectives. The Commission indicated that it will propose to the Council to open deficit-based excessive-deficit procedures in spring 2024 on the basis of the outturn data for 2023, in line with existing legal provisions.

(8) On 26 April 2023, the Commission presented legislative proposals to implement a comprehensive reform of the Union's economic governance rules. The central objective of the proposals is to strengthen public debt sustainability and promote sustainable and inclusive growth in all Member States through reforms and investments. In its proposals, the Commission aims to improve national ownership, simplify the framework and move towards a greater medium-term focus, in combination with effective and more coherent enforcement. According to the Council conclusions of 14 March 2023 on orientations for a reform of the EU economic governance framework, the objective is to conclude the legislative work in 2023.

(9) On 11 May 2021, Hungary submitted its national recovery and resilience plan to the Commission, in accordance with Article 18(1) of Regulation (EU) 2021/241. Pursuant to Article 19 of Regulation (EU) 2021/241, the Commission assessed the relevance, effectiveness, efficiency and coherence of the recovery and resilience plan, in accordance with the assessment guidelines set out in Annex V to that Regulation.
On 15 December 2022, the Council adopted its Implementing Decision on the approval of the assessment of the recovery and resilience plan for Hungary[6]. The release of instalments is conditional on the adoption of a decision by the Commission, in accordance with Article 24(5) of Regulation (EU) 2021/241, stating that Hungary has satisfactorily fulfilled the relevant milestones and targets set out in the Council Implementing Decision. Satisfactory fulfilment presupposes that the achievement of preceding milestones and targets has not been reversed.

[6] ST 15447/22; ST 15447/22 ADD 1.

(10) On 2 May 2023, Hungary submitted its 2023 National Reform Programme and its 2023 Convergence Programme, in line with Article 8(1) of Regulation (EC) No 1466/97. To take account of their interlinkages, the two programmes have been assessed together. In accordance with Article 27 of Regulation (EU) 2021/241, the 2023 National Reform Programme also reflects Hungary's biannual reporting on the progress made in achieving its recovery and resilience plan. On 1 June 2023, a new law on the judicial system entered into force.

(11) On 24 May 2023, the Commission published the 2023 country report for Hungary. It assessed Hungary's progress in addressing the relevant country-specific recommendations adopted by the Council between 2019 and 2022, and took stock of Hungary's implementation of the recovery and resilience plan. On the basis of that analysis, the country report identified gaps with regard to those challenges that are not addressed or only partially addressed by the recovery and resilience plan, as well as new and emerging challenges. It also assessed Hungary's progress in implementing the European Pillar of Social Rights and in achieving the Union headline targets on employment, skills and poverty reduction, as well as progress in achieving the United Nations Sustainable Development Goals.

(12) The Commission carried out an in-depth review under Article 5 of Regulation (EU) No 1176/2011 for Hungary and published its results on 24 May 2023. The Commission concluded that Hungary is experiencing macroeconomic imbalances. In particular, vulnerabilities related to very strong price pressures and external and government financing needs have increased and are significant. Inflation has risen significantly and has not yet started moderating visibly. Should inflation remain elevated for an extended period, it would further undermine cost competitiveness and could leave financing costs elevated. The large current account deficit was strongly increased by the higher energy prices in 2022, and short-term external debt has risen. Improvements in the current account in 2023 and 2024 depend on the expected further moderation of energy prices, but the current account deficit is nonetheless forecast to remain non-negligeable in 2023 and 2024. The high energy intensity of the economy is important for current account dynamics. The government deficit has been large, only partly driven by the policy responses to the pandemic and the energy crises, and accounts for much of the external borrowing of the economy. The government debt ratio decreased thanks to marked nominal GDP growth, but that may be challenged by a slowdown in activity and the persistence of high deficits. Sovereign borrowing costs have increased since 2021, and the government is facing an increasing interest burden, while debt maturity is still relatively low. House prices doubled over five years but price increases halted in late 2022. However, the likelihood of a substantial nominal price drop seems limited amid low household indebtedness, and also in light of the current high inflation environment. Policy inconsistencies have exacerbated the identified vulnerabilities. Effective coordination and clear demarcation of macroeconomic policies, underpinned by a strong institutional policy framework, is instrumental to safeguard fiscal and external sustainability as well as to anchor expectations. Timely and full implementation of structural reforms included in Hungary's recovery and resilience plan is expected to help reduce macroeconomic vulnerabilities and support growth and adjustment in the medium term.

(13) According to data validated by Eurostat, Hungary's general government deficit decreased from 7,1 % of GDP in 2021 to 6,2 % in 2022, while general government debt fell from 76,6 % of GDP at the end of 2021 to 73,3 % at the end of 2022. On 24 May 2023, the Commission issued a report under Article 126(3) of the Treaty. That report discussed the budgetary situation of Hungary, as its general government deficit in 2022 exceeded the 3 %-of-GDP Treaty reference value. The report concluded that the deficit criterion was not fulfilled. In line with the communication of 8 March 2023, the Commission did not propose to open new excessive-deficit procedures in spring 2023. The Commission subsequently stated that it would propose to the Council to open deficit-based excessive-deficit procedures in spring 2024, on the basis of the outturn data for 2023. Hungary should take account of this in the execution of its 2023 budget and in preparing its budget for 2024.

(14) The general government balance has been impacted by the fiscal policy measures taken to mitigate the economic and social impact of the increase in energy prices. In 2022, such fiscal policy revenue-decreasing measures included a cut in excise duties on fuels, while such fiscal policy expenditure-increasing measures included subsidies to utility companies for the losses incurred due to caps on residential energy prices, and support schemes for energy-intensive companies. The cost of those measures was partly offset by new taxes on windfall profits of energy producers and suppliers, namely a temporary tax on the spread between Brent and Urals oil, a temporary tax on the income of energy suppliers and a temporary increase in mining royalty. The Commission estimates the net budgetary cost of those measures at 1,0 % of GDP in 2022. The general government balance has also been impacted by the budgetary cost of offering temporary protection to displaced persons from Ukraine, which is estimated at 0,1 % of GDP in 2022. At the same time, the estimated cost of temporary emergency measures related to the COVID-19 crisis dropped to 0,1 % of GDP in 2022, from 1,9 % in 2021.

(15) On 18 June 2021, the Council recommended that in 2022 Hungary[7] maintain a supportive fiscal stance, including from the impulse provided by the Facility, and preserve nationally financed investment.

[7] Council Recommendation of 18 June 2021 delivering a Council opinion on the 2021 Convergence Programme of Hungary (OJ C 304, 29.7.2021, p. 78).

(16) According to the Commission estimates, the fiscal stance[8] in 2022 was supportive, at -0,4 % of GDP, as recommended by the Council. As recommended by the Council, Hungary continued to support the recovery with investments to be financed by the Facility. Expenditure financed by grants under the Facility and other Union funds amounted to 1,5 % of GDP in 2022 (2,1 % of GDP in 2021). The decrease in expenditures financed by Facility grants and other Union funds in 2022 was due to a lower absorption of the European structural and investment funds. Nationally financed investment provided a contractionary contribution of 0,2 percentage points to the fiscal stance[9]. Hungary therefore did not preserve nationally financed investment, which is not in line with the Council recommendation. At the same time, the growth in nationally financed primary current expenditure (net of new revenue measures) provided a contractionary contribution of 0,6 percentage points to the fiscal stance. Hungary therefore sufficiently kept under control the growth in nationally financed current expenditure.

[8] The fiscal stance is measured as the change in primary expenditure (net of discretionary revenue measures), excluding temporary emergency measures related to the COVID-19 crisis but including expenditure financed by non-repayable support (grants) from the Facility and other Union funds, relative to medium-term potential growth. For more details see Box 1 in the Fiscal Statistical Tables.

[9] Other nationally financed capital expenditure provided an expansionary contribution of 1,7 percentage points of GDP, which is driven by the impact of the purchase of gas stockpiles by a special entity classified as part of the general government.

(17) The macroeconomic scenario underpinning the budgetary projections in the 2023 Convergence Programme is more favourable than the Commission's 2023 spring forecast for 2023 and thereafter. The government projects real GDP to grow by 1,5 % in 2023 and 4,0 % in 2024. By comparison, the Commission's 2023 spring forecast projects a lower real GDP growth of 0,5 % in 2023 and 2,8 % in 2024, mainly due to lower expected growth in private consumption driven by lower expected growth in nominal wages and a slightly higher unemployment rate. The Commission also projects lower growth in government consumption and net exports. The nominal GDP growth projected in the Commission's spring 2023 forecast is lower over the forecast horizon due to the lower expected GDP growth and GDP deflator.

(18) In its 2023 Convergence Programme, the government expects that the general government deficit will decrease to 3,9 % of GDP in 2023. The decrease in 2023 mainly reflects higher tax revenue driven by the high inflation and temporary windfall profit and sectoral taxes estimated at 1,5 % of GDP in 2023. According to the 2023 Convergence Programme, the general government debt-to-GDP ratio is expected to decrease from 73,3 % at the end of 2022 to 69,7 % at the end of 2023. The Commission's 2023 spring forecast projects a government deficit of 4,0 % of GDP for 2023. This is in line with the deficit projected in the 2023 Convergence Programme. The Commission's 2023 spring forecast projects a higher general government debt-to-GDP ratio, of 70,7 % at the end of 2023. The difference is due to the lower GDP growth and GDP deflator in the Commission's spring 2023 forecast.

(19) The general government balance in 2023 is expected to continue to be impacted by the fiscal measures taken to mitigate the economic and social impact of the increase in energy prices. They consist of measures extended from 2022, in particular subsidies to utility companies for the losses incurred due to caps on residential energy prices and support schemes for energy-intensive companies. The cost of those measures continues to be partly offset by taxes on windfall profits of energy suppliers. Taking those revenues into account, the net budgetary cost of the support measures is projected in the Commission's 2023 spring forecast at 1,2 % of GDP in 2023[10]. The measures in 2023 do not appear to be targeted at the most vulnerable households or firms, and most of them do not fully preserve the price signal to reduce energy demand and increase energy efficiency. As a result, no targeted support measures are to be taken into account in the assessment of compliance with the Council Recommendation of 12 July 2022[11].

(20) In its Recommendation of 12 July 2022, the Council recommended that Hungary take action to ensure in 2023 that the growth of nationally financed primary current expenditure is in line with an overall neutral policy stance[12], taking into account continued temporary and targeted support to households and firms most vulnerable to energy price hikes and to people fleeing Ukraine. Hungary should stand ready to adjust current spending to the evolving situation. Hungary was also recommended to expand public investment for the green and digital transitions, and for energy security taking into account the REPowerEU initiative, including by making use of the Facility and other Union funds.

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10 The figure represents the level of annual budgetary cost of those measures, including current revenue and expenditure as well as — where relevant — capital expenditure measures.

11 Council Recommendation of 12 July 2022 on the National Reform Programme of Hungary and delivering a Council opinion on the 2022 Convergence Programme of Hungary (OJ C 334, 1.9.2022, p. 136).

12 Based on the Commission's 2023 spring forecast, the medium-term (10-year average) potential output growth of Hungary, which is used to measure the fiscal stance, is estimated at 16,6 % in nominal terms.

(21) In 2023, the fiscal stance is projected in the Commission's 2023 spring forecast to be contractionary (+4,2 % of GDP), in a context of high inflation. This follows an expansionary fiscal stance in 2022 (-0,4 % of GDP). The growth in nationally financed primary current expenditure (net of discretionary revenue measures) in 2023 is projected to provide a contractionary contribution of 2,2 % of GDP to the fiscal stance. Therefore, the projected growth of nationally financed primary current expenditure is in line with the Council Recommendation of 12 July 2022. Expenditure financed by grants under the Facility and other Union funds is projected to amount to 2,3 % of GDP in 2023, while nationally financed investment is projected to provide a contractionary contribution to the fiscal stance of 0,6 percentage points[13]. Therefore, Hungary plans to finance additional investment through the Facility and other Union funds, although it is not projected to preserve nationally financed investment. It plans to finance public investment for the green and digital transitions, and for energy security, such as development of the electricity grid, modernisation of suburban railways, support for the use of residential solar panels, provision of laptops to teachers and pupils in lower and upper secondary schools and digitalisation measures in healthcare, which are funded by the Facility and other Union funds.

[13] Other nationally financed capital expenditure is projected to provide a contractionary contribution of 2,2 percentage points of GDP. The large fall in other capital expenditure in 2023 is related to the large impact of the purchase of gas stockpiles by a special entity classified as part of the general government in 2022.

(22) According to the 2023 Convergence Programme the general government deficit is expected to decrease to 2,9 % of GDP in 2024. The decrease in 2024 mainly reflects a significant reduction in general government spending as a share of GDP, in particular on gross fixed capital formation, intermediate consumption and compensation of employees. According to the 2023 Convergence Programme, the general government debt-to-GDP ratio is expected to decrease to 66,7 % at the end of 2024. On the basis of the policy measures known at the cut-off date of the forecast, the Commission's 2023 spring forecast projects a government deficit of 4,4 % of GDP in 2024. This is higher than the deficit projected in the 2023 Convergence Programme, mainly due to higher projected expenditure on gross fixed capital formation in line with recent trends and higher intermediate consumption driven by lingering inflationary pressures. The Commission's 2023 spring forecast projects a higher general government debt-to-GDP ratio, of 71,1 % at the end of 2024.

(23) The 2023 Convergence Programme envisages the phasing-out of some of the energy support measures in 2024. The Commission currently assumes the net cost of energy support measures at 0,4 % of GDP in 2024, compared to 1,2 % of GDP in 2023. Those estimates are based on the assumption of no renewed energy price increases. The energy support measures that are currently planned to remain in place in 2024 do not appear targeted to vulnerable households or firms. They do not fully preserve the price signal to reduce energy demand and to increase energy efficiency.

(24) Regulation (EC) No 1466/97 calls for an annual improvement in the structural budget balance toward the medium-term budgetary objective, with 0,5 % of GDP as a benchmark[14]. Taking into account fiscal sustainability considerations and the need to reduce the deficit to below the 3 %-of-GDP Treaty reference value, an improvement in the structural balance of at least 0,5 % of GDP for 2024 would be appropriate, according to the Commission. To ensure such an improvement, and in accordance with the Commission's methodology, the growth in net nationally financed primary expenditure[15] in 2024 should not exceed 4,4 %, as reflected in this Recommendation. This will also contribute to reducing core inflation, which is well above the Union average and which could lead to competitiveness losses if persistent, and to safeguarding the external position. At the same time, the remaining energy support measures (currently estimated by the Commission at 1,2 % of GDP in 2023) should be phased out, if energy-market developments so permit and starting with the least targeted measures, and the related savings should be used to reduce the government deficit. According to Commission estimates, this would lead to a growth in net primary expenditure lower than recommended for 2024.

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[14] Article 5 of Regulation (EC) No 1466/97 also requires an adjustment of more than 0,5 % of GDP for Member States with a government debt exceeding 60 % of GDP, or with more pronounced debt sustainability risks.

[15] Net primary expenditure is defined as nationally financed expenditure net of discretionary revenue measures and excluding interest expenditure and cyclical unemployment expenditure.

(25) Assuming unchanged policies, the Commission's 2023 spring forecast projects the net nationally financed primary expenditure to grow at 7,0 % in 2024, which is above the recommended growth rate. The adjustment projected in the Commission's 2023 spring forecast is less than the savings from the full phasing-out of the energy support measures, which is due to higher expenditure on intermediate consumption and on gross fixed capital formation and the expected phasing-out of the temporary windfall profit and sectoral taxes.

(26) According to the 2023 Convergence Programme, government investment is expected to decrease from 5,1 % of GDP in 2023 to 3,7 % of GDP in 2024. The lower investment reflects lower nationally financed investment and lower investment financed by the Union.

(27) The 2023 Convergence Programme outlines a medium-term fiscal path until 2027. According to the 2023 Convergence Programme, the general government deficit is expected to gradually decline to 1,9 % of GDP in 2025, 1,4 % in 2026 and 0,9 % in 2027. Therefore, the general government deficit is planned to remain below 3 % of GDP over the Programme horizon. According to the 2023 Convergence Programme, the general government debt-to-GDP ratio is expected to decrease from 66,7 % at the end of 2024 to 56,3 % by the end of 2027.

(28) Monetary, fiscal and economic development policies responded to recent economic challenges in an uncoordinated way, weakening the effectiveness of the overall policy response. Monetary policy started to tighten in 2021, but fiscal expansion continued until early 2022. Several temporary policy measures introduced since 2021 have aimed to preserve households' purchasing power in an untargeted manner, through price and interest-rate caps and fiscally costly energy subsidies. Price caps were introduced on motor fuels and certain basic food items. Interest-rate caps were introduced on variable rate mortgages, loans to small and medium-sized enterprises, certain student loans, and large bank deposits. Most of those measures are due to expire in 2023. The cost of the measures has mostly been borne by companies and the financial sector, through higher indirect taxes, and their distortive effects have contributed to lower domestic production and higher prices among products not directly affected by the caps. They have also hindered the adjustment of demand to a new economic environment. Economic development policies have relied on subsidised loan schemes to help companies adjust to economic shocks. A large, subsidised loan scheme with fixed interest rates was launched in February 2023, to support companies that face rising energy costs. The price and interest-rate caps and subsidised lending have counteracted monetary policy efforts to reduce inflation, *inter alia* by reducing the effectiveness of the central bank's instruments. The European Central Bank has found that certain regulatory measures, including the cap on bank deposit rates, impede the conduct of an efficient monetary policy.

(29) Weaknesses in budget planning and execution have increased the expansionary bias of fiscal policy and have therefore contributed to many of Hungary's current macroeconomic challenges. Since 2016, the very early adoption of annual budgets has reduced the quality of the macroeconomic and budgetary forecasts. Various budget flexibility rules and large budget reserves allowed for higher discretionary spending, which exacerbated the procyclicality of fiscal policy. Ad hoc spending decisions were often made at the end of the budget year or were enacted by government decrees throughout the year without adequate parliamentary oversight and public consultation, in turn reducing budget transparency. The national fiscal framework has not prevented high public deficits due to shortcomings in the design of domestic fiscal rules, including a debt rule with procyclical features, the weak enforcement of medium-term budget planning, further eroded by the special provisions of the "state of danger" regime, and the limited role and resources of the national fiscal council. The national fiscal council's limited mandate and resources limit its effectiveness in steering public discussions on fiscal issues.

(30) House prices have grown strongly in Hungary in the last decade, while housing supply has remained limited. Weakly targeted subsidy schemes for home purchase, also available for higher income households already in possession of a dwelling, have contributed to recent price increases. Subsidies on housing construction, including grants, subsidised loans and preferential VAT rates, are similarly untargeted.

(31) In accordance with Article 19(3), point (b), of Regulation (EU) 2021/241 and criterion 2.2 of Annex V to that Regulation, the recovery and resilience plan includes an extensive set of mutually reinforcing reforms and investments to be implemented by 2026. In accordance with Article 14(6) of Regulation (EU) 2021/241, Hungary expressed its intention to request up to EUR 6 600 000 000 of additional loan support under the Facility. Proceeding swiftly with the implementation of the recovery and resilience plan is essential due to the temporary nature of the Facility in place until 2026. It is equally important for Hungary to ensure an adequate administrative capacity to deliver on the commitments of the recovery and resilience plan. The swift inclusion of the new REPowerEU chapter in the recovery and resilience plan will allow additional reforms and investments to be financed in support of Hungary's strategic objectives in the field of energy and the green transition. The systematic and effective involvement of local and regional authorities, social partners and other relevant stakeholders remains important for the successful implementation of the recovery and resilience plan, as well as other economic and employment policies going beyond that plan, in order to ensure broad ownership of the overall policy agenda. The implementation of Hungary's recovery and resilience plan has been significantly delayed due to the late adoption of the Council Implementing Decision on the approval of the assessment of the recovery and resilience plan for Hungary in December 2022. A swift and steady implementation of the recovery and resilience plan would require the fulfilment of 27 milestones related to strengthening judicial independence and safeguarding the protection of the financial interests of the Union. No payment under the recovery and resilience plan is possible until these milestones are fully and correctly implemented. Hungary's REPowerEU grant allocation amounts to EUR 701,6 million. Hungary plans to use the REPowerEU grant and additional loan on energy related investments.

(32) The Commission approved all Hungary's cohesion policy programming documents in 2022. Proceeding with the swift implementation of the cohesion policy programmes in complementarity and synergy with the recovery and resilience plan, including the REPowerEU chapter, is key to achieving the green and digital transitions, increasing economic and social resilience, and achieving balanced territorial development in Hungary.

(33) Beyond the economic and social challenges addressed by the recovery and resilience plan and cohesion policy programmes, Hungary faces a number of additional challenges related to poverty, labour market competition in services and energy.

(34) While the overall poverty indicators have improved over the last decade, the relative situation of certain disadvantaged groups such as low-income households, children, people with disabilities, Roma and people living in remote rural settlements has worsened. The severe material and social deprivation rate is one of the highest in the Union, with significant disparities between regions. It is especially high among children and Roma. Disadvantaged groups face difficulties in accessing adequate social assistance, education, healthcare and job-seeking services. Households without a stable income face a weakening social safety net. The tax system disproportionately burdens lower-paid workers. The major sources of income for low-income households have not kept up with the cost of living in the last decade. The adequacy of minimum income is one of the lowest in the Union. Recent increases in energy and food prices disproportionately burden low-income earners, while support measures are mainly untargeted. The recent amendment of the social protection legislation reduced the State's responsibility to provide social care.

(35) The headline employment rate is relatively high, but certain disadvantaged groups such as Roma, low-skilled people, women with caring responsibilities and people with disabilities face difficulties in entering the open labour market due to weaknesses in education, training and social assistance systems and support structures for jobseekers. The employment rate gaps for the low-skilled, Roma and people with disabilities remain persistently high. One in five women seeking paid employment is left out of the labour market due to caring responsibilities for children or dependents with disabilities. Benefits and access to effective active labour market measures for disadvantaged groups are inadequate. The duration of the unemployment benefit is 3 months, while the average length of unemployment was 9,4 months, according to data from a labour force survey conducted in 2022. Four out of ten registered unemployed people are without benefits. The long average registration period signals capacity challenges in the public employment service. The share of jobseekers with low basic skills is more than double compared to the national average. The share of adults participating in learning remains low, in particular among the low-skilled and the unemployed.

(36) Social dialogue remains among the weakest in the Union and has further deteriorated recently. The main tripartite body serves mainly as an information-sharing and consultation forum and it has no formal legal framework, with no meaningful dialogue except for minimum wage setting. While the shortage of teachers is an increasing challenge, new legal provisions have curbed the rights of teachers to collective action and widened employers' possibility to retroactively dismiss teachers participating in civil disobedience to protest labour conditions. Recent reforms, introduced without meaningful dialogue with the relevant unions, negatively affected working conditions and weakened self-representation for healthcare workers.

(37) Recently, there have been cases of public interference in a number of markets, which has weakened legal certainty. Those interventions tended to discourage or limit Union and foreign investment in certain markets, in effect enabling purchases of companies by State-owned enterprises or private firms with close ties to the government. The interventions also seriously affect the principles of the single market and of the rule of law, curbing opportunities for sustainable economic growth. For example, specific firms and industries face discriminatory treatment through tailor-made taxes, price caps and regulations imposed at short notice and without prior consultation. Since 2020, the government has also used its extraordinary power under the "state of danger" to introduce such measures. Budget revenues from sector-specific taxes are significant. For example, the government recently imposed administrative price caps and a 90 % profit tax on the production of cement and ceramic materials. These are industries with a high degree of foreign ownership. In December 2022, the government suddenly increased the tax on insurance and pharmaceutical companies. Banks were burdened by a cap on flexible mortgage rates, impacting their ability to lend and their profitability. Selective and arbitrary administrative inspections, fines and withholding of permits have been used to exert undue pressure on certain companies, in particular in retail and transport. Effective remedies seem to be lacking against arbitrary measures taken by the authorities. The retail sector continues to face unpredictable regulations. The conditions for authorising the establishment of or changes to shops above 400 square metres do not seem to be transparent, and the availability of judicial review is questionable. The tax on the retail sector disproportionately burdens larger companies that do not have their headquarters in Hungary. The government frequently uses its power to exempt transactions from merger control.

The impact of such transactions on the economy, competition and the single market is not being assessed. The criteria for the exemptions are not set out transparently, and there is no formal procedure to contest those criteria or the decision itself. As a result of the interventions, State or State-friendly domestic ownership has increased in banking, telecommunications, utilities, media, TV and radio broadcasting, to the detriment of foreign ownership. Based on announcements by members of the government, similar transactions can be expected in insurance, retail and the transport sector, in particular regarding Budapest Airport. The decreased presence of foreign capital and know-how, in particular in high value-added industries such as banking and telecommunications, risks curbing Hungary's opportunities for productivity growth and innovation.

(38) Hungary's energy mix is determined by oil and gas, each accounting for about one third of overall energy use. Nuclear and renewable energy sources have a share of 15 % and about 14 %, respectively. Hungary continues to rely heavily on Russia for fossil fuels as well as nuclear power and its efforts to shift away from Russian dependence are slow. Three quarters of the domestic gas consumption is covered by imports from Russia. In 2021, Hungary signed a long-term gas supply agreement with Gazprom and an amendment to it was negotiated in April 2023, with an option for additional quantities. Decreasing dependency on Russian fossil fuels will require significant additional action, in particular to strengthen cooperation with neighbouring countries, including where necessary on infrastructure, to ensure access to alternative fossil fuel sources. Electrification and the envisaged investment in energy-intensive industries will increase the need for electricity production. Despite the significant increase in solar energy capacity in recent years, the share of renewable energy capacity is still one of the lowest in the Union. The installation of wind power plants has been suspended and is expected to resume after the removal of legal restrictions. Geothermal energy has been underutilised. The frequently changing regulatory environment poses several challenges to the development of renewable energy. In addition, the limitations of the electricity grid's capacity create a significant bottleneck for connecting renewables to the grid, while the lack of flexibility solutions on the demand and supply sides, and limited consumer empowerment, create a major constraint on the development of clean, renewable electricity production. Suboptimal integration into the Union balancing market is also a missed opportunity to optimise the grid for additional renewables capacity.

(39) Hungary has significant potential in energy efficiency, in particular in residential buildings. Hungary's consumption of natural gas dropped by 20 % in the period between August 2022 and March 2023, compared with the average gas consumption over the same period in the preceding 5 years, beyond the 15 % reduction target laid down in Council Regulation (EU) 2022/1369[16], also due to measures in the public sector and the amendment of the energy price cap system applied for households. Hungary is encouraged to keep pursuing efforts to temporarily reduce gas demand until 31 March 2024, pursuant to Council Regulation (EU) 2023/706[17]. Nevertheless, despite the recent changes, the administrative prices system on energy still does not allow price signals to work properly and to create sufficient incentives for energy savings. Price caps are uniformly applied to all households. High-income households also benefit from the subsidised administrative price, while low-income families often live in less energy-efficient homes. Targeted schemes for low-income households would be more efficient, both in supporting vulnerable households and generating energy savings.

(40) Labour and skills shortages in sectors and occupations key for the green transition, including manufacturing, deployment and maintenance of net-zero technologies, are creating bottlenecks in the transition to a net-zero economy. High-quality education and training systems that respond to changing labour market needs and targeted upskilling and reskilling measures are key to reducing skills shortages and promoting labour inclusion and reallocation. To unlock untapped labour supply, those measures need to be accessible, in particular for individuals and in sectors and regions most affected by the green transition. In 2022, labour shortages were reported in Hungary for 31 occupations that require specific skills or knowledge for the green transition. At the same time, worker participation in training in energy-intensive industries has significantly declined and is now below the Union average.

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16 Council Regulation (EU) 2022/1369 of 5 August 2022 on coordinated demand-reduction measures for gas (OJ L 206, 8.8.2022, p. 1).

17 Council Regulation (EU) 2023/706 of 30 March 2023 amending Regulation (EU) 2022/1369 as regards prolonging the demand-reduction period for demand-reduction measures for gas and reinforcing the reporting and monitoring of their implementation (OJ L 93, 31.3.2023, p. 1)

(41) In the light of the Commission's assessment, the Council has examined the 2023 Convergence Programme and its opinion[18] is reflected in recommendation (1).

(42) In the light of the Commission's in-depth review and this assessment, the Council has examined the 2023 National Reform Programme and the 2023 Convergence Programme. Its recommendations under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendation (1). Policies referred to in recommendation (1) help address vulnerabilities linked to very strong price pressures and external and government financing needs. Recommendations (2) and (4) contribute to addressing recommendation (1),

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[18] Under Article 9(2) of Regulation (EC) No 1466/97.

HEREBY RECOMMENDS that Hungary take action in 2023 and 2024 to:

1. Wind down the emergency energy support measures in force, using the related savings to reduce the government deficit, as soon as possible in 2023 and 2024. Should renewed energy price increases necessitate new or continued support measures, ensure that such support measures are targeted at protecting vulnerable households and firms, are fiscally affordable and preserve incentives for energy savings.

   Ensure prudent fiscal policy, in particular by limiting the nominal increase in nationally financed net primary expenditure in 2024 to not more than 4,4 %[19].

   Preserve nationally financed public investment and ensure the effective absorption of grants under the Facility and of other Union funds, in particular to foster the green and digital transitions.

   For the period beyond 2024, continue to pursue a medium-term fiscal strategy of gradual and sustainable consolidation, combined with investments and reforms conducive to higher sustainable growth, in order to achieve a prudent medium-term fiscal position.

   Pursue effective coordination and clear demarcation of macroeconomic policies in order to ensure fiscal and external sustainability. Phase out price and interest-rate caps in order to reduce distortive effects and to facilitate the smooth transmission of monetary policy. Target support measures in the housing sector to low-income households. Strengthen the medium-term budgetary framework, align the preparation of annual budgets with the budgetary year and limit discretion in the implementation of annual budgets.

[19] Which is estimated to correspond to an annual improvement in the structural budget balance of at least 0,5 % of GDP for 2024, as described in recital 24.

2. Urgently fulfil the required milestones and targets related to strengthening judicial independence and safeguarding the protection of the financial interests of the Union in order to allow for a swift and steady implementation of its recovery and resilience plan. Swiftly finalise the REPowerEU chapter with a view to rapidly starting the implementation thereof. Proceed with the speedy implementation of cohesion policy programmes, in close complementarity and synergy with the recovery and resilience plan.

3. Improve the adequacy of the social assistance system, including unemployment benefits. Improve access to effective active labour market measures, in particular upskilling opportunities for the most disadvantaged groups, and ensure effective social dialogue. Improve the regulatory framework and competition in services by avoiding selective and arbitrary administrative interventions and the use of tailor-made legislation providing undue advantage or disadvantage to specific companies, by applying competition scrutiny systematically to business transactions and by reducing the use of emergency measures to what is strictly necessary, in line with the principles of the single market and of the rule of law.

4. Reduce overall reliance on fossil fuels by accelerating the deployment of renewables, including wind energy, geothermal and sustainable biomethane, in particular by streamlining permitting procedures, while conducting regular environmental impact assessments, and by creating a supportive and predictable regulatory environment. Phase out subsidies for fossil fuels. Reform the rules on the balancing of the energy market and tariff setting in order to allow for cost recovery and an optimum use of the grid. Where necessary, upgrade the electricity infrastructure, including grid and storage capacities. Diversify imports of fossil fuels in order to significantly decrease dependence on Russia, including by strengthening cooperation with other Member States, including, where necessary, on infrastructure. Improve energy efficiency, in particular in buildings, and continue efforts to reduce overall gas consumption. Adjust the current system of regulated energy prices in order to encourage energy saving while providing targeted support for low-income households. Step up policy efforts aimed at the provision and acquisition of skills and competences needed for the green transition.

Done at Brussels,

For the Council
The President