18 October 2021

## Press release: Assessments of budgetary documents for 2022 and 2023

The proposed budget documents set out an additionally stimulative fiscal policy for the coming years, over and above that included in the documents currently in force, although there are already signs of overheating in the economy, with supply-side constraints emerging. This increases the risk that the temporary exceptional increase in public spending, which was largely justified because of the epidemic, could turn into a structural and thus permanent deterioration of public finances. Fiscal policy should, to a greater extent than indicated in the budget documents, strike a balance between the need to create room for manoeuvre to cope with future crises, effective strengthening of long-term economic potential and resilience, and short-term economy boosting.

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The epidemic and the measures put in place to mitigate its effects are a key reason for the significant deterioration in public finances both last and this year. The measures imposed were similar to those in other countries and largely in line with the guidelines that they should be temporary and aimed at addressing the immediate effects of the epidemic. The large-scale package, amounting to around 5% of GDP per year, has made an important contribution to cushioning the fall in economic activity last year and to supporting the recovery this year. Nevertheless, the measures have revealed certain shortcomings, which also point to systemic weaknesses in the allocation of the otherwise large public funds available in a situation that allows budget users too much spending discretion.

The general government deficit, excluding expenditure on COVID-19 measures, is expected to increase significantly both this year and next as a result of expenditure growth. The projected increase in public investment contributes to this to a lesser extent than the increase in current expenditure, which should be limited in the face of a sharp increase in public debt due to the crisis. The deficit in 2023 is projected to be more than 3% of GDP if the budget documents materialise.

The growth in current expenditure, excluding measures to mitigate the effect of the epidemic and investments, is expected to be well above the long-term average this year and next. The proposed expenditure levels in 2022, following the expected lower actual outturn this year, will show higher growth than would be justified by the legislation currently in force. Such fiscal planning opens the way for measures to be taken in the final phase of the policy cycle, which could lead to inefficient spending or a structural deterioration of the public finances. The planned deficit reduction in 2023 will be mainly due to the projected reduction in current expenditure growth, despite the insufficient presentation of the measures to ensure this. Growth in this expenditure in 2023 is projected to be well below the long-term average. While the high investment spending is to be retained, the projection of very low increase in compensation of employees and the unchanged level of expenditure on social benefits stand out in particular.. Indicative estimates suggest that, if all plans are implemented, general government expenditure will remain above the level allowed by the fiscal rules in 2022. In 2023, the projected levels are partly appropriate, but with insufficiently specified policies for that year.

If well targeted and implemented effectively, public investments can make an important contribution to kick-starting the economy in the short term and to building resilience and increasing economic potential in the long term. According to the submitted budget plans, the level of general government investment is set to rise to around 6.5% of GDP over the next two years, which is well above its highest level ever. The decrease in the outturn estimate for this year confirms the Fiscal Council's previous assessment that the plans in this area exceed the absorption capacity of the economy and the administration. If plans are to be implemented in full, the risk of inefficient project implementation and also of creating macroeconomic imbalances increases. The Fiscal Council assesses that it would make sense to give priority to projects financed by EU grants, where control over the efficiency of spending is also stricter. The domestically-funded investments should, however, be more closely aligned with cyclical conditions and the absorption capacities of the economy.

The excessive general government debt is only expected to decline in line with the rules in 2023 and 2024, remaining well above the 60% of GDP threshold. The favourable macroeconomic outlook and the high liquidity of the state budget, combined with more moderate expenditure growth than currently projected, would allow for a faster reduction of debt without jeopardising the economic recovery. The level of debt achieved and the increased possibility of a reversal of the highly accommodative monetary policy, which is a key contributor to the current low financing costs, suggest that in future there will be no additional room for fiscal policy created based on lowering interest expenditure.

Macroeconomic risks are predominantly concentrated on the downside, which, in addition to the epidemic, is mainly related to institutional and logistical constraints in international trade, which are currently also reflected in high prices of commodities. Risks to the realisation of the fiscal scenario are more balanced mainly due to the probably overestimated investment projections as well as current spending.

In September 2021, the Fiscal Council assessed that, based on currently available information and forecasts, the conditions for the existence of exceptional circumstances will continue to be met in 2022. The Fiscal Council expects that, once none of the conditions for invoking exceptional circumstances is met any longer, the Government will immediately adhere to the implementation of the correction mechanism in accordance with the legislation.