REPORT ON THE
BALANCE OF PAYMENTS

JANUARY
2016

'We may not always be able to do what must be done,
but we must always do what can be done.'

Letters 27
Gábor Bethlen

REPORT ON THE
BALANCE OF PAYMENTS

JANUARY
2016

Published by the Magyar Nemzeti Bank

Publisher in charge: Eszter Hergár

H-1054 Budapest, Szabadság tér 9.

www.mnb.hu

ISSN 2064-8707 (print)

ISSN 2064-8758 (on-line)

In accordance with Act CXXXIX of 2013 on the Magyar Nemzeti Bank, the primary objective of the MNB is to achieve and maintain price stability and, without prejudice to its primary objective, the central bank is also responsible for maintaining the stability of the financial intermediary system. Developments in the external balance are key to financial stability, as processes relating to the balance of payments allow for conclusions to be drawn concerning the sustainability of economic growth and relevant risks. Moreover, analysis of the balance of payments makes it possible to identify and take actions to avoid economic problems earlier, when they are developing.

To that end, the Magyar Nemzeti Bank performs comprehensive analyses of trends relating to Hungary's external balance on a regular basis, examining a number of indicators to assess macroeconomic imbalances and identifying elements and processes of critical importance for Hungary's vulnerability.

Given the lessons learnt from the financial crisis and the recent period, a country's balance of payments and trends therein indicating potential dependence on external financing are particularly important in the economic media. Developments in the external balance position are also closely monitored by market participants and analysts. Therefore, the primary goal of the publication entitled 'Report on the Balance of Payments' is to inform market participants – by way of this regular analysis – about developments in the balance of payments and thus provide deeper insight into the workings of the economy.

This analysis was prepared by the MNB's Directorate Monetary Policy and Financial Market Analysis under the general guidance of Barnabás Virág, Executive Director in charge of Monetary Policy, Financial Stability and Lending Incentives. Contributors: Anna Boldizsár, Zsuzsa Kékesi, Balázs Kóczián, Péter Koroknai, Rita Lénárt-Odorán, Balázs Sisak and Márton Teremi. The Analysis was approved for publication by Deputy Governor Márton Nagy.

This Report is based on information pertaining to the period ending 23 December 2015.

SUMMARY

External balance indicators continued to improve in 2015 Q3. The annual surplus on the current account rose above 4 per cent of GDP, and due to the rise in EU transfers the capital account approached 5 per cent. **Net lending exceeds 9 per cent, substantially outstripping the levels observed in other countries in the region.** In addition to rising net lending, banks and corporations repaid a large part of their external debt**, resulting in a further substantial reduction of external debt ratios, further decreasing the external vulnerability of the Hungarian economy.**

The growth in lending under the **real economy approach** was attributable to several factors. The **trade surplus is primarily attributable to exports continuing to grow faster than imports, and the improvement in the terms of trade** caused by the decline in commodity prices. Exports were supported **by the expansion in industrial production**, while moderate energy imports and the decline in investments restrained imports. Approaching the end of the programming period, the four-quarter value of the **absorption of EU transfers exceeded EUR 7 billion,** and consequently the transfer balance once again supported net lending to a record extent. **The deficit on the income balance declined slightly, due to the falling interest expenditure caused by the decrease in debt ratios and yields**, as well as to the correction of last year's increase in corporate profits, which in part was caused by one-off events.

According to financing side approach, **in the third quarter the repayment of external debts was extremely high,** while **FDI inflow increased as result of reinvested earnings. Net external debt decreased by roughly EUR 3.5 billion**, mostly caused by loan repayments by banks and to a lesser extent by corporations. **The decline in banks' external debt was still significantly attributable to processes related to the conversion of foreign currency loans into forint**, but the tightening of the **central bank regulations** applicable to banks which was announced in the middle of the year also worked towards decreasing external debt. The **decline in the net external debt of the state decelerated** compared to previous quarters, as the sale of government securities by non-residents was partially offset by the foreign currency liquidity provided by the central bank to banks, reducing receivables from non-residents.

Both net and gross external debt declined significantly in the third quarter. As a result of large-scale repayment of foreign loans and the increase in nominal GDP, **at the end of September the net external debt ratio amounted to just 27.5 per cent of GDP.** Following the stagnation seen in previous quarters, gross external debt registered a more substantial decline (5.5 percentage points) falling below 79 per cent of GDP, which was also due to the MNB's programmes. **Short-term external debt fell by EUR 2 billion to below EUR 22 billion**, mainly attributable to the banks. Furthermore, foreign currency reserves decreased to EUR 32 billion, primarily as a result of withdrawals related to the conversion into forint. **The level of foreign currency reserves thus still significantly exceeds the indicators monitored by investors.**

Examining the savings of the sectors, the rise in net lending is linked both to **the historically low borrowing by the state (less than 1 per cent of GDP) and the increase in the private sector's financial savings**. The low budget deficit resulted from the higher personal income tax revenues owing to rising wages and employment, as well as higher VAT revenue and declining interest expenditure. **In the case of household savings, the underlying processes pointed to an increase**, which was also supported by the settlement of the foreign currency loan as a temporary factor. In the third quarter **purchases of government securities by households were was significant again,** which may have contributed t**o reducing the government's external debt.**

The special topic in this Report discusses developments in EU transfers, which are examined from several aspects. In recent years, the net absorption of transfers reached 5-6 per cent of GDP, which was primarily due to the **rising weight of capital transfers supporting investments,** while the current transfers were stable. As regards the sectoral breakdown of the absorption of transfers, it can be stated that **EU grants contributed to public investment to a much greater degree** than to private sector investment. In the **countries of the region, the absorption of cohesion funds developed similarly** and the total budget was drawn down in almost all of them. However, **in proportion to GDP the highest volume of resources was absorbed in Hungary**, which may be attributable to the fact that compared to its development a favourable budget was allocated to Hungary.

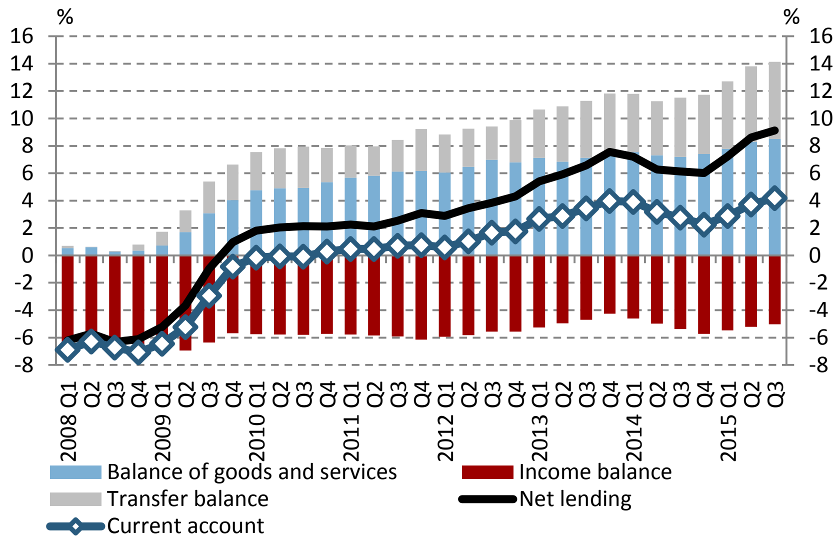
CONTENT

1. REAL ECONOMY APPROACH

In the third quarter, the four-quarter net lending of the Hungarian economy rose to 9.1 percent of GDP. This rise in net lending resulted from the improved foreign trade balance, income balance and transfer balance. Growth in exports still slightly exceeded the expansion of imports, resulting in a rising trade surplus. Furthermore, the slight improvement in the terms of trade – by way of moderate oil prices – may have also supported the growth in net exports. The deficit on the income balance may have slightly decreased in the third quarter, which is related to the improvement in interest payments on foreign loans and the development of equity income. The increase in the transfer balance in the third quarter is once again attributable to the expansion in the absorption of EU transfers.

Under the real economy approach, the four-quarter net lending of the Hungarian economy rose to 9.1 percent of GDP in the third quarter. In this period, the seasonally unadjusted external financing capacity rose to EUR 2.7 billion, with surpluses of EUR 1.7 billion and EUR 1 billion on the current and capital accounts, respectively. All three components of the real economy approach contributed to the rise in the external balance indicators: the four-quarter value of the trade balance and the transfer balance increased further, while the income balance deficit declined slightly (Chart 1). Hungary's net lending still considerably exceeds the corresponding indicators for the countries in the region: In mid-2015 the surplus of the Slovakian and Polish economies was around 1-2 per cent of GDP, while the lending of the Czech Republic stood at 3.7 per cent of GDP.

Chart 1: Developments in net lending components* (four-quarter values as a percentage of GDP)



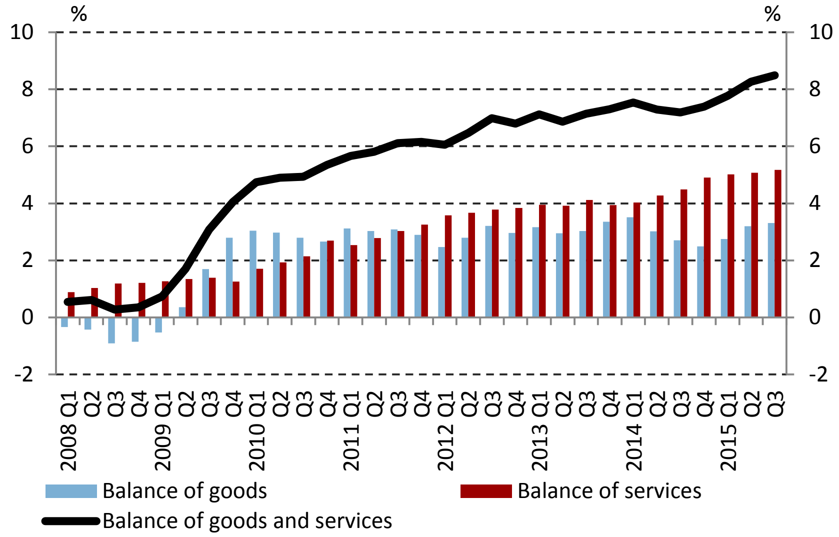
All charts by the MNB unless otherwise indicated.

*Income balance: labour income, income on equity and income on debt. Transfer balance: sum of the capital account, other primary income and secondary income.

1.1. Balance of trade

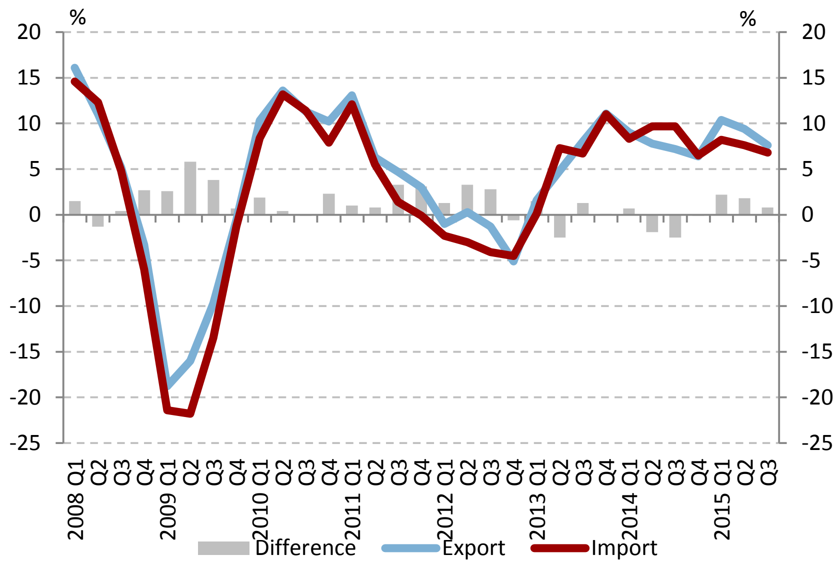
The significant rise in the trade surplus is due to the increase in net exports of goods and the balance of services (Chart 2). The four-quarter value trade surplus reached a new historic high, rising to 8.5 per cent of GDP. After an increase in the previous quarters, the surplus on the balance of goods continued to expand slightly in Q3 as well, and thus the four-quarter value stood at 3.3 per cent of GDP. The surplus on the balance of services also continued to increase in the period under review and already exceeds 5 per cent of GDP. The balance of services, which is high compared to that of the other countries of the region, is primarily attributable to outstanding surplus realised by tourism and transport services.

Chart 2: Developments in the balance of trade and its components (four-quarter values as a percentage of GDP)



In the third quarter, exports once again rose faster than imports, but deceleration in export and import growth was still observed (Chart 3). Due to the general slowdown in economic activity, external demand was more moderate, as a result of which the growth in industrial production declined in the third quarter. The performance of the industrial sectors show a mixed picture: the fall in the output of light industry and chemical industry only partially offset the expansion in the output of the engineering and food industries. Real growth in exports slightly exceeded import growth, facilitating the rise in net exports. In accordance with seasonal patterns, energy imports increased quarter on quarter, but fell short of the year-on-year value. Household consumption continued to expand in the third quarter, while investments with higher import content declined, which lowered import growth.

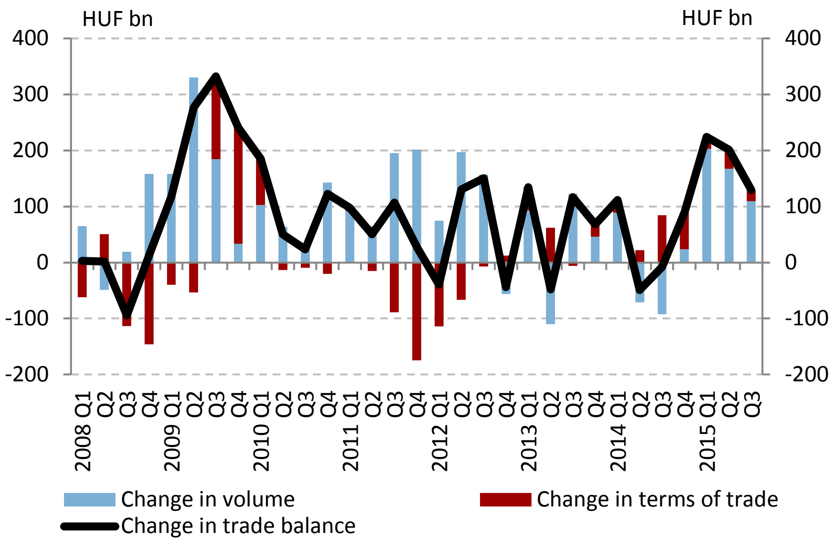
Chart 3: Annual real growth of exports and imports



Sources: HCSO, MNB

In addition to real growth in exports which was higher than the growth in imports, the rise in the trade surplus was also supported by the improvement in the terms of trade to a smaller extent (Chart 4). In the third quarter, the fall in import prices slightly exceeded the decline in export prices, which supports the increase in trade surplus through the moderate improvement in the terms of trade. The improvement in the terms of trade may be attributable to the moderate commodity prices, which represent a higher weight in imported goods.

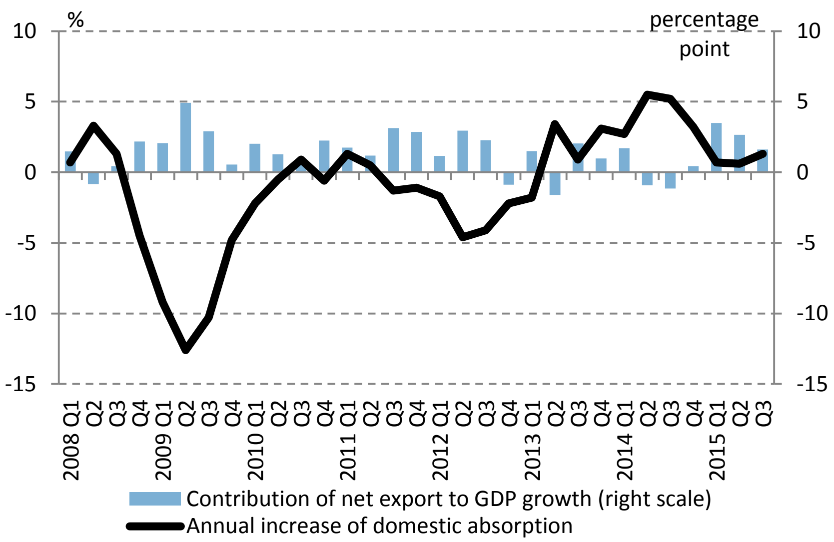
Chart 4: Developments in the balance of trade according to GDP (year-on-year)



Source: HCSO.

In parallel with accelerating growth in domestic consumption, the growth contribution of net exports is more moderate, but still substantial (Chart 5). The structure of economic growth was more balanced in the third quarter compared to the previous quarters: the acceleration of domestic consumption was accompanied by a slight decline in the growth contribution of net exports. The increase in domestic consumption is due to the continued expansion in household consumption, while there was a slight decline in investments, in the context of a decrease in corporate investment activity – attributable to the completion of large investments – and the increase in public investments.

Chart 5: Annual rate of increase in domestic absorption and the contribution of net exports to GDP growth

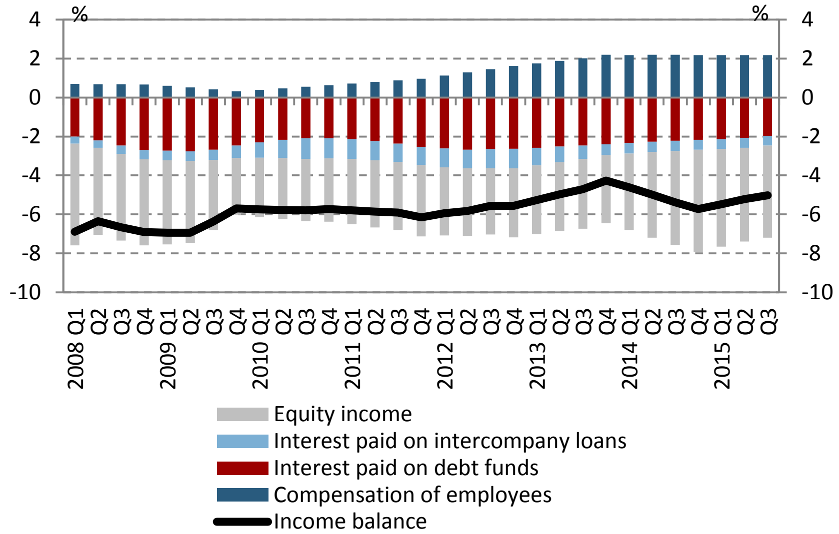


Source: HCSO

1.2. Income balance

The moderate decline in the income balance deficit observed since the beginning of 2015 continued in the third quarter as well. The four-quarter value of the income balance deficit fell to 5 percent of GDP in the third quarter (Chart 6). The steady decline was still facilitated by the improvement in the interest balance of foreign loans and the (estimated) development in income on equity. As a result of the decline in external debt and the repricing of loans, interest paid on foreign loans decreased in the third quarter. Currently, only estimates[1] are available for the 2015 profits of foreign-owned companies, and according to these estimates GDP-proportionate net profit expenditures may have decreased slightly in 2015, after the increase seen last year which partially reflected growth in profits due to one-off effects. The GDP-proportionate value of income received by persons who have worked abroad for a period of less than one year remained stable at the level of 2.2 per cent of GDP, thereby reducing the income balance deficit to the same degree as before.

Chart 6: Developments in the items of the income balance* (four-quarter values as a percentage of GDP)



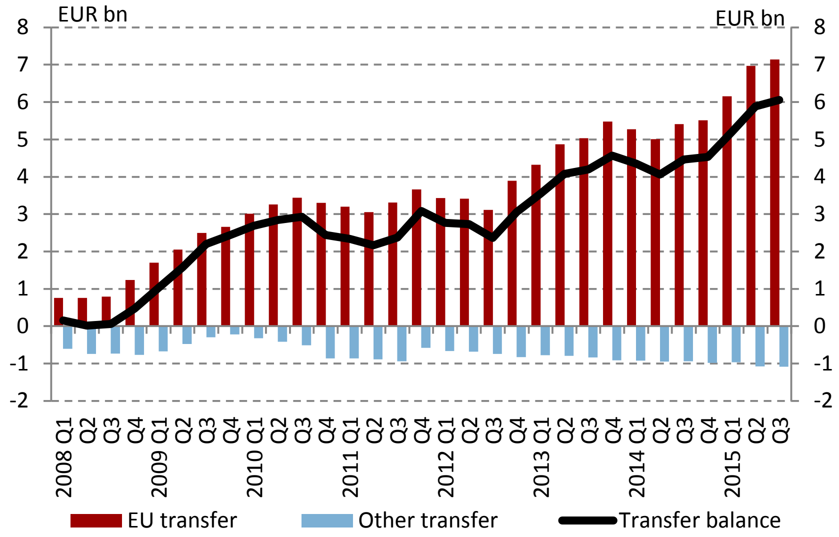
*Income balance: labour income, income on equity and income on debt.

1.3. Transfer balance

The four-quarter transfer balance surplus increased again in the third quarter, due to the increase in the absorption of EU grants, while other transfers steadily reduced the balance. The increase in the four-quarter value of the transfer balance surplus occurred in the context of a significant inflow of EU transfers, (almost EUR 7 billion), which was recognised in the balance of payments (Chart 7). The gradual increase in the transfer balance is supported by the relatively stable development in current items and the substantial increase in capital transfers, which typically finance investments (see more details in the special topic in Chapter 5). The deficit on the balance of other transfers has steadily remained around 1 per cent of GDP in recent years. The greatest contribution to this is made by tax payments to foreign states made by individuals temporarily employed abroad (which ultimately can be offset by the employees' income received from abroad, stated in the income balance).

[1] Quarterly data on the profitability of foreign-owned corporations operating in Hungary is limited, and therefore information on quarterly outflow of profits is based mostly on estimates. For more details, see the statistics publication entitled 'Hungary's Balance of Payments and international investment position statistics, 2012 on the website of MNB'. 2015 corporate profit estimates will be replaced by actual data from corporate annual financial statements to be disclosed in September 2016.

Chart 7: Development of net EU transfers (four-quarter values)

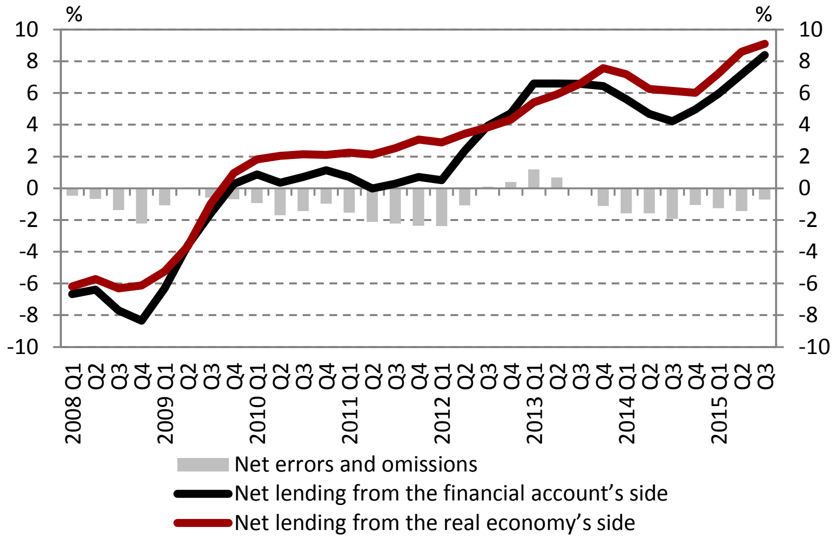


2. FINANCING APPROACH

The financial account data also indicate a further rise in net lending, but its four-quarter level once again slightly falls short of that based on the real economy approach. In the third quarter, domestic agents repaid a large volume of their external debts, with banks contributing to this to the largest extent. Since the beginning of the year, the structure of the net outflow of funds was influenced by the liquidity provided for the conversion of foreign currency loans into forints: the net reduction of state debt was restrained by the decline in foreign currency reserves, while banks were able to use the foreign currency provided by the central bank to reduce their external liabilities. The state's net outflow of funds during the quarter was supported by the continuing sale of government securities by the non-resident sector and the absorption of EU transfers. As regards non-debt items, contrary to the decline seen in recent quarters, FDI funds increased, which was mainly attributable to reinvested earnings.

The economy's four-quarter net lending has continued to increase under both approaches. According to the financing approach, the four-quarter net lending was around 8.4 per cent of GDP in Q3, still falling short of the four-quarter value calculated from the side of the real economy.[2] Similarly to previous years, net lending calculated on the basis of real economy figures still exceeds the level calculated under the financing approach. This means that the decline in the economy's external debt indicators fell short of that calculated from the data from the real economy, based on the current and capital accounts; however, this is typical both of the Hungarian economy and the economies of the region. The difference between the two approaches decreased, amounting to 0.7 per cent of GDP in the third quarter (Chart 8).

Chart 8: Two types of external financing and “Net errors and omissions” (four-quarter data as a percentage of GDP)

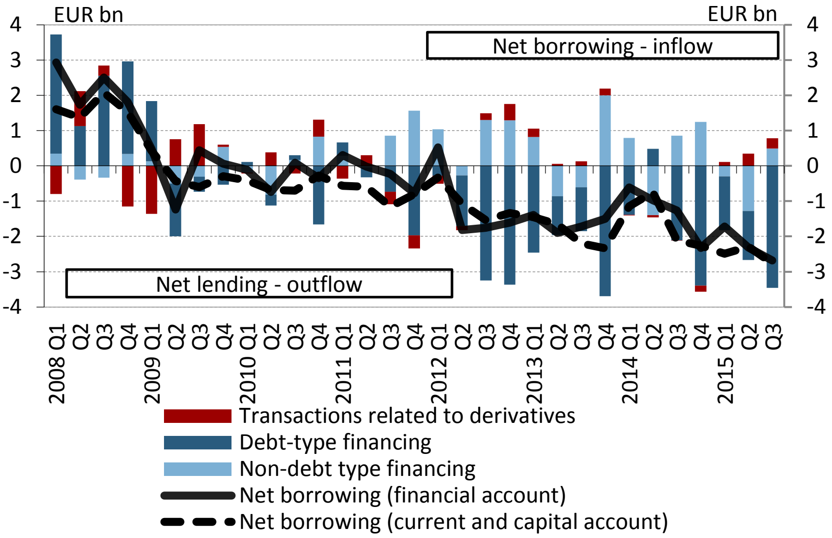


With the debt reduction of about EUR 3.5 billion, which significantly exceeded the amount registered in the previous quarter, the net outflow of debt liabilities continued, accompanied by an increase in net foreign direct investments. In the third quarter, net lending calculated according to the financing approach rose to EUR 2.7 billion, which substantially exceeds the year-on-year figure (Chart 9). There was also a change in the structure of the outflow of funds: the outflow of debt liabilities increased significantly, while the foreign non-debt liabilities of the economy increased, in contrast to the decline seen in the previous quarters. The latter is mostly attributable to the inflow of

[2] Trends in the balance of payments can also be analysed by examining the financing of real economy transactions. Indeed, the financial account shows what types of transactions were used by resident economic agents to finance transactions in the real economy that had an effect on net financial worth. While data derived from the real economy approach and the financing approach should be identical in theory, differences are likely to arise in practice due to non-integrated data sources, incomplete observation and the different treatment of the exchange rate, as indicated by the category of “Net errors and omissions”.

foreign direct investment, while the decrease in debt liabilities in the amount of EUR 3.5 billion is primarily due to the active deleveraging by economic agents.

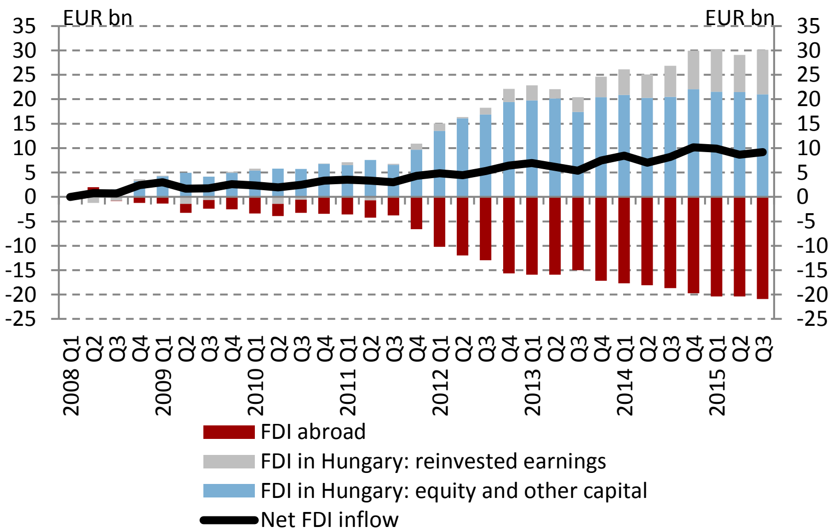
Chart 9: Developments in the structure of external financing (unadjusted transactions)



2.1. Non-debt type liabilities

In 2015 Q3, net foreign direct investments increased by more than EUR 0.5 billion; the net inflow of funds was mainly attributable to the increase in reinvestments, the impact of which was reduced by the investment of residents abroad. In contrast to the contraction seen in the previous quarter, net foreign direct investments in Hungary rose in the third quarter. This was primarily due to the increase in reinvested earnings, which amounted to more than EUR 1.5 billion (Chart 10). On the other hand, the impact of this was reduced by the decrease in inter-company loans and the increase in investments abroad by domestic enterprises; thus on the whole, net FDI liabilities increased by more than EUR 0.5 billion. Based on the data,[3] it can be still stated that investors that made capital investments in Hungary previously invested a large part of their earnings in Hungary.

Chart 10: Developments in direct investment (cumulative transactions)

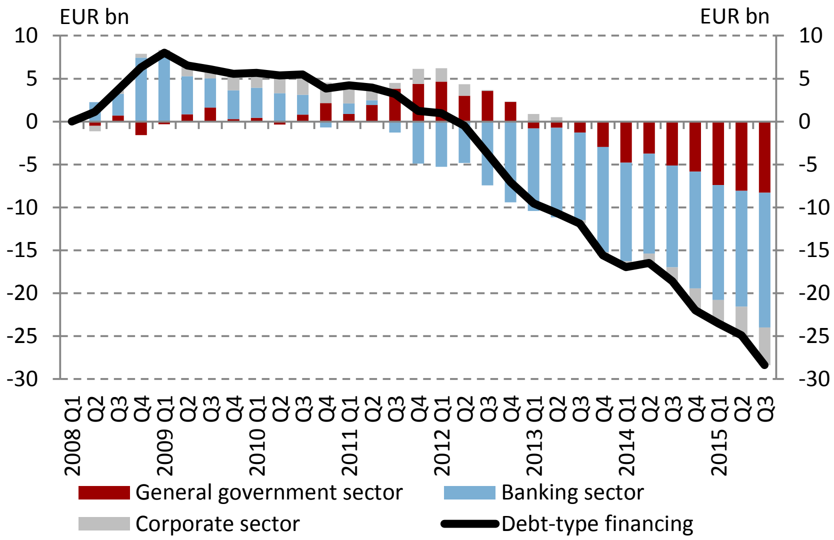


[3] The 2015 profitability figures of enterprises are based on estimates until the receipt of the corporate questionnaires in September 2016.

2.2. Debt funds

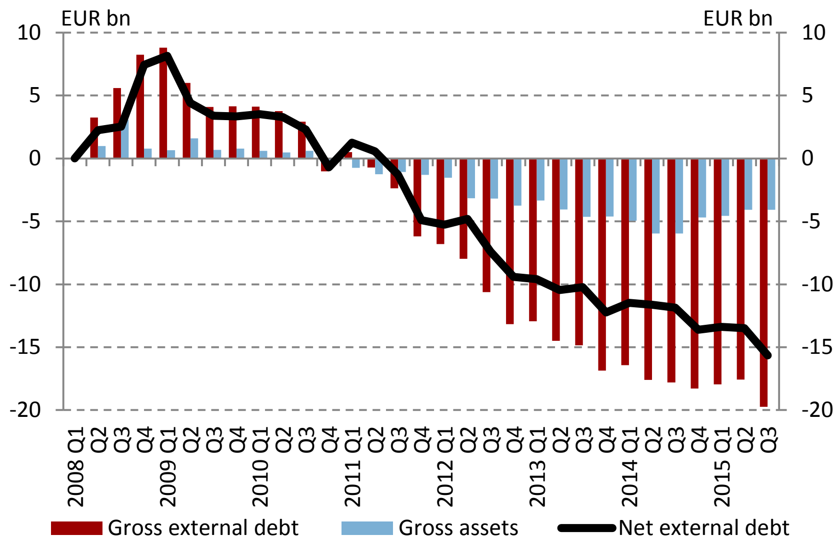
In the third quarter, all three sectors continued to decrease their net external debt. This process was led by the banking sector, while the decrease in net public external debts slowed down. Deleveraging by economic agents continued, as a result of which net external debt decreased by EUR 3.5 billion. The reduction in net external debt was led by the banking sector, while the pace of decline in public net external debt decelerated, in parallel with the decrease in gross external debt and foreign exchange reserves. The corporate sector has also reduced its external debt substantially, by about EUR 1.1 billion, which was due both to the repayment of foreign loans and the drop in commercial loans, while the external receivables of the sector also increased during the quarter (Chart 11 shows the cumulated data, with the difference in the size of columns illustrating the changes in net external debt of the relevant sector).

Chart 11: Developments in net debt-type financing per sector (cumulative transactions)



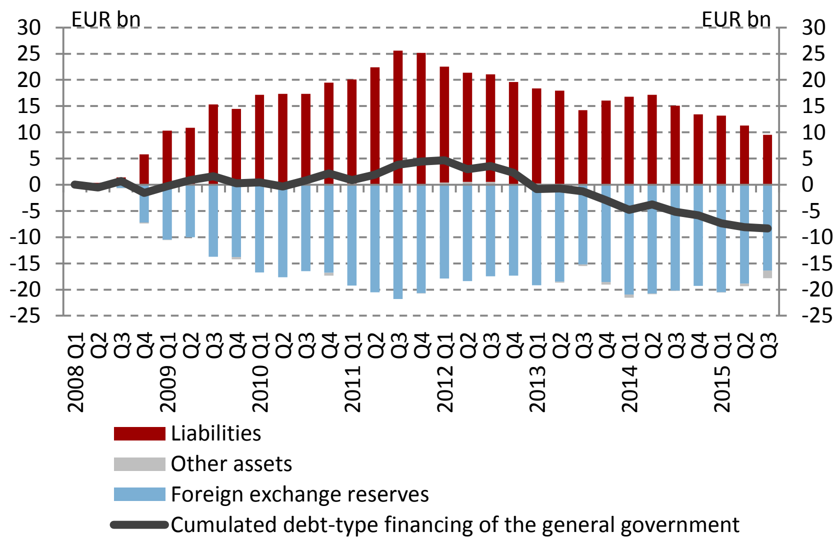
The net external debt of the banking sector dropped by EUR 2.2 billion, which was almost fully attributable to the reduction of gross debt, while there was no material change in the external receivables of banks (Chart 12). The fall in external debt was relatively concentrated, as a number of agents did not make any major changes to their external debts. The foreign currency liquidity, available from the central bank for the conversion of foreign currency loans into forints, which the banks could use for the repayment of their external liabilities, may have also contributed to the reduction of the banks' debts since the beginning of the year. In addition, the foreign currency provided for the conversion of automobile loans into forints may have also resulted in a decline in net external debt. The tightening of the foreign exchange funding adequacy ratio announced in July and the new foreign exchange equilibrium ratio, which limits the foreign currency exposure in the balance sheet also decreased banks' external liabilities. This may force deleveraging particularly in the case of branch offices, with this process possibly already starting in the third quarter. The conversion into forints and the regulations may have resulted in a steady fall in liabilities, but at the same time, transitory factors also influenced the outflow of funds from the sector. At the end of September, the reduction in the external debt of foreign-owned banks – typical at the end of the quarters for balance sheet optimisation reasons – was higher than usual (on the other hand, this is usually adjusted in the beginning of the next quarter, as also confirmed by the data reported by the banks in October). In line with this the largest decrease within the banks' external debts was seen in short-term foreign deposits, which amounted to more than EUR 2 billion during the quarter.

Chart 12: Developments in the banking sector's gross external debts and receivables (cumulative transactions)



The net external debt of the state consolidated with the MNB continued to decrease, while the decline in the sector's net external debt decelerated (Chart 13). In the third quarter, non-residents continued to sell bonds, which impacted both the forint and foreign currency bonds held by non-residents. A vast part of the forint bonds sold by non-residents appeared in the banks' balance sheets, while the decrease in the foreign currency bond portfolio is mainly attributable to the foreign currency bond purchases by the central bank. The state's external debts also decreased, which is in part attributable to the prepayment of state's foreign currency loan taken earlier from EIB. The decrease in foreign currency liabilities also reduced the central bank reserves and thus had no impact on consolidated net public debt. Apart from this, foreign exchange reserves were also decreased by the foreign currency liquidity granted in connection with conversion into forints, and thus on the whole the state's foreign assets and debts decreased by EUR 1.5 billion and EUR 1.7 billion, respectively. As a result of this, the state's net repayment of foreign debt amount to EUR 0.2 billion, marking a decline in quarter-on-quarter terms.

Chart 13: Breakdown of net external debt of the general government consolidated with the MNB (cumulative transactions)



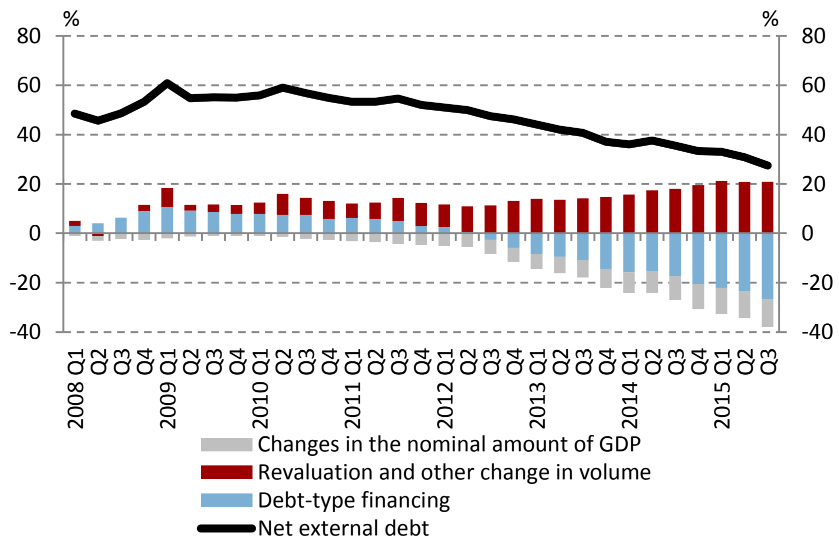
3. DEVELOPMENT OF STOCK INDICATORS

In the third quarter, the external debt indicators of the Hungarian economy once again declined considerably, primarily as a result of the significant outflow of funds and to a lesser extent due to the increase in GDP. Net external debt fell to below 28 per cent of GDP and gross external debt fell to below 79 per cent of GDP. The gross external debt fell to larger degree than the net indictor, i.e. by 5.5 percentage points, which reflected the purchase of foreign currency bonds by the central bank and the prepayment of the EIB loan by the state. In terms of sectoral breakdown, it can be stated that the adjustment of net external debt was related to the corporate sector, in addition to the banking sector. In the third quarter, short-term external debt based on residual maturity fell by almost EUR 2 billion to below EUR 22 billion, primarily due to the decrease in the banking system's originally short-term external debt. The increase in the amortising debt of the government sector also continued in the third quarter, but due to the prepayment of the development loan it reached a lower level than previously expected. Foreign currency reserves decreased to EUR 32 billion, primarily as a result of conversion into forints, the foreign currency financing by the Government Debt Management Agency and the purchase of foreign currency bonds by the MNB. Taken together, the level of foreign currency reserves continues to substantially exceed the level expected by investors.

3.1. Developments in debt ratios

Hungary's net external debt continued to fall in the third quarter, mainly due to the outflow of debt liabilities (Chart 14). The indicator, which also considers Hungary's foreign receivables,[4] decreased primarily due to the decline in the foreign debt components. In addition, the decrease in the GDP-proportionate ratio was also supported by the increase in nominal GDP, while the revaluation effects only had minor impact on the level of the indicator. Although the appreciation of the forint against the US dollar and euro[5] on its own would have reduced net external debt, this impact was offset by the repricing of the government securities due to the decrease in yields.[6]

Chart 14: Components of changes in net external debt* (cumulated, GDP-proportionate values, end-2007 = 0)



In the third quarter, net external debt amounted to 27.5 per cent of GDP: the decrease of almost 3.5 percentage points is mainly attributable to the decrease in the net external debt of the banking system. Although all three sectors contributed to the fall in net external debt, the largest decrease was observed in the banking system (Chart

[4] Based on economic considerations, it makes sense to adjust the debt indicators for ownership loans; for further details, see Box 3 in the Report on the Balance of Payments of April 2015. External debt calculated from forint values.

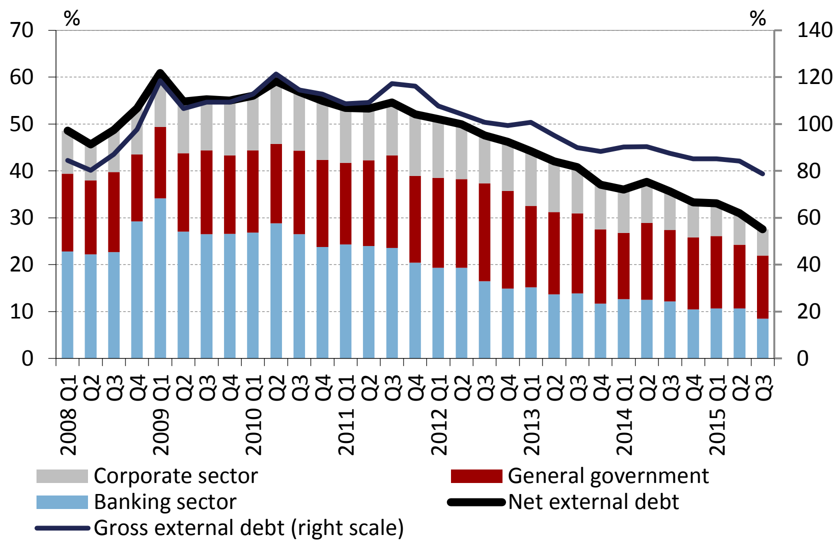
[5] The change in the HUF/EUR exchange rate only had a minor impact on the net external debt due the revaluation of the foreign currency reserves.

[6] Since balance of payments statistics present government security holdings at market rate, their value may be affected significantly by shifts in yields. By contrast, the Government Debt Management Agency recognises the government bond holdings of non-residents at face value.

15). The net external debt of the banking system fell by more than 2 per cent of GDP in the third quarter, mainly due to the decrease in its gross debts. Furthermore, the almost 1 percentage point decrease in the corporate sector's debt also contributed to the decline in the net external debt, which was supported by the increase in the sector's foreign receivables in addition to the repayment of foreign loans. On the other hand, the net external debt of the general government consolidated with the MNB only fell to a smaller degree: this is due to the fact that the impact of the decrease in non-residents' government securities holdings was offset by the decrease in the central bank's foreign currency reserves as a result of conversion into forints.

At the end of the third quarter, gross external debt fell to a greater degree than the net indicator (by 5.5 percentage points) to 78.7 per cent of GDP. In addition to the factors already mentioned in connection with net external debt, the larger decrease in gross external debt was caused by the repayment of debt liabilities and appreciation of the forint against the US dollar. The indicator was reduced primarily by the decrease in the banking system's debts and in non-residents' government securities holdings, as well as by the prepayment of the state's foreign currency loans (EIB loan) and the purchase of foreign currency bonds by the MNB (in parallel with the latter, the level of the foreign currency reserves also decreased, and thus the repayment had no impact on Hungary's net external debt, but reduced gross external debt). Taken together, the ratio of gross external debt to GDP decreased at a higher rate than in the case of net external debt.

Chart 15: Net external debt in a sectoral breakdown and gross external debt (as a percentage of GDP, excluding intercompany loans)

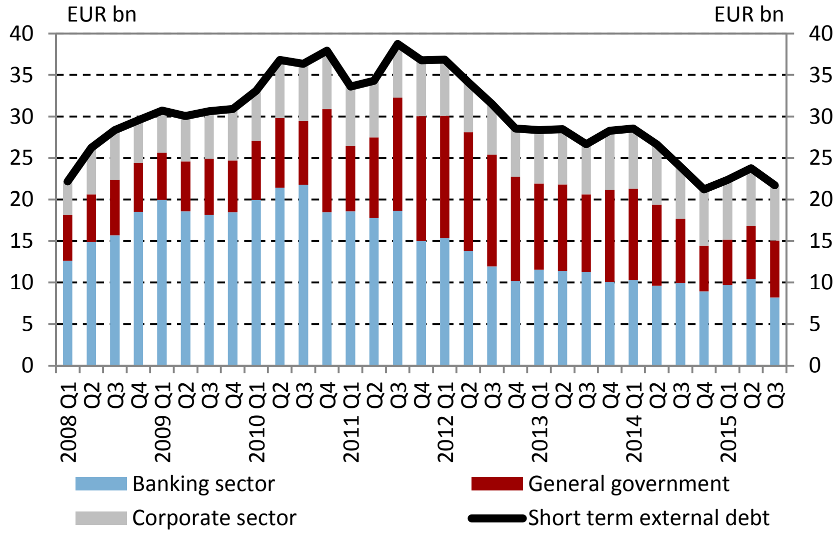


At the end of September 2015, the short-term external debt of the economy amounted to EUR 21.7 billion, marking a quarter-on-quarter decline of EUR 2.1 billion (Chart 16). This fall was fully attributable to the short-term external debt based on original maturity, and within that to the banking system to greater degree and to the corporate sector to a lesser extent, whereas the amortising debt of the general government consolidated with the MNB slightly increased.

- There was a major, EUR 2.2 billion gross outflow of funds in the banking system in the third quarter, almost all of which occurred in the category of short-term maturity. The decrease in short-term funds was observed both at banks effected by conversion into forints and at branch offices. However, it should be noted that the low level of short-term external debt may have also reflected the impact of the deleveraging which is typical at the end of the quarters.
- In addition to the banking sector, the short-term external debt of the corporate sector also decreased by almost EUR 0.4 billion in the third quarter.
- The increase in the short-term external debt of the general government is attributable to the rise in amortised debt (EUR 0.5 billion), which is mainly related to the bond maturities becoming due in 2016 Q3. It is important to add that the sale of bonds by foreign agents, the MNB's foreign currency bond purchase

programme and the prepayments by the Government Debt Management Agency lowered the amortising debt stock of the state, and consequently the amortising debt of the general government may peak at a much lower level than previously expected.

Chart 16: Developments in short-term external debt based on residual maturity



3.2. Foreign currency reserve and development of reserve adequacy

The stock of foreign currency reserves decreased in 2015 Q3, primarily due to the repayment of the Government Debt Management Agency's foreign currency debts and the drawdown of swap instruments in connection with the conversion of households' foreign currency loans. At the end of 2015 Q3, international reserves amounted to EUR 32.1 billion, representing a quarter-on-quarter decline of EUR 2.6 billion. On the whole, the foreign currency transactions of the Government Debt Management Agency reduced foreign currency reserves by EUR 1.2 billion, with the prepayment of certain foreign currency loans – mainly the outstanding debt to the European Investment Bank (EIB) – playing a major role. The volume of foreign currency drawn down by the banks from the central bank as part of the forint conversion instruments, which amounted to EUR 0.9 billion in total in the third quarter, played an important role in the decrease in foreign currency reserves. Of this, the expiry and termination of central bank FX swaps connected to the conversion of mortgage loans into forints[7] totalled EUR 0.6 billion, while the volume of foreign currency drawn down as part of the conversion of consumer foreign currency loans[8] amounted to EUR 0.3 billion. The purchase of foreign currency bonds by the MNB, the foreign currency transactions of the Hungarian State Treasury (HST) and the revaluation of reserve items also reduced reserves. All this was only partially offset by the EUR 0.5 billion reserve increasing impact of EU funds.

In addition to the decrease in foreign currency reserves, short-term external debt also declined and the volume of foreign currency reserves still substantially exceeds the level expected by investors (Chart 17). On the basis of

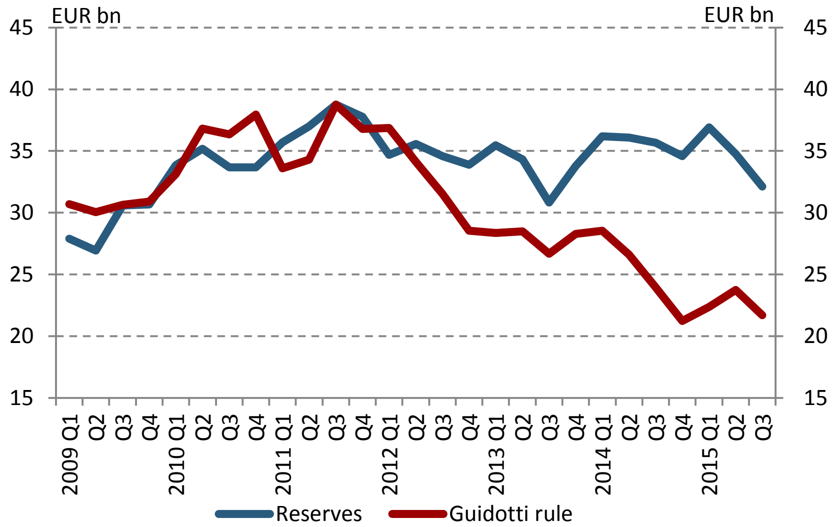
---

[7] Related to the conversion of mortgage loans into forint, credit institutions roll over the FX liquidity required for the termination of exchange rate position, made available by the MNB to them via FX swap and CIRS instruments. The swap instruments expire continuously and gradually until the end of 2017, or become terminable in the framework of a separate termination tender, extending the settlement to the charge of the FX reserve to this period. The banks had the opportunity to close the unconditional FX swaps latest expiring in March 2016 earlier, in April 2015 in a maximum amount of 20 per cent of the value of foreign currencies bought on settlement and forint conversion tenders. From June until the end of September, the MNB held further termination tenders, at which the unconditional swaps could already be terminated prior to expiry without any restriction.

[8] From the end of August 2015, the MNB held spot Swiss franc sale tenders related to the conversion of consumer foreign currency and foreign currency-denominated loans, in addition to mortgage loans, supplemented by one-week FX swap transactions of an opposite direction, which could be rolled over weekly.

Guidotti-Greenspan rule which is closely monitored by both investors and the central bank, FX reserves exceeded the stock of short-term external liabilities by more than EUR 10 billion in 2015 Q3. Looking ahead, excess reserves based on the Guidotti rule also remain at a safe level.

Chart 17: Short-term external debt and the stock of foreign exchange reserves of the Hungarian economy



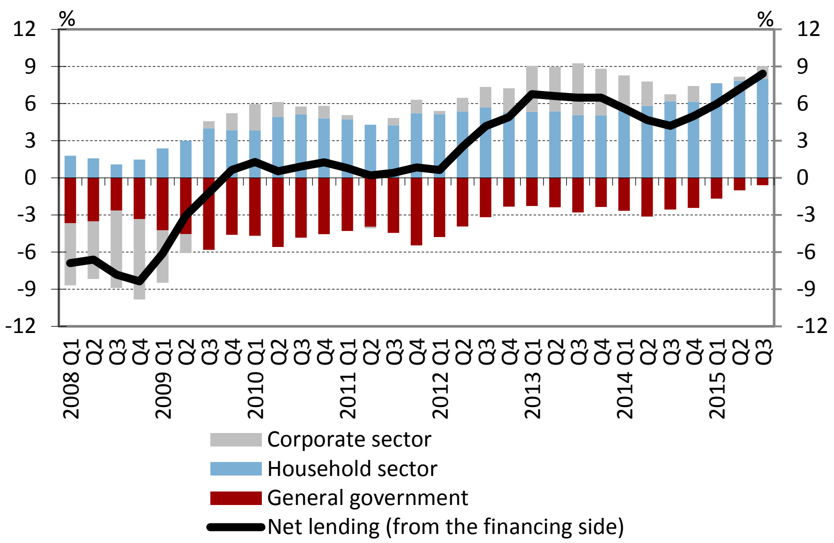
*Guidotti indicator: short-term external debt based on residual maturity.

4. SECTORS' SAVINGS APPROACH

Net lending continued to increase in 2015 Q3, partly due to the record low general government net borrowing and the improving financial position of the private sector. According to the underlying processes, households' net lending reached a stable, high level in the third quarter as well. The net lending of corporations – after the one-off effect of the foreign currency loan settlement in the first quarter which affected financial corporations – increased again. Households continue to place most of their new savings in government securities, which may have contributed to the ongoing decrease in the external debt of the government.

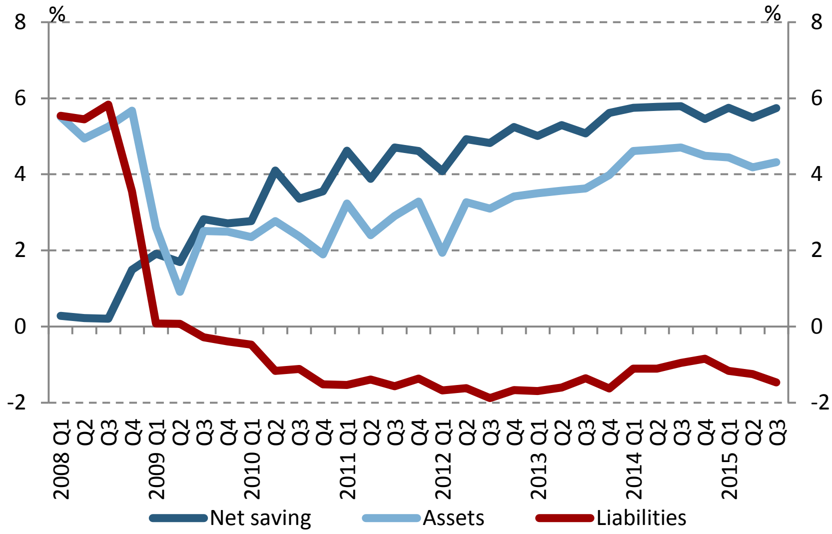
In the third quarter, the four-quarter net lending of the economy rose to 8.4 per cent of GDP, with all sectors contributing to this growth, but the historically low net borrowing of the general government should be specifically highlighted (Chart 18). The favourable fiscal processes are linked to rising tax revenues, due to the growth in wages and employment, and to the continued increase in VAT income and the gradual decrease in interest expenses. The net lending of the private sector increased further: the net lending of corporations rose again, while net household savings also increased slightly. The high four-quarter net lending of households is partly attributable to the one-off effect of the settlements, which decreased enterprises' net lending and increased the lending of households in 2015 Q1 to the greatest degree, but also had some impact in the subsequent quarters as well.

Chart 18: Net lending capacity of specific sectors (four-quarter values as a percentage of GDP)



Calculated on the basis of seasonally adjusted underlying developments, the net savings of households rose to 5.7 per cent of GDP in Q3, which was realised in a context of poor credit demand and increasing accumulation of assets. As a result of the continued strong precautionary considerations, households increased their net repayments further, and the wage bill, which rose as a result of the increasing employment and wages, sustained the accumulation of financial instruments at a high level (Chart 19). Although the conversion of the foreign currency loans into forints reduced the exchange rate exposure of households, which would justify the easing of precautionary considerations, households increased their net repayments in the past quarter.

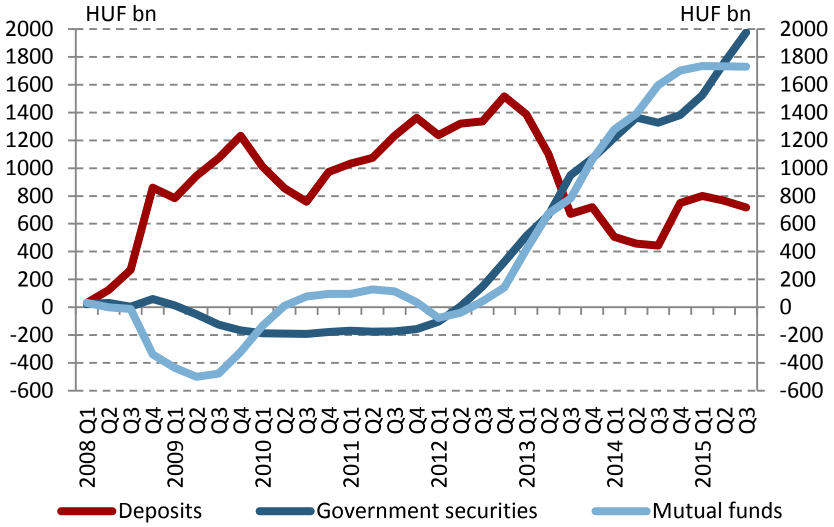
Chart 19: Household sector net lending based on underlying development (seasonally adjusted revised* values, as a percentage of GDP)



* The revised net saving figure of households excludes transactions which boost the savings of the sector related to pension fund savings, the early repayment scheme, the disbursement of real yields, the indemnification of deposit holders of defaulting cooperative banks and certain investment service providers, and the estimated impact of the settlement related to foreign currency loans and conversion into forints.

In the third quarter, holdings of government securities continued to increase dynamically, which contributed substantially to the decline in the state's external debt. The restructuring of household portfolios from bank deposits to securities was no longer typical this year: the decline in bank deposits stopped in mid-2014, and after an adjustment the portfolio stabilised in 2015 (Chart 20). In parallel with this, holdings of mutual fund shares stabilised after a major surge and have not changed substantially this year. New household investments appeared almost completely in the growth of government securities holdings, mostly attributable to the yield advantage of household government securities over mutual fund shares and bank deposits. The growth in government securities continued in October and November as well, since the bank deposits rates are still extremely low and the price increase of the mutual fund shares also stopped in line with the closing of the easing cycle. The expansion of household savings invested in government securities may have also been supported by the uncertainties in the investment services market and the payment of the reimbursements related to the foreign currency loans. As a result of the foregoing, by the end of Q3 households' government securities holding exceeded HUF 2,900 billion. On the other hand, the indirect financing of the state by households – in line with the decreasing popularity of mutual fund shares – slightly declined, as the assets managed by money market and bond funds decreased.

Chart 20: Cumulative transactions of household instruments



5. SPECIAL TOPIC: TRENDS IN EU TRANSFERS

The absorption of EU funds is of key importance for the development of investments and the external balance, and therefore this special topic deals with EU transfers in detail. In recent years, the net absorption of transfers reached 5-6 per cent of GDP, which was primarily due to the increasing weight of the capital transfers supporting investments, while current transfers were stable. As regards the sectoral breakdown of the absorption of transfers, it can be stated that EU grants contributed to public investments to a much greater degree (almost 50 per cent in recent years) as compared to private sector investments. As regards the regional impacts of the transfers, the highest volume of resources was channelled to the Central Hungary region; however, the more underdeveloped – in terms of per capita GDP – regions also received considerable resources, which may have contributed to the fact that they managed to reduce their deficit compared to the EU average to a slight degree. In addition, it is also worth mentioning that the more developed regions managed to achieve faster convergence despite the lower EU transfers received. In the Visegrád countries, the absorption of cohesion resources developed similarly and the total budget was drawn down in almost all of these countries. However, in proportion to GDP the highest volume of resources was absorbed in Hungary, which may be attributable to the fact that a favourable budget was allocated to Hungary compared to its level of development.

5.1. Introduction

Monitoring the grants received from the EU is important in terms of the development of investments, the external balance indicators and the central bank's foreign exchange reserves. This special topic analyses the trends in EU funds primarily in the context of the macroeconomic developments, focusing on the issues related to investments and external balance.

Grants received from the EU are a key factor in the context of investments and trends in external balance. Since a major part of the grants are capital transfers financing investments, the monitoring thereof and their sectoral distribution are of the utmost importance when evaluating the dynamics of investments. As the transfers increase the economy's disposable income and finance investments, they are also regarded as an important indicator in the context of the trends in external balance. Net EU transfers also appear in the current and capital accounts of the balance of payments, as well as in the financial account.

- The current and capital accounts reflect the absorption of transfers; this is the amount that increases the disposable income of the individual sectors and, *ceteris paribus*, net lending (accrual approach).
- On the other hand, the financial account reflects the disbursed EU transfers in the change of the foreign exchange reserves, since the state converts the transfers received in euro to forint at the central bank, thereby increasing the central bank's reserves and the economy's external assets.

Thus, the funds that increase net lending via the current and capital accounts may be interpreted in the financial account, through the increase in foreign exchange reserves, as an outflow of foreign funds (i.e. by receiving and absorbing the EU transfers, *ceteris paribus*, the economy's dependency on external finance decreases). Accordingly, the EU transfers work toward reducing the economy's external indebtedness.

The most important terms related to the transfers are as follows.

In terms of the economic content:

- Current transfers: consumption-related grants increasing the disposable income (e.g. direct agricultural subsidies), which are stated in the balance of payments among the secondary or other primary incomes.
- Capital transfers: typically investment-financing grants, stated in the capital account.

The grants may be analysed from two aspects:

- Absorption of EU transfers: the amount already effectively obtained by the beneficiary for a specific project (affects the external financing capacity reflected in the accrual-based balance of payments),

- Disbursement of EU transfers: the amount disbursed by the EU to Hungary – this may differ from the date of the absorption, as the state typically advances the financing of the projects, and the EU also provides pre-financing, which may be used later (cash approach, impacts the trends in foreign exchange reserves).

The volume of the received grants may be examined in two ways:

- Gross transfer: the volume of grants received by Hungary from the EU,
- Net transfer: in addition to the grants (income) received from the EU it also considers the payments to the EU (expense).

Box: Key features of EU grants

Hungary is a net beneficiary of EU grants, that is the grants received exceed its contribution to the EU's budget. Hungary receives grants from the European Union for a variety of projects. A dominant part of the resources are received from the Structural Funds (European Social Fund, European Regional Development Fund) and from the Cohesion Fund, the primary objectives of which are to foster convergence, increase regional competitiveness and expand employment. These may include, for example, infrastructure investments. The other part of the grants is aimed at agriculture and rural development (European Agricultural Guarantee Fund, European Agricultural Fund for Rural Development), which may also include subsidies for investments, and the direct subsidies on production belong here as well. Apart from these, grants of smaller amount may be received for cultural and youth programmes, consumer protection, etc.[9]

The process of accessing the EU funds commences by the European Commission's determining the total financing budget for the grants, which is then distributed among the individual objectives (convergence, regional competitiveness and employment, European territorial cooperation) and the Member States, taking account of the "eligible population, national and regional prosperity, and the unemployment rate". Thereafter, the decision is made on the national strategic reference framework drawn up by the individual Member States, i.e. on the operative programmes. The budget commitments in respect of each fund and objective are implemented on an annual basis (European Commission, 2007).

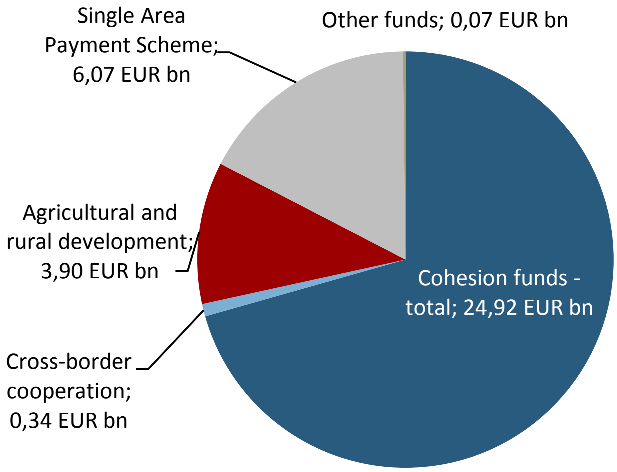
It is important to note that that the unused funds are not lost automatically; the Commission withdraws only those budgets in respect of which no drawdown request is received by the end of the second year from the commitment (n+2 rule). Until 2010 an n+3 rule, based on similar principle, applied to the new member states, including Hungary, as well as to Greece and Portugal (European Commission, 2007). Accordingly, it was possible to absorb funds from the 2007-2013 budget even in 2014 and 2015.

5.2. Available EU transfers and their absorption in the past

In the period 2007-2013 the EU made a commitment to Hungary in the amount of EUR 35.3 billion, which accounts for roughly 35 per cent of annual GDP. Calculated at the average exchange rate of the period of EUR/HUF 280, this equals almost HUF 9,900 billion. The major part of the available resources, i.e. about EUR 24.9 billion (HUF 7,000 billion) could be drawn down from the Structural Funds and the Cohesion Fund, while EUR 3.9 billion (HUF 1,100 billion) was available from the Rural Development Fund. The direct agricultural subsidies amounted to EUR 6 billion (HUF 1,700 billion). Besides the transfers granted for Hungary, the government had to pay the EU contributions, so the amount of the net EU transfer may be smaller than mentioned before by EUR 7 billion (Chart 21). Furthermore, Hungary also received about EUR 0.3 billion (HUF 100 billion) as part of the cross-border cooperation programme. It is also worth mentioning that the national budget supplemented the EU funds by a further EUR 7.2 billion (HUF 2,000 billion), which was the result of the mandatory co-financing that follows from the principle of additionality applicable to EU funds.

[9] For more information on the financial assets allocated to the EU's community policies see: the website of the EU Communications Service *(http://www.euvonal.hu/index.php?op=kozossegi_politikak&id=3)* and its publication entitled "Cohesion policy 2007-2013" *(http://ec.europa.eu/regional_policy/sources/docoffic/official/regulation/pdf/2007/publications/guide2007_hu.pdf).*

Chart 21: EU commitment for the 2007-2013 programming period (EUR billion)



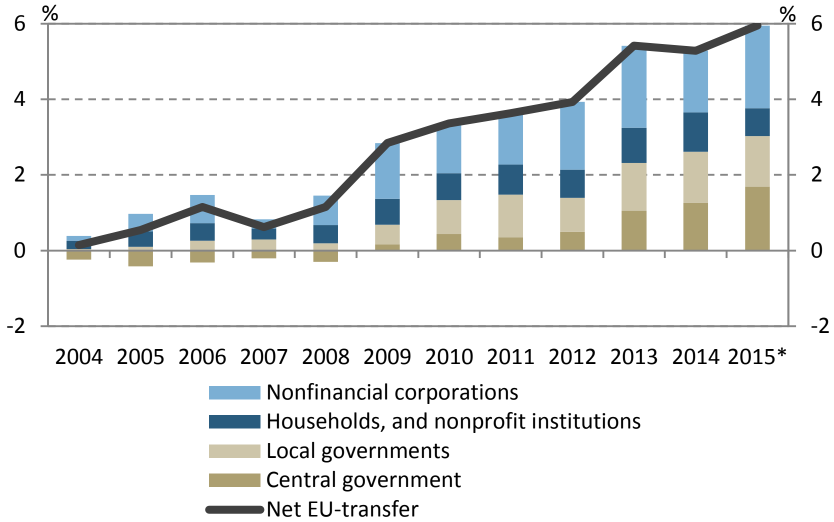
The forint exchange rate also considerably influences the extent of the grants received from the EU, as the seven-year budget allocable to the individual countries is determined in foreign currency. The 2007-2013 programming period was planned at the exchange rate of EUR/HUF 280; therefore the depreciation of the forint, which commenced in 2012, significantly increased the forint equivalent of the EU grants, thus providing the opportunity to implement more projects. That is, the beneficiaries of the grants always submit the invoices in forint: as such, when the forint depreciates the Commission needs to transfer less foreign currency for making the annual payments. Due to the weakening of the exchange rate, the available funds are expected to exceed the planned level of almost HUF 9,900 billion by about HUF 380-400 billion (State Audit Office, 2015).[10] On the other hand, the full impact of the exchange rate is qualified by the fact that due to the import content of the planned investments, the investment expenses may also increase, i.e. it will be possible to implement more projects as long as the exchange rate effects does not materialise at the expense side.

Between 2007 and 2015 Q3, domestic agents absorbed transfers in the net amount of EUR 31.4 billion.[11] The absorption of transfers accelerated after 2009 and the net transfer absorption (the amount subdued by the government contribution) was already around 3 per cent of GDP compared from the previous level of 1 per cent (Chart 22). In 2009, the increase in the absorption of EU transfers was registered at non-financial enterprises, and in the following years 1.5-2 per cent of GDP was connected to this sector. There was another steep rise in the absorption of transfers from 2013, which was attributable to the increase in the transfers received by the general government. In 2014, the grants received by the general government already accounted for about half of the total net absorption of EUR 5.5 billion.

[10] Állami Számvevőszék (2015): Tanulmány a 2007-2013. évi EU költségvetési időszakban Magyarország részére juttatott közösségi támogatások összefoglaló bemutatásáról, értékeléséről (*http://www.asz.hu/tanulmanyok/2015/tanulmany-a-2007-2013-evi-eu-koltsegvetesi-idoszakban-magyarorszag-reszere-juttatott-kozossegi-tamogatasok-osszefoglalo-bemutatasarol-ertekeleserol/2007-2013-eu-koltsegvetesi-idoszakban-magyarorszag-reszere-juttatott-kozossegi-tamogatasok-osszefoglalo-bemutatasa-ertekelese.pdf)*

[11] The substantial absorption of the funds of the 2007-2013 programming period commenced only from 2009; in 2007 and 2008 typically still the funds of the previous programming period were absorbed.

Chart 22: Absorption of EU transfers and trends in expenditures (as a per cent of GDP)

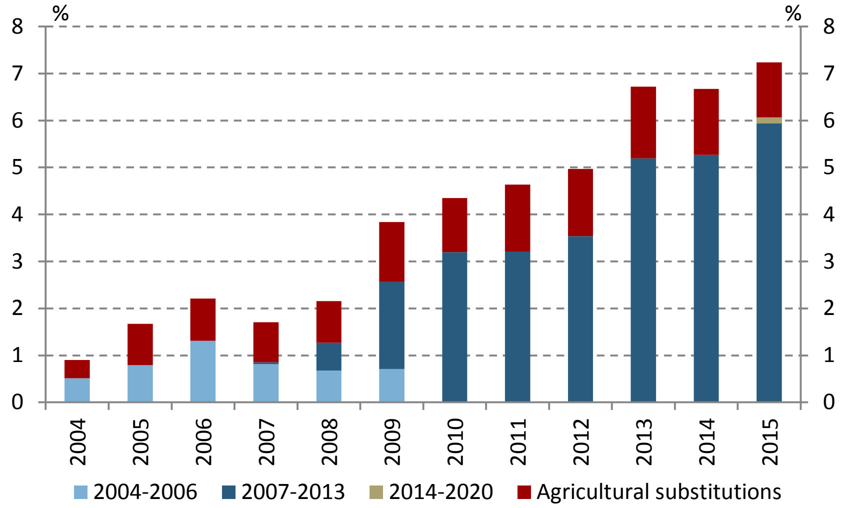


* Based on the first three quarters of 2015

The amount of absorbed EU grants is expected to peak in 2015, after the end of the 2007-2013 programming period, which is rendered possible by the n+2 rule (Chart 23). The fluctuations in EU grants are essentially attributable to the drawdown of resources from the Cohesion Fund and the Structural Fund; the agricultural subsidies (which to a lesser degree also contain the grants of the Rural Development Fund) (amounting to about 1 per cent of GDP) are distributed evenly among the years. As mentioned earlier, the yet undrawn resources from the Cohesion and Structural Funds may also be used in the next two years following the individual EU programming periods. This occurred in the 2004-2006 programming period, when almost 30 per cent of the allocation was absorbed in 2008 and 2009. In the 2007-2013 programming period, the EU grant allocation – which increased considerably, i.e. by 24 per cent of GDP compared to the previous period – was implemented with gradually increasing absorption. In the two years after 2013 the inflow of EU funds was around 7 per cent of GDP, which was rendered possible by the n+2 rule. On the other hand, the figures also included the absorption of pre-financing related to the next, 2014-2020 programming period, albeit this not significant for the time being, as it hardly exceeds 0.1 per cent of GDP (Babos-P. Kiss, 2016).[12]

[12] Babos Dániel – P. Kiss Gábor (2016): 2016-ban fel kell készülni az Európai Uniótól érkező támogatások átmeneti csökkenésére, MNB expert article, manuscript

Chart 23: Distribution of the gross inflow of the EU transfers by programming periods* (as a per cent of GDP)

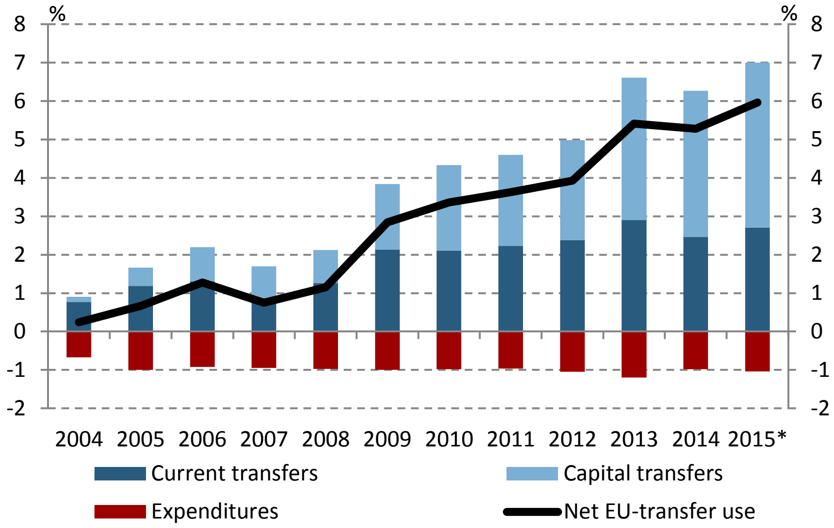


Note: MNB estimation.

As regards the 2007-2013 programming period, capital transfers accounted for an increasing part of absorbed grants. After 2009, current transfers were relatively stable and accounted for more than 2 per cent of GDP annually (Chart 24). These are mostly agricultural aids paid on area basis (and to a smaller degree also include the grants from the Rural Development Fund), and thus do not depend on the implementation of specific projects and were more stable. On the other hand, capital transfers may be tied to the implementation of specific investments. The accelerating absorption of transfers seen in recent years was significant in the case of capital transfers, which increased from 1 per cent of GDP to almost 4 per cent, which was also felt in the dynamics of investments (see more details on this later). Meanwhile, the payments to the EU steadily accounted for 1 per cent of GDP, which are mostly incurred on behalf of the general government. The budgetary revenue of the EU comprises of the payments made by the individual states, of which the most important one is the so-called GNI-based contribution and the VAT-based payments, paid by each Member State to the EU budget based on a standard rate.[13]

[13] The own resources of the EU are broken down into three groups. The GNI-based contribution is calculated on the basis of the national income, while the VAT-based contribution is levied on the harmonised value added tax base. The rate of the GNI-based contribution is fixed upon each budgeting; in 2010 this was 0.75 per cent. The VAT-based contribution rate is 0.3 per cent since 2007. The third group of own resources – the traditional own resources – consist mainly of customs duties on imports from outside the EU and sugar levies, collected by the respective Member States and paid to the EU budget, keeping 20 per cent (formerly 25 per cent) of the amounts to cover their collection costs.

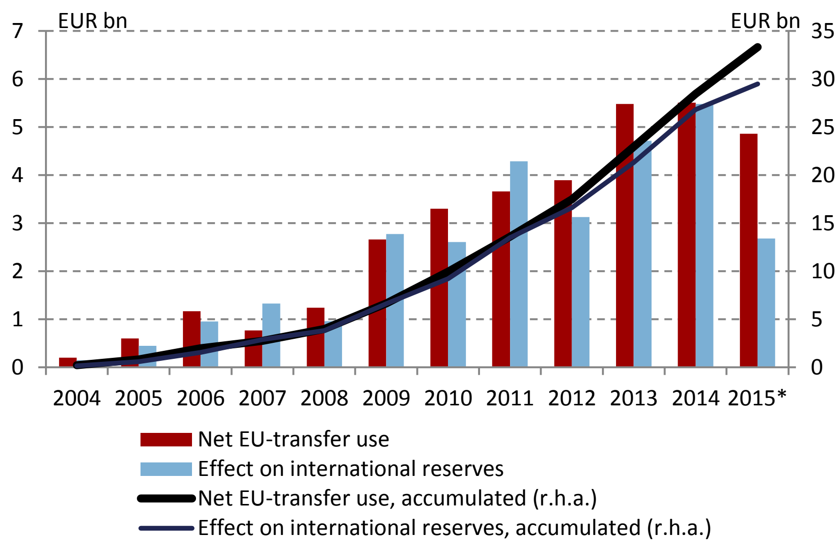
Chart 24: Current/capital breakdown of the EU transfers, as a per cent of GDP



* Based on the first three quarters of 2015

The impact of EU transfers on foreign exchange reserves fell short of the amounts absorbed by domestic agents. A major portion of the grants received from the EU is converted from euro to forint by the central bank, and thus the converted amount increases foreign exchange reserves. On the other hand, there are also payments made in forint rather than in foreign currency (these are performed by EU against the national payments due to it). This is important, because in 2015 there was a substantial wedge between the absorbed EU transfers and the amounts that appeared in the reserves (Chart 25). The wedge may have been attributable, on the one hand, to the massive pre-financing by the state – while the EU suspended the transfers belonging to certain operative programmes – but on the other hand, due to the above-mentioned facts, it is not justified to link the degree of the wedge in full with the unpaid EU funds. According to the budget cash flow data, in the period of October-November EU funds were received in excess of EUR 1.5 billion, and thus the gap between the absorption and the EU transfers may have decreased. The wedge between the absorption of the EU funds and the impact on the foreign exchange reserves may also have been attributable to the fact that the EU will only refund the last 5 per cent of the allocation of the 2007-2013 programming period later.

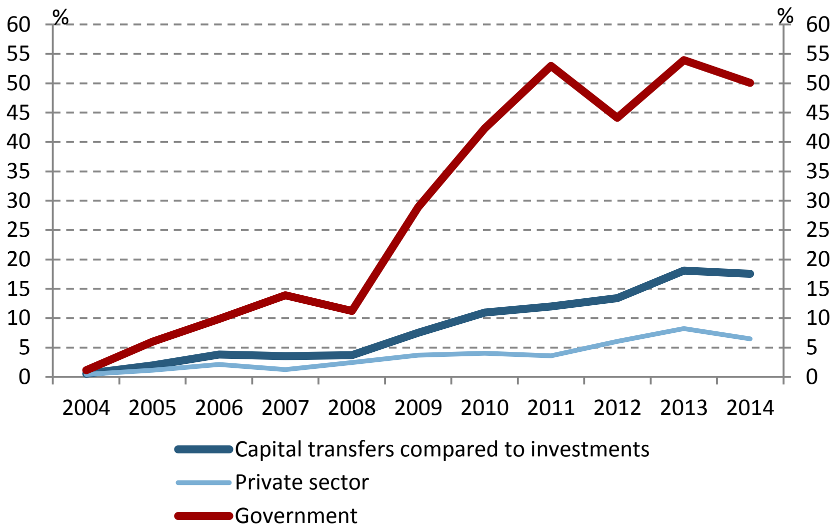
Chart 25: Absorption of net EU transfers and the impact of EU transfers on foreign exchange reserves



* Based on the first three quarters of 2015

The role of capital transfers within public investments increased considerably.[14] The absorption of public capital transfers and the financing of public investment by EU grants rose sharply after 2008 (investments should be compared to the accrual use of EU-funds). In 2011, the ratio already exceeded 50 per cent, which continued in 2013-2014 as well (Chart 26). The financing of private sector investments by capital transfers started from a lower level from the outset, but some increase could be observed there as well, and after 2011 the ratio of capital transfers was 5-8 per cent.

Chart 26: Development in the rate of capital transfers compared to investments



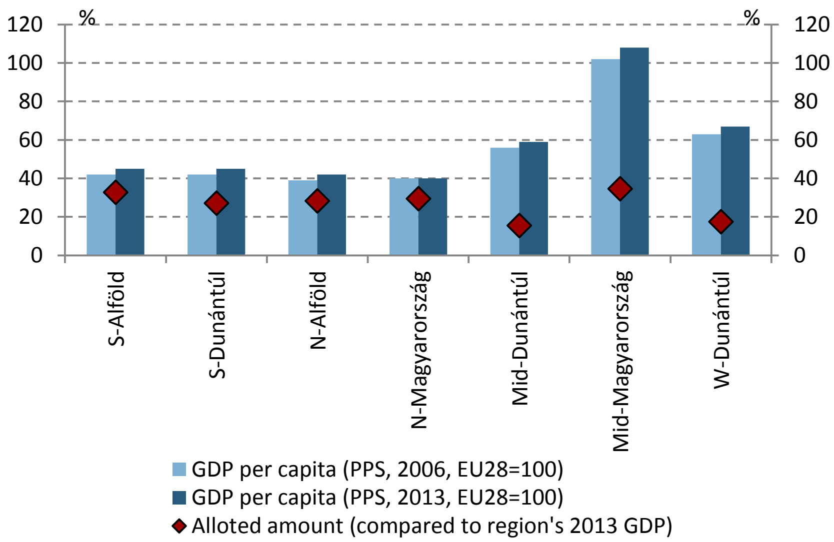
Sources: Eurostat, European Commission

5.3. Transfers allocated to the regions of Hungary

EU transfers were absorbed to the largest degree in the Central Hungary region, but the less developed regions also benefited considerably from the grants. The convergence of these regions to the EU average fell short of that observed in the more advanced regions. As regards the regional data related to the absorption of the EU transfers, the largest volume of resources was used in the Central Hungary region (Chart 27). In this region, per capita GDP significantly exceeds the average of the rest of the country (and even the EU average to a slight degree) and showed a considerable increase between 2006 and 2013. The major infrastructure and transport investments implemented (e.g. the M4 underground and the extension of the M0 ring) in Budapest (which belongs to the region) may have contributed to this. It should be noted that the regions that are less developed in terms of per capita GDP also received relatively large amounts, the average value of which accounted for 30 per cent of 2013 GDP. However, it is important to note that in these regions in 2006, as well as in 2013, per capita GDP was only about 40 per cent of the EU-28 GDP level. Despite the considerable absorption of EU grants, this has still not increased significantly. The second and third most developed regions of the country, in terms of per capita GDP, (i.e. the West Transdanubian and the Central Transdanubian regions) received EU funds less on average compared to their GDP. Despite the lower absorption of transfers, these regions converged to the EU average to a greater degree than the less developed regions. This may suggest that the geographical location of the regions may also play a substantial role in convergence. On the other hand, the crisis may have also influenced convergence to a large degree, and thus it cannot be precluded that without the EU transfers the lag in the growth of the less developed regions would have been greater.

[14] Large public enterprises developing and operating infrastructure also form part of the general government sector (e.g. Nemzeti Infrastruktúra Fejlesztő Zrt., Magyar Közút Nonprofit Zrt.).

Chart 27: Absorption of EU transfers, by regions



Sources: Eurostat, EMIR

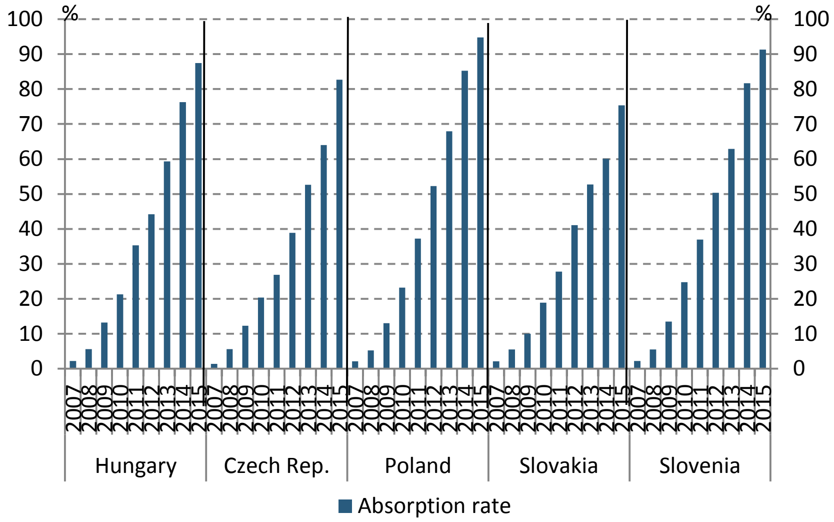
5.4. International experiences

As already discussed in the introduction, the purpose of the Cohesion and Structural Funds is to reduce and eliminate the regional differences within the European Union. These funds are essentially meant to finance investments, which is why it is important to ensure that the countries that joined the EU in 2004 use these funds to reduce their deficits in terms of development compared to the EU core countries.

The absorption of cohesion resources is similar in the countries of the region, and most of the countries have already drawn down a major part of their cohesion resources. According to the figures of the European Commission, Hungary's position in terms of the drawdown of the cohesion funds is relatively favourable among the Visegrád countries, as by November 2015 it had drawn down almost 90 per cent of the resources (Chart 28).[15] Among the Visegrád countries only Poland's absorption rate is higher than that, while in regional terms it is exceeded by Slovenia: to date Poland has already drawn down more than 90 per cent of the allocation. The fact that in Poland the distribution of the EU funds is controlled by a very efficient institutional system may have played a significant role in this, and the considerable degree of the infrastructure investments may have also contributed to the high absorption rate (State Audit Office, 2015). On the other hand, Slovakia received less than 80 per cent of the cohesion funds; the frauds explored in connection with the investments and the penalties imposed for corruption both played a significant role in this (State Audit Office, 2015).

[15] The absorption rates show the amount transferred by the European Commission from the available allocation to the given Member State rather than the effective use of the EU transfers. The EU does not transfer the last 5 per cent of the grants to the Member State until the completion of the full review of the given grant (in relation to the 2007-2013 programming period the Commission is expected to make the payment in 2017-2018).

Chart 28: Absorption rate of the cohesion funds in the region (as a per cent of the total allocation)

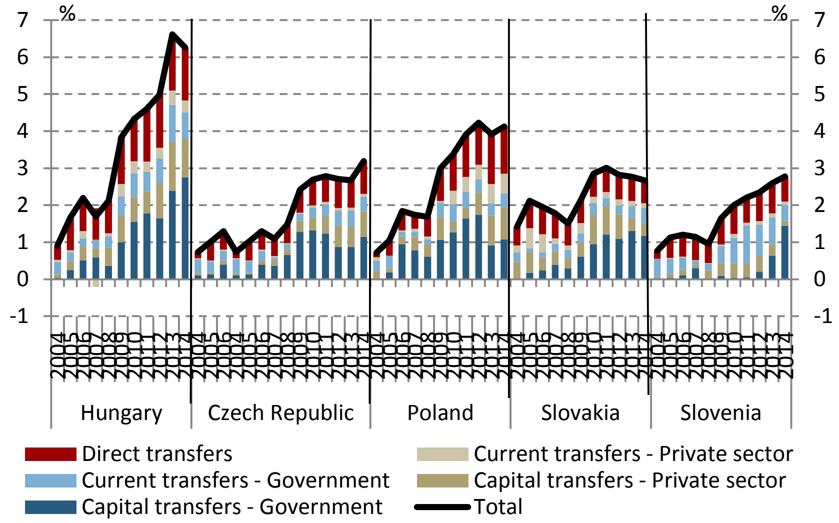


Sources: European Commission, EU Cohesion Funding

Despite the fact that the use of the cohesion funds was similar in the region, the use of the received EU resources in proportion to GDP in Hungary considerably exceeds that of the other countries of the region, which is mainly attributable to the state transfers and, to a lesser extent, to the private sector transfers. Apart from the utilisation rate of the cohesion funds, it is also worth examining the ratio of the surplus funds, as a per cent of GDP, that the EU funds accounted for in the individual countries in the implementation of the investments. In this regard, Hungary has an outstanding position in the region: in recent years the ratio of the used EU resources, as a per cent of GDP, was the highest in Hungary. It is also worth mentioning that despite the fact that Poland managed to utilise the cohesion funds to a higher degree (compared to the size of the full allocation), the inflow of the GDP-proportionate EU transfers was the highest in Hungary. On the other hand, the use of the EU funds was the most uneven in Hungary. In the beginning of the programming period the absorption of the funds started relatively slowly in Hungary, followed by a gradual increase and in 2014 it already exceeded 6 per cent of GDP.

In terms of the sectoral breakdown, it can be stated that the public sector and the gradual increase of capital transfers are typical, and by 2013 the absorption of capital transfers already exceeds the absorption of current transfers (Chart 29). The absorption of transfers in the Czech Republic was similar to that in Hungary; almost half of all resources was received by the state, and one fifth thereof by the private sector, while the remaining part was paid in the form of direct aids, e.g. as part of the area aids. By contrast, in Poland the weight of the private sector is slightly higher; on average, this sector used one quarter of the resources, while the state absorbed slightly more than 45 per cent of the resources. It should be noted that in 2013-14 the structure of absorption observed in Poland differed from the earlier trends and almost one third of the resources was absorbed by the private sector. It could be often observed that the larger part of resource absorption is reserved by the state for large-amount investments. However, despite the increasing weight of the private sector, the absorption of funds did not decrease in Poland. Presumably this is related to the high increase in the Polish economy's investments, and the change of the EU programming period may also pose similar challenges in Poland as well, in the financing of the investments.

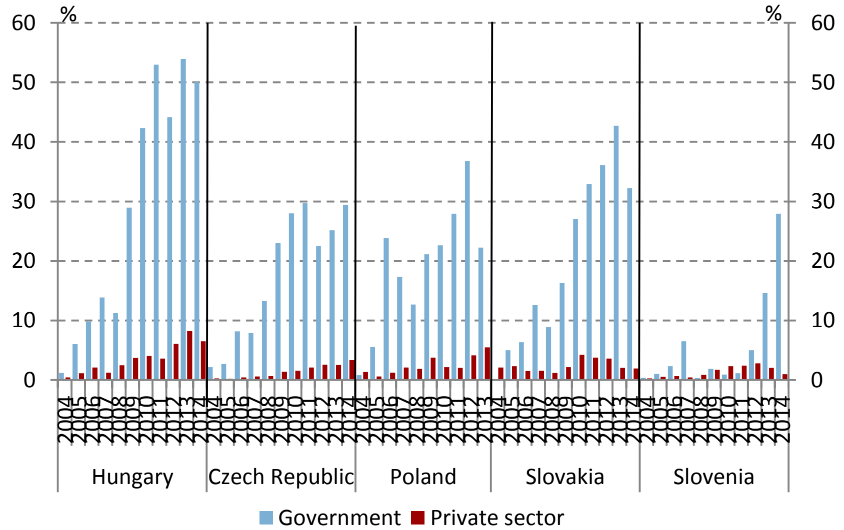
Chart 29: Breakdown of the received EU resources by sector and transfer type (as a per cent of GDP, on accrual basis)



Source: European Commission

In Hungary, capital transfers played a more significant role in both the public and private sector investments than in the countries of the region (Chart 30). Capital transfers from the EU accounted for 40-50 per cent of public investments in Hungary in recent years, as a result of which major investments were realised without generating a substantial increase in the budget deficit. On the other hand, it should be noted that public investments accounted for 4 per cent of GDP on average between 2007 and 2014, which lags considerably behind the average value of 17 per cent registered in the private sector. By contrast, in other countries of the region, the role of the EU resources was usually lower and remained below 40 per cent of total public investment. Capital transfers received by the private sector also have much lower weight in private investments, while Hungary exceeds the regional average in this respect as well. On the whole, all this may suggest that the change of the programming period may have the most severe consequences for Hungary in the financing of the investments of the individual sectors. It should be also noted that in Slovenia – although in the first half of the programming period only a smaller part of public investments was financed by EU resources – in recent years the ratio of the EU resources used by the public sector within the public investments increased at a fast rate.

Chart 30: Size of capital transfers from the EU relative to the investments of the individual sectors



Sources: European Commission, Eurostat

Gábor Bethlen

(15 November 1580 – 15 November 1629)

Prince of Transylvania (1613–1629), elected King of Hungary as Gábor I (1620–1621), one of the most prominent personalities of 17th century Hungary. At the beginning of his career he loyally served the Princes of Transylvania Zsigmond Báthory, Mózes Székely, István Bocskai and Gábor Báthory. When Gábor Báthory contemplated alliance with the Hapsburgs, he turned against him and got himself elected to the throne of the principality. During his reign, he consolidated the position of Transylvania setting both the economy and the cultural life of this part of Hungary on a path of development later generally referred to as the 'golden age of Transylvania'.

The twenty-five years preceding the rule of Bethlen were heavy with external and internal wars leaving the population considerably thinned out. Bethlen set out to stabilise the domestic situation, to consolidate his power and to rebuild Transylvania with great patience. He established a centralised state apparatus and concurrently sought to strengthen the financial status of the principality. He ordered an accurate statement of treasury revenues, had the lands and properties granted since 1588 reviewed and ratified only those which had been awarded in recognition for service to the country.

To promote industry and trade, Bethlen encouraged an economic policy of mercantilism and settled foreign craftsmen in the country. Instead of taxation, he relied on the more rational utilisation of other means deriving from his status as prince in building his rule. He developed precious metals mining, invited renowned specialists from abroad and strove to boost trade. Gábor Bethlen minted coins of a stable value and regulated the multidirectional trade in goods by prohibiting exports of key merchandise.

Gábor Bethlen attempted to form an international anti-Hapsburg coalition among western and eastern European countries. In order to strengthen his ties with the Protestant Powers, on 1 March 1626 he wed the sister of George William Elector of Brandenburg, Catherine of Brandenburg, and in 1626 he joined the Westminster alliance of the Protestant Powers.

REPORT ON THE BALANCE OF PAYMENTS

January 2016

Print: Prospektus–SPL consortium

H-8200 Veszprém, Tartu u. 6.

mnb.hu