REPORT ON THE BALANCE OF PAYMENTS

2018

OCTOBER

*'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

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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 the relevant risks. Moreover, the analysis of the balance of payments enables earlier identification of economic problems, when they are developing, and thus steps can be taken to avoid such problems.

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

Given the lessons from the financial crisis and the recent period, a country's balance of payments and the 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. The primary goal of the Report on the Balance of Payments is to inform market participants about the developments in the balance of payments by way of this regular analysis, 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 for Monetary Policy and Economic Analysis. Contributors: Eszter Balogh, Anna Boldizsár, Gabriella Csom-Bíró, Orsolya Csortos, Bence Gerlaki, Zsuzsa Kékesi, Balázs Kóczián, Péter Koroknai and Balázs Sisak. The Report was approved for publication by Márton Nagy, Deputy Governor.

This Report is based on information pertaining to the period ending 20 September 2018.

Summary

Developments in 2018 Q2 indicate a **further decline in external vulnerability**. In conjunction with strong domestic demand, **the net lending of the economy amounted to 4 percent of GDP, and the current account surplus amounted to 2.5 percent**. **These indicators for Hungary remain outstanding in a regional comparison**. In connection with the significant net lending, **net external debt declined to a historical low, falling to below 10 percent of GDP**.

According to the real economy approach, **the surplus on the balance of goods and services was around 7 percent of GDP**. This surplus, which is somewhat lower than before, is mainly attributable to the goods balance, while the services balance improved slightly. Evolution of the goods balance was primarily driven by an expansion in import-intensive investments and a pick-up in households' consumption, as well as – to a lesser extent – the deterioration in the terms of trade. In addition, **the surplus on the transfer balance also declined slightly**, due to the restrained absorption of EU transfers. Compensation of employees and interest expenditures had impacts of similar size, but in opposite directions, on the **deficit of the income balance, which was thus stable**.

The **net lending of the economy declined on the basis of the financing side as well, which was mainly related to the continued decline in external debt**, while FDI funds stemming from transactions remained practically unchanged, as opposed to the significant declines typical of the same periods of previous years. **The decline in net external debt was related to the general government** and was partly offset by a slight increase in the net external debt of companies and banks. Both the rise in external assets – attributable to expanding FX reserves and EU fund absorption – as well as the drop in non-residents' holdings of forint-denominated government securities played a role in the continued improvement in the net debt position of the general government.

Net external debt fell to a historical low of less than 10 percent of GDP, indicating a further decline in the country's external vulnerability. In addition to debt repayment, the revaluation of stocks (related to rising yields) and the expansion of nominal GDP also contributed to the fall in the indicator. **The gross external debt of the economy amounted to 60.3 percent of GDP**. **Foreign exchange reserves expanded faster than short-term external debt, and thus the reserves exceed the level expected and considered safe by investors to a greater degree than before**.

According to the savings of sectors, the modest decline in net lending is explained by the fact that the increase in households' net lending was exceeded by the expansion in the net borrowing of the government and companies. The **general government's net borrowing increased slightly compared to the previous quarter**, but remains subdued. The **increase in the net financial savings of households** resulted from a rise in net credit flow, which was exceeded by the accumulation of financial assets. In the period under review, in addition to liquid investment assets, **households' holdings of government securities continued to grow**; the increase in the proportion of long-term securities in these holdings results in a decrease in rollover risk, and thus **a decline in the economy's external vulnerability**.

In our special topic we describe that – on the basis of the actual data replacing estimates – the profits of foreign-owned companies expanded in 2017 as well. Accelerating export dynamics, the decline in the corporate tax as well as one-off corporate effects may also have contributed to the **rise in corporate profits**. Foreign companies **reinvested nearly two thirds of their earnings in Hungary**, while the ratio of dividends paid to abroad declined further, resulting in a historically high reinvestment rate. At the same time, the income balance deficit was reduced by **the fact that – following the previous year – the profits of companies owned by residents and operating abroad increased again**. In a regional comparison, as a result of recent years' steady rise, **the return on equity observed in Hungary already exceeds the levels in Slovakia or Poland**, while dividends as a proportion of income remains the lowest in Hungary. In spite of the rise in foreign companies' profits, the Hungarian GNI–GDP gap is relatively low.

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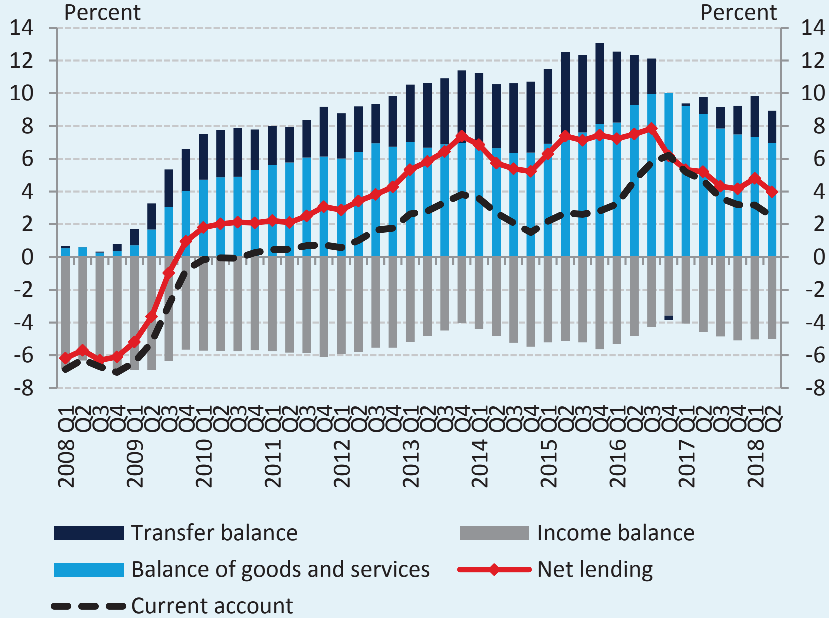
1 Real economy approach

Based on the real economy approach, in 2018 Q2 the net lending of the Hungarian economy and the current account surplus amounted to 4.0 percent and 2.5 percent of GDP, respectively. Developments in external balance indicators were primarily affected by the balance of goods and services, with buoyant household consumption and expanding investment as underlying factors. In conjunction with the subdued absorption of EU transfers, the surplus on the transfer balance declined slightly during the quarter under review. The income balance deficit did not change significantly compared to Q1, remaining at 5 percent of GDP.

In 2018 Q2, Hungary's four-quarter net lending according to the real economy approach and the current account surplus amounted to 4.0 percent of GDP and 2.5 percent of GDP, respectively (Chart 1). According to seasonally unadjusted figures, net lending in Q2 amounted to EUR 1.2 billion, with surpluses of EUR 800 million and EUR 400 million on the current and capital accounts, respectively. In Q2, the decrease in the trade surplus and the lower transfer balance also played a role in the changes in net lending, while the income balance deficit remained practically unchanged.

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



**Income balance: earned income, income on equity and income on debt. Transfer balance: sum of the capital account and other primary and secondary income.*
All charts by the MNB unless otherwise indicated.

Box 1.: Revision of the balance of payments

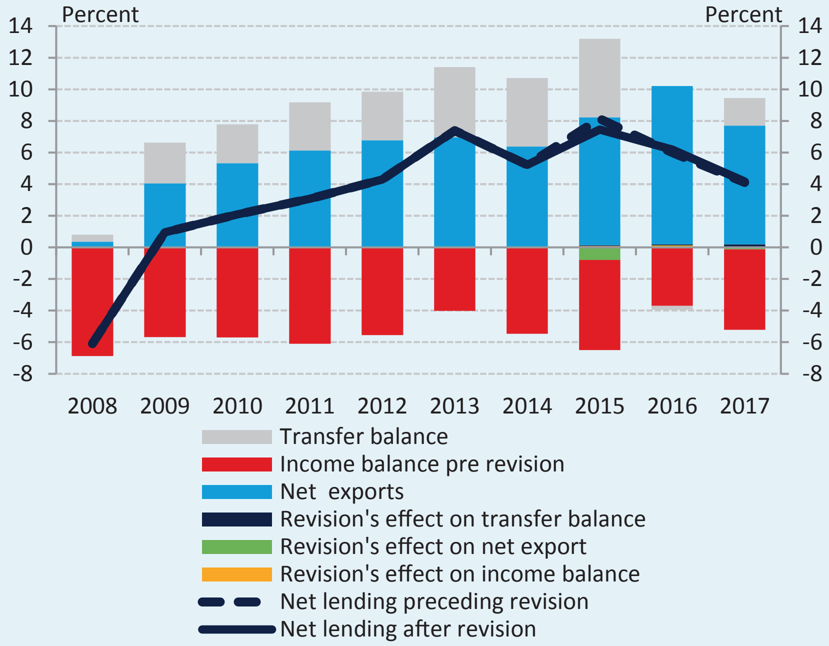
The balance of payments data were retroactively amended in the data reporting on the balance of payments, reducing the 2015 net lending by 0.8 percent of GDP compared to the previously published data, but without any major impact on 2016 or 2017 (Chart 2). Many figures in the balance of payments can be considered preliminary data until the September data reporting: amongst others, the final annual figures on the profits of foreign-owned companies also become known with the September data release. Accordingly, the income figures for 2017 first appear in this balance of payments publication dated 20 September 2018, as part of the revision. In addition, the balance of goods and services, the transfer balance and – to a lesser degree – the balance of the incomes of those who temporarily work abroad also changed. Nevertheless, these changes do not result in a material change in our view of the external balance developments in recent years. The most important changes are as follows:

– The surplus of the goods and services balance declined to a greater degree in 2015 in relation to the integration of the source and absorption tables linked to the national accounts, which was also reflected in the net lending figure. The 2017 and 2018 Q1 shifts in the data were also in conformity with the national account statistics of the HCSO.

– According to the questionnaire-based actual figures on corporate profits, in 2017 the income balance of foreign-owned corporations was some EUR 20 billion lower than the earlier estimate. This difference, however, evolved with a larger-than-expected increase in the gross components.

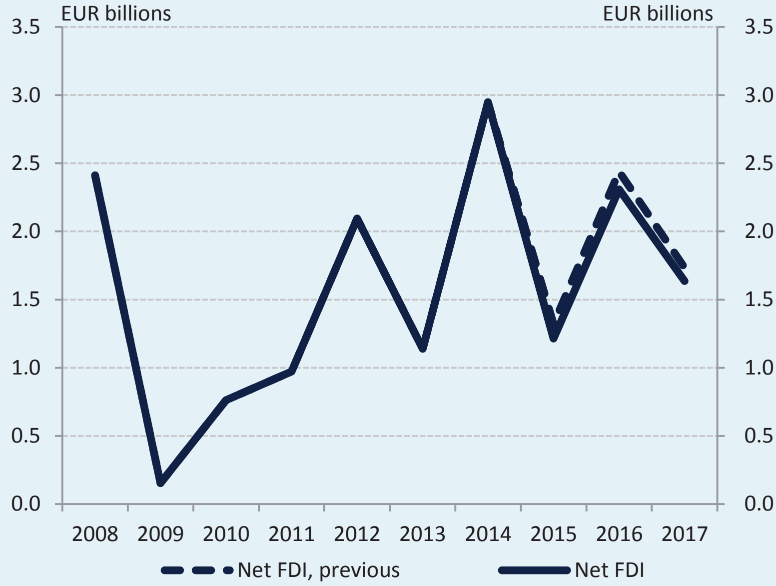
On the whole, based on real economy transactions and compared to the previously published data, in 2015 net lending declined by 0.6 percent of GDP and then remained practically unchanged in 2016 and 2017. The 2015 decline in net lending calculated using the top-down approach reduced the difference between the net lending figures calculated according to the two approaches, i.e. it lowered the balance of errors and omissions. In the data for 2018 Q1, the surplus on the balance of goods and services decreased.

Chart 2: Impact of the revisions on the income balance and net lending, values as a percentage of GDP



As a result of the revision of the balance of payments, net FDI inflows in 2017 were EUR 100 million lower compared to the preliminary data. There were only minimal changes in the FDI data for 2017. Upon revision of the balance of payments statistics in September, the questionnaires received from companies usually result in significant amendments to the data concerning foreign companies' profits, and thus to the value of foreign direct investments. For the year 2017, this change added a mere EUR 20 million to the balance of foreign direct investments. However, its impact was offset by the fact that the balance of equities within foreign direct investments changed within the framework of the usual revisions. This reduced the balance of FDI inflows by some EUR 130 million in 2017, and thus net FDI inflows declined by around EUR 100 million compared to the previous data release. As a result of the above, net FDI inflows amounted to EUR 1.6 billion in 2017, roughly corresponding to the average of the previous two years (Chart 3).

Chart 3: Impact of the revisions on net FDI



The revisions of 2018 Q1 mainly concerned transactions involving debt items, which reduced the error of the balance of payments. In Q1, net outflows of debt expanded by EUR 0.3 billion as a result of the revisions, which was also supported by lower FDI inflows, and thus net lending calculated using the bottom-up method exceeded the figure shown in the previous data release by EUR 0.4 billion. By contrast, the net lending figure calculated using the top-down approach declined by EUR 0.2 billion, mainly as a result of a smaller surplus on the balance of goods and services. Thus, on the whole, the difference between the net lending figures according to the two approaches of the balance of payments declined by EUR 0.6 billion in Q1.

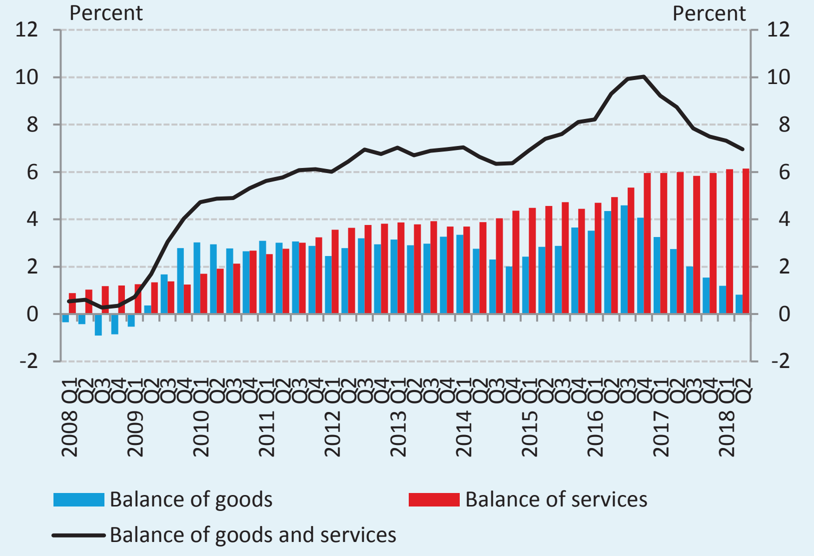
Table 1.: Impact of the revisions on the components of net lending (EUR billions)

	2015	2016	2017	2018. Q1
I. Change in net lending from real economy's side (1+2+3)	**-0.8**	**0.2**	**0.1**	**-0.2**
1. Balance of goods and services	-0.9	0.0	-0.2	-0.2
2. Income balance	0.1	0.1	0.0	0.0
3. Transfer balance	0.0	0.1	0.2	0.1
Current account	***-0.8***	***0.2***	***0.1***	***-0.2***
II. Change in net lending from financing side -(5+…+8)	**0.1**	**0.2**	**-0.1**	**0.4**
5. Foreign direct investment	0.1	0.1	0.1	0.2
6. Portfolio equity	0.0	0.0	0.1	0.0
7. Derivatives	0.0	0.0	0.0	0.0
8. Net debt	0.0	0.0	-0.3	0.3
Net errors and omissions (I.-II.)	***-0.9***	***0.0***	***0.2***	***-0.6***

1.1 Trade balance

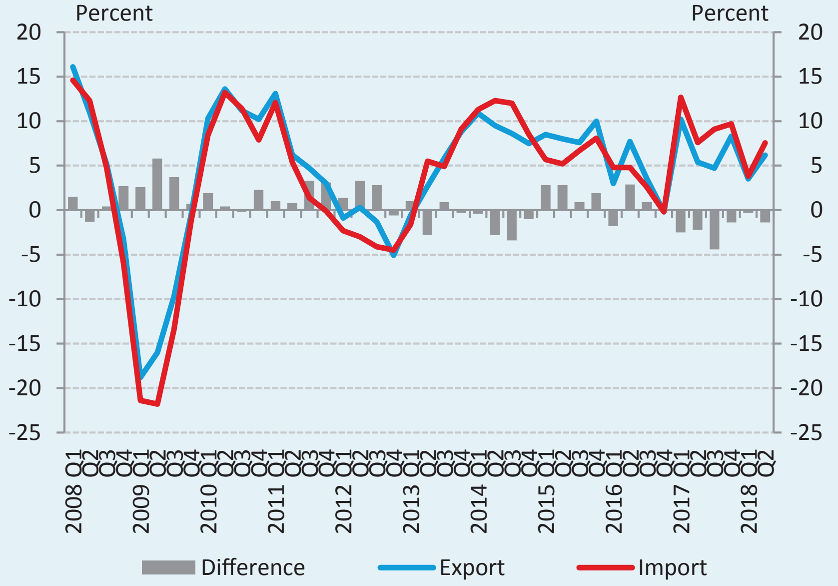
The trade surplus amounted to 7 percent of GDP, reflecting a slight decline in connection with the decrease in the surplus on the goods balance (Chart 4). The trade surplus amounted to 7 percent of GDP in 2018 Q2. The decline in the balance was attributable to the goods balance, while the balance of services improved slightly in Q2. Similarly to the previous quarters, the decline in the goods balance was primarily attributable to the expansion in import-intensive investment, the increase in household consumption and – to a lesser extent – the deteriorating terms of trade. As in the previous quarter, the surplus on the services balance amounted to 6.1 percent of GDP, as a result of which the share of net exports of services within the annual trade balance was close to 90 percent, while services exports account for only some 20 percent of total exports. The further rise in the surplus of tourism and transportation services contributed to the high services balance in Q2 as well.

Chart 4: Developments in the balance of trade and its components (four-quarter values as a percentage of GDP)



As in the previous periods, annual real growth in imports exceeded the expansion in exports in 2018 Q2 as well (Chart 5). As a result of stronger consumption and growth in capacity expanding investment, annual real growth in imports increased to 7.5 percent in the period under review. Similarly to imports, export growth accelerated in Q2, although the rate fell short of that of imports, and thus net exports declined slightly. The increase in export dynamics may have been attributable to the further improvement in the performance of the services sector as well as the dynamic rise in the production of the chemical and metal industries and also to the sales from inventories.

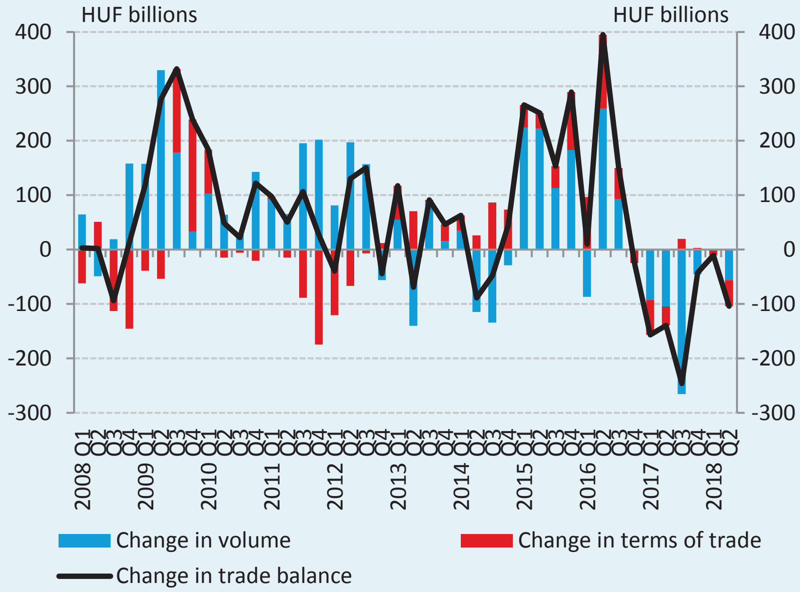
Chart 5: Annual real growth in exports and imports



Source: HCSO, MNB.

In addition to the change in volume, the change in the terms of trade also played a role in the decline in the trade surplus in Q2 (Chart 6). Before 2017, Hungary's terms of trade improved considerably due to the moderate commodity prices, but in the past one and a half years the terms of trade tended to have a negative impact on the trade balance because of the rising oil prices. At the beginning of the year, the impact of rising oil prices was still more or less offset by favourable developments in the prices of other export products. In Q2, the annual decline in the goods and services balance of more than HUF 100 billion evolved in parallel with a similar decline in the change in volume and the terms of trade impact.

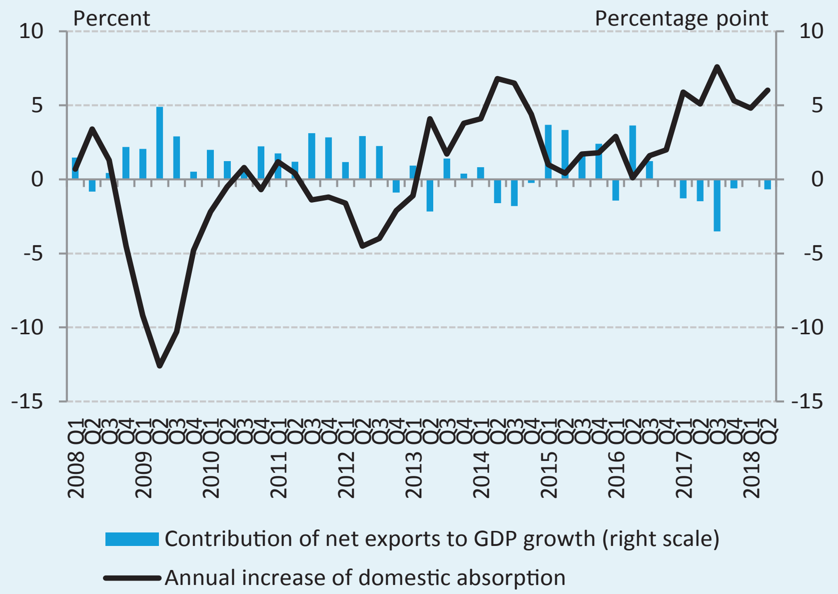
Chart 6: Developments in the balance of trade factors according to GDP (year-on-year)



Source: HCSO.

As opposed to the previous quarters, the annual growth rate of domestic absorption rose again, while the contribution of net exports to growth turned negative (Chart 7). In Q2, buoyant household consumption and gross fixed capital formation were the sources of economic growth entirely. Purchases of durable and semi-durable goods played a major role in the expansion in consumption expenditures, which was also reflected in the decline in the goods balance. As exports grew more slowly than imports in Q2, the contribution of net exports to GDP growth was negative on the whole.

Chart 7: Annual growth rate of domestic absorption and contribution of net exports to GDP growth

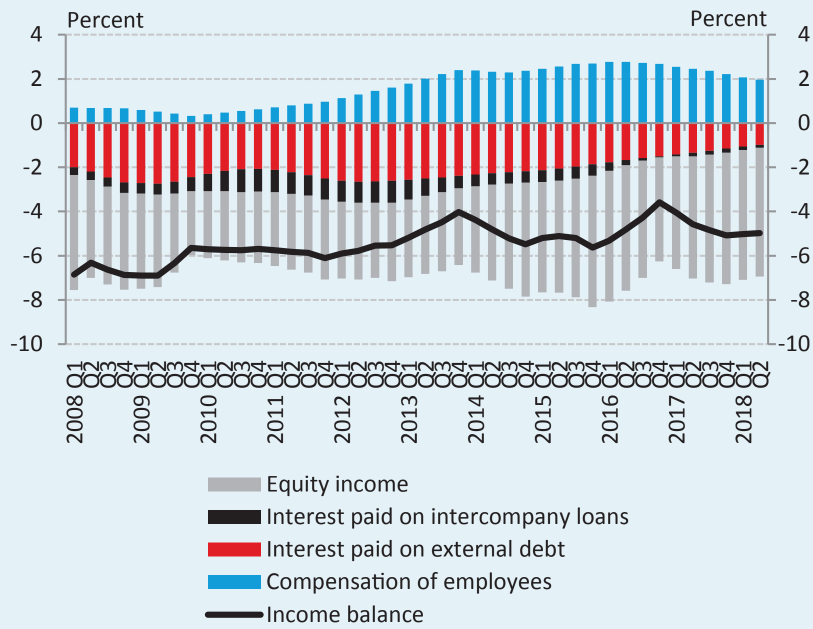


Source: HCSO.

1.2 Income balance

The deficit on the income balance was stable in 2018 Q2, evolving in parallel with declines in employee incomes and interest expenditures, which were similar in terms of magnitude, but in different directions (Chart 8). As in the previous quarter, the deficit on the income balance did not change significantly in Q2. The decline in employee incomes observed in previous periods continued in Q2 as well, although its effect was offset by an improvement in the interest balance of foreign loans. According to preliminary data, the profit of foreign-owned companies did not change in Q2 and still amounted to 6 percent of GDP: consequently, it remains the most significant item in the income balance. It is important to emphasise that, thanks to the September data reporting, actual data are now available for foreign companies' 2017 profits and these data show values that are similar to the earlier estimate (for more details in connection with the profits of foreign companies, see the special topic of the Report).

Chart 8: Developments in the items of the income balance*
(four-quarter values as a percentage of GDP)

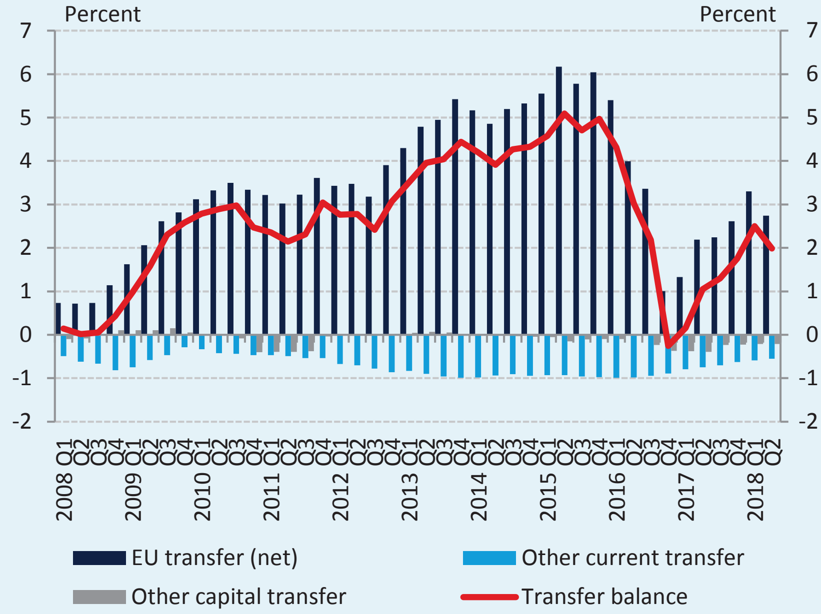


** Income balance: earned income, income on equity and income on debt.*

1.3 Transfer balance

The surplus on the transfer balance declined slightly in 2018 Q2, owing to more restrained EU transfer absorption (Chart 9). The transfer balance dropped in 2016 due to the closing of the funds from the 2007–2013 EU budget cycle, which was followed by steady improvement in the balance in 2017 as a result of inflows of transfers from the new cycle. In 2018 Q1, the absorption of EU funds was significant, but in Q2 the transfer balance declined slightly as a result of lower inflows of funds. At the end of the period under review, net EU transfer inflows amounted to 3 percent of GDP, which is still below the level observed before 2016, although their contribution to Hungary's favourable external balance position is significant. In contrast to EU transfers, the deficit of other transfers improved slightly, which had a positive effect on the transfer balance.

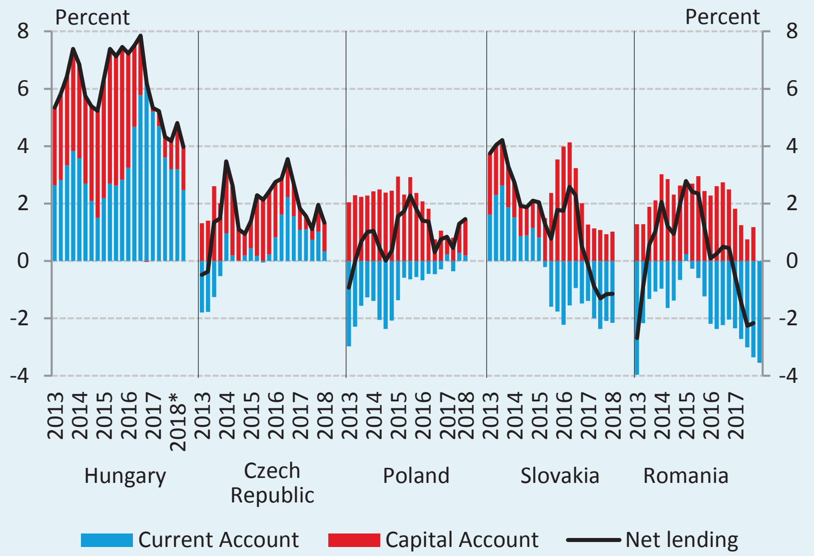
Chart 9: Four-quarter developments in the items of the transfer balance (four-quarter values as a percentage of GDP)



1.4 Regional review

In a regional comparison, Hungary's net lending is still outstandingly high. The current account balance typically declined, while the capital balance improved due to the absorption of the funds from the new EU cycle (Chart 10). In 2016, net lending dropped in general, which was primarily attributable to the decline in EU funds from the previous cycle and the decrease in the current account surplus driven by foreign trade developments, which continued in 2017 as well (for more details on the latter, see the special topic of the January 2018 Report on the Balance of Payments). In line with the inflows of funds from the new cycle, developments in the capital balance had a positive impact on the external balance position of all of the countries of the region in the past quarters. In early 2018, Hungary's net lending continued to significantly exceed the level typical of the region, which was mainly attributable to Hungary's high services balance and the capital balance, which is higher than that of the other countries.

Chart 10: Four-quarter net lending of the countries of the region (as a percentage of GDP)



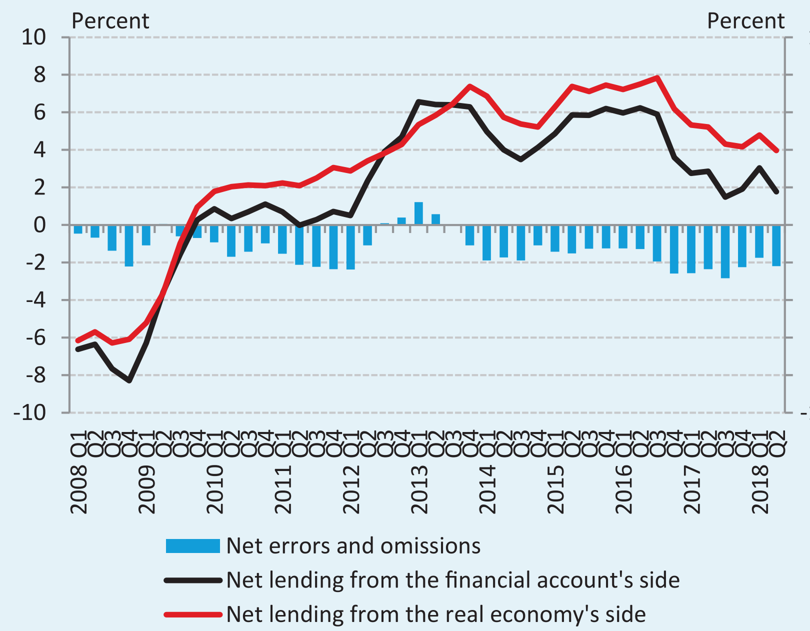
**2018 Q2 data were available only for Hungary.*
Sources: MNB, Eurostat.

2 Financing approach

Net lending amounted to 1.8 percent of GDP in 2018 Q2. Net lending declined slightly on the basis of the financial account as well, which was mainly related to the smaller decrease in external debt compared to the previous quarter. Mainly due to the dividends usual in Q2, inflows of FDI funds declined, but at the same time – contrary to the experiences of the same periods of previous years – there were no major outflows of funds. The decline in debt was related to the general government, which was partly offset by a slight increase in the net external debt of companies and banks. Banks' debt inflows were related to the decline in the sector's foreign assets, which exceeded the liabilities, with a possible contribution from a rise in the central bank's FX swaps to provide forint liquidity as well as a decrease in households' FX deposits. The rise in companies' net external debt was related to the expansion in foreign liabilities. Both the rise in external assets – attributable partly to the increase in FX reserves and partly to EU fund absorption – as well as the decline in liabilities played a role in the decrease in the debt of the general government as a result of transactions. The decline in non-residents' forint government securities holdings also contributed to the decrease in the net external debt of the government. The FX bond repayment that took place in the quarter under review reduced the gross external liabilities of the general government, while the rise in margin deposits slightly increased these liabilities. At the same time, due to their impact on FX reserves, on the whole, these developments only had a minor effect on net external debt.

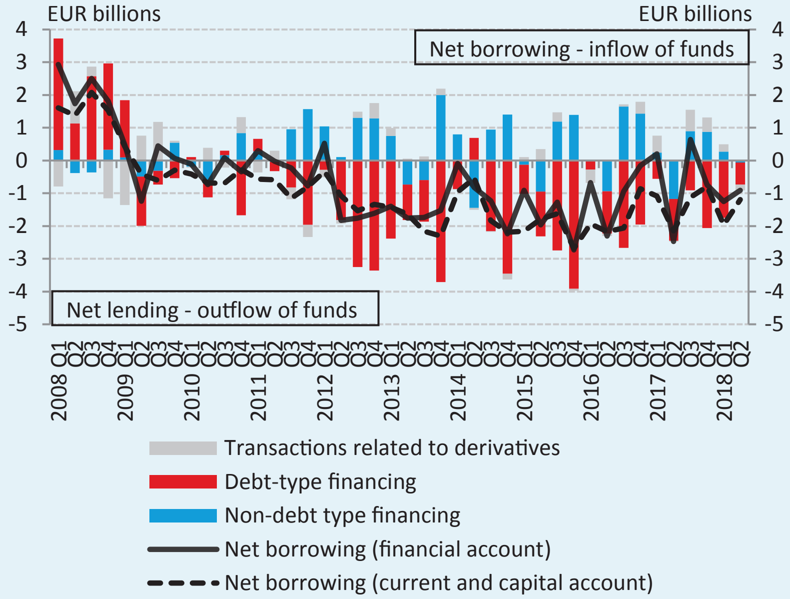
Four-quarter net lending according to the financing side declined to 1.8 percent of GDP in 2018 Q2 (Chart 11). The decline in the indicator calculated on the basis of the financial account exceeded the change that took place in net lending calculated on the basis of the real economy approach, and thus the gap between the two indicators widened. The balance of errors and omissions rose to 2.2 percent of GDP, corresponding to the average value of the past two years. All of this means that the decline in the country's external debt and liabilities indicators continues to be lower than that indicated by the current and capital account.

Chart 11: Two types of net lending and 'Net errors and omissions' (four-quarter values as a percentage of GDP)



Following a slight rise in the previous quarter, in Q2 net lending calculated on the basis of the financing side declined and amounted to some EUR 0.9 billion (Chart 12). The net outflow of funds was mainly related to the debt outflow, which was lower than in Q1, but non-debt liabilities also declined slightly. As a result of transactions, the country's net external debt decreased by some EUR 0.7 billion, while non-debt liabilities declined by nearly EUR 0.1 billion in Q2, mainly as a result of an increase in portfolio investments abroad. Net FDI fund inflows declined mainly due to the dividend payments usual in the period.

Chart 12: Structure of external financing (unadjusted transactions)

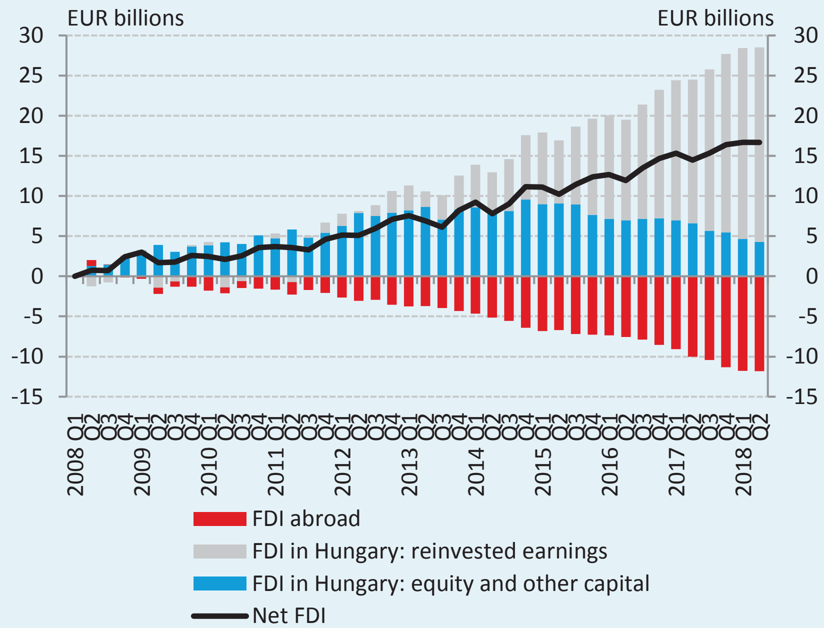


2.1 Non-debt liabilities

In contrast to the significant decline typical in the same period of previous years, net foreign direct investment was around zero in Q2 (Chart 13). In order to eliminate the distorting effects, it is advisable to examine the data net of capital-in-transit transactions and the rearrangement of the asset portfolio. Accordingly, in Q2 the increase in non-residents' investments in Hungary as well as the investments abroad of domestic companies slowed down, as a result of which the rise in foreign direct investments experienced in the previous quarters stopped. As a result of the equity-reducing effect of the superdividend disbursement,[1] foreign companies' equities in Hungary fell slightly, while the increase in reinvested earnings continued at a slower pace because of the dividends usual at this time. Contrary to the same period of previous years, there was no major decline in FDI during Q2, which is partly a result of the higher value of reinvested earnings and partly of the lower increase in domestic companies' investments abroad compared to last year.

[1] The dividend granted from retained profits (to the debit of previous periods) is considered to be a superdividend, which must be accounted for as disinvestment according to the BPM6 methodology.

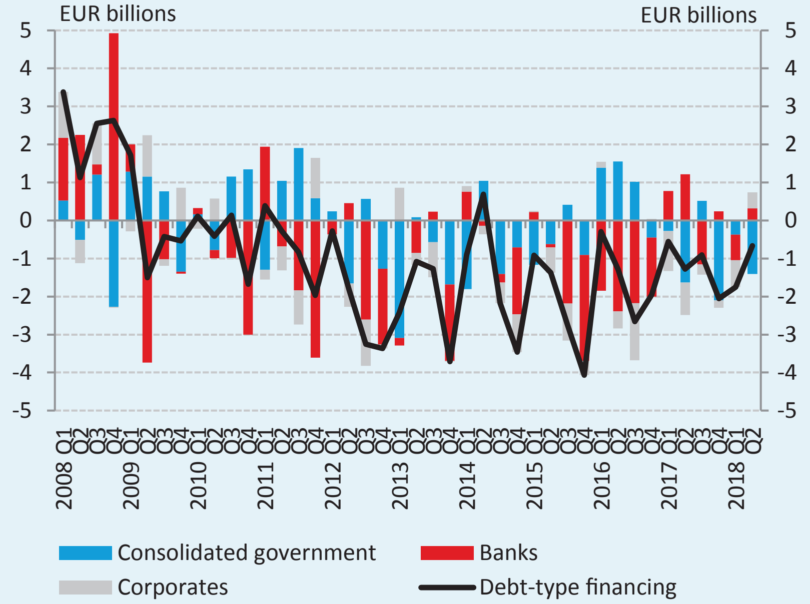
Chart 13: Developments in FDI without capital-in-transit transactions (cumulative transactions)



2.2 Debt liabilities

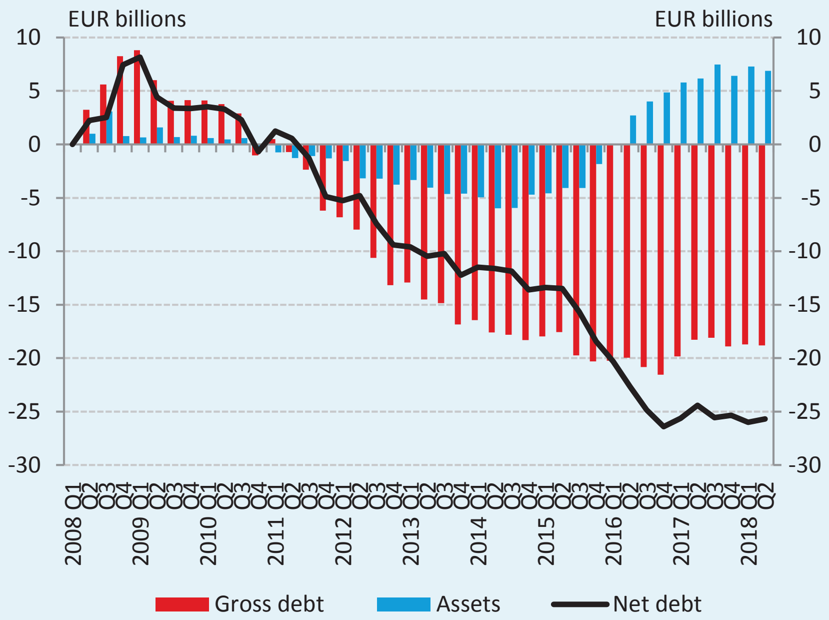
Outflows of debt liabilities fell in Q2: the decline in the net external debt of the general government as a result of transactions was partly offset by the debt inflows of the banking sector and companies (Chart 14). Debt outflows of the consolidated general government amounted to EUR 1.4 billion, which was mainly attributable to the FX reserve-increasing effect of the rise in the central bank swap instruments providing forint liquidity, the absorption of EU transfers as well as the decrease in non-residents' government securities holdings. At the same time, the improvement in the country's external debt indicators was decelerated by the fact that, following a decline in Q1, the banking sector's net external debt as a result of transactions rose by EUR 300 million, while that of the corporate sector increased by EUR 400 million in Q2.

Chart 14: Developments in net debt-type financing by sector



Banks' debt inflows as a result of transactions were primarily related to the decline in the sector's foreign assets, which was only partly offset by the modest decrease in liabilities (Chart 15). Following the previous quarter's larger increase, the banking sector's foreign assets were down by EUR 400 million in 2018 Q2, while the sector's gross external debt – as a result of transactions – declined to a lesser degree, by some EUR 100 million. As a result, banks' net debt-type financing amounted to EUR 300 million. The decline in foreign assets may have been attributable to the increase in the central bank's holdings of FX swaps providing forint liquidity as well as the decrease in the FX deposits of households and corporations. The decline in banks' gross external debt was the result of an increase in loans with maturities over one year and a decrease in bonds which exceeded this increase, while originally short-term liabilities remained practically unchanged.

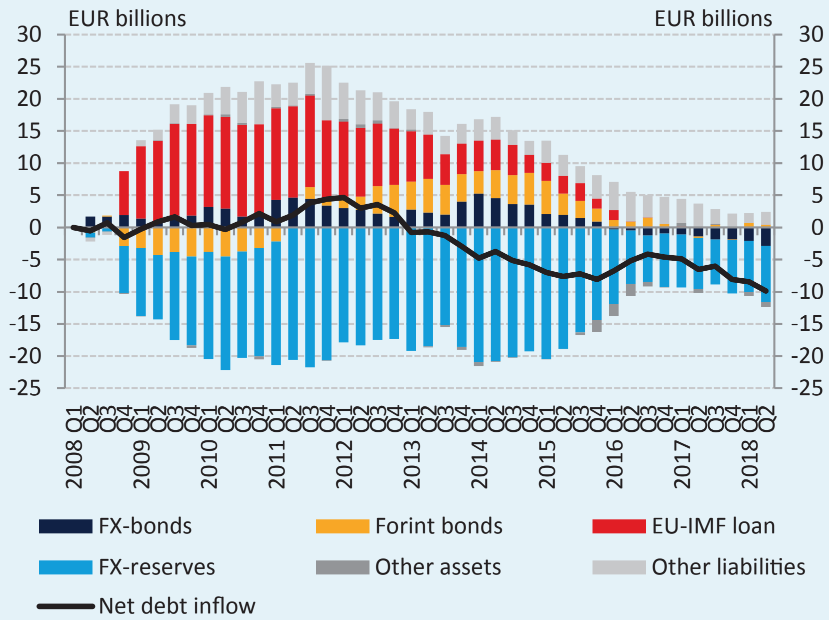
Chart 15: Developments in the banking sector's external debt and receivables (cumulative transactions)



The debt-type external liabilities of the consolidated general government including the MNB declined significantly, with contributions from an increase in foreign assets and a decrease in foreign liabilities (Chart 16). In 2018 Q2, the net external debt of the consolidated general government continued to decline, falling by EUR 1.4 billion as a result of transactions. The net outflow of funds was also supported by an expansion of EUR 0.8 billion in the foreign assets of the consolidated general government including the MNB and a decline of EUR 0.6 billion in liabilities. The foreign assets of the government increased as a result of a more than EUR 0.7 billion rise in FX reserves, which was primarily attributable to the central bank's fine-tuning FX swap facilities providing forint liquidity, and an expansion of EUR 0.1 billion in other receivables, related to EU transfer absorption. The decline in non-residents' holdings of forint-denominated government securities also supported the decrease in the government's net external debt as a result of transactions. The FX bond repayment that took place in the quarter under review reduced the gross external liabilities of the government, while the rise in margin deposits slightly increased these liabilities. At the same time, this effect was more than offset by the change in FX reserves,[2] and thus, on the whole, net external debt was affected to a smaller degree.

[2] A portion of the FX bonds maturing during the quarter was in the hands of domestic players, and thus, due to the repayment from the FX reserves, the foreign assets of the government declined to a greater degree than its foreign liabilities.

Chart 16: Breakdown of changes in the net external debt of the consolidated general government including the MNB (cumulative transactions)



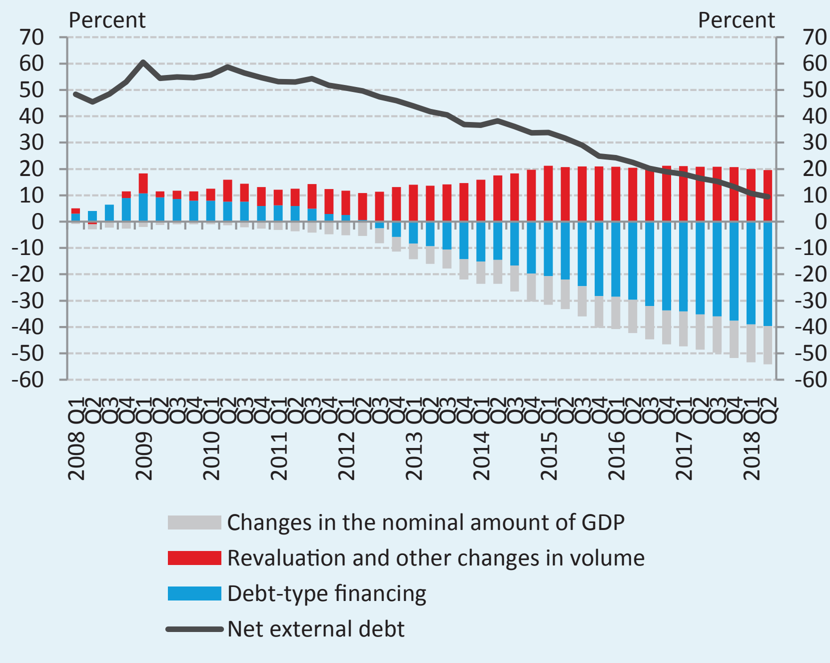
3 Developments in debt ratios

In Q2, as a result of continued outflows of debt liabilities, net external debt declined to a historical low, while gross external debt increased due to revaluation. In Q2, owing to a decline of 1.3 percentage points, net external debt fell to 9.4 percent of GDP, while gross external debt rose to 60.3 percent of GDP. The decline in net external debt received nearly equal support from the outflow of funds and the revaluation of stocks, and – to a much lesser degree than these two effects – the change in nominal GDP also contributed to this trend. The revaluation of the net external debt stock was attributable to the result of contrasting effects: while the rise in yields reduced the level of net external debt, the revaluation of exchange rates increased it. In line with the developments in transactions, the general government played the main role in the decline in net external debt, which was supported by revaluation effects as well, while the ratio of banks and the corporate sector remained almost unchanged. In terms of gross external debt as a proportion of GDP, while the gross external debt of the consolidated general government declined, the gross external debt of the private sector increased. In 2018 Q2, the country's short-term external debt3 increased slightly further, and amounted to EUR 18.7 billion. The increase is primarily related to the consolidated general government, the effect of which was only partly offset by the decline seen in the case of the banking sector. FX reserves continue to significantly exceed the level expected and considered safe by investors.

3.1 Developments in net and gross external debt

In 2018 Q2, the net external debt of the economy declined by 1.3 percentage points to 9.4 percent of GDP, reaching the historically lowest level for this ratio. The decline was primarily attributable to outflows of debt-generating liabilities and the revaluation of stocks (Chart 17). The stock of net external debt declined to below 10 percent of GDP, indicating a further reduction in the country's external vulnerability. The outflow of debt-generating liabilities observed in recent years continued in Q2 as well, resulting in a 0.5-percentage point decline in the stock of net external debt as a proportion of GDP. The revaluation of stocks also reduced the debt ratio by 0.5 percent of GDP, while the expansion in nominal GDP reduced it by 0.3 percentage point. Net external debt was slightly increased by the revaluation of exchange rates and was reduced to a greater degree by an increase in yields through the repricing government securities holdings.

Chart 17: Components of changes in net external debt (cumulative values excluding intercompany loans as a percentage of GDP, end-2007 = 0)

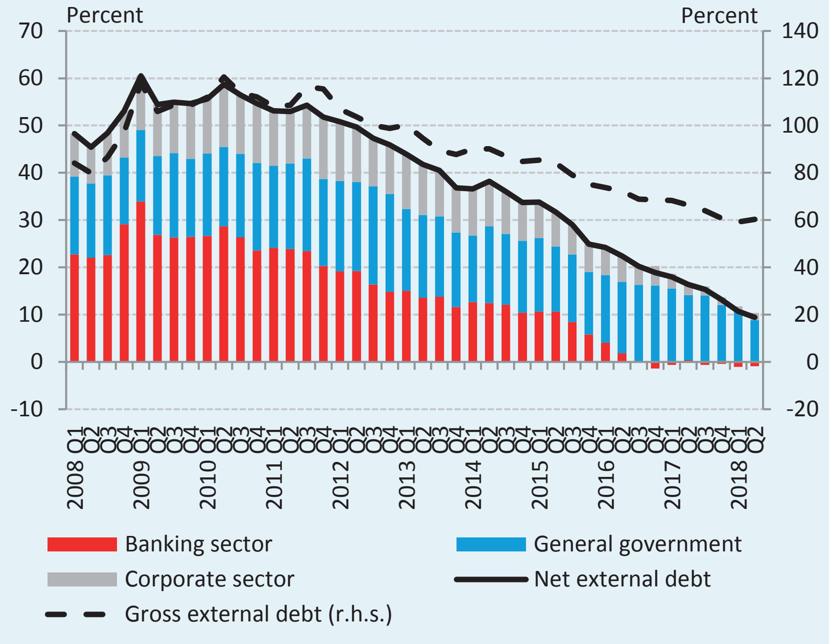


3 In general, short-term external debt means external debt that is short-term according to residual maturity.

The decline in the historically low net external debt in Q2 was related to the general government, while the indicator of the corporate sector increased and that of the banking sector remained practically unchanged (Chart 18). The change in the net external debt of the general government as a result of transactions was mainly attributable to the increase in FX reserves and the rise in external assets due to the expansion in EU transfers. In addition, the rise in yields related to the repricing of long-term government securities held by non-residents reduced the external debt of the government, while the revaluation of exchange rates increased this debt. The impact of the revaluation on net external debt was reduced by the fact that – in addition to the foreign exchange liabilities – it also affected the stock of foreign assets through FX reserves. The impact of the modest inflow of funds to banks was offset by the joint effect of the revaluation of the stock and the nominal GDP that reduced the net external debt, and thus in the case of this sector, net external debt as a proportion of GDP remained practically at the same level. The net external debt of the corporate sector increased in line with the transactions during the quarter under review.

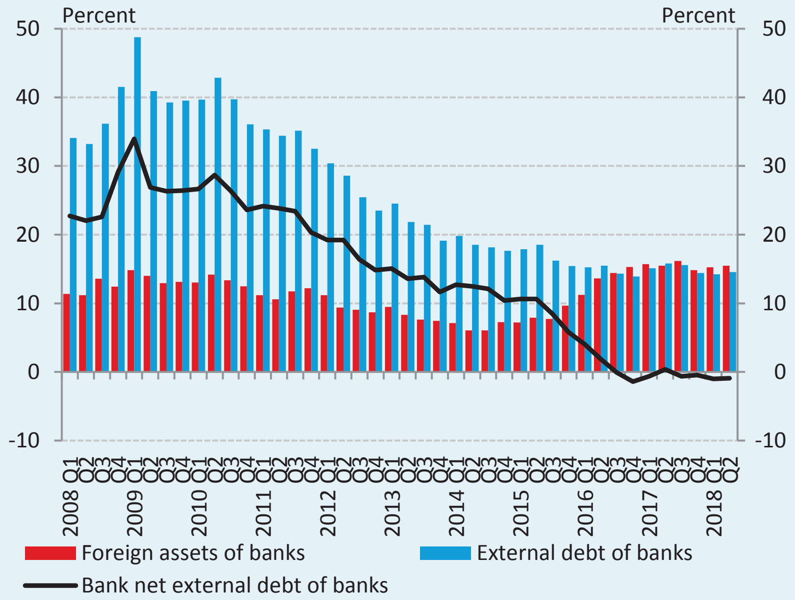
In 2018 Q2, gross external debt corresponded to 60.3 percent of GDP, representing a slight rise as a result of developments in private sector debt. According to the breakdown by sectors, while the private sector's gross external debt grew by 1.6 percent of GDP, that of the consolidated general government fell by 0.5 percent of GDP. Accordingly, the rise in the stock indicator is mainly attributable to the gross external debt of the private sector, and within that primarily to the expansion in the private sector's gross external debt. The gross external debt of the general government was reduced by a decline in non-residents' government securities holdings as well as a rise in yields, although this effect was offset to some extent by the revaluation of exchange rates. The rise in the corporate sector's commercial loans outstanding and the revaluation of stocks was also a factor behind the increase in the private sector's gross external debt.

Chart 18: Net external debt in a sectoral breakdown and gross external debt (as a percentage of GDP, excluding intercompany loans)



In 2018 Q2, as a result of nearly identical increases in assets and liabilities, the banking sector's net external debt remained practically unchanged, and thus the sector's foreign assets continue to exceed its foreign liabilities (Chart 19). The stabilisation in the net external debt of the banking sector is the result of the fact that – in contrast to transactions – both foreign assets and foreign liabilities increased slightly. The expansion of gross liabilities amounting to 0.4 percent of GDP and of gross foreign assets amounting to 0.3 percent of GDP was primarily attributable to the revaluation of the exchange rate.

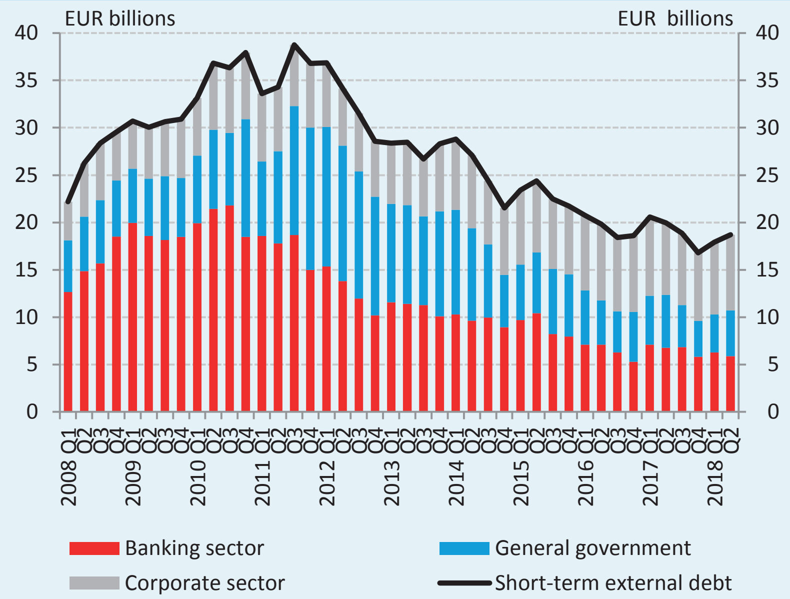
Chart 19: Developments in the banking sector's external assets and liabilities (as a percentage of GDP)



3.2 Developments in short-term external debt

At the end of the second quarter of 2018, following a rise of EUR 0.8 billion, short-term external debt amounted to EUR 18.7 billion (Chart 20). The increase in short-term external debt is primarily related to the consolidated general government, the effect of which was only partly offset by the decline seen in the case of the banking sector. The rise of EUR 800 million in the short-term external debt of the general government is entirely attributable to the expansion in the short-term external debt based on original maturity, which is mainly explained by the rise in margin accounts that hedge the US dollar exposure to the euro, due to the appreciation of the US dollar. The sector's stock with shortening maturity remained practically unchanged, as the effect of the fact that the MNV's (Hungarian National Asset Management Inc.) bond that can be exchanged for Richter shares became maturing within one year was offset by a euro bond maturing in June. The short-term external debt of the banking sector declined by EUR 400 million, which is attributable to a lesser extent to the decline in short-term external debt based on original maturity and to a greater extent to the decline in external debt with shortening maturity related to bond maturities. The corporate sector's short-term external debt rose by EUR 0.4 billion, which is attributable to the expansion in commercial loans.

Chart 20: Developments in gross short-term external debt based on residual maturity



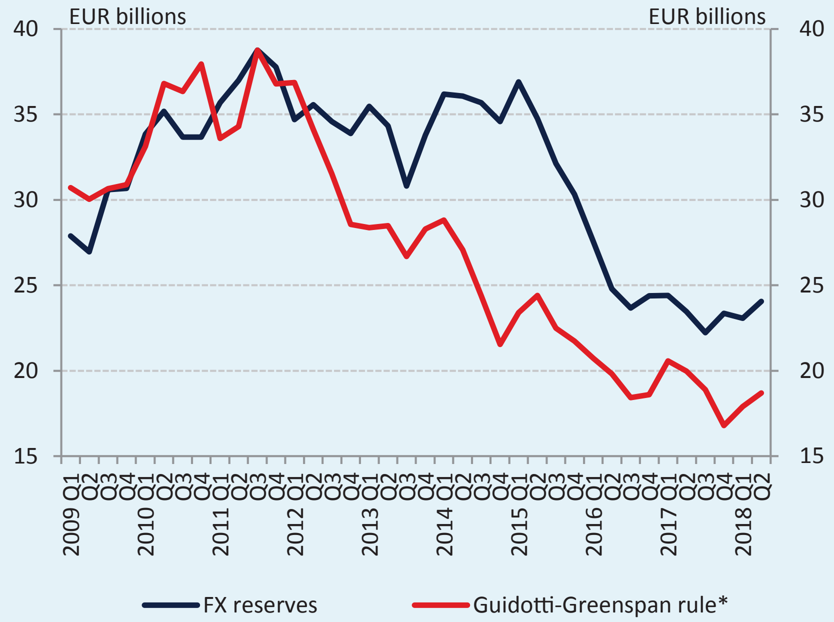
3.3 Developments in foreign exchange reserves and reserve adequacy

FX reserves increased in 2018 Q2, mainly as a result of FX swap tenders providing forint liquidity as well as the weakening of the euro against the major currencies and the EU funds received. At end-June 2018, international reserves amounted to EUR 24.1 billion, representing a rise of EUR 1 billion compared to the level at the end of the first quarter of 2018. The following main items influenced the changes in FX reserves:

- The impact of FX swap instruments providing forint liquidity on FX reserves amounted to EUR 1.4 billion in Q2.
- The reserve-increasing effect of the change in *margin deposit holdings related to the ÁKK's (Government Debt Management Agency) and the MNB's hedging swap transactions* was close to EUR 600 million, which is mainly attributable to the depreciation of the euro against the US dollar observed for most of the period.
- Other major reserve-increasing items included *revaluation effect* stemming from the appreciation of the euro against other currencies as well as the *EU funds* received during the quarter, which amounted to nearly EUR 300 million.
- The reserve-reducing effect of *public foreign currency expenditures* was around EUR 1.7 billion, which was mostly related to the *ÁKK's net FX financing*. A euro bond with a 10-year original maturity and a value of nearly EUR 1.3 billion matured in June 2018, and the repayment of FX loans as well as the ÁKK's FX interest payments and other FX expenditures of the Hungarian State Treasury also resulted in a decline in FX reserves.

As a result of the increase in FX reserves and a smaller rise in short-term external debt, FX reserves continue to significantly exceed the level expected by investors (Chart 21). Based on the Guidotti–Greenspan rule, which is closely followed by both the central bank and investors, the foreign exchange reserves of EUR 24.1 billion at the end of June 2018 significantly exceed the level of short-term external debt, which amounts to EUR 18.7 billion. In parallel with a rise of EUR 1 billion in FX reserves, short-term external debt rose by roughly EUR 0.8 billion compared to its end-March level. A considerable portion of this was related to the increase in the ÁKK's and the MNB's margin debt, which, in addition to the aforementioned impact on FX reserves, adds to short-term external debt as well and is thus neutral in terms of reserve adequacy according to the Guidotti–Greenspan indicator. As a result of the two changes, on the basis of the Guidotti–Greenspan rule, FX reserves in 2018 Q2 exceeded the short-term external debt by EUR 5.4 billion, which continues to represent a safe level.

Chart 21: Short-term external debt and FX reserves of the Hungarian economy



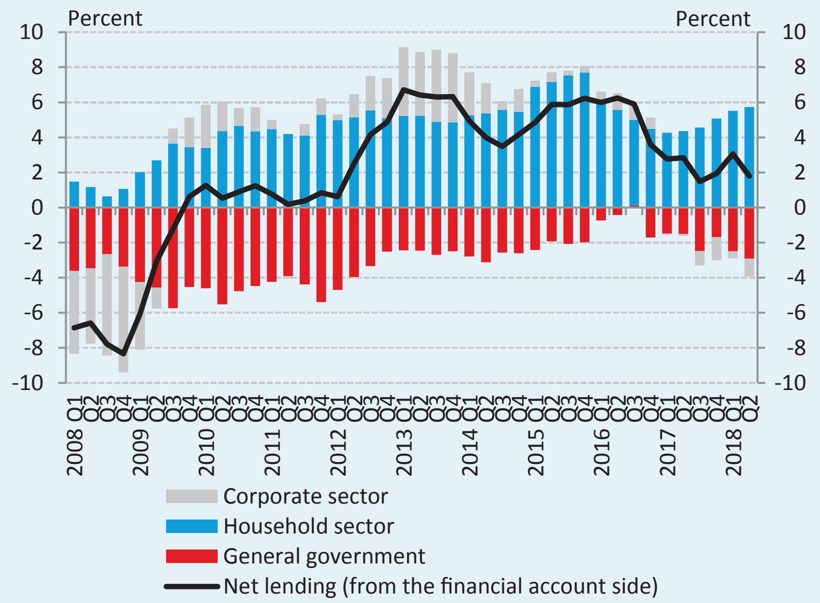
** Guidotti–Greenspan indicator: short-term external debt based on residual maturity.*

4 Sectors' savings approach

According to the savings of sectors, the four-quarter net lending of the Hungarian economy declined in 2018 Q2, and amounted to 1.8 percent of GDP. The rise in households' net lending was significantly exceeded by the expansion in the net borrowing of the general government and companies, which was thus reflected in the decline in net lending. Compared to the previous quarter, the net borrowing of the general government increased slightly, but can still be considered subdued. Based on seasonally adjusted data, the increase in households' net credit flow was mainly attributable to the expansion in housing loans and to a lesser extent to the expansion in consumer loans, while financial asset accumulation remains high. Households mostly increased their liquid financial assets in the quarter under review, but government securities holdings also rose considerably. Long-term government securities, which came to the fore at the beginning of 2017, are still preferred over short-term securities by households, resulting in a decline in the rollover risk through the increase in average maturity, and thus in lower vulnerability of the economy.

According to the savings of sectors, the four-quarter net lending of the Hungarian economy declined to 1.8 percent of GDP in 2018 Q2 (Chart 22). The four-quarter net borrowing of the general government increased to nearly 3 percent of GDP, explained by the expansion in budgetary institutions' own – investment, personnel and operating – expenditures as well as by lower revenues due to the absence of one-off items related to the tax credit for growth. The net borrowing of the corporate sector increased further in Q2, which is mainly attributable to the steady expansion in investment. Households' four-quarter net financial savings rose to nearly 6 percent of GDP in the past quarter, primarily as a result of an expansion in financial assets. Rising gross financial asset accumulation is in line with the strong wage dynamics stemming from the tight labour market environment, while the expansion in liabilities is attributable to long-term housing loans.

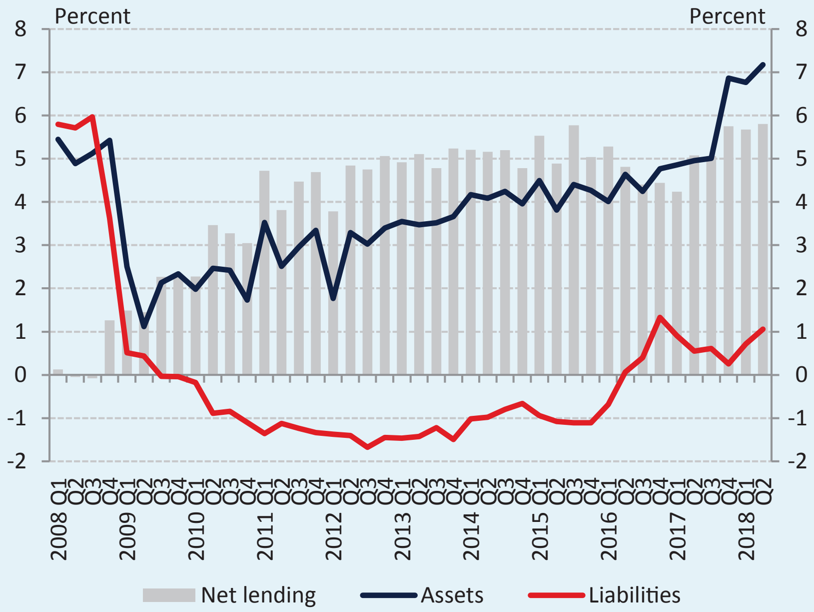
Chart 22: Net lending of the individual sectors* (four-quarter values as a percentage of GDP)



** General government represents the net borrowing according to the financial accounts. Corporate savings calculated as a residual.*

Following a slight increase, households' net financial savings according to seasonally adjusted underlying developments amounted to 5.8 percent of GDP in Q2 (Chart 23). Households' seasonally adjusted net credit flow increased to 1 percent of GDP in Q2, with an expansion in real estate loans as the main contributor, while consumer loans also rose slightly. Households' gross financial savings amounted to 7.2 percent of GDP in Q2, in which a major increase in banks' liquid assets and cash holdings played the main role. The expansion in households' cash holdings amounted to nearly HUF 300 billion in Q2, which marks a historical high. In addition, holdings of long-term securities – and within that mostly the holdings of government securities – also increased.

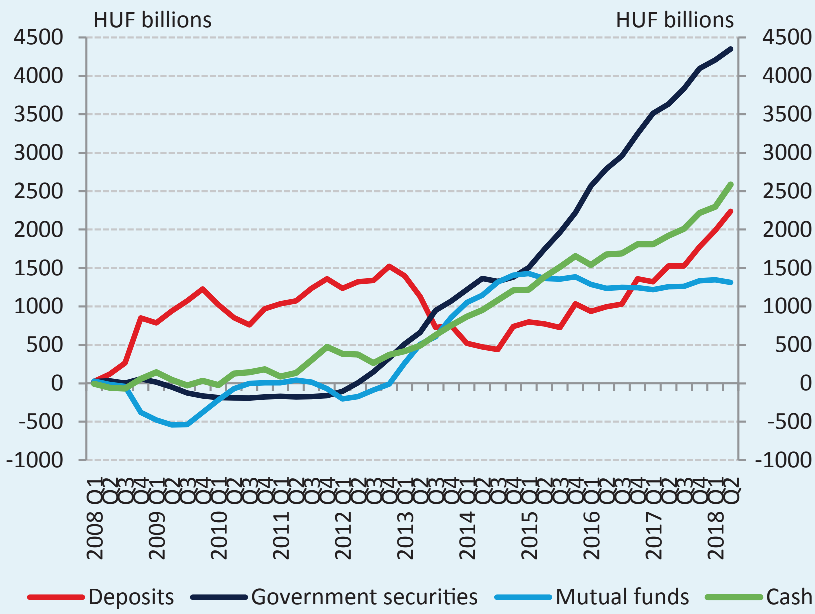
Chart 23: Net lending of households (seasonally adjusted revised* values, as a percentage of GDP)



**Figures showing underlying trends, adjusted for the impact of pension savings, the early repayment scheme and the real yield payment, the indemnification of the depositors of liquidated mutual savings banks as well as the forint conversion and settlement. Time series are adjusted separately.*

In Q2, in addition to liquid investment assets, a rise in government securities characterised the accumulation of households' gross financial assets, with this increase continuously playing a significant role in financing the general government from domestic sources (Chart 24). Within households' financial assets, liquid investment forms still tend to have a significant overweight: the increase in the sector's cash holdings slightly exceeded even the major expansion in current account deposits in Q2. The growth in households' government securities savings continued: the sector's government securities holdings were close to HUF 5,300 billion. Preference for longer-term securities over short-term ones was observed in the past quarter as well, although the latter also showed a slight increase.

Chart 24: Developments in households' key financial assets (cumulative transactions)



5 Profits of foreign-owned companies

Our special topic provides a detailed presentation of the earnings realised by foreign-owned companies4 in 2017. Based on the actual data replacing estimates, the profits of foreign-owned companies increased in 2017 as well. In addition to the acceleration in export dynamics to close to 10 percent and the reduction of the corporate tax rate, one-off corporate effects may also have played a role in the significant increase in corporate profitability. Foreign companies disburse a decreasing share of their profits as dividend, as a result of which they reinvested nearly two thirds of the profits in Hungary, and thus the magnitude of reinvestment rose to a historical high, i.e. 5 percent of GDP. In a sectoral breakdown, in line with the expansion in lending and the improving macroeconomic environment, banks' profit rate increased to a greater degree, although in terms of its level it falls short of the rate observed at non-financial corporations.5 According to the sectoral breakdown, profits on foreign direct investment grew considerably in a wide range of sectors in 2017. In a regional comparison, as a result of the steady increase in recent years, profits as a proportion of the total investment observed in Hungary already exceed the levels in Slovakia or Poland, while across the countries of the region, reinvestment is the highest in Hungary. The Hungarian GNI–GDP gap is relatively low, in spite of the rise in foreign companies' profits.

5.1 Introduction

The special topic presenting the profits of foreign-owned companies is relevant because in the September balance of payments data release the previous, estimate-based data on corporate incomes in 2017 were replaced by actual data based on the questionnaires received. In the balance of payments, until the Q2 data publication following the reporting year, the income of the foreign-owned corporate sector is based on estimates, which are replaced in the September data reporting by actual data calculated on the basis of questionnaires regarding corporate and bank incomes.[6] Accordingly, data concerning the profitability of the foreign-owned corporate sector is first available with the September data reporting. Based on the relevant statistics, the balance of the incomes on equities in the income account was slightly below the preliminary estimate, which was a result of a rise in the profitability of foreign companies owned by residents to a historical high and a slightly larger-than-expected expansion in the profitability of foreign-owned companies. However, it is also worth taking into account that the balance of payments statistics contain corporate income related to current operating performance, excluding outliers, i.e. one-off profit/loss items. This is due to the fact that, according to the methodology of the balance of payments,[7] the profit/loss realised outside the current operating performance – for example, from exchange rate revaluation – is not considered as part of the incomes and thus it is stated among changes in stock. In this section, we first review the incomes of foreign-owned non-financial corporations and banks, and then examine the background of the changes in profits in 2017. Thereafter, we present companies' profits according to the current operating performance concept – shown in the balance of payments – as well as their after-tax profit (Section 5.5). Finally, we analyse the developments in the profits of foreign-owned companies operating in Hungary in a regional comparison as well, and provide a detailed presentation of the changes in the difference between GNI and GDP in the countries of the region.

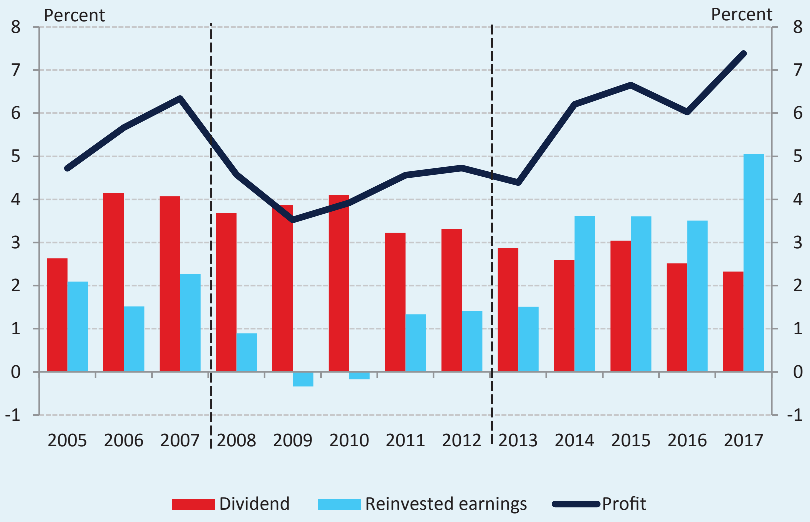
5.2 Income of foreign-owned companies in the balance of payments

In 2017, the balance of the incomes of foreign-owned companies rose to more than 7 percent of GDP, which again took place with an expansion in reinvestments in Hungary, while the ratio of corporate dividends to GDP continued to decline (Chart 25). In the years following the crisis, foreign companies' profit as a proportion of GDP fell to below 4 percent from the previously typical 6 percent, with the deceleration in domestic and foreign demand – which occurred in line with GDP – possibly playing a prominent role. Simultaneously with that, reinvestment decreased at foreign-owned companies, while an increasing portion of incomes was disbursed as dividend to the owners.[8] This may also have been attributable to the fact that growth prospects worsened significantly after the crisis, and the liquidity needs of parent companies may also

[4] Foreign-owned companies are companies owned by non-residents through direct investment.
[5] Taking into account the profitability compared to equity.
[6] For more details see: Hungary's Balance of Payments and International Investment Position Statistics, MNB (2014)
[7] Balance of Payment Manual, 6th edition
[8] It should be also noted that companies usually vote on and pay dividends from their previous year's profit, thus in fact the dividend payments of the given year should be compared to the previous year's profit. However, since the stocks included in the balance of payments data are influenced by the transactions of the given year, we present the profit of the given year together with the dividend payments of the same year.

have diverted processes towards higher dividend payment. In line with economic growth, the rise in incomes has also accelerated since 2014, which has considerably increased the value of reinvestments as a result of restrained dividend disbursement.[9] In addition to EU funds, this may have played a major role in the dynamic expansion in corporate investment in recent years as well. External demand, which also facilitated the dynamic expansion in exports, may have also contributed to the increase in foreign-owned companies' profitability. In addition, the rise in corporate profits was attributable to the fact that some foreign companies have reorganised their respective domestic corporate structures, and thus the profit they made appears in the balance of payments, irrespective of the degree of reinvestment (see more details below). As a result of all of this, foreign-owned companies' profits rose to above 7 percent of GDP, and companies continued to invest nearly 70 percent of that in Hungary.[10] The increase in the reinvestment ratio resulted in historically high reinvested earnings, rising to 5 percent of GDP. A substantial part (still over 90 percent) of foreign companies' profits can be linked to the non-financial corporations sector.

Chart 25: Utilisation of foreign-owned companies' income[11] (as a percentage of GDP)



5.3 Comparison of the profitability of banks and non-financial corporations

In line with the expansion in lending and the improving macroeconomic environment, banks' profit rate increased to a greater degree, although in terms of its level it is still lower than the rate for corporations. Although the profitability of non-financial corporations is already close to pre-crisis levels, the dividend payout ratio is still historically low (Chart 26). Before the crisis, the profit calculated as a percentage of FDI equity was around 10 percent at non-financial corporations and higher than that at banks, running at nearly 14 percent. While during the crisis the profitability of non-financial corporations dropped, similar developments in the case of banks were observed only some years later, with banks' profit margin declining to below corporate profits. Following that, foreign banks' profitability according to the current operating performance concept increased considerably in 2017, and profits measured as a proportion of capital invested rose to nearly 9 percent. The expansion is partly attributable to banks' balance sheet cleaning and partly to the upswing in lending in line with the economic cycle. In the first years of the crisis, the profits of non-financial corporations declined considerably, falling to around 5 percent. Income on equity as a proportion of the stock has been rising gradually since 2013, expanding to above 12 percent in 2017, which may have also been attributable to the reduction of the upper rate of the corporate

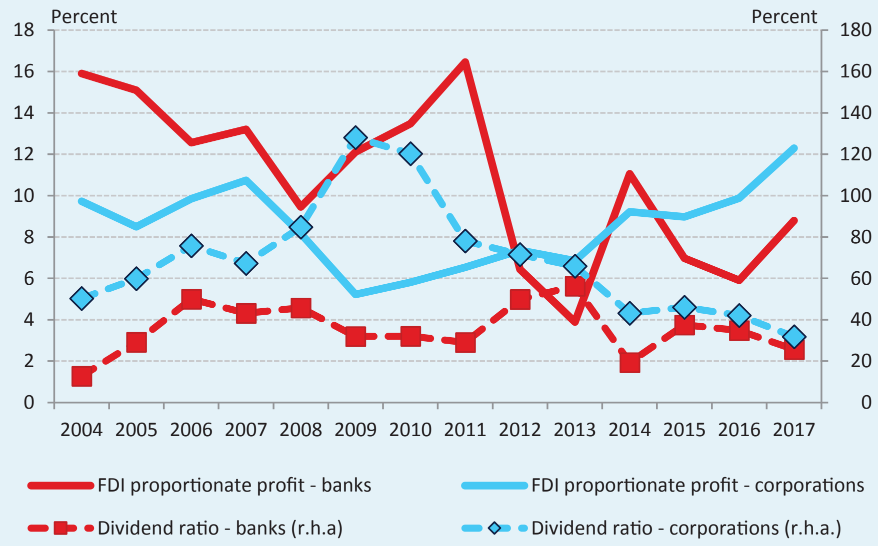
[9] Taking account of the superdividend as well, dividends increased gradually between 2014 and 2016.

[10] Since reinvested earnings are the difference between the profit earned and the dividends paid, the applied COPC adjustment and the treatment of superdividends have a major impact on the value of reinvested earnings (for more details, see the July 2017 Report on the Balance of Payments). Considering these factors as well, the ratio of reinvestment would amount to nearly 50 percent.

[11] From an analytical standpoint there is a trend change in the time series: since 2008 the profit (and thus the reinvested earnings as a residual) only contains the income according to the current operating performance concept (COPC). However, it can be presumed that the profit items not related to the current operating performance and stemming from a major shift in exchange rates increased after the crisis, and thus the time series presumably remains comparable to the previous period as well. It may represent an additional break that since 2013 superdividends have been eliminated from the profit, and have been recognised as capital withdrawal rather than as dividend payment, which thus influences the distribution of corporate profit between dividend payment and reinvestment.

tax (Chart 26). Banks' dividend ratio falls short of that of non-financial companies over the entire horizon, i.e. banks usually reinvest the larger part of their profits in Hungary. Presumably this is partly attributable to the fact that the foreign owners of banks had to increase capital in order to offset the losses suffered during the crisis, and part of this capital increase may have been provided by the profits earned. At the same time, non-financial corporations' dividend payout ratio has been declining gradually since the crisis, and was already below 40 percent in 2017. This may be attributable to the improvement in growth prospects and expected further expansion in corporate profits, based on which foreign owners invest an increasing portion of their earned income in Hungary.

Chart 26: Profit of foreign-owned companies and banks as a percentage of their FDI equity investment in Hungary and dividends paid as a percentage of the profit

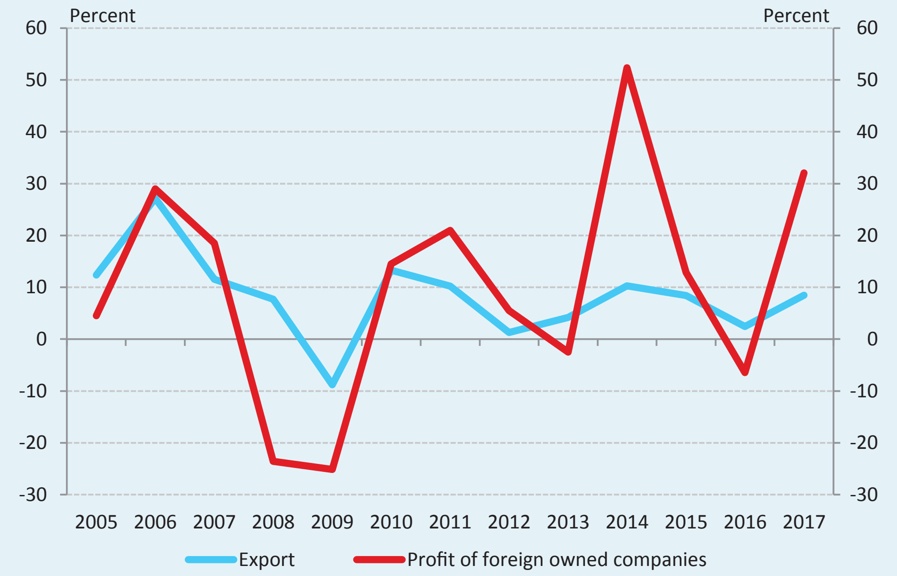


Note: The profit rate is a value calculated from the year-end stock.

5.4 Factors underlying developments in corporate profits

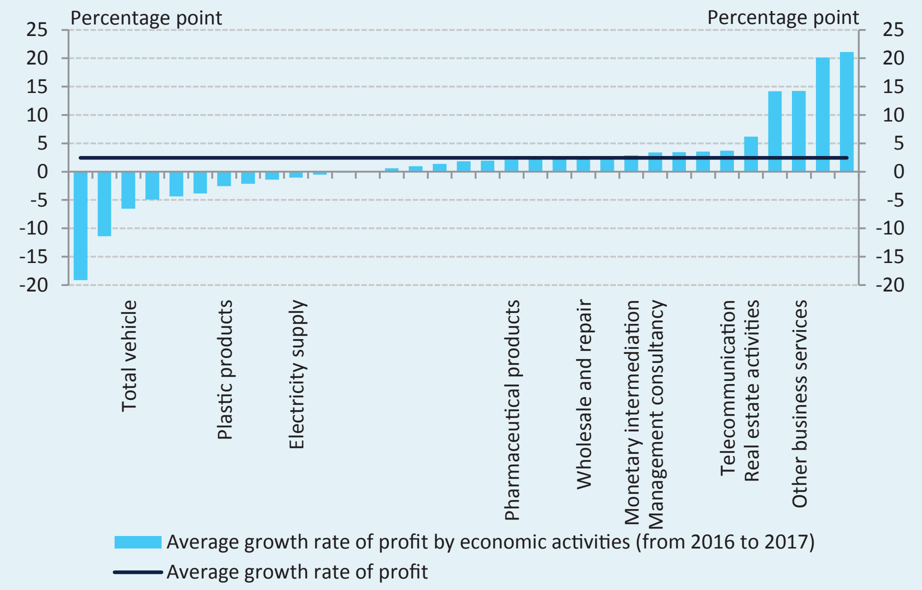
In addition to the acceleration of export dynamics to nearly 10 percent, one-off corporate effects may also have contributed to the surge in corporate profits. A considerable portion of foreign-owned companies are active in the export sector. Accordingly, based on past data it can be stated that there is a correlation between the profitability of foreign companies and the export performance of the economy. While in the earlier years (between 2005 and 2013) this co-movement was very tight, export dynamics in the years since then have tended to be an indicator of the direction of corporate profitability only (Chart 27). This correlation was valid in 2017 as well: export dynamics accelerated, which was also reflected in the stronger growth in the profits of the corporate sector. It is worth noting, however, that in 2017 the restructuring of multinational companies also played a role in the rise in corporate profits. Some companies producing in Hungary merged with their Hungarian subsidiaries, which thus became directly foreign-owned, and their total profits also appear in the balance of payments statistics, irrespective of the portion of their income that was reinvested. This is also important because if previously – as they were directly owned by a resident company – they reinvested their income in full, and thus they did not pay it as dividend to their directly foreign-owned parent company operating in Hungary, neither their profits, nor their reinvestments appeared in the figures of the balance of payments, which may have contributed to the rise in reinvestment seen in 2017.

Chart 27: Profit of foreign-owned companies and developments in exports (change compared to the previous year)



In 2017, return on equity increased significantly in a number of sectors with major foreign direct investments, of which other business services, which were determinants in the previous years, are worth highlighting. Foreign-owned companies' profitability as a proportion of FDI equity rose by nearly 2.4 percentage points on average between 2016 and 2017. Corporate profits increased in the majority of the sectors where foreign investment is significant (where the amount of the invested foreign capital exceeds EUR 2 billion). It is also worth noting that the strongest expansion was observed in the chemical industry, where the rate rose by more than 20 percentage points, although the aforementioned restructuring observed at multinational companies played a role in this as well (Chart 28).

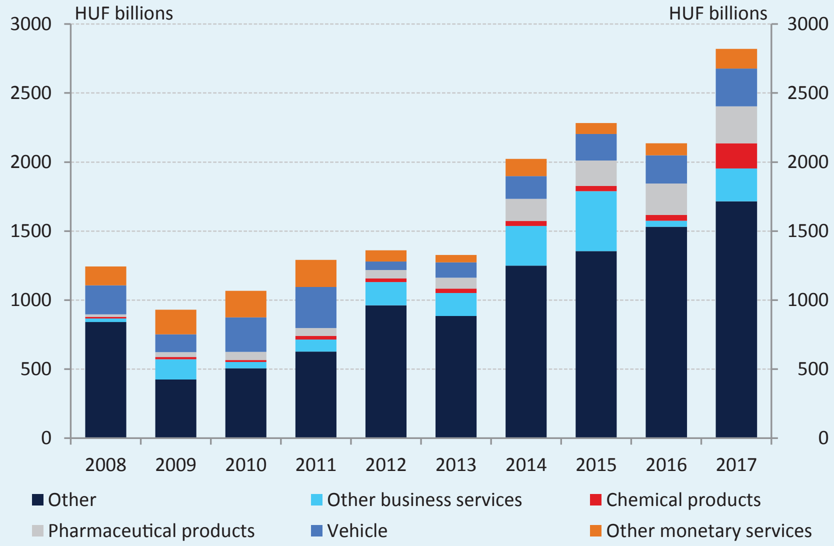
Chart 28: Growth in the profit of foreign corporations as a proportion of FDI equity in selected sectors in 2017



Note: The sectors with FDI stock over EUR 2 billion were specified by name.

Profits on foreign direct investment increased significantly in a wide range of sectors in 2017, which indicates that there is significant foreign investment in several sectors (Chart 29). While in 2016 the decline in corporate profits was related to one sector to a large degree, the rise in incomes in 2017 involved a wide range of sectors. Profits rose significantly in pharmaceutical production, in the production of chemical substances, vehicle manufacturing, banking services and the sector of other business support services. The profitability of investments has increased in a wide range of sectors in recent years, indicating that foreign direct investments are significant in a number of sectors.

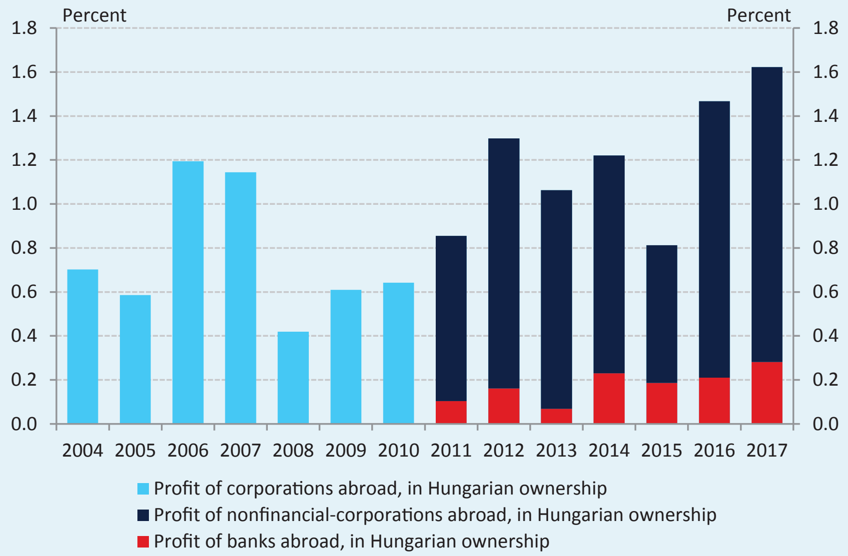
Chart 29: Profit of foreign-owned companies



The profits of foreign subsidiaries of resident companies also have an impact on the net balance of the profit that affects net lending, which was related to the rise in the incomes of banks and non-financial corporations operating abroad to a similar degree (Chart 30). In addition to the income of foreign companies operating in Hungary, the profits of companies operating abroad and owned by residents also have to be taken into account in the income account of the balance of payments.[12] From the high level observed in 2016, its value as a proportion of GDP rose further in 2017, reaching a historical high. The rise in income was related to both banks and non-financial corporations operating abroad. The rise in the profits of banks may also have been attributable to the fact that in 2016 OTP acquired Croatian and Serbian banks as well, which added to the 2017 profits of the group.

[12] Based on analytical considerations, in the income account we present the primary incomes, except for other primary incomes, which in the previous statistics formed part of current transfers, and thus we state them in the transfer balance.

Chart 30: Profits of companies operating abroad and owned by residents (as a percentage of GDP)

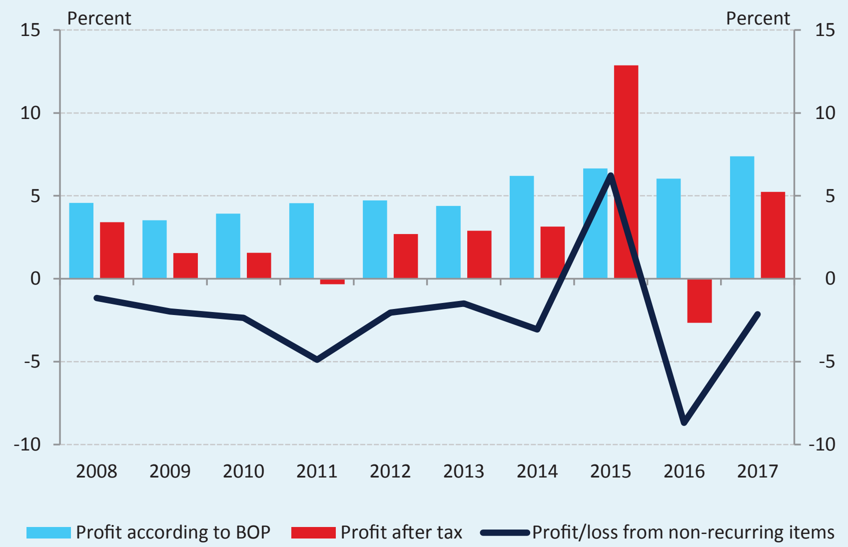


5.5 After-tax profit of foreign-owned corporations

In 2017, the actual income of companies was lower than the income according to the 'current operating performance concept' shown in the balance of payments. At the same time, after-tax profit rose to a greater extent due to the elimination of the one-off items that had caused a loss on the whole in 2016 (Chart 31). In line with international rules, statistics include only foreign-owned companies' profits according to the current operating performance concept, i.e. one-off, typically revaluation-related items are excluded,[13] and thus the profit – according to the current operating performance concept – shown in the balance of payments is much more stable. Since the crisis, the items outside of the current operating performance have typically reduced corporate profits, and thus the exclusion of these items resulted in higher income and a larger deficit of the income account in the balance of payments statistics. In 2015, however, due to the sale of a branch of business of a multinational company operating in Hungary at an extremely high value, as opposed to earlier years, the income shown in the balance of payments was lower. This was adjusted in 2016: while the profit of foreign companies as stated in the balance of payments was close to 6 percent of GDP, its value according to the after-tax profit amounted to nearly -3 percent, i.e. to a large degree the 2016 loss of the corporate sector was related to one-off items. In 2017, the difference between the two indicators returned to the value observed in the past, and was around -2 percent of GDP. On the whole, while income as a proportion of GDP stated in the balance of payments increased only to a lesser extent, the after-tax profit of foreign capital investments rose considerably in 2017 and was already close to the pre-crisis level.

[13] Such one-off impacts at corporations include the losses from exchange rate revaluation and at credit institutions the early repayment at preferential exchange rate or the settlements related to household loans.

Chart 31: Profit* according to current operating performance and based on the profit/loss after tax (as a percentage of GDP)

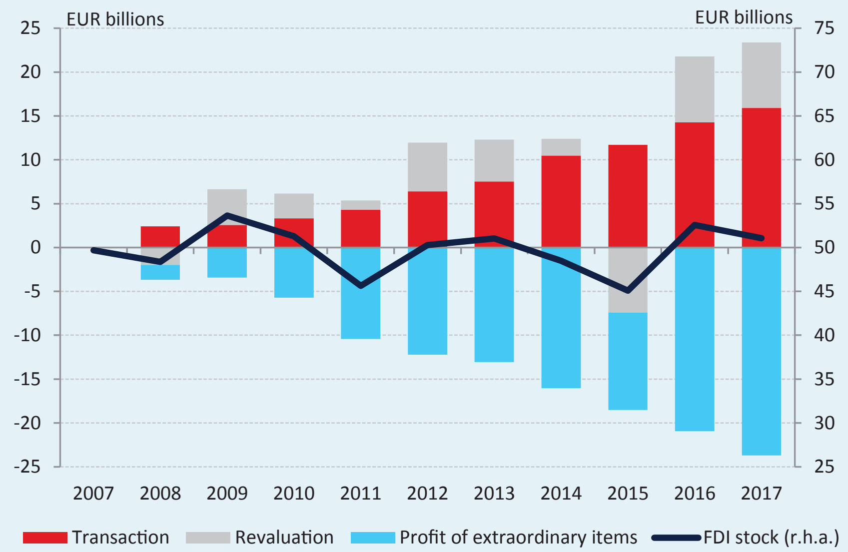


** The profit realised by foreign-owned corporations has a negative impact on the income account, in line with the income account of the balance of payments.*

5.6 Changes in the FDI stock

The FDI inflows and the stock-increasing effect of revaluations were offset by one-off profit/loss items in the past decade. Accordingly, in spite of significant inflows, there was no major expansion in the FDI stock. Although based on transactions, non-residents' net foreign direct investment has expanded by more than EUR 15 billion since the crisis, only a much lower rise amounting to a mere EUR 1.4 billion is observed in the stock data (Chart 32). This is attributable to the fact that in the balance of payments the profit/loss items outside of the current operating performance are excluded within the framework of the COPC adjustment. With the exception of 2015, these items have comprised the losses of the corporate sector since the crisis. The cumulative value of these losses amounted to nearly EUR 25 billion in the past decade. The situation was similar in 2017 as well: while transactions show an expansion of EUR 1.6 billion in net FDI, the profit/loss items outside of the current operating performance reduced the stock by EUR 2.8 billion. As a result, in spite of the FDI inflows, stock indicators declined by more than EUR 1 billion in 2017.

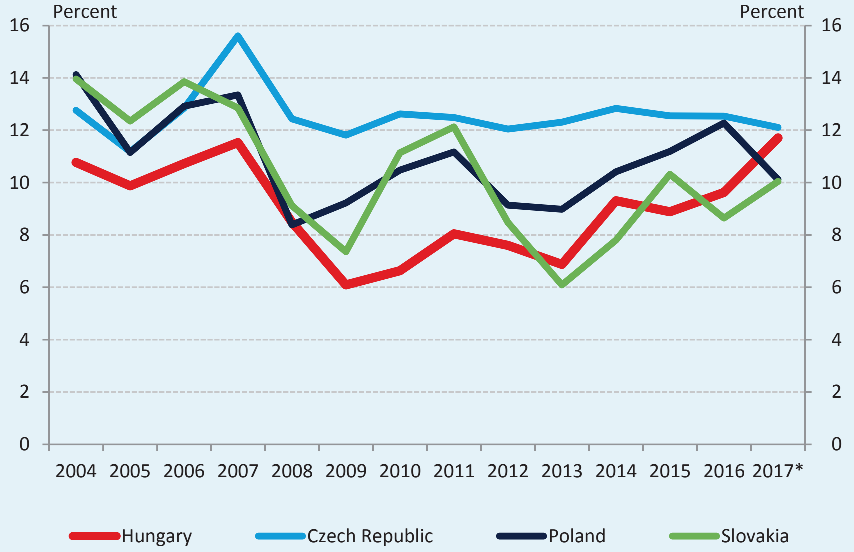
Chart 32: Cumulative factors of the changes in FDI stock



5.7 International comparison

As a result of the steady increase in recent years, the profitability observed in Hungary already exceeds the regional average (Chart 33). In order to examine the return on foreign direct investments in the region, the profit compared to the capital invested is worth analysing. Available data suggest that the return on FDI has increased in all the countries in the region since 2013. Co-movement of the ratios was already observed in the previous years as well: the ratio of foreign companies' income to the FDI stock declined in Hungary as well as in Slovakia and Poland following the outbreak of the crisis and between 2011 and 2013. All of this indicates that international developments have a significant impact on changes in profitability. The downturns were followed by an upswing starting in 2013 for Hungary as well as for Slovakia and Poland. As a result, the Hungarian rate of return is already close to the values typical before the crisis, and exceeds the Slovak and Polish levels. According to preliminary data, the continuous increase observed in Poland in the past years reversed: the return in Poland fell from a level close to the Czech one to the lowest value in the region. The profits of foreign companies operating in the Czech Republic continue to exceed the levels observed in the other countries of the region, although the difference compared to the other countries declined considerably.

Chart 33: Return on FDI equity investment (value of the profit realised on the FDI stock relative to total FDI stock)



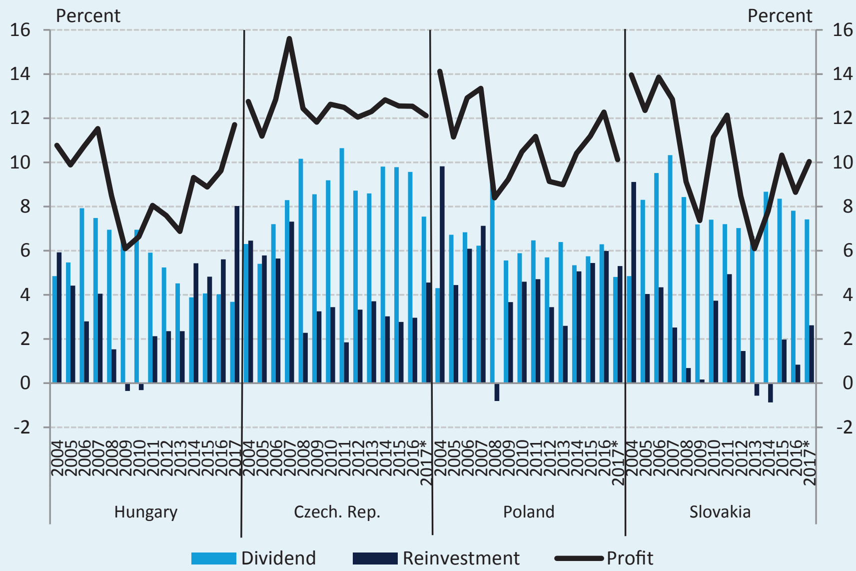
** The 2017 value for the countries of the region is presumably an estimate only.*
Source: Eurostat.

Looking at the countries in the region, reinvestment is the highest in Hungary: foreign-owned companies reinvest nearly two thirds of their profits (Chart 34). While the initial increase in foreign companies' profits typically entailed higher dividends in the countries of the region, dividend payments followed a declining trend in Hungary.[14] At the same time, based on preliminary 2017 data, dividend disbursements declined in all the countries of the region, resulting in a rise in reinvestments, with the exception of Poland. In Poland, although the fall in profits in 2017 was mostly reflected in the decline in dividends, the degree of the decline in income was such that reinvestments also decreased. At the same time, in spite of a rise in reinvestments in the region, the reinvestments of foreign-owned companies operating in Hungary are the highest and continue to exceed the degree of dividend payments,[15] which is not typical of the other countries of the region.

[14] However, as of 2013 the accounting of superdividends in Hungary may have played a role in this.

[15] The treatment of superdividends could also increase reinvested earnings as a percentage of profit, because through reducing the profit it raises the role of the reinvested earnings as a percentage of income, while it reduces that of dividends. Hence this may also contribute to the higher reinvestment, as a percentage of profits, by foreign-owned companies operating in Hungary.

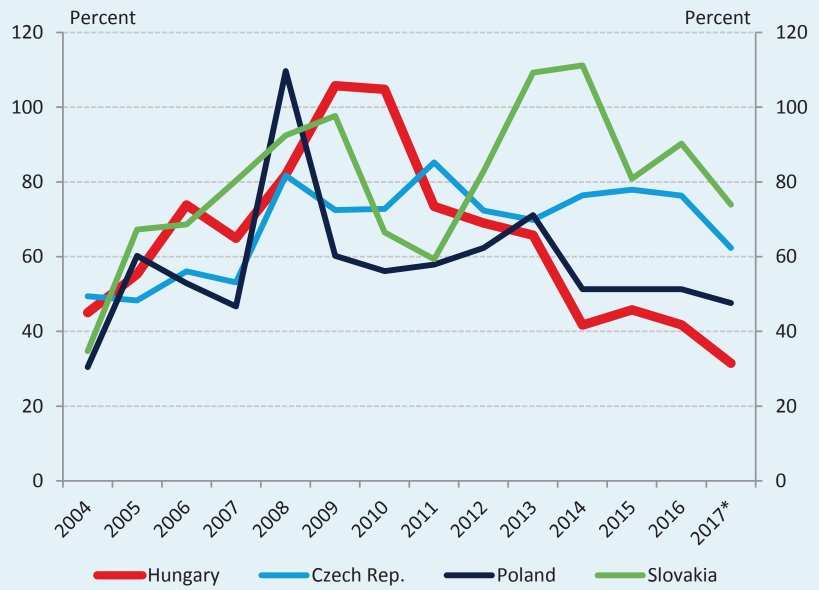
Chart 34: Breakdown of FDI earnings in the countries of the region (as a percentage of FDI equity)



** The 2017 value for the countries of the region is presumably still based on estimation.*
Source: Eurostat.

Dividend disbursement as a proportion of income is still the lowest in Hungary within the region, which is coupled with a high value of reinvestments (Chart 35). Foreign companies' dividends as a proportion of income increased prior to and in the first couple of years of the crisis, and reached its highest value during the years of the crisis. In parallel with a decline in growth prospects, foreign parent companies' liquidity demand increased, the result of which was that companies in Hungary, and for a short time in Poland as well, paid dividends to their foreign owners not only from their profits of the given year, but also from the retained earnings accumulated from previous years' profits. After 2013–2014, the dividend disbursement ratio declined in all the countries of the region, with the largest decline taking place in Hungary: foreign companies pay a mere 30 percent of their income earned in Hungary as a dividend. It also means that foreign-owned companies' reinvestment is the highest in Hungary.

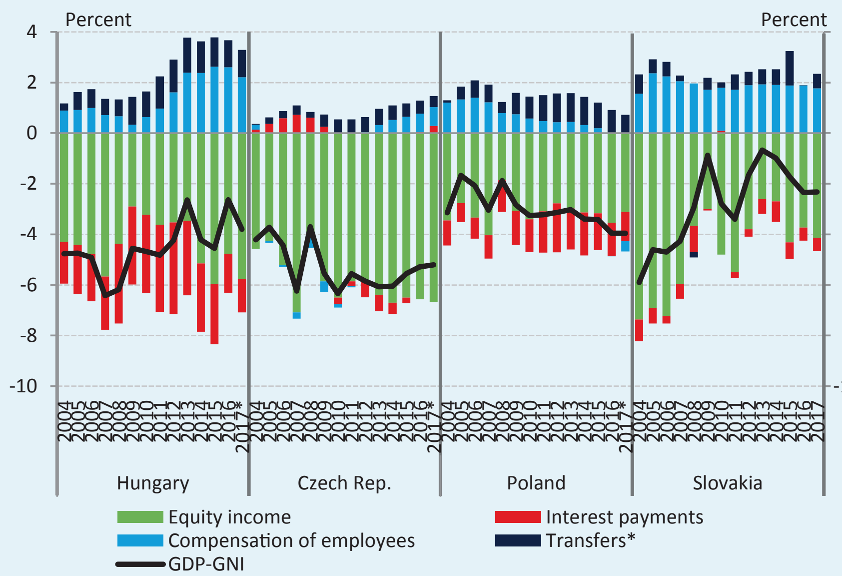
Chart 35: Ratio of dividend payments to profit



** The 2017 value for the countries of the region is presumably still based on estimation.*
Source: Eurostat.

The Hungarian GNI–GDP gap is relatively low, despite the increase in foreign companies' profits (Chart 36). The difference between gross national income (GNI) and gross domestic product (GDP) consists of the income payments related to the rest of the world, a considerable part of which is constituted by interest payments related to the rest of the world and the profits of foreign companies, i.e. the developments in the income of foreign companies have an impact on the GNI–GDP gap as well. In the countries of the region, foreign direct investments tend to considerably exceed residents' investments abroad; therefore, the value of the GNI is also below the value of the gross domestic product. Due to the high external debt, income outflows were the highest in Hungary and the Czech Republic in the years prior to the crisis. The underlying reason for this was that interest payment in Hungary was higher due to the external debt that exceeded that of the countries of the region, while in the Czech Republic it was due to the higher profitability of foreign companies. Following the outbreak of the crisis, foreign companies' profits declined considerably, but the increasing interest expenditures – primarily in Hungary – kept the difference between GNI and GDP at a high level. In parallel with the growth following the crisis, income outflows related to equities rose in all of the countries of the region. In Hungary, while interest expenditures continued to decline, the balances of both employee and transfer incomes made a positive contribution to the rise in incomes and thus to the narrowing of the gap. As a result, in the past years the Hungarian GNI–GDP gap declined considerably, and today it is considered relatively low in the region, in spite of the increase in foreign companies' income in 2017.

Chart 36: Decomposition of the difference between GNI and GDP (as a percentage of GDP)



** The 2017 value for the countries of the region is presumably still based on estimation.*
Source: Eurostat

List of charts and tables

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

October 2018

Print: Pauker–Prospektus–SPL consortium

H-8200 Veszprém, Tartu u. 6.

mnb.hu

H-1054 BUDAPEST, SZABADSÁG SQUARE 9.