REPORT ON THE BALANCE OF PAYMENTS

2022
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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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 allows for the 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.

The analysis was prepared by the Directorate Monetary Policy and Financial Market Analysis. Contributors: Judith Balázs, Anna Boldizsár, Péter Koroknai, Balázs Sisak, Daniella Tóth and Márton Varga. The Report was approved for publication by Barnabás Virág, Deputy Governor.

The Report is based on information for the period ending 23 September 2022.

Summary

In 2022 Q2, ***Hungary's current account balance continued to decline, similarly to the other countries in the region.*** *As a result of the* ***significant deterioration in the energy balance due to high energy prices,*** *the four-quarter deficit of the current account amounted to 6.6 percent of GDP, while net borrowing rose to 3.3 percent of GDP.* ***Parallel with a decline in the goods balance, developments in other current account items – such as the services, income and transfer balances – supported the improvement in the external balance.*** *The Hungarian level of net borrowing roughly corresponds to what was observed in Poland, but is much lower than the figures for Slovakia and Romania.*

Due to the data revision carried out simultaneously with the quarterly data release, ***the current account deficit-to-GDP ratio rose by 1 percentage point in 2021*** *compared to the previous release. The lower balance is basically attributable to two factors: in relation to the revision of annual GDP, the HCSO* ***reduced last year's trade balance,*** *and the* ***size of current transfers*** *declined. Foreign-owned companies' income was also slightly higher. In parallel with that, profits reinvested in Hungary also increased, and thus* ***the value of net FDI inflows exceeded EUR 2.8 billion*** *last year.*

In 2022 Q2, the increase in the economy's net borrowing according to the financial account fell short of the value calculated on the basis of real economy data, and thus the difference between the two indicators, i.e. ***net errors and omissions, narrowed considerably below 2 percent of GDP.*** *During the quarter, net borrowing was financed partly by debt inflows related to the state and partly by a* ***rise in net foreign direct investment.*** *FDI inflows* ***even increased in the third quarter,*** *as net FDI inflows amounted to nearly EUR 2.2 billion in July.*

By end-June 2022, Hungary's net ***external debt*** *according to underlying trends dropped to* ***7 percent*** *of GDP, i.e. close to its historical low, which is attributable to revaluation as a result of yield increases and to the effect of expansion in nominal GDP. The decline in net external debt was* ***mainly related to the general government consolidated with the MNB,*** *while the debt indicator for the private sector was stable overall. In line with these developments,* ***gross external debt excluding intercompany loans decreased to 60 percent of GDP by end-June 2022. International reserves rose to EUR 37.5 billion*** *at the end of the quarter,* ***still significantly exceeding the level of short-term external debt expected by investors, by nearly EUR 5 billion.***

Looking at the sectors' savings, ***the lower external balance position was attributable to a decrease in the savings of the private sector,*** *as the* ***net borrowing of the state continued to fall*** *in the second quarter again, in conjunction with rising tax revenues. In parallel with this, the net position of households and corporations dropped, which was partly explained by still buoyant investment and domestic absorption, and partly by the income-reducing effect of rising energy and commodity prices.*

In our special topic, we present ***the changes in the income of foreign-owned companies.*** *The* ***increase in foreign-owned companies' profit as a percentage of GDP in 2021 occurred in line with the robust expansion in exports,*** *in parallel with the rapid economic recovery following the crisis. The increase in profit was also reflected in the further rise in* ***the reinvestment ratio, which was high*** *in the previous years as well. In* ***the major industries, the return on equity of foreign-owned companies typically increased:*** *the largest gains were recorded in the production of chemical substances as well as in tourism and transportation (e.g. air transport), which had been hit hard by the pandemic. The increase in the income balance deficit due to corporate profit* ***was attenuated by the fact that the profit of companies owned by residents and operating abroad also rose.*** *The* ***income-to-equity ratio increased in most of the regional countries as well,*** *and this was also typically reflected in the rise in reinvestments in the other countries as well. In line with the increase in foreign-owned companies' profit, the* ***GNI–GDP gap*** *also tended to* ***widen slightly in the countries of the region.***

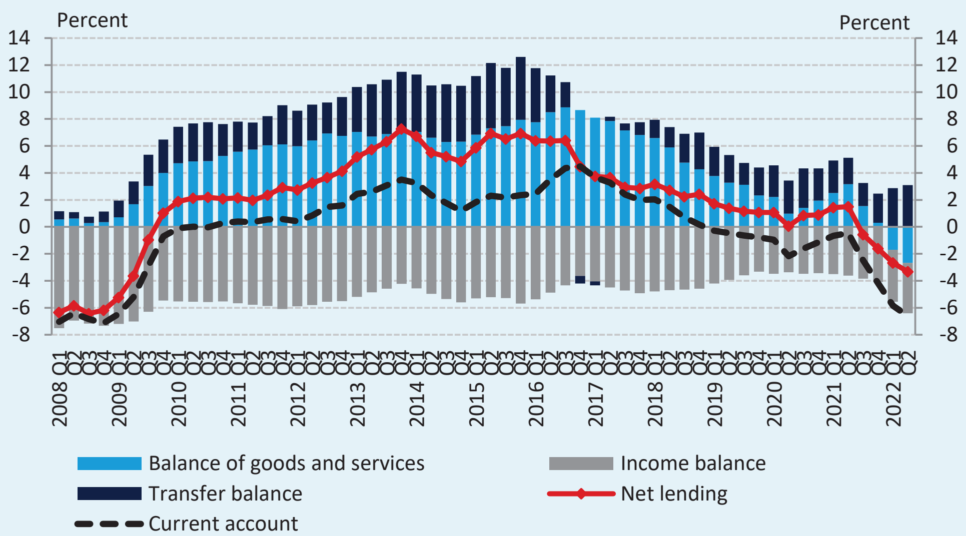
Content

1 Real economy approach

According to the real economy approach, Hungary's four-quarter net borrowing amounted to 3.3 percent of GDP in 2022 Q2, while the current account deficit stood at 6.6 percent of GDP. The decline in external balance indicators was mainly attributable to the decrease in the trade surplus, which was driven by the deterioration in the energy balance due to worsening terms of trade, while changes in the income and transfer balance had an opposite effect. Similarly to the developments observed in Hungary, external balance indicators continued to decline in the countries of the region as well in the second quarter.

According to the real economy approach, in 2022 Q2 Hungary's four-quarter net borrowing amounted to 3.3 percent of GDP, while the current account deficit rose to 6.6 percent of GDP (Chart 1). According to *unadjusted quarterly data,* net borrowing amounted to more than EUR 1.6 billion in the second quarter, as a result of a current account deficit of EUR 2.6 billion, which was partially offset by a capital account surplus of EUR 950 million. The increase in four-quarter net borrowing was mainly due to the trade balance (and within that the energy balance corresponding to a deficit of 6.7 percent of GDP), whereas the slight improvement in the income and transfer balance had an opposite effect.

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

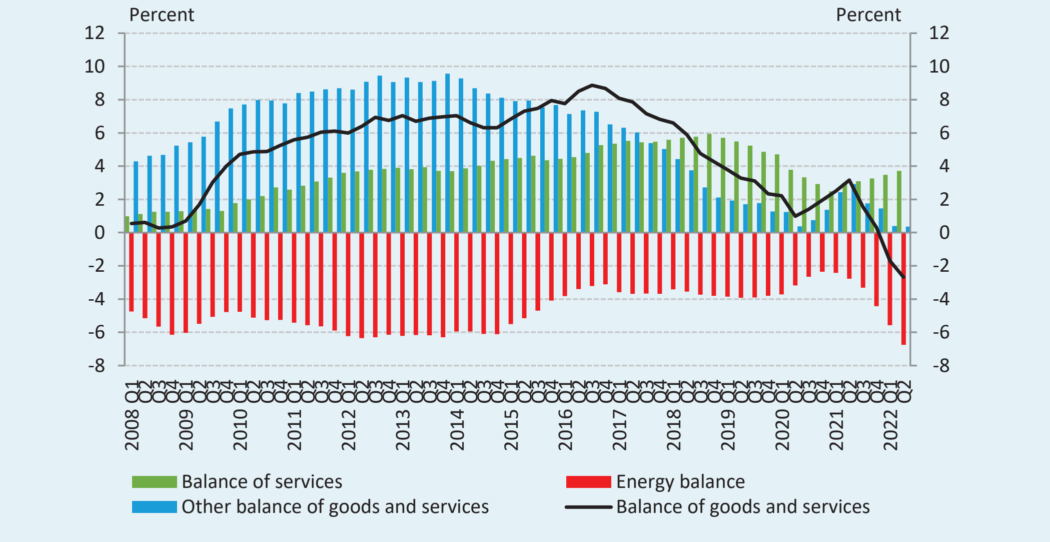


** Income balance: earned income, income on equity and income on debt. Transfer balance: sum of the capital account and other primary and secondary income.*
Unless otherwise indicated, the source of the charts is the MNB.

1.1 Trade balance

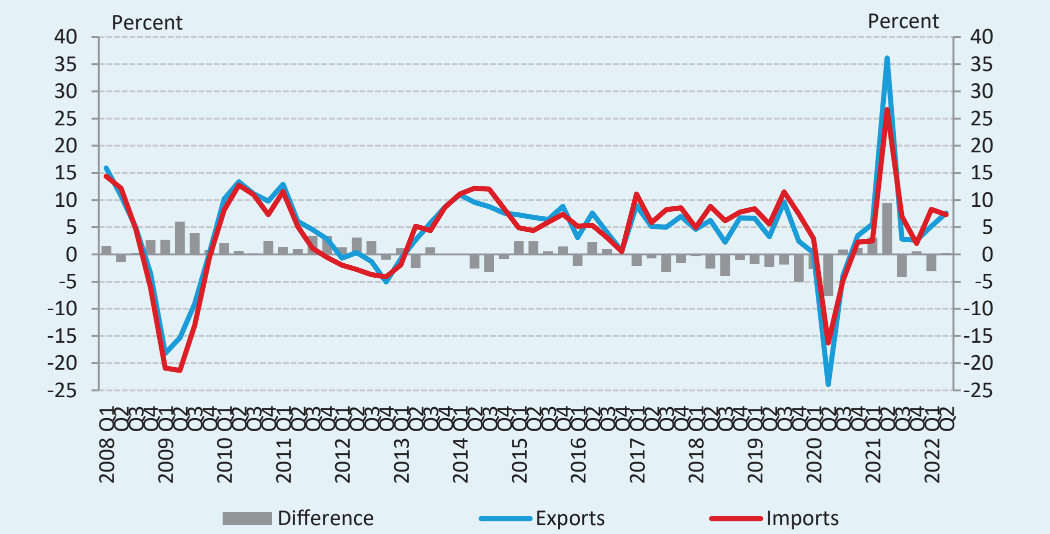
The four-quarter trade deficit continued to rise in 2022 Q2. The deterioration in the trade balance was primarily related to the increasing deficit on the energy balance due to the sharp rises in energy prices (Chart 2). Following the previous years' growing negative balance, the balance of goods as a proportion of GDP turned into a temporary surplus in early 2021, but this positive trend broke in 2021 H2, and since then the balance of goods has reflected an increasing deficit. Within the balance of goods, the deterioration in the energy balance seen since 2021 resulted in the decline in the indicator. Following the downturn due to the outbreak of the pandemic, with the lifting of containment measures, the surplus of the balance of services, which plays an important role in the development of the trade balance, rose to 3.5 percent by 2022 Q1 and 3.7 percent by 2022 Q2. The last time the indicator was at a similarly high level was in 2020 Q2. The rise in the balance of services surplus was a result of the recovery of tourism and transportation services, which represent a major weight within the sector. Accordingly, the surplus on the balance of services was, to some extent, able to offset the further decline in the goods balance in the second quarter as well, but, on the whole, the trade balance still showed a deficit of around 2.7 percent of GDP.

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



In 2022 Q2, export growth increased more strongly compared to the beginning of the year, while the growth rate of imports decelerated slightly (Chart 3). Exports accelerated in parallel with an upswing in domestic industrial production, thanks to improved performance by the manufacturing sectors. Import dynamics decelerated only moderately compared to the previous quarter, which is in line with the expansion in investment (based on the domestic use of inventories) and households' higher consumption, which was also stimulated by the significant government transfers disbursed in 2022 Q1. As a result of faster export growth and slightly slower import growth, the difference between the increases in the two indicators declined to a minimum: annual real growth in both indicators was around 7.5 percent in the second quarter.

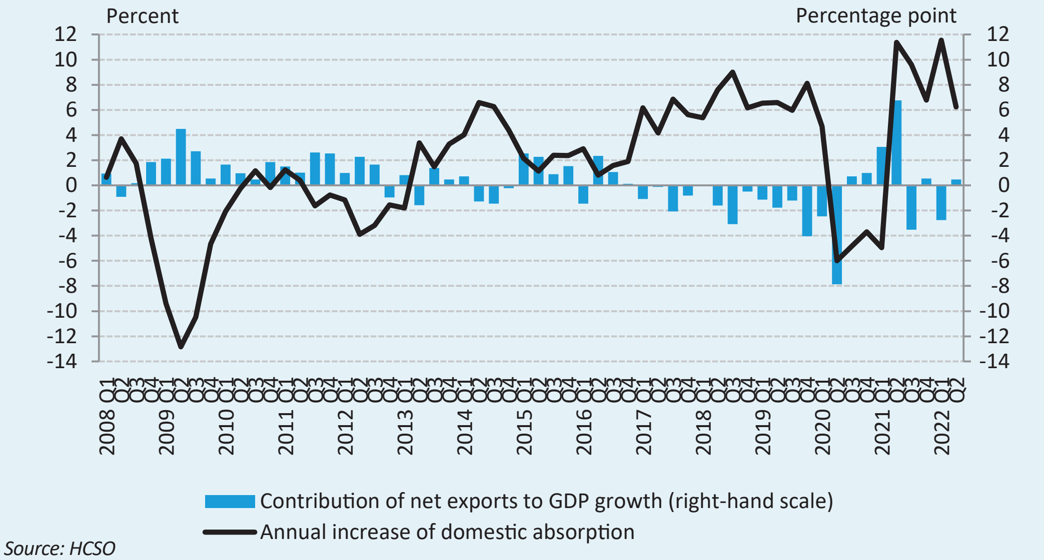
Chart 3: Annual real growth in exports and imports



Source: HCSO, MNB

The growth contribution of net exports was moderately positive in 2022 Q2, while the annual growth rate of domestic absorption was subdued, in parallel with the deceleration of imports (Chart 4). A wide range of absorption items was responsible for the slower growth rate of domestic absorption: in addition to a decline in real household consumption growth and actual final government consumption, investment growth also decelerated. Despite the falling growth rate, household consumption increased strongly in the second quarter as well, due to the spring wave of the pandemic fading and the disbursement of significant government transfers in 2022 Q1 (PIT refund, service benefits for armed forces and law enforcement, 13th month pension). In line with the lower growth in domestic absorption, the contribution of net exports to the expansion in GDP was slightly positive.

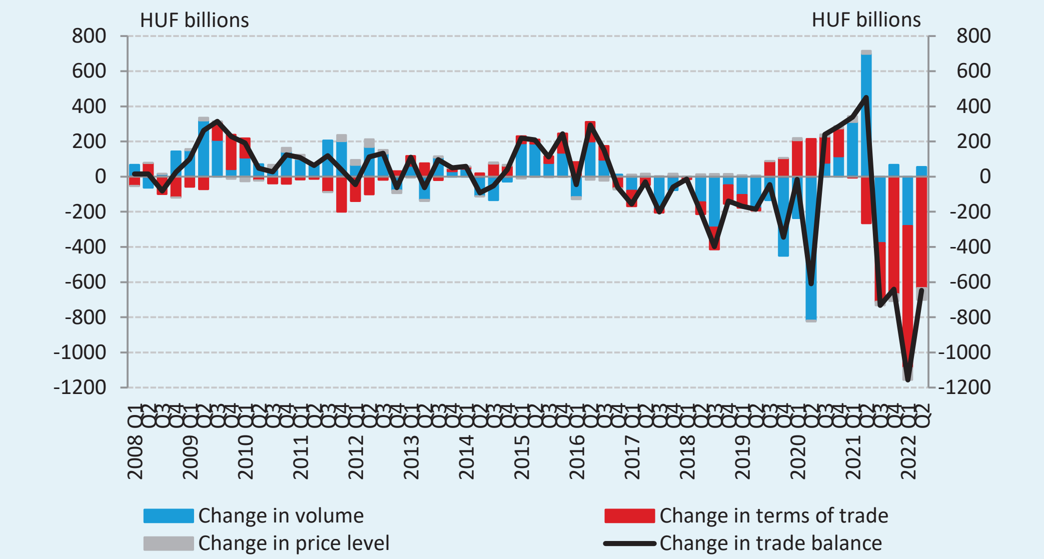
Chart 4: Annual growth rate of domestic absorption and contribution of net exports to GDP growth



Source: HCSO

The unfavourable trend in the trade balance in 2022 Q2 was primarily driven by the effect of the deterioration in the terms of trade, whereas the change in volume supported an improvement in the balance. In the second quarter, in line with the contribution of net exports to growth, the increase in exports due to volume slightly exceeded that of imports, and thus modestly improved the trade balance. At the same time, the continued rise in commodity and energy prices was reflected in a sharp deterioration in the terms of trade, which had an unfavourable impact on net exports. In addition, in recent quarters the rising level of foreign trade prices – together with the trade deficit – also reduced net exports.[1]

Chart 5: Development of trade balance factors according to GDP (year-on-year)



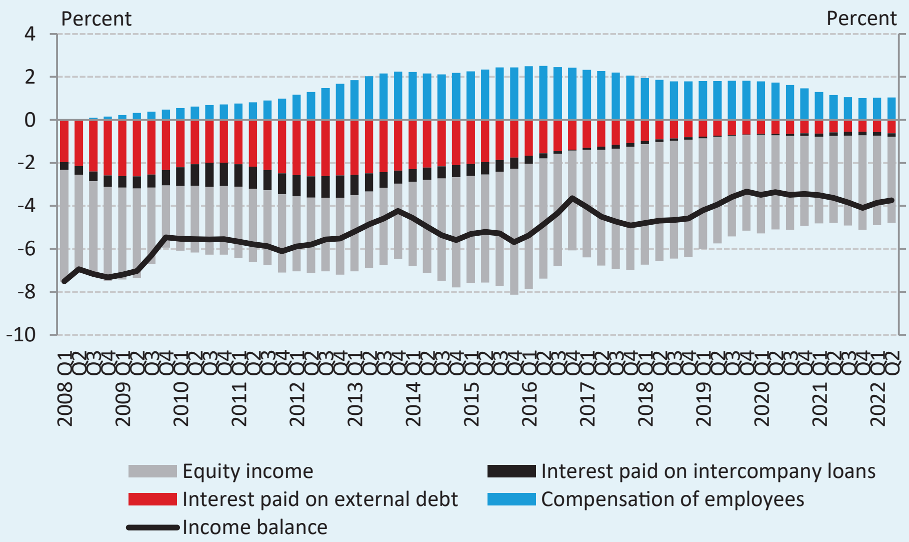
Source: HCSO

[1] For more information on decomposing the trade balance into factors, see, for example, Gábor Oblath: The effect of changes in the terms of trade on gross domestic income, domestic absorption and income convergence (Külgazdaság, Vol. LXIII, November–December 2019).

1.2 Income balance

The income balance deficit as a percentage of GDP fell slightly in 2022 Q2, due to improvement in the balance of profit incomes of foreign-owned companies (Chart 6). **In 2021, while the income of residents working temporarily abroad declined,** the four-quarter deficit of the income balance exceeded 4 percent of GDP, before falling to 3.9 percent of GDP in 2022 Q1 and 3.7 percent of GDP in 2022 Q2, primarily due to a decrease in the profit of foreign-owned companies. At the same time, interest paid on external debt had a negative impact on the changes in the indicator, in parallel with higher nominal debt and the rising interest rate environment. Despite the lifting of containment measures, Hungarian employees' income from abroad remained at an unchanged low level of around 1 percent of GDP (compared to nearly 2 percent prior to the pandemic).

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



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

Box 1: Revision of the balance of payments

As a result of revisions, data were modified retroactively in the disclosure of the balance of payments, mostly affecting 2021; the balance of payments data show lower net exports and unrequited transfers than before (Chart 7). Together with the release of the Q2 balance of payments data, the MNB also published the revision of the data for 2019–2021, as usual. The revision was partly attributable to the fact that the 2021 corporate income data became known after receiving the corporate questionnaires, at the time of the September data release. The changes mostly affected the balance of net exports and current transfers. The changes affecting 2021 are summarised below:

- Net exports declined by some EUR 700 million compared to the previous disclosure. This was the result of the HCSO's revision, according to which the trade deficit exceeded the previously released figure by 0.5 percentage point.

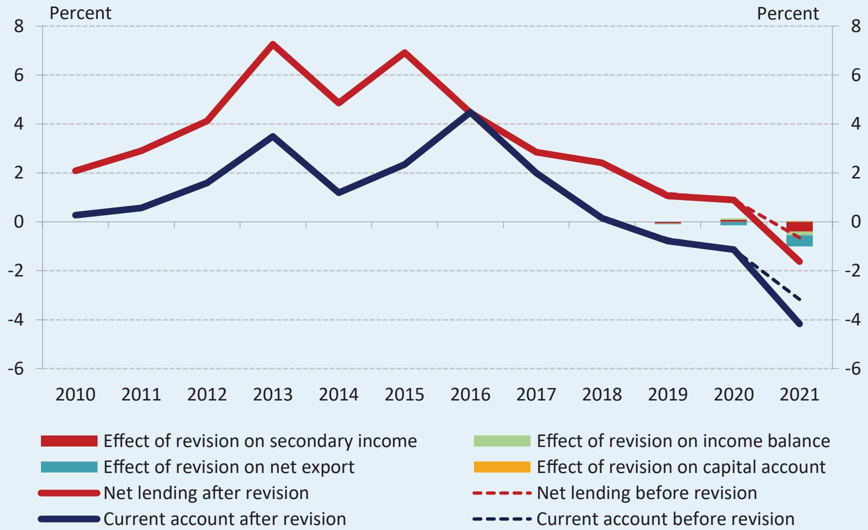
- The deterioration in the transfer balance compared to what was indicated before is attributable to the fact that unrequited current transfers were revised down by more than EUR 600 million (0.4 percent of GDP), which was related to the cancellation of EU transfer revenues previously recognised within the framework of the RRF.

- As a result of the revision, the income balance deficit was 0.1 percent of GDP higher, as following the recovery after the coronavirus corporate profits improved to a greater degree than previously estimated.

On the whole, as a result of the revision and compared to the previous disclosure, the current account balance declined by around EUR 1.5 billion in 2021 (by 1 percentage point as a proportion of GDP) and thus amounted to -4.2 percent of GDP. Net borrowing of the economy changed to a similar degree during the data revision, i.e. it worsened by 1 percentage point, and thus its value was -1.6 percent of GDP in 2021.

In 2022 Q1, both net lending calculated from the real economy's side and the current account balance declined by EUR 0.1 billion as a result of the revision, primarily due to the deterioration in the goods and services balance, which was only partly offset by a slight improvement in the income balance (Table 1).

Chart 7: Impact of the revisions on the income balance and net lending, figures as a percentage of GDP



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

As a result of the revision of the balance of payments and partly due to stronger FDI inflows owing to the higher profit balance, the 2021 financing side developments also indicated an increase in net borrowing, but to a lesser degree than real economy developments. With the September revision, the data of the balance of payments statistics regarding foreign-owned companies' profits change in line with the corporate questionnaires received, which also has an impact on the value of foreign direct investment. Compared to the previous estimate, the balance of 2021 foreign direct investments increased by approximately EUR 250 million as a result of an increase in reinvestment due to the effect of the data of corporate questionnaires. In addition, net debt inflows also exceeded the previously indicated level to a similar degree, while its negative effect on the balance was partly offset by slightly higher portfolio equity outflows. Net lending calculated using the two approaches worsened in both cases in 2021, but to different degrees. Accordingly, 'net errors and omissions', which shows the difference in the balance of payments statistics between the two approaches, fell considerably compared to the previous disclosure.

Table 1: Impact of the revisions* on components of net lending (EUR billion)

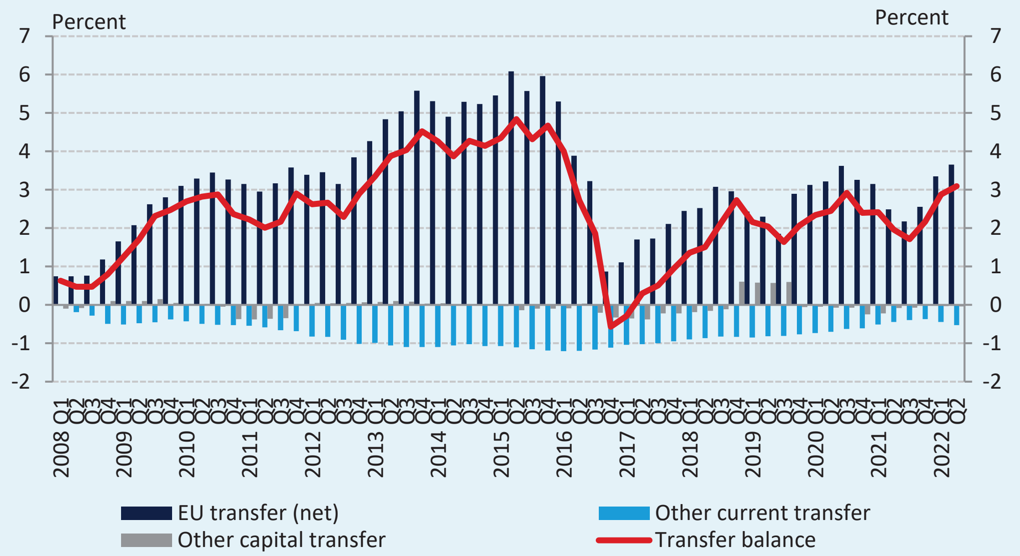
	2019	2020	2021	2022 Q1
I. Change in net lending from real economy's side (1+2+3)	**-0.1**	**0.0**	**-1.5**	**-0.1**
1. Balance of goods and services	0.0	-0.2	-0.7	-0.2
2. Income balance	0.0	0.1	-0.2	0.1
3. Transfer balance	-0.1	0.1	-0.6	0.0
Current account	***-0.1***	***0.0***	***-1.5***	***-0.1***
II. Change in net lending from financing side (5+…+8)	**-0.1**	**0.1**	**-0.5**	**0.5**
5. Foreign direct investment	-0.1	0.0	-0.3	0.0
6. Portoflio equity	0.0	0.0	0.1	0.0
7. Financial derivatives	0.0	0.0	0.0	-0.3
8. Net debt	0.1	0.1	-0.3	0.9
Net errors and omissions (I.-II.)	***-0.1***	***-0.1***	***-1.1***	***-0.6***

The positive figure in the table indicates growth in the external balance indicator, compared to its previous value.

1.3 Transfer balance

In 2022 Q2, the surplus on the transfer balance rose to 3.1 percent of GDP, thus mitigating the impact of the trade balance deterioration (Chart 8). According to four-quarter data, the net inflow of EU funds climbed to 3.7 percent of GDP in 2022 Q2, exceeding the values seen in the previous quarters. Other current transfers only resulted in a mild deterioration in the transfer balance. The four-quarter surplus on the transfer balance, which was higher than in the previous quarter, resulted from the above factors.

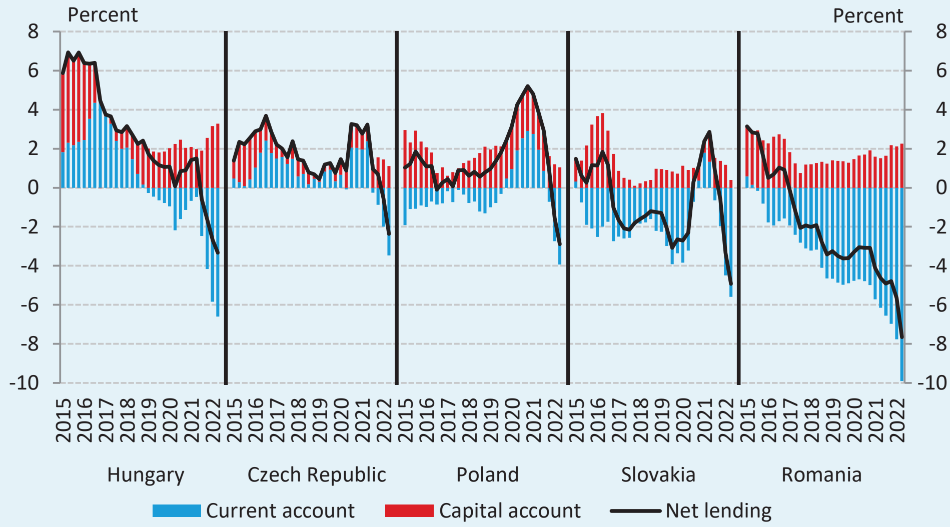
Chart 8: Four-quarter development of transfer balance items (four-quarter values as a percentage of GDP)



1.4 Regional comparison

As a result of rising global commodity and energy prices, external balance indicators continued to deteriorate in the countries of the region, and net borrowing increased in all of the countries in the region (Chart 9). Starting from 2020 H2, the external balance position of the region's countries typically improved due to the impact of the coronavirus pandemic, but from 2021 H2 the trade balance and thus the current account of all of the countries in the region worsened, owing to disruptions in supply chains as well as the global increases in commodity and energy prices. Net borrowing in the Czech Republic and Poland continued to deteriorate significantly in the second quarter, amounting to 2–3 percent of GDP, which was not far below Hungary's level of 3.3 percent. In the region, the level of net borrowing was the highest in Slovakia and Romania, at around 5 percent and 8 percent, respectively, as in Romania even the relatively low surplus on the stable capital account was unable to really offset the high trade deficits of the past period. At the same time, the surplus on the capital account also dropped considerably in Slovakia in recent quarters, further increasing the country's net borrowing.

Chart 9: Four-quarter net lending in the countries of the region (as a percentage of GDP)



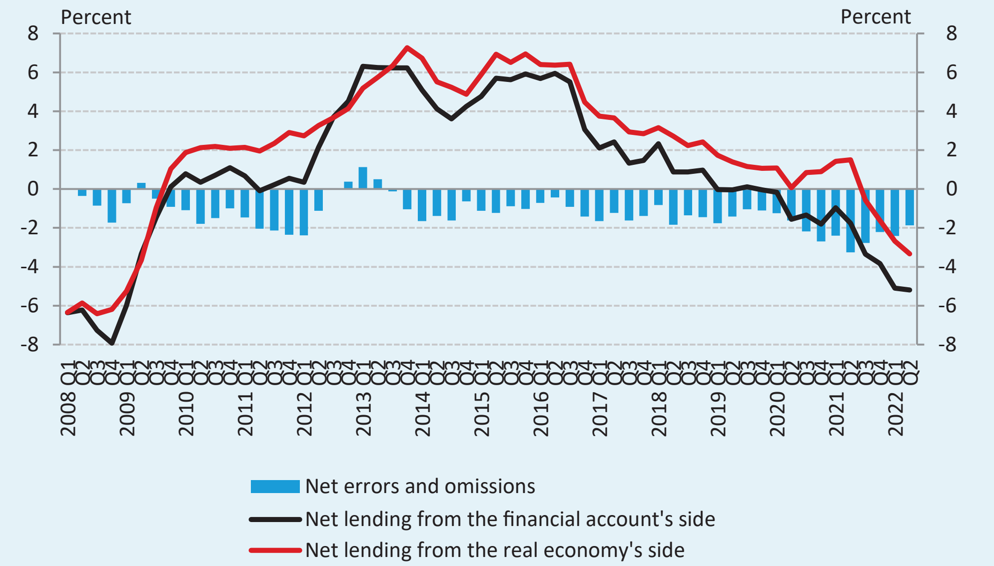
Note: Except for Hungary, the 2022 Q2 data were calculated from monthly data.
Source: MNB, Eurostat

2 Financing approach

In 2022 Q2, the increase in the net borrowing of the economy according to the financial account fell short of its value calculated on the basis of real economy data, and thus the difference between the two indicators, i.e. net errors and omissions, narrowed. During the quarter, the expansion in net external liabilities was partly related to debt inflows and partly to an increase in net foreign direct investment, while the net outflow of portfolio equities, which had been typical in previous quarters as well, continued. The main contributor to the net external debt inflow, which declined considerably compared to the outlier of the previous quarter, was the general government. In parallel with that, the indicator for companies also rose moderately, while banks' net external debt due to transactions fell slightly.

According to financing-side data, following a slight rise, the four-quarter net borrowing of the economy corresponded to nearly 5.2 percent of GDP in 2022 Q2 (Chart 10). The rise in the four-quarter external borrowing position calculated on the basis of the real economy approach exceeded the inflow of funds according to financing items, and thus the difference between the two indicators narrowed considerably. As a result, the value of the difference between the four-quarter external balance indicators ('Net errors and omissions' [2]) fell to below 2 percent of GDP, thus corresponding to the average of the indicator observed in previous years.

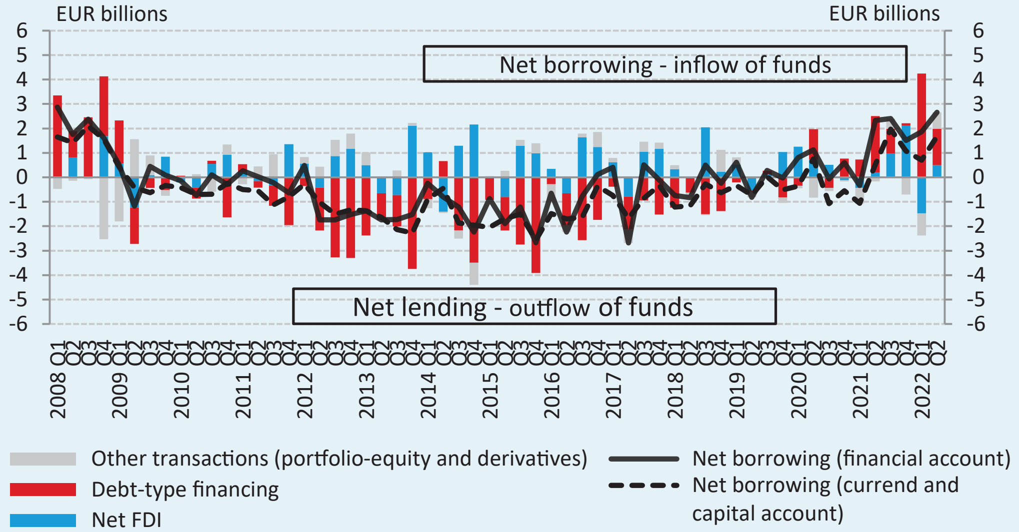
Chart 10: Two types of net lending (four-quarter data as a percentage of GDP)



According to quarterly data, the net borrowing of the economy amounted to EUR 2.7 billion in 2022 Q2, with contributions from inflows of debt liabilities and net foreign direct investment (Chart 11). Following adjustment after the financial crisis, net borrowing was again consistently around EUR 2 billion in the last five quarters. Fund inflows were financed by debt liabilities and net foreign direct investment. After the extremely high expansion of more than EUR 4 billion in 2022 Q1, net outstanding debt rose by EUR 1.5 billion due to transactions in the second quarter.

[2] Developments in the balance of payments can also be described in terms of the financing of real economy transactions. The financial account shows what kinds of transactions affecting net financial worth were used by resident economic agents to finance real economy transactions. 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 exchange rates, as indicated by the category "Net errors and omissions".

Chart 11: Structure of net lending (unadjusted transactions)

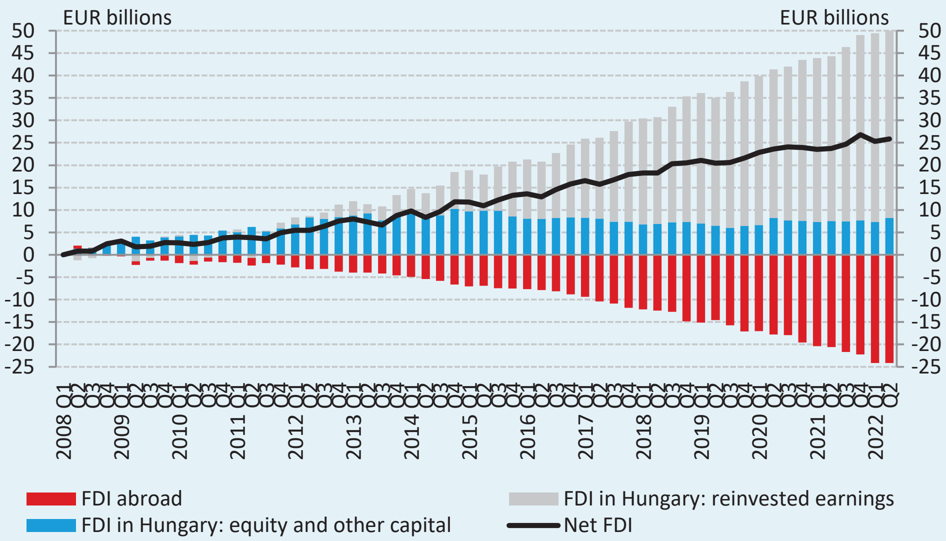


In economic terms, the fundamental development of the debt is not influenced by the conversion between account balance and bullion balances, and thus this technical effect has been eliminated.

2.1 Non-debt liabilities

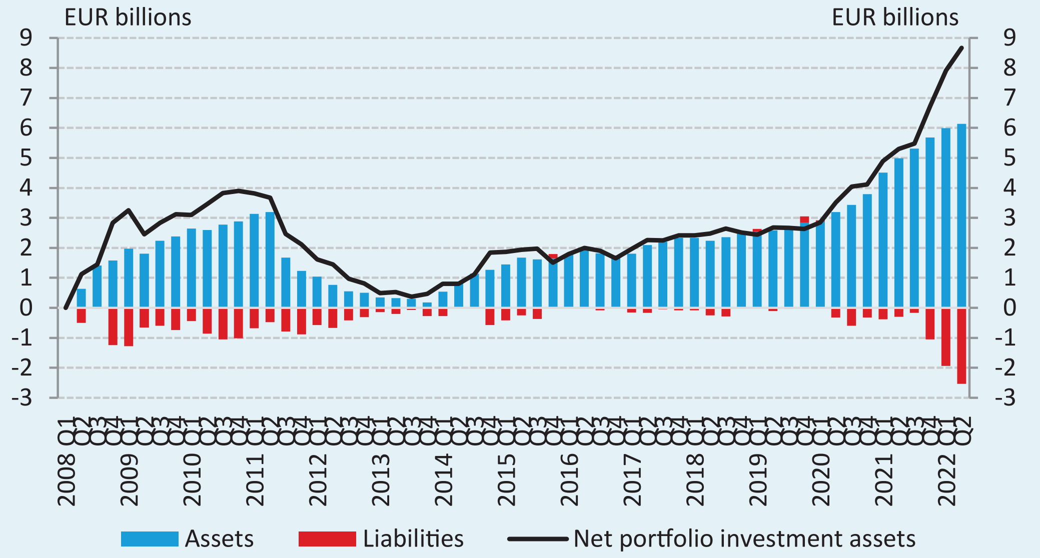
The stock of net foreign direct investment rose again in 2022 Q2 due to transactions (Chart 12). Net FDI inflows excluding capital in transit amounted to nearly EUR 0.5 billion in the second quarter. According to data net of capital-in-transit transactions and asset portfolio restructuring, after a decline in 2022 Q1, foreign-owned companies' investments in Hungary rose slightly. Dividend disbursements approved in the second quarter reduced FDI equities as usual, but a major part of these were not paid yet, resulting in an increase in intercompany loans. Following a major expansion in the previous quarter, Hungarian investments abroad remained practically unchanged in the second quarter. According to recent data, the net inflow of FDI increased significantly in the third quarter, reaching the extremely high value of nearly 2.2 EUR billion in July.

Chart 12: Development of FDI, excluding capital-in-transit transactions (cumulative transactions)



Net portfolio investment outflows continued in 2022 Q2 as well, which was mostly related to a decline in non-residents' investments in Hungary (Chart 13). In the second quarter, net portfolio equity investments shrank the net balance of non-debt liabilities by more than EUR 0.8 billion due to transactions. Non-residents reduced primarily their Hungarian equity holdings by more than EUR 0.6 billion, but holdings of mutual fund shares also dropped slightly. As for Hungarian investments abroad, residents further increased their assets held in foreign portfolio equities and mutual fund shares by nearly EUR 0.2 billion, reflecting a major slowdown compared to previous quarters. Domestic agents' steady foreign investment fund and equity purchases lasting since 2018 seem to be gradually decelerating.

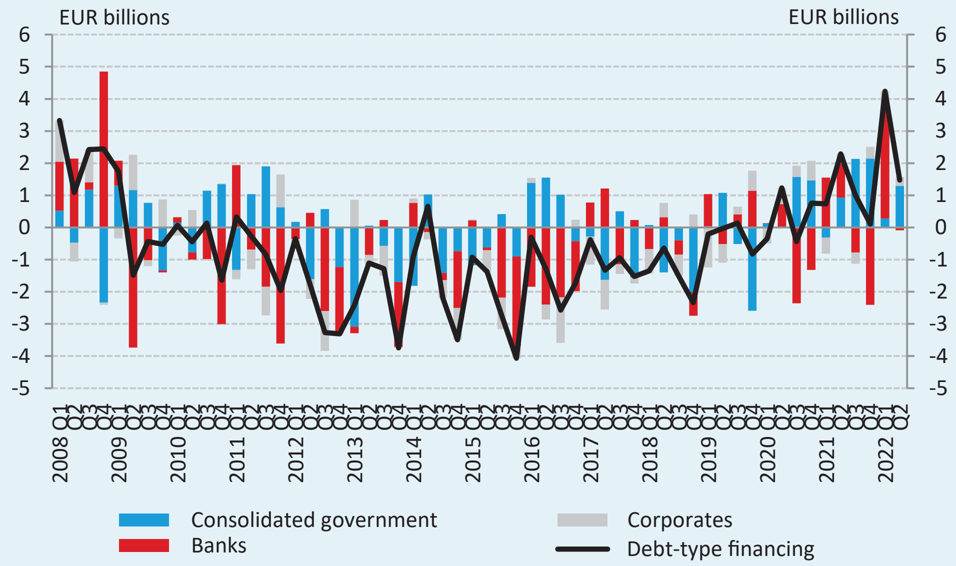
Chart 13: Developments in net portfolio equity and mutual fund share receivables (cumulative transactions)



2.2 Debt liabilities

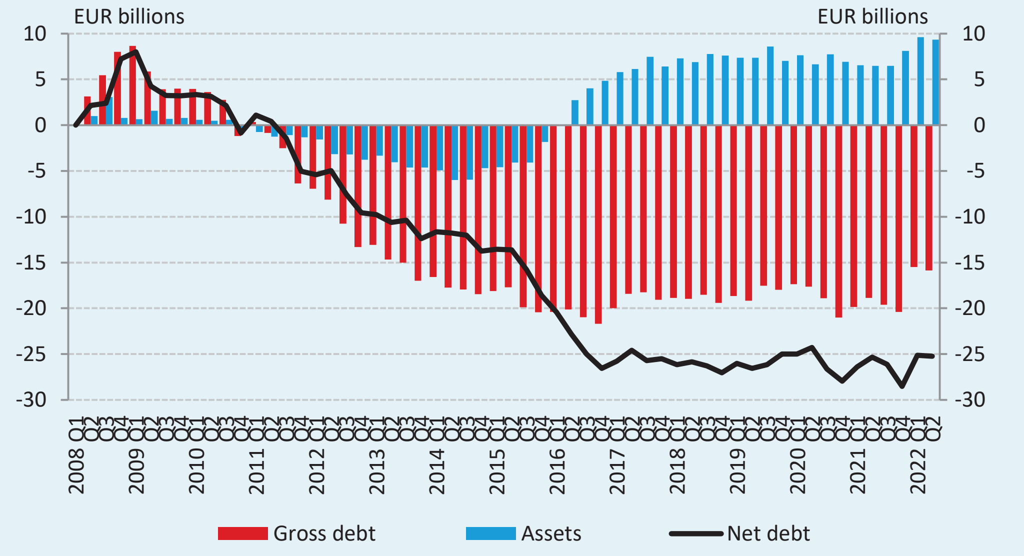
Following the outlier in 2022 Q1, inflows of debt liabilities fell considerably in the second quarter (Chart 14). Net debt due to transactions rose by roughly EUR 1.5 billion, mainly in relation to the consolidated general government, while the banking sector indicator fell slightly. Companies' net external debt advanced by nearly EUR 0.3 billion, attributable in large part to the expansion in liabilities related to an increase in commercial loans.

Chart 14: Development of net debt-type financing by sector



The net external debt of the banking sector fell slightly in the second quarter (Chart 15). The decrease of around EUR 0.1 billion in the net indicator was due to the fact that the decline in banks' liabilities modestly exceeded the decline in assets. The decline in liabilities primarily concerned short-term debt, but long-term liabilities also fell.

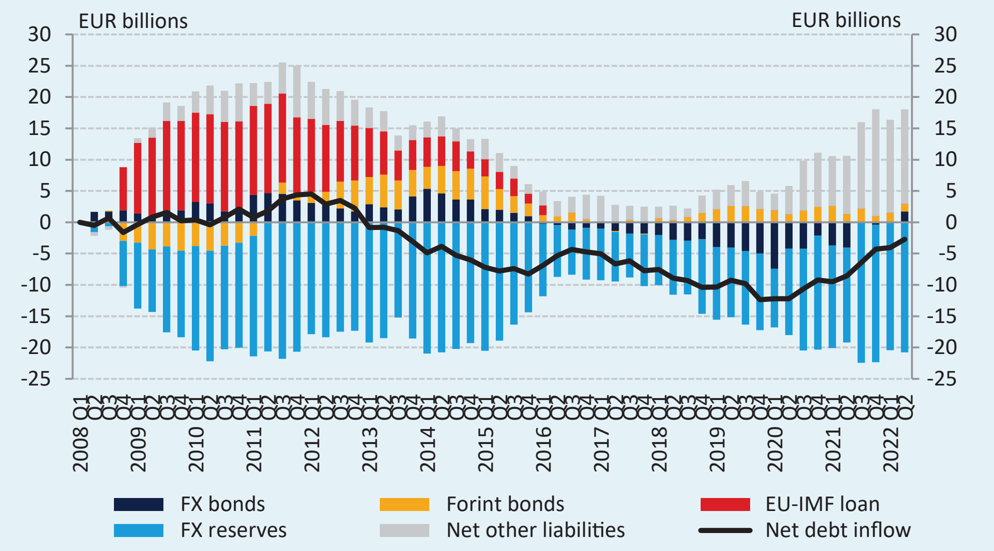
Chart 15: Development of the banking sector's external debt and asset (cumulative transactions)



The expansion in the net external debt liabilities of the consolidated general government including the MNB amounted to EUR 1.3 billion in the second quarter, representing a significant increase compared to the previous quarter, but falling short of the levels seen in 2021 H2. The change in the net external debt of the state was the result of contrasting effects (Chart 16).

- Foreign exchange expenditures of the Hungarian State Treasury contributed to the rise in net external debt through the decline in reserves.
- In line with phasing out the instrument, expiration of the central bank's forint liquidity-providing swaps lowered the foreign exchange reserves by EUR 800 million, increasing the net external debt of the government. In addition, it also contributed to the decline in FX reserves that recourse to central bank swaps providing FX liquidity to banks slightly exceeded the March 2022 holdings. It should be noted that – as a factor contributing to the decline in banks' external debt – the changes in the central bank's outstanding swap contracts had a neutral effect on net external debt at the national economy level.
- Issuance of the one-off central bank discount bond used to ease swap market tensions was nearly EUR 350 million higher than in 2022 Q1, and this increased the net external debt of the consolidated general government, but had a contrasting effect on the indicator for banks.
- On the whole (as a result of the USD- and EUR-denominated FX bond issues and USD bond repurchases in June), the FX financing operations of the Government Debt Management Agency increased both the FX reserves and the gross external debt, and thus had a neutral effect on the net indicator.
- Gross external debt was increased by the recourse to the MNB's repurchase agreements vis-á-vis international organisations, but FX reserves also increased simultaneously, and so this transaction itself did not affect net external debt.
- The decline of nearly EUR 200 million in HUF-denominated government securities held by non-residents reduced the net external debt of the government.
- The absorption of EU funds also contributed to the decrease in the net external liabilities of the government.

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



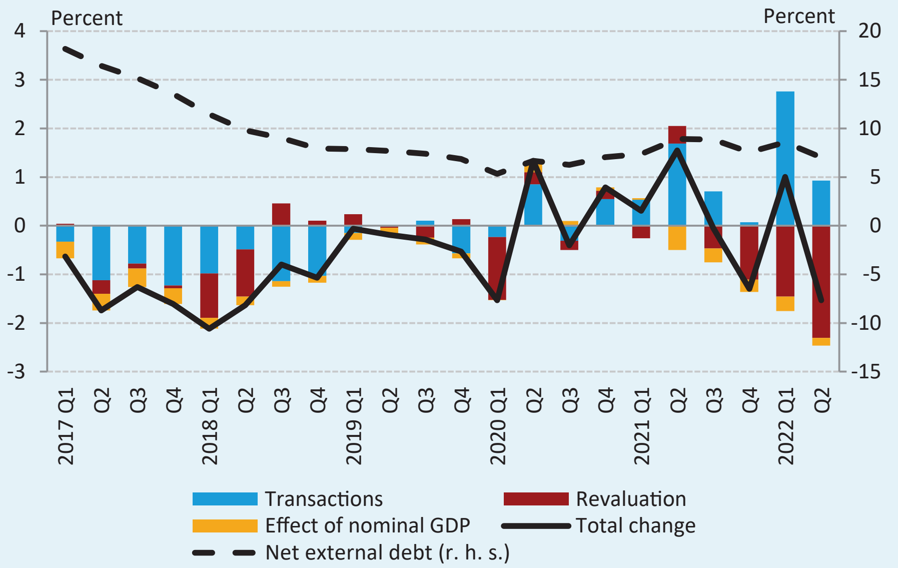
3 Developments in debt ratios

By end-June 2022, Hungary's net external debt according to underlying trends declined to 7 percent of GDP, i.e. close to its historical low. The 1.5-percentage point decrease in the debt ratio observed in the second quarter is attributable to the effect of the revaluation of net outstanding debt due to an increase in yields as well as to the expansion in nominal GDP, which together exceeded the debt-increasing effect of transactions during the quarter. The decline in net external debt was mainly related to the general government consolidated with the MNB, while the debt indicator for the private sector was stable overall. At end-June 2022, gross external debt dropped to 60 percent of GDP, which was also a result of revaluation, the degree of which exceeded the significant fund inflows and contributed to the decline in debt. International reserves amounted to EUR 37.5 billion at the end of the quarter, and thus still significantly exceed the level of short-term external debt expected by investors.

3.1 Developments in debt indicators

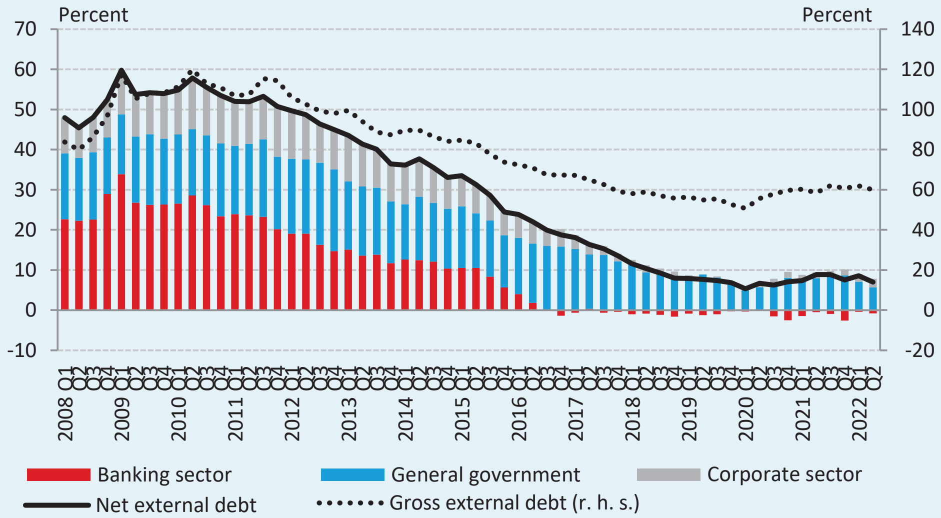
In the second quarter, the net external debt of the economy according to underlying trends fell to 7 percent of GDP, i.e. close to its historical low. Although the inflow of debt liabilities caused the indicator to rise, this effect was more than offset by revaluation reducing the outstanding debt and by nominal GDP growth (Chart 17). Revaluation was due to the fact that, as a result of rising yields, prices of government securities held by non-residents declined, which lowered the outstanding debt. As in the previous quarters, the rise in nominal GDP reduced the net external debt-to-GDP ratio in the second quarter as well.

Chart 17: Components of change in net external debt (values excluding intercompany loans as percentage of GDP)



The decline in net external debt was mainly related to the state, while the debt indicator for the private sector was stable on the whole (Chart 18). The net external debt of the *general government consolidated with the MNB* declined by 1.5 percent of GDP, as the effect of the major debt inflow in the second quarter was more than offset by the revaluation of outstanding debt due to yield increases. The private sector's net external debt-to-GDP ratio stabilised: banks' debt indicator fell slightly, while that of companies increased to a similar degree. In parallel with relatively stable net debt generating financing, the decline in *banks'* net external debt was also related to revaluation, resulting in an expansion in foreign receivables and a decrease in liabilities. The banking sector's net external debt ratio continues to be negative, i.e. banks' foreign assets exceed foreign liabilities. *Companies'* net external debt-to-GDP ratio edged slightly higher, by 0.3 percent of GDP, as the rise in foreign liabilities (related to borrowing and commercial loans) exceeded the expansion in foreign receivables.

Chart 18: Breakdown of net external debt by sectors and gross external debt (as a percentage of GDP, excluding intercompany loans)



At the end of the first quarter, Hungary's gross external debt fell to nearly 60 percent of GDP. The private sector's indicator also improved slightly, but the almost 2-percentage point drop in the debt indicator was mainly related to the decline in the external debt of the *general government,* as the rise in foreign liabilities resulting from transactions was more than offset by revaluation due to yield increases which reduced the outstanding debt, as well as by the effect of nominal GDP growth. The decrease in the private sector's gross external debt was related to the decline in banks' debt ratio, while that of companies increased slightly. The decline in the *banking sector's* debt indicator was primarily related to the drop in banks' short-term foreign loans, but long-term liabilities also fell slightly. The increase in the gross external debt-to-GDP ratio for *companies* was mainly driven by an expansion in commercial loan debts and long-term loans, with the effect of supply problems due to the war and surging energy prices also playing a role.

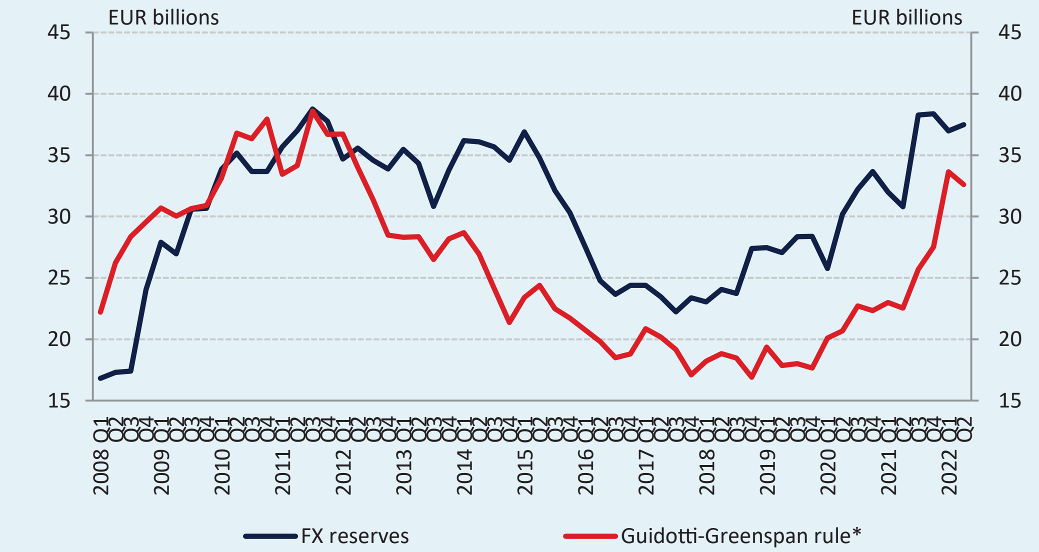
3.2 Foreign exchange reserves and reserve adequacy

At the end of 2022 Q2, international reserves amounted to EUR 37.5 billion, reflecting an increase of EUR 0.5 billion versus the end-March 2022 level. Changes in the reserves were affected by various factors: the increase was primarily related to the FX financing operations of the Government Debt Management Agency and EU fund inflows, while the change in the stock of the forint liquidity-providing FX swap instrument had a significant downward effect:

- The *net FX financing operations of the Government Debt Management Agency (GDMA)* boosted reserves by EUR 2.4 billion in total. In June, the GDMA sold USD-denominated government securities with maturities of 7 and 12 years and a total value of USD 3 billion as well as EUR-denominated securities with a maturity of 9 years in a nominal value of EUR 750 million. The successful issues were followed by a repurchasing auction, within the framework of which USD-denominated securities maturing in 2023 and 2024 were repurchased in a value of nearly USD 1.2 billion.
- *Funds from the European Union* also increased the foreign exchange reserves mainly in relation to disbursements connected to agricultural support programmes.
- The *revaluation* stemming from other currencies appreciating against the euro and the rise in the price of gold expressed in EUR only slightly increased the reserves.
- The *FX transactions of the Hungarian State Treasury* reduced the FX reserves.
- The *change in the stock of the forint liquidity-providing FX swap instrument* reduced the reserve level by EUR 0.8 billion.
- The balance of the *euro liquidity-providing swap instrument* and the international *repo drawdowns* also reduced reserves compared to end-March 2021.

At the end of 2022 Q2, the MNB's international reserves exceeded the level of short-term external debt, which is closely monitored by investors, by EUR 4.9 billion. At end-June 2022, international reserves and short-term external debt amounted to EUR 37.5 billion and EUR 32.6 billion, respectively. Compliance with the Guidotti–Greenspan indicator improved in the second quarter thanks to the increase in international reserves as well as the decline in short-term external debt. The leeway above the Guidotti–Greenspan indicator, which is closely monitored by both the central bank and investors, rose from EUR 4.2 billion at end-March 2022 to EUR 4.9 billion, which still represents sound reserve adequacy (Chart 19).

Chart 19: Short-term external debt of the Hungarian economy and foreign exchange reserves



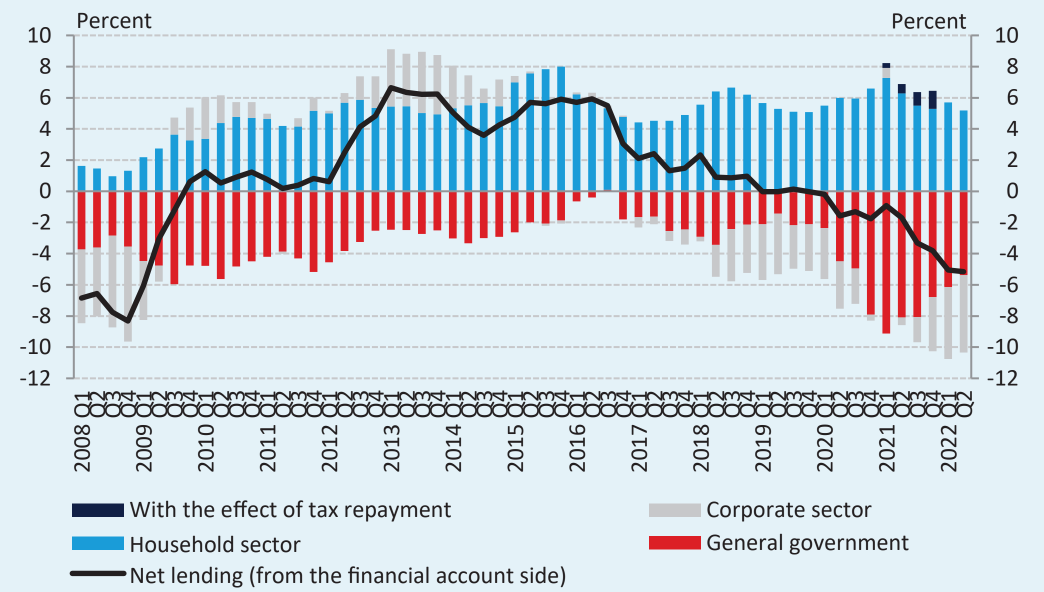
** Guidotti–Greenspan indicator: short-term external debt based on residual maturity.*

4 Sectors' savings approach

The external balance position of the economy according to sectors' savings fell further, due to the reduction in the savings of the private sector. The net borrowing of the general government continued to decline in 2022 Q2, primarily owing to the effect of rising tax revenues. In parallel with that, the net position of households and corporations dropped, which was partly explained by the still buoyant investment and domestic absorption, and partly by the negative effect of higher energy and commodity prices on corporate income. Household savings rose slightly in nominal terms, but due to the strong GDP growth in the second quarter, the indicator as a percentage of GDP declined.

In terms of sectors' savings developments, the rise in the net borrowing of the economy reflected the falling savings of the private sector (Chart 20). The changes in household savings were significantly affected by the sharp expansion in incomes and consumption observed in the first quarter, which was also facilitated by government transfers resulting in one-off expenditures (13th month pension, service benefits for armed forces and law enforcement). Income related to the PIT refund was generated in 2021, and thus – in line with the methodology of financial accounts – the PIT refund was recognised in the statistics for this period, increasing the 2021 savings of households in parallel with the higher budget deficit, while it did not affect net savings in 2022 Q1 and Q2, and only resulted in a rearrangement of financial assets in that period. According to underlying trends and excluding the effect of the PIT refund, households' financial savings once again decreased slightly in 2022 Q2, but remained above the 5-percent value observed at end-2021, following a temporary rise in 2022 Q1. In parallel with the pick-up in the economy and as a result of higher tax revenues stemming from the rapid nominal increase in wages and consumption following inflation, the four-quarter net borrowing of the government declined in the second quarter as well. Meanwhile, a continued increase in net borrowing has been observed in companies' balance position, linked to the still-buoyant investment activity as well as presumably to the negative effect of higher energy and commodity prices on corporate income. Accordingly, on the whole, despite the declining net borrowing of the state, as a result of a decrease in households' net lending as a percentage of GDP and a rise in net borrowing of the corporate sector, the net borrowing of the national economy increased in the second quarter.

Chart 20: Net lending of specific sectors* (four-quarter values as a percentage of GDP)

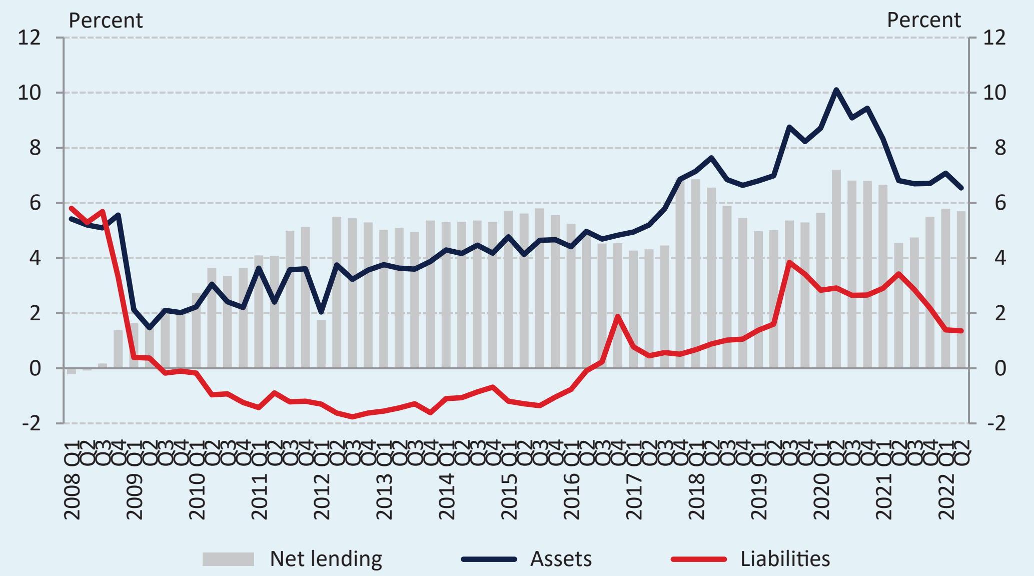


** General government represents net borrowing according to the financial accounts. Corporations based on the residual principle.*

According to the underlying trends, households' seasonally adjusted net financial savings decreased moderately in 2022 Q2 versus the previous quarter, driven by a decline in financial assets (Chart 21). For economic considerations, the MNB excludes one-off effects (such as pension fund savings, early repayment, real yield disbursement, indemnification of the depositors of liquidated mutual savings banks, forint conversion and settlement) from the indicator based on underlying trends. The one-off effects also influence the net indicator via the accumulation of financial assets and the liabilities, and therefore, in addition to presenting the gross legs, we present the underlying trends using seasonally adjusted data.

According to the seasonally adjusted indicator as a proportion of GDP, which captures the underlying developments, the decline in households' financial asset accumulation is partly attributable to the disappearance of the temporary effect of one-off government transfers in 2022 Q1 (13th month pension, service benefits for armed forces and law enforcement). The dynamics of households' seasonally adjusted net borrowing as a percentage of GDP remained low in the past quarter, which mainly reflected the effect of the high-amount of repayments observed in securities loans outstanding as well as caution due to geopolitical tensions, which was partly offset by the increased interest in the closing FGS Green Home Programme and demand brought forward due to the rising interest rate environment. In addition to the prenatal baby support loan, the new housing subsidies available from 2021 continue to play a prominent role in households' credit demand.

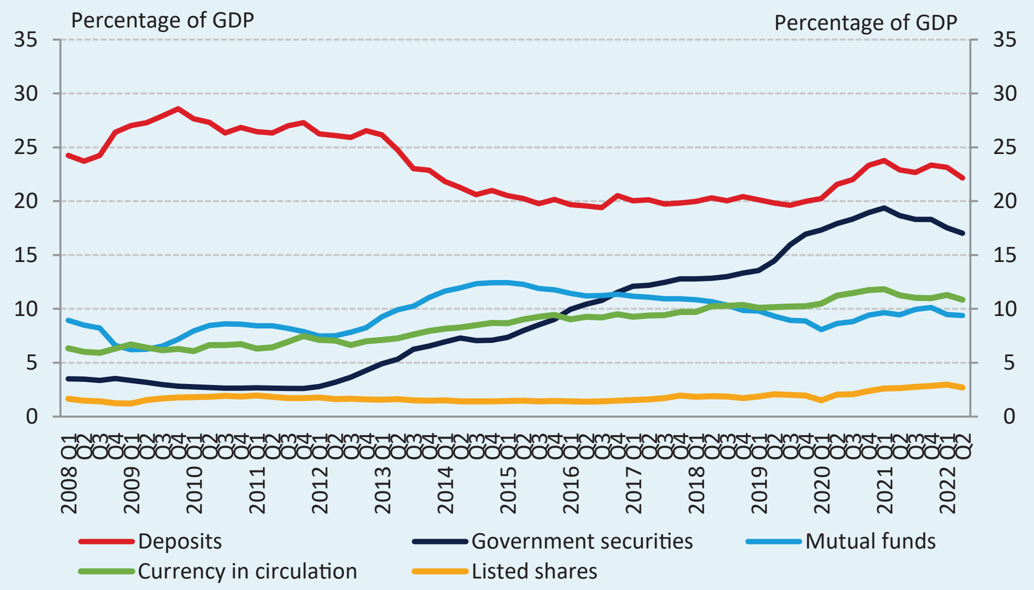
Chart 21: Households' net lending according to underlying trends (seasonally-adjusted, revised values, as a percentage of GDP*)



** Figures showing underlying trends, adjusted for pension fund savings, the early repayment scheme and the real yield disbursement, the indemnification of the depositors of liquidated mutual savings banks, the effect of the forint conversion and settlement, and the personal income tax refund. Time series adjusted separately.*

Households' financial asset accumulation rose slightly in nominal terms, but declined as a percentage of GDP. Rearrangement across the forms of savings continued in parallel with this (Chart 22). Compared to the previous quarter, overnight deposits increased slightly, by HUF 60 billion, in the second quarter. Of the sight and overnight deposits, households' foreign currency deposit holdings increased, while HUF-denominated deposits declined. The rate of cash accumulation, which had increased considerably in 2022 Q1 due to precautionary considerations in view of the conflict between Russia and Ukraine and presumably to the demand for cash of refugees arriving in the country, came to a halt in the second quarter, and continued to increase only to a small degree. In parallel with that, however, households' demand for government securities rose, and thus a low net inflow of government securities was registered. Nevertheless, this was overshadowed by the robust Q2 GDP growth, resulting in a decline in the indicator as a proportion of GDP. Within government securities, in parallel with the increase in inflation, redemptions of MÁP+ securities continued, and their holdings declined by HUF 860 billion compared to 2022 Q1. Starting from the final quarter of 2021, households gradually shifted from fixed-rate government securities towards inflation-indexed government securities in view of the rising inflation. Holdings of inflation-indexed PMÁP securities increased dynamically (partly as a result of the outflow from MÁP+). Over the past one-year period, with the widening of investment options, households steadily increased their financial wealth held in investment funds, and within that, inter alia, their foreign assets. Although there were outflows from the segment of mutual fund shares as well due to the international uncertainty in 2022 Q1, households increased their wealth in this form of savings again in the second quarter (GDP growth obscured the rise in the debt ratio in this case as well). In parallel with that, quoted share holdings, which had been rising dynamically in the previous period, continued to increase on a transaction basis in the second quarter, but there was a minor decline as a percentage of GDP here as well.

Chart 22: Development of households' major financial assets



5 Income of foreign-owned companies

The special topic in the Report on the Balance of Payments discusses developments in the income of foreign-owned companies. According to incoming actual data, the profit of foreign-owned companies as a percentage of GDP increased in 2021, in line with the significant expansion in exports in parallel with the rapid economic recovery following the crisis. The increase in profit was also reflected in the further rise in the reinvestment ratio, which had been high in the previous years as well: against the background of a high investment rate, foreign-owned companies continued to invest most of their earned income in Hungary. In the major industries, the return on equity of foreign-owned companies typically increased, with the strongest increases recorded in the production of chemical substances as well as in tourism and transportation (e.g. air transport), which had been hit hard by the pandemic. The rise in the income balance deficit due to corporate profits was partly offset by the fact that, in relation to the recovery after the pandemic, the profits of companies owned by residents but operating abroad also increased. The income-to-equity ratio rose in most of the regional countries as well, which was typically reflected in higher reinvestments in the other countries as well. In line with the rise in foreign-owned companies' profits, the GNI–GDP gap also tended to increase in the countries of the region.

In the September balance of payments data release, the previous, estimation-based data for corporate income in 2021 are replaced by actual figures on the basis of the received annual data reports.[3] According to the relevant data, the increase in the balance of profits in the income account slightly exceeded the previously indicated rise. In parallel with the significant growth in export revenues as a result of the recovery following the pandemic, the profit of foreign-owned companies operating in Hungary increased faster than the profits of Hungarian companies operating abroad.

As discussed in the special topic, in relation to corporate profits, it is important to bear in mind that this item contains the corporate income related to current operating performance, excluding outliers, i.e. one-off profit or loss items, shown in the balance of payments statistics. Based on the methodology of the balance of payments,[4] the profit/loss realised outside of current operating performance (for example, from exchange rate changes) does not form part of the incomes. Profit or loss items stemming from sources like this are stated among changes in stock – not due to transactions. In the first subsection, we present the changes in the income of foreign-owned companies and the absorption of it as shown in the balance of payments. After that, we first review the incomes of foreign-owned non-financial corporations and banks, and then examine the background of the changes in profits in 2021. Following the presentation of corporations' profit or loss, shown in the balance of payments, and their after-tax profit or loss, in the final subsection we conclude this special topic in the Report on the Balance of Payments with a regional comparison.

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

In 2021, the balance of foreign-owned companies' equity income rose to nearly 6 percent of GDP (Chart 23). **As in the meantime the value of dividends disbursed to owners as a percentage of GDP fell short of the previous year's level, the increase in income was also reflected in the significant, nearly 1-percentage point rise in reinvestments.** After the 2008–2009 crisis, the profit of foreign-owned companies as a proportion of GDP fell in parallel with the weaker demand. After 2013, however, in line with the faster economic growth and also supported by external demand, which also contributed to the dynamic expansion in exports, the value of foreign-owned companies' produced income also rose. The decline in profits after 2018 was exacerbated in 2020 by the negative effect on profitability of the lockdowns due to the pandemic, but the level of the profit-to-GDP ratio remained relatively high, while it was restrained by the dividend disbursement,[5] and thus the size of reinvestments reached a significant level, which played an important role in the dynamic expansion in corporate investment in the past years. In 2021, profits of foreign-owned companies rose to 6 percent of GDP in parallel with the recovery following the pandemic and with strengthening export revenues. Accordingly, as a result of the lower dividend disbursement, the dividend-to-profit ratio fell to below 40 percent from a level of nearly

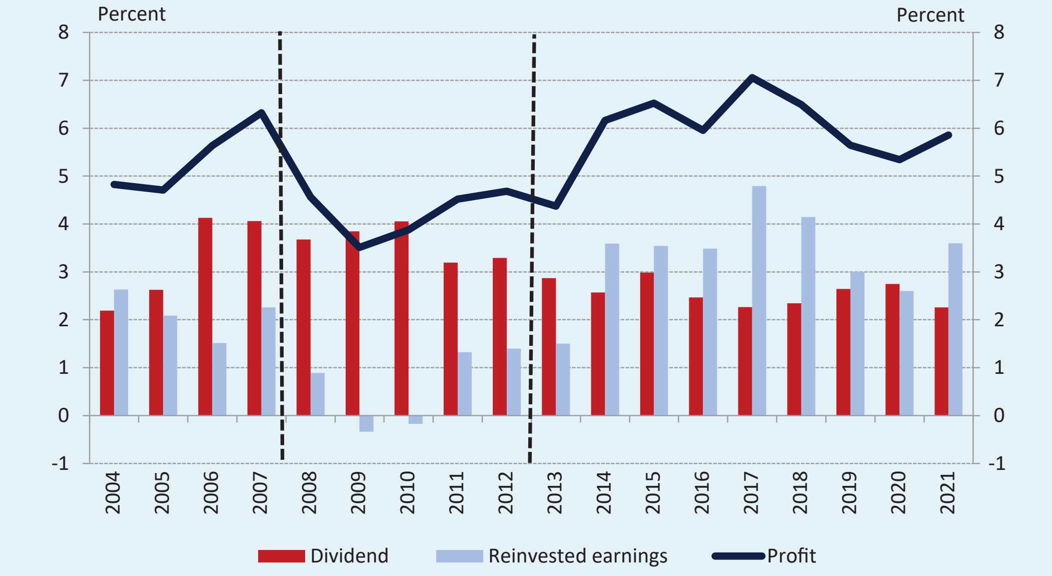
[3] For more details, see: Hungary's balance of payments and international investment position statistics, MNB (2014)

[4] Balance of Payment Manual, 6th edition

[5] It should be noted that in the balance of payments statistics dividend payments exceeding the profit of the reference year are not shown in the income balance, as this item is recognised as disinvestment in the financial account. Its degree is shown by the extremely high dividends, the value of which exceeded EUR 7 billion in 2021, which is much higher than the values typical in previous years. The outstandingly high dividends were mostly attributable to the dividend payments by a multinational corporation operating in Hungary, which formerly had not paid any dividend to its owner for a longer period, and thus this dividend payment reflects the profit generated in previous years.

50 percent one year earlier. In parallel with that, the level of reinvestments rose in the past year, and already accounted for 3.6 percent of GDP in 2021.[6] A substantial portion of foreign-owned companies' profits (more than 94 percent) was produced by non-financial corporations.

Chart 23: Foreign-owned companies' income and its utilisation[7] (as a percentage of GDP)



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

The profit rates of both banks and non-financial corporations increased as a result of the recovery following the pandemic. Prior to the 2008–2009 crisis, the value of companies' and banks' profits calculated as a percentage of their FDI equity was close to 10 percent and 13 percent, respectively. Following the outbreak of the crisis, the profit rate of non-financial corporations declined, but that of banks only decreased to a greater degree in 2012.

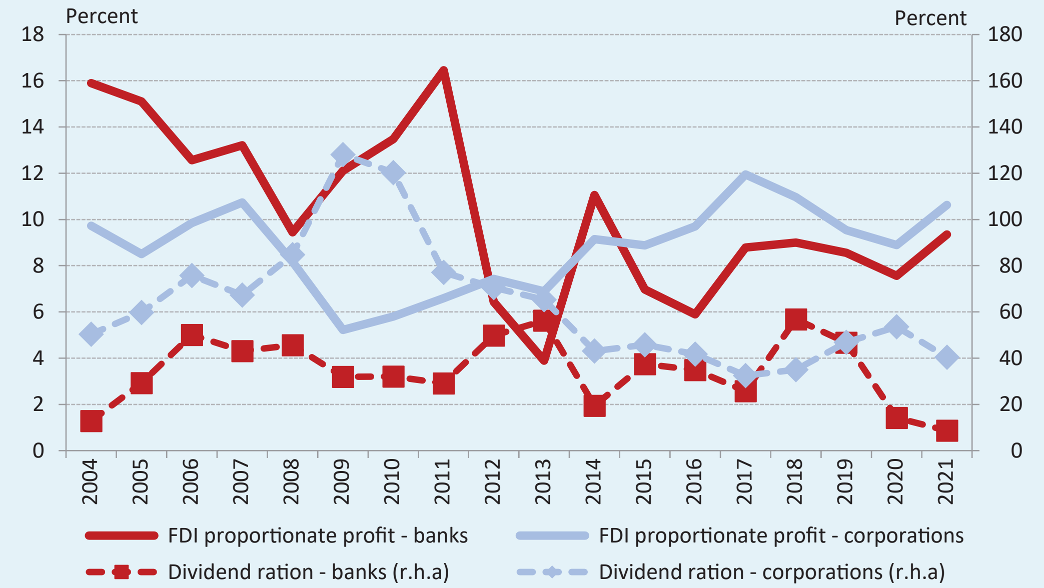
- In parallel with banks' balance sheet cleaning and the upswing in lending in line with the economic cycle, foreign-owned banks' profit rate according to current operating performance rose to nearly 9 percent in the period between 2017 and 2019, before declining to below 8 percent in 2020. In 2021, however, banks' profit rate increased considerably to nearly 10 percent, which is attributable to much lower loan loss provisioning in a more favourable macroeconomic environment and higher interest revenues in a rising interest rate environment.
- After the financial crisis, the profit of non-financial corporations gradually rose to nearly 12 percent by 2017, but then started to decline again due to the high wage outflow and strong investment spending. In 2020, it decreased further, falling to nearly 9 percent, due to the restrictions and lockdowns related to the pandemic and lost output due to frictions in production chains. In 2021, however, the robust increase in export revenues due to strengthening external demand raised the profit rate of foreign-owned non-financial corporations to nearly 11 percent again.

[6] Since reinvested earnings, related to the normal business operations, 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).

[7] 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 profit/loss 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 dividends paid to foreign owners 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.

Banks' dividend payout ratio declined further from the 15-year low seen last year, while non-financial corporations' dividend disbursements decreased after a temporary rise. The significant reinvestment by banks observed in the past two years was related to a regulatory decision: in March 2020, the MNB's Financial Stability Council helped mitigate the impacts of the state of emergency resulting from the pandemic on the financial intermediary sector by adopting a comprehensive package of policies. One of the measures was a temporary restriction on dividend payments, intended to strengthen the liquidity and financial situation of the domestic banking sector. This restriction was lifted at end-2021, and thus banks have been allowed to pay dividends again since January 2022. Following the rising trend seen in recent years, non-financial corporations' dividend payout ratio began to decline, reaching about 40 percent. The reason for the decline may have been that the funding requirement for the buoyant investment activity entailed by the rapid economic recovery following the pandemic stimulated corporate reinvestments.

Chart 24: Profit of foreign-owned companies as a percentage of FDI equity, and as a percentage of dividends voted

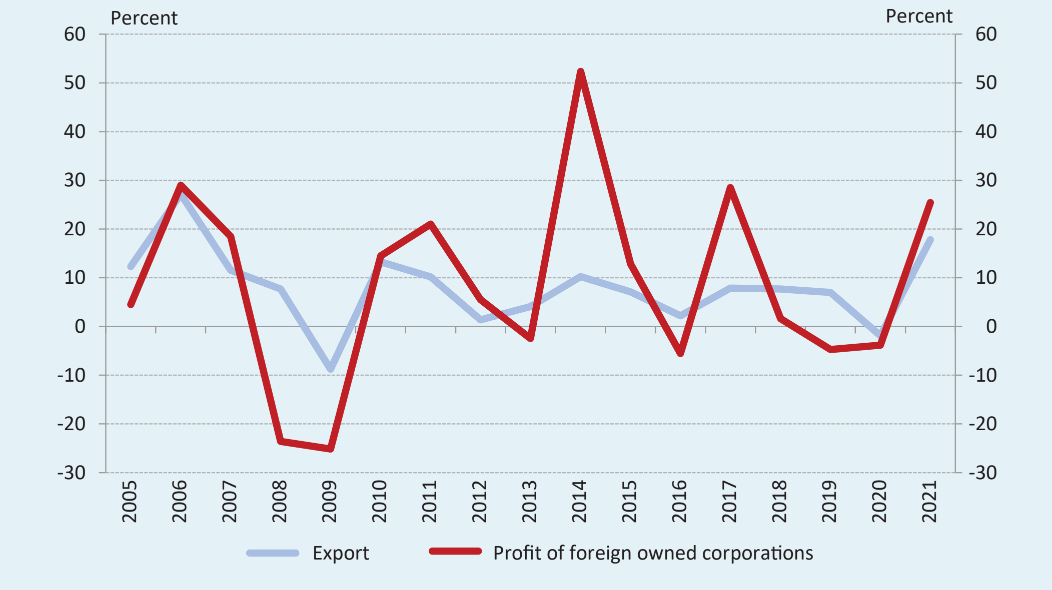


Note: The profit rate is a value calculated from the year-end stock.

5.3 Factors underlying developments in corporate profits

With the rapid economic recovery and in parallel with the significant expansion in exports in 2021, there was a major increase in corporate profits as well. As many foreign-owned companies are active in the export-oriented sector, and also based on past experiences, it is justified to compare foreign-owned companies' profit to export performance. Following the divergence seen in previous years, closer co-movement has been observed once again in the trends of export dynamics and corporate profitability (Chart 25). After the downturn in 2020 due to the pandemic, export growth rose strongly in 2021, at a pace unseen since the early 2000s, and corporate profits also grew significantly in parallel with this.

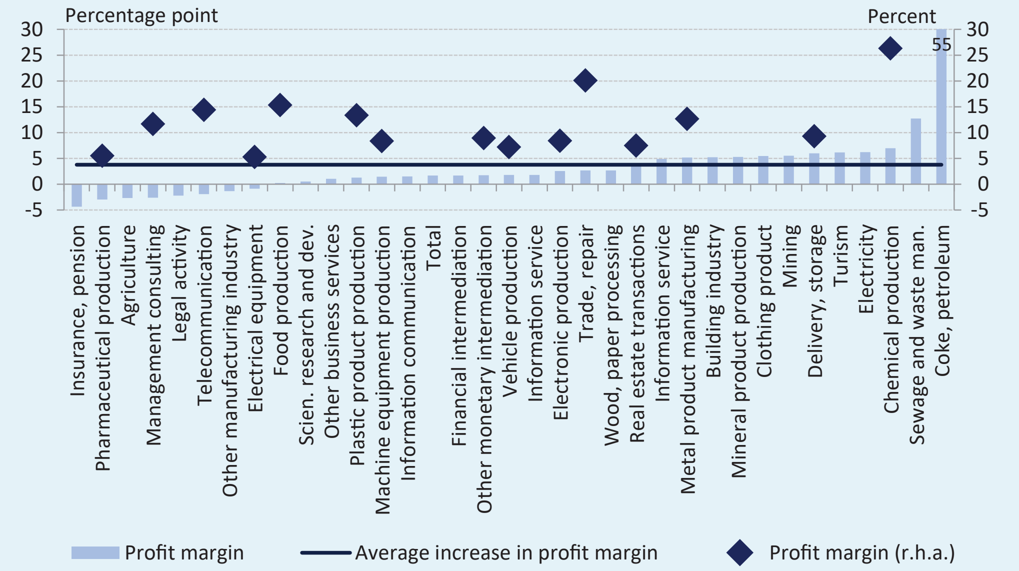
Chart 25: Profit of foreign-owned companies (in HUF) and developments in exports (change compared to previous year)



Following the unfavourable developments in 2020, return on equity rose in the major sectors in 2021, mainly in the production of chemical substances, while in the smaller sectors the performance of accommodation services and catering improved with the restart of tourism. The profit rate of foreign-owned companies as a percentage of FDI, calculated by industries, increased by nearly 4 percentage points on average between 2020 and 2021 (due to the rise in the profit of low-weight sectors, the degree of the increase slightly exceeds the aggregate figure applicable to the entire sector). Following the previous year's unfavourable income trends, in 2021 there were more sectors where profits increased compared to the number of those where profits declined (Chart 26), and corporate profits rose in the majority of the sectors where foreign investment is significant, exceeding EUR 2 billion. The greatest improvement was achieved in the production of chemical substances as well as in transportation and storage, while corporate profits declined slightly in pharmaceutical production, management consulting and telecommunication.

In 2021, the average profit rate of major foreign-owned companies operating in Hungary was above 5 percent, showing relatively high dispersion. The increase in the profit margin on sales of vehicle manufacturing, where foreign investment is the highest, continued in 2021 as well. This increase was presumably related to the recovery of industrial production and exports, which was, however, restrained by the frictions in supply chains that existed in 2021 as well. The profit ratio of around 7 percent in vehicle manufacturing continues to be relatively low among the sectors with major foreign direct investments. In commerce, which is the sector with the second highest foreign investment, the profit margin on sales rose to 20 percent following a decline in the previous year, which may have been attributable to the strong domestic demand in view of the pick-up in consumption and investment activities in parallel with the restart of the economy. On the whole, the return on invested capital of major foreign-owned companies operating in Hungary was typically around 10–12 percent, although it showed relatively high dispersion within the band between 5–25 percent.

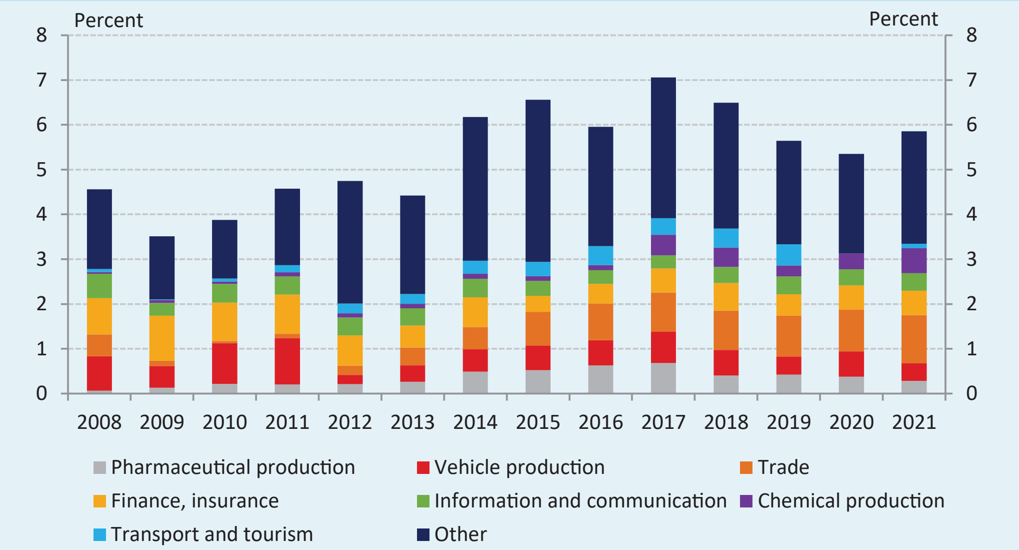
Chart 26: Growth in the profit of foreign-owned corporations as a proportion of FDI in selected sectors in 2021



Note: For the sectors with FDI stock over EUR 2 billion we indicated the profit ratio of the given sector.

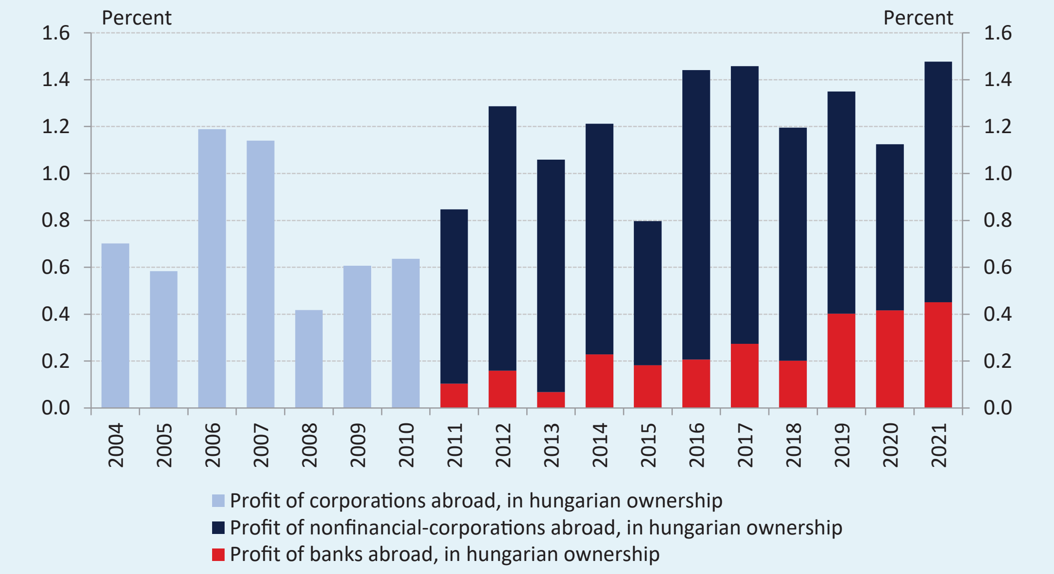
Foreign-owned companies' profit on FDI is relatively concentrated: seven sectors account for nearly 60 percent of the profit. Until 2017, the rise in the profit of foreign-owned companies affected a wide range of sectors, with the profitability of the largest sectors being particularly strong. The decline in the profit-to-GDP ratio seen in 2018 and 2019 was also a general phenomenon, as it affected sectors with the highest and lower weights alike. In terms of sectoral profitability, stronger and more concentrated changes took place in 2020: while profitability improved in most of the major sectors (such as the production of chemical substances, vehicle manufacturing, finance and insurance), the economic effects from the pandemic seriously impacted transportation and tourism, the profits of which fell to zero. In 2021, tourism and transportation services became profitable again as the pandemic subsided, although their profitability was still much lower than the values seen at the end of the 2010s. In line with the economic recovery, most sectors were able to boost their profitability in 2021: of the main sectors, the profitability of the production of chemical substances and commerce improved to a greater degree in 2021, while the performance of other, smaller sectors also increased. At the same time, the income of vehicle manufacturing and pharmaceutical production compared to GDP declined slightly. There were no significant changes in the weights of sectors: the income of the major industries still account for around 60 percent of the total profits of foreign companies operating in Hungary.

Chart 27: Profits of foreign-owned companies (as a percentage of GDP)



In parallel with a rise in the income of foreign-owned companies operating in Hungary, the profit of resident companies' foreign affiliates also increased in 2021. 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.[8] Following a downturn in 2020, their value as a percentage of GDP increased in 2021 to the high level seen in 2016–2017. This was primarily related to the major improvement in resident non-financial corporations' foreign profits, which reflected the recovering economic performance following last year's pandemic-induced decline. Foreign affiliate banks' profits, which had been at stable, high levels since 2019, rose slightly further in 2021, which also contributed to the increase in resident companies' foreign profits.

Chart 28: Profits of companies operating abroad and owned by residents (as a percentage of GDP)



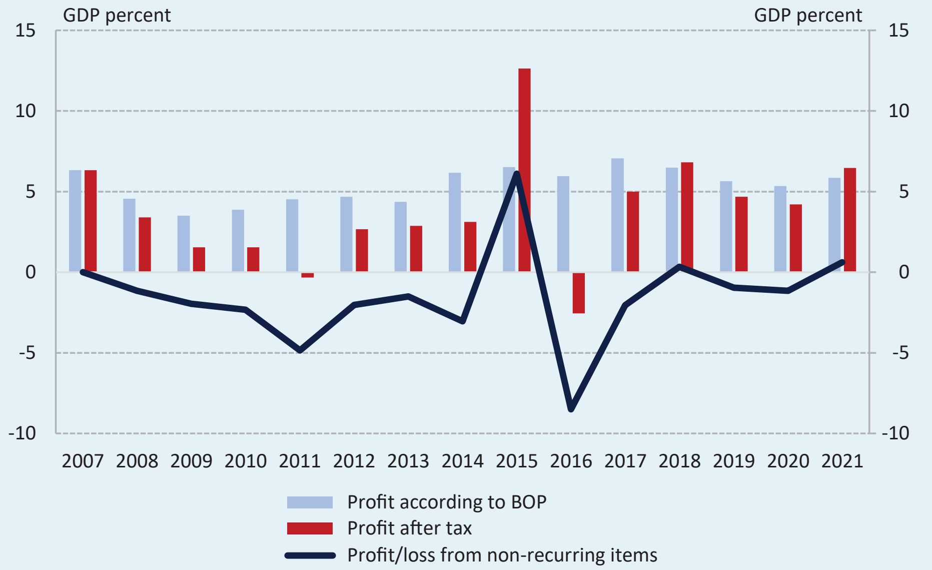
5.4 After-tax profit of foreign-owned companies

Similarly to the income from 'current operating performance' shown in the balance of payments, after-tax profits of corporations also increased in 2021, and thus the gap between the two indicators – which is mostly attributable to one-off items – remains small (Chart 29). In line with international regulations, the balance of payments statistics only show the income from the current operating performance of foreign-owned companies, i.e. one-off effects, which are typically related to revaluation, are excluded.[9] As a result, the profit – according to current operating profit – shown in the balance of payments is much more stable. For example, in 2015 and 2016, the outlier profitability data of a multinational corporation operating in Hungary strongly affected the after-tax profit figure, while the income in the balance of payments, in which the one-off items are eliminated, was stable. The data available since 2008 show that items outside current operating performance typically reduced the profit of corporations, and thus the elimination of these items in the balance of payments statistics led to higher income (and thus higher reinvested earnings given the size of the dividend payment realised) and a larger deficit on the income account. The difference between the two indicators was relatively small, i.e. there was no one-off, high-amount non-recurring item that could have significantly affected the income, and thus the after-tax profit/loss and the profit/loss according to the current operating performance concept shown in the balance of payments differed by merely 1 percent of GDP. In 2021, as a proportion of GDP, the levels of both the profit according to the balance of payments (related to current operating performance) and the after-tax profit increased: the former amounted to 5.9 percent and the latter to 6.5 percent of GDP.

[8] Based on analytical considerations, in the income account we present the primary incomes, except for other primary incomes, which in the former methodology formed part of unrequited transfers, and thus we state them in the transfer balance.

[9] Such one-off impacts at corporations are, for example, losses from exchange rate revaluation; at credit institutions the early repayment at preferential exchange rate or the settlements related to household loans.

Chart 29: Profits from current operating performance and based on the profit/loss after tax* (as a percentage of GDP)

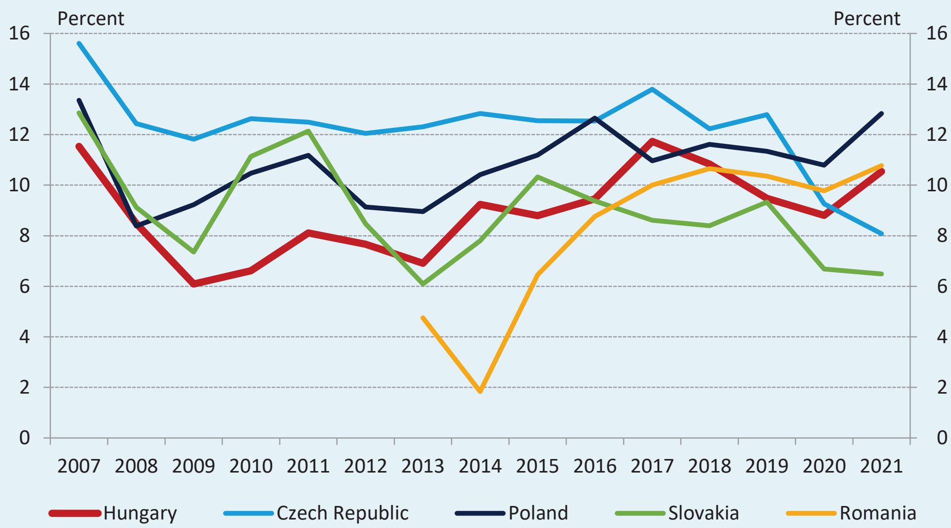


** The profit realised by foreign-owned corporations has a negative impact on the income account, in line with the income account of the balance of payments.*

5.5 International comparison

Within the region (except for the Czech Republic and Slovakia), foreign-owned companies' profitability typically rose in 2021, which is attributable to the recovery and favourable export growth after the pandemic. In the countries of the region, the profitability index showed a high degree of co-movement in the years following the financial crisis, likely due to the significant impact of international, external trends. The ratio of foreign companies' income to FDI shares dropped in several regional countries after the 2008 crisis and started to rise from 2013. In 2020, however, the pandemic undermined the situation of the corporate sector on both the demand and supply side, which reduced profits. According to the current estimate, which presumably does not yet contain any actual data, in 2021 the largest profit margin on sales (13 percent) was achieved by foreign-owned companies operating in Poland, and thus their profitability significantly exceeded the levels (of around 10–11 percent) observed in Hungary and Romania. At the same time, after 2020, foreign-owned companies' profitability declined in the Czech Republic and Slovakia in 2021 as well (to 8 percent and 6 percent, respectively).

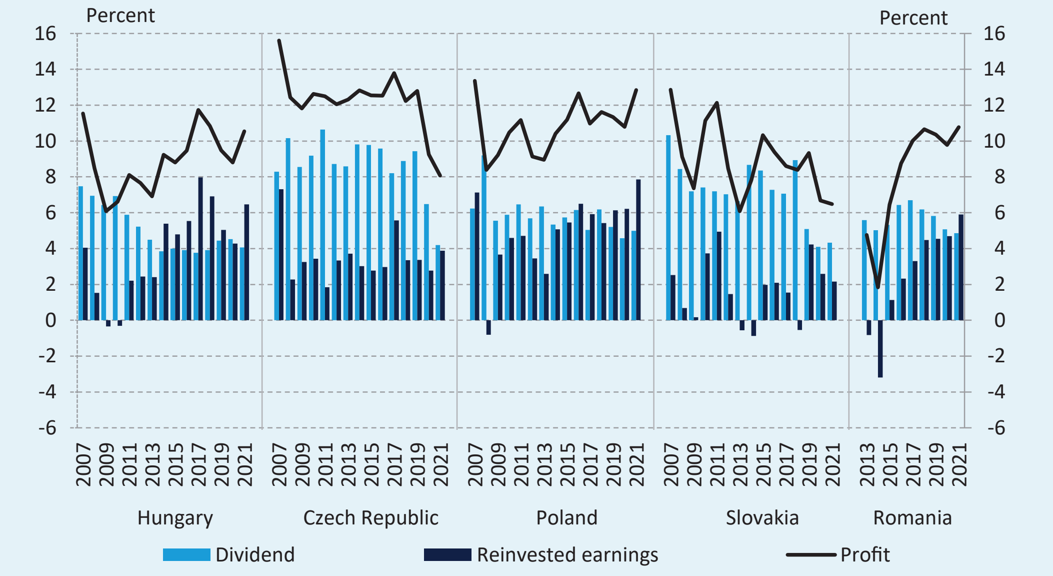
Chart 30: Return on FDI equity investment (value of profit realised on the FDI stock relative to total FDI stock)



*Source: Eurostat *The 2021 value for the countries of the region is presumably still based on estimation.*

In the Czech Republic and Slovakia, foreign-owned companies responded to the deterioration in their profitability by reducing dividends, while in the rest of the countries the rise in profitability was also reflected in the increase in reinvestments (Chart 31). Whereas in the past an increase in profits typically entailed an expansion in dividend payments in the regional countries, in the past ten years the ratio of dividend payment to equity has stabilised at a low level in Hungary.[10] According to preliminary data, in 2021 dividend payments in the Czech Republic continued to decline significantly (to around the level observed in Hungary), while reinvested earnings were at a higher level compared to the previous year. The fall in dividend payments may have been largely due to the European Central Bank and the European Systemic Risk Board's proposed dividend cap on the banking system, while the Czech Republic has a much higher share of foreign-owned banks in the banking sector than Hungary (around 90 percent). In Slovakia, while dividends increased slightly, the volume of reinvestments as a percentage of FDI declined. By contrast, in Hungary, Poland and Romania, the increase in profitability and the roughly unchanged dividend ratio were coupled with a rise in reinvested earnings in the case of foreign-owned companies. The ratio of reinvestments to FDI equity in Poland (7.9 percent) and Hungary (6.5 percent) is still considered high.[11]

Chart 31: Breakdown of FDI earnings (as a percentage of FDI equity)



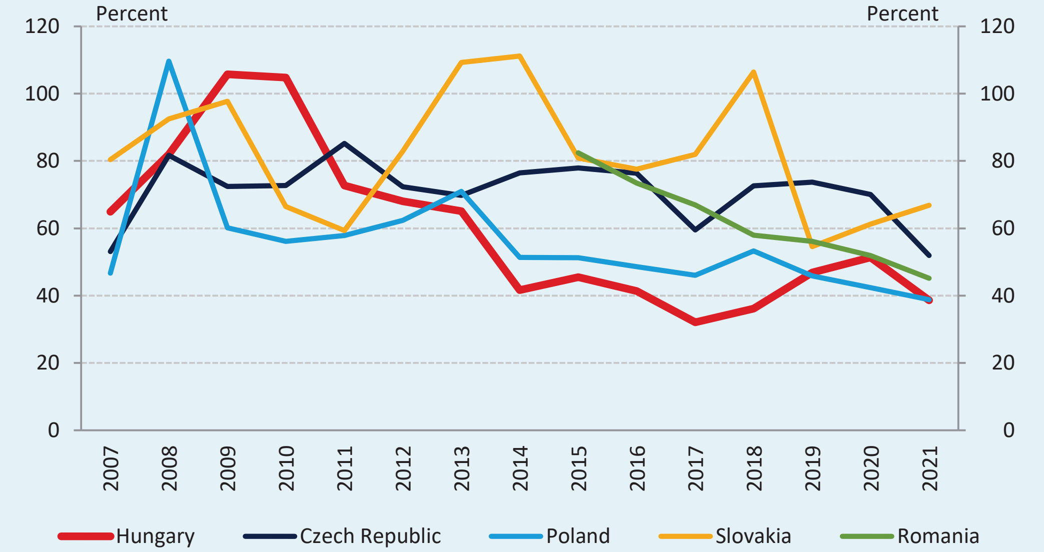
*Source: Eurostat. *The 2021 value for the countries of the region is presumably still based on estimation.*

The dividend payout ratio typically declined in the countries of the region in 2021, and the indicator continues to be the lowest in Hungary and Poland (Chart 32). Before 2009–2010, dividend payments by foreign corporations steadily rose as a percentage of income. As a result of the increased liquidity demand of foreign parent companies due to the crisis and owing to the weaker growth prospects of the regional countries, corporations in several countries also paid dividends to their foreign owners from the retained earnings accumulated from previous years' profits. The dividend payout ratio declined in all the countries from the middle of the decade, dropping to the greatest degree in Hungary, where foreign-owned corporations disbursed a mere 32 percent of their earned income as dividends in 2017. From 2018, in the case of foreign subsidiaries in Hungary the declining trend observed until then turned around and the dividend-to-income ratios started to rise, before declining to below 40 percent (i.e. close to the 2018 figure) again in 2021. Looking at the countries in the region, in 2021 the ratio of dividend disbursement to profit only increased in Slovakia, where it amounted to 67 percent, the highest figure for the Visegrád countries. In the other countries of the region, partly in relation to the dividend limitation of the Czech banking sector, where foreign ownership is high, the indicator fell to around 40–50 percent in the past one year.

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

[11] The treatment of superdividends may also increase reinvested earnings as a percentage of profit, because by reducing the profit it raises the role of the reinvested earnings as a percentage of income, while it reduces that of dividends. With regard to other countries in the region, no information is available whether they take into account the recommendations of the IMF concerning the application of superdividends.

Chart 32: Ratio of dividend payments to profit

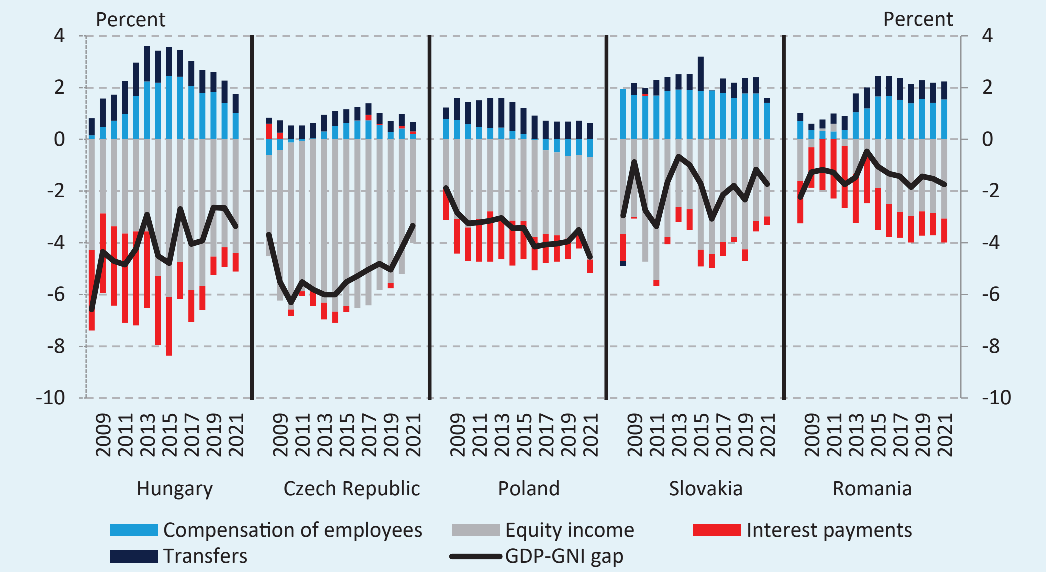


*Source: Eurostat *The 2021 value for the countries of the region is presumably still based on estimation.*

Against the background of a downward longer-term trend, compared to the previous year the GDP–GNI gap in Hungary rose slightly in 2021 and was thus near the figure for the Czech Republic, ranking in the middle of the field for the region (Chart 33). The difference between gross domestic product (GDP) and gross national income (GNI), i.e. the GDP–GNI gap, is the result of summing up the income payments vis-à-vis the rest of the world. The factors of the indicator are: interest payments related to the non-resident sector (interest), the net profit of foreign-owned companies (income on FDI shares), the income of people employed abroad (wage) and foreign transfers (recognised among primary incomes). In view of the profits on significant FDI in the countries of the region, disposable income is below the value of the gross domestic product. At the same time, the net income of people employed abroad and EU transfers typically reduce the difference between GDP and GNI in the countries of the region. Following the 2008 crisis, as a result of companies' improving profitability, profit outflows related to equity increased considerably in the countries of the region, which was partly offset by the rise in the income of those employed abroad and transfer inflows. In addition, the steady decline in interest expenditures also contributed significantly to the narrowing of the GDP–GNI gap. With the exception of the Czech Republic, GDP–GNI gap increased in the countries of the region in 2021.

- In Hungary, despite the pandemic, foreign-owned companies' profitability increased, and the decline in the income of people employed abroad and in transfers continued, and thus the gap between the two indicators widened to -3.4 percent.
- Companies' profit balance rose in Poland, just like in Hungary, resulting in a 1-percentage point increase in the gap between the two indicators. Moreover, in contrast to the other countries in the region, in Poland the earned income of those employed abroad cannot reduce the difference between the two indicators, because the number of Ukrainian guest workers employed in Poland exceeds the number of Poles working abroad, and thus has a negative impact on the income balance.
- In 2021, the GDP–GNI gap increased slightly in Slovakia and Romania as well, but was still the lowest in the region. In Slovakia, the decline in the compensation of employees and transfers was the main contributor to the increase in the gap, whereas in Romania the rise in corporate profits caused the higher value of the difference between the two indicators compared to the previous year, while the slight increase in the compensation of employees was offset by a moderate decline in transfers, and thus the result was neutral in terms of the changes in the indicator.
- Of the countries of the region, the GDP–GNI gap only decreased in the Czech Republic in 2021, primarily due to the sharp fall in the profit balance of foreign-owned companies, presumably owing to the impacts of the pandemic and disruptions in supply chains.

Chart 33: Breakdown of the GNI–GDP gap* (as a percentage of GDP)



*Source: MNB, HCSO, Eurostat *The 2021 value for the countries of the region is presumably still based on estimation.*

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.

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