REPORT ON THE BALANCE OF PAYMENTS

OCTOBER
2017

‘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 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 Deputy Governor Márton Nagy.

This Report is based on information for the period ending on 20 September 2017.

SUMMARY

In the second quarter of 2017, **in parallel with the pick-up in domestic demand, the current account balance deteriorated slightly**, while **– as a result of increasing transfers – net lending improved**. Net lending, which remains high in terms of its level, **reduced Hungary's external indebtedness** further, which **had a favourable impact on the economy's external vulnerability**. In the second quarter, the **four-quarter surplus of the current account declined to 4.8 percent of GDP**, while **the economy's net lending rose to 6 percent of GDP**, which still substantially exceeds the level observed in the Visegrád countries.

In the September data release, the **balance of payments data were revised**, which had a significant effect on the 2016 data. According to the actual corporate data, the profit balance of foreign-owned companies decreased to a larger degree than previously estimated, and thus the **income balance deficit contracted**. In parallel with this, the **trade surplus fell in connection with the revision of the national accounts**, which pointed to lower net lending. As a combined effect of the data changes, **2016 net lending was higher by 0.8 percent of GDP and changed to 6.3 percent of GDP.**

In the second quarter of 2017, **net lending** according to the **real economy approach rose to 6 percent of GDP**. The slight rise in the net lending position was achieved in such a way that the **moderately declining trade surplus and the increasing income balance deficit** deteriorated, while the transfer balance improved net lending, due to the **rising absorption of EU transfers**. The small drop in the balance of goods is the combined result of **decelerating goods exports resulting from moderate industrial production** and **rising imports generated by burgeoning domestic demand**. The absorption of EU transfers, which was moderate at the beginning of the new programming period, rose in the second quarter, but still falls short of the level of previous years.

According to financing side processes, in the second quarter **net FDI stock in Hungary decreased due to dividend payments**, while **external debt continued to fall**. The **outflow of net debt liabilities amounted to EUR 1.5 billion**, supported by the absorption of EU transfers, sales of government securities by non-residents and corporate adjustment. The net external debt of the **consolidated general government and non-financial corporations declined** as a result of transactions, while after the growth observed in the first quarter, the **net external debt of the banking sector rose** in the second quarter as well. In line with these developments, **the decline in external debt ratios as a percentage of GDP continued in the second quarter of 2017 as well**: net and gross external debt both fell by almost 2 percentage points (net external debt dropped to 16 percent of GDP, while the gross debt ratio decreased to 67 percent). The decline in net external debt was also moderately supported by GDP growth and revaluation effects, in addition to outflows of liabilities. As a result of the increase in the banking sector's external liabilities, this sector's external debt once again exceeds banks' stock of external assets. **Hungary's short-term external debt fell to HUF 19.8 billion**, with a decline in the indicator for the private sector and a rise in the government indicator, and thus **the foreign exchange reserves of EUR 23.5 billion still significantly exceed the level expected and deemed sound by investors**.

According to the **sectors' saving approach, the modest increase in net lending** can be linked to the declining the government's net borrowing, while the downward trend in households' net financial savings has also halted. The **government's** favourable net borrowing is primarily attributable to **increasing revenues** from rising consumption and higher employment. **Households continued to boost their savings in government securities**, albeit at a moderately slower rate, and **bank deposits also increased substantially**, which continues to **support the reduction in external vulnerability.**

In our special topic, we present a more detailed analysis of the **2016 developments in the income of foreign-owned companies** operating in Hungary. **According to the 2016 data revised on the basis of corporate questionnaires, the profit of foreign-owned companies amounted to almost 7 percent of GDP**, which indicates that profits are slightly lower than in the previous years, but higher than during the crisis years. **Foreign-owned companies reinvested more than half of their profits in Hungary**, while dividend payments decreased on the whole. In the vast majority of the sectors, profits either increased or did not change much; a decrease in incomes characterised companies rendering other auxiliary business services. The income balance deficit was mitigated by the rising profit realised by the foreign subsidiaries of Hungarian companies. A regional comparison shows that the **Hungarian profit rate is close to the Slovakian and Polish indicator, but falls well short of the Czech level**. It is unprecedented in the region that **the foreign-owned companies operating in Hungary use a larger part of their income for reinvestment** than for dividend payment.

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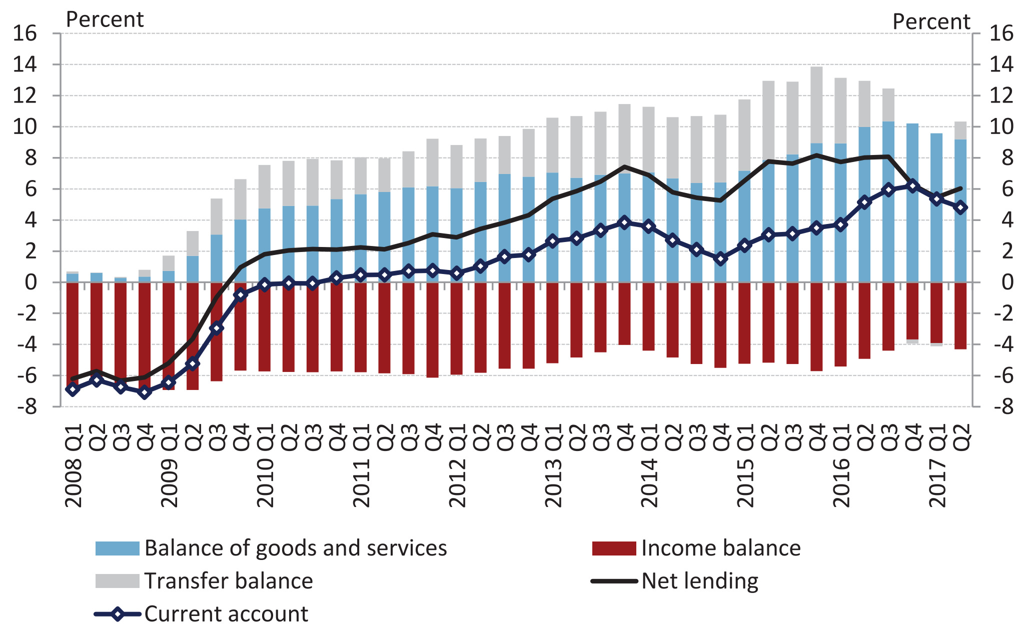
1. REAL ECONOMY APPROACH

In the real economy approach, the net lending of the Hungarian economy rose to 6 percent of GDP in the second quarter of 2017, while the current account surplus fell to 4.8 percent of GDP. Higher net lending was supported by the larger surplus on the transfer balance and the continued substantial surplus on the balance of goods and services . In the second quarter, the expansion in domestic consumption and the rise in import-intensive investments resulted in a decrease in the trade surplus. With the increasing absorption of EU funds, the transfer balance showed a substantial rise during the quarter. The moderate increase in the income balance deficit continued, accompanied by a rise in the profits of foreign-owned companies and a slight decrease in the wage income of residents working abroad.

In the second quarter of 2017, Hungary's four-quarter net lending rose to 6 percent of GDP, while the current account balance decreased to 4.8 percent of GDP (Chart 1). Based on seasonally unadjusted data, net lending in the second quarter exceeded EUR 3.1 billion, thereby reaching a historic high. This substantial surplus was composed of a surplus of EUR 1.7 billion on the current account and EUR 1.4 billion on the capital account. The high net lending was still mainly supported by the surplus on the goods and services balance, while the increase in the second quarter mostly resulted from the improvement in the transfer balance. The larger surplus on the capital account is attributable to the stronger absorption of EU funds, which significantly exceeded the rate observed in the previous two quarters and resulted in an increase in net lending. Similarly to the previous quarter, the income balance deficit continued to increase to a small degree.

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



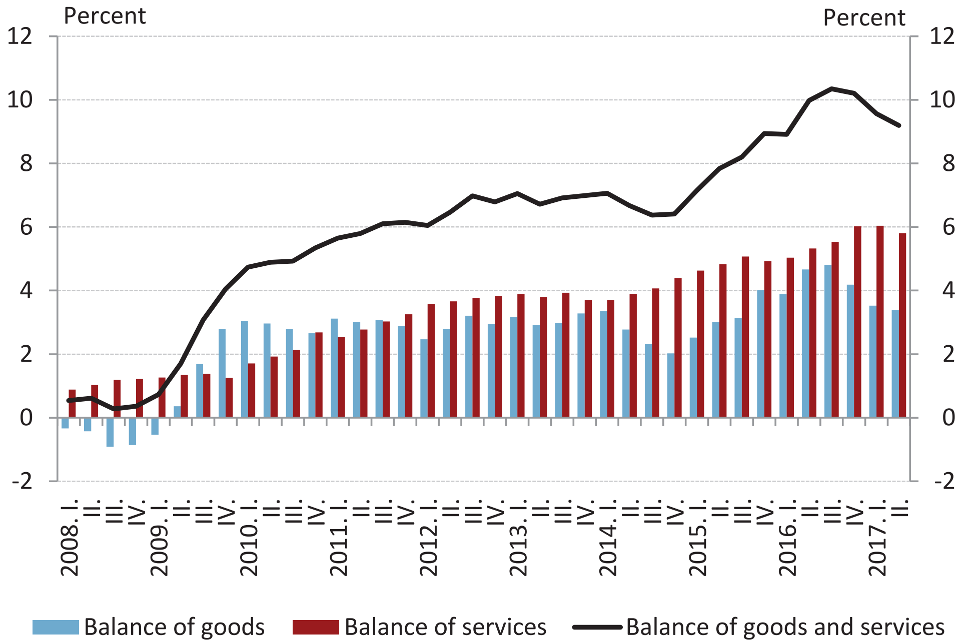
* Income balance: labour income, income on equity and income on debt. Transfer balance: sum of the capital account and other primary and secondary income.

All charts by the MNB unless otherwise indicated.

1.1 Trade balance

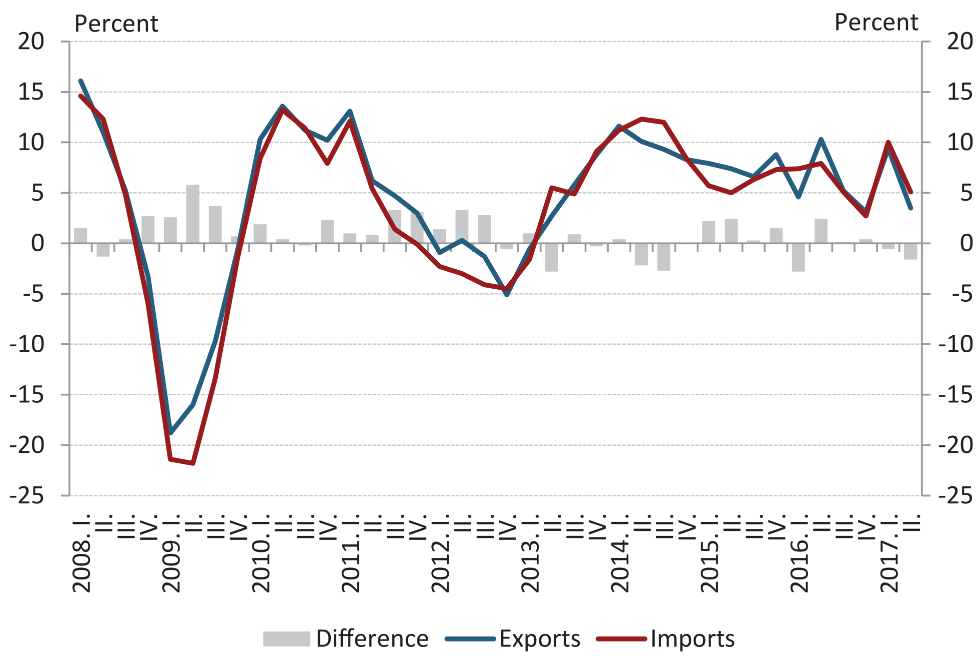
The decrease in the trade surplus stemmed from the decline in net exports of goods and the balance of services (Chart 2). The four-quarter trade surplus continued to decline in the second quarter – similarly to the first quarter – and amounted to 9.2 percent of GDP. In addition to the decline in the goods surplus, in the second quarter – contrary to the previous periods – the decrease in the services balance also reduced the trade surplus. The slight deterioration in the balance of goods was driven by higher goods imports on the back of expanding consumption and import-intensive investments (e.g. machinery investment and infrastructural development). In addition, the export of goods was restrained by the moderate industrial production in the second quarter, mostly in the field of vehicle manufacturing, which has a high weight. Due the growth in services imports, attributable to tourism, the services balance surplus fell slightly, but still reached a high level, following the dynamic growth observed in past years.

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



Compared to the very high value in the previous quarter, annual real growth in exports and imports decelerated in the second quarter of 2017 (Chart 3). Despite the improving industrial output of Germany, Hungary's key trading partner, and favourable business sentiment at the regional level, the second-quarter industrial production was more moderate,[1] which was reflected in a more modest rise in export growth, which was also attributable to the base effect of the substantial growth observed one year earlier. In the second quarter, annual real growth in imports exceeded the increase in exports, resulting in a decline in net exports. The stronger growth in imports was mostly attributable to the rising demand for imports stemming from the expansion in domestic demand components.

Chart 3: Annual real growth of exports and imports

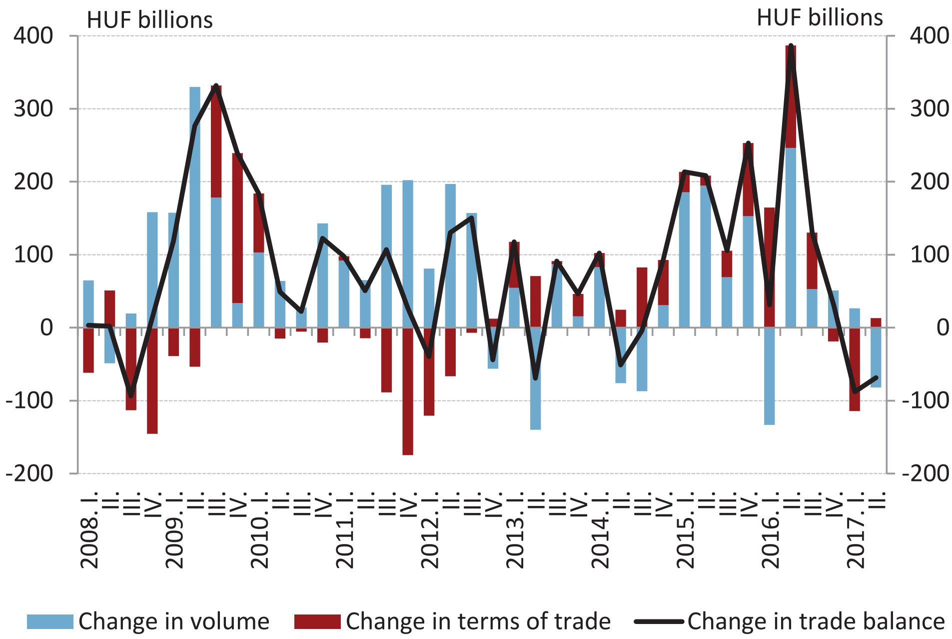


Source: HCSO, MNB

[1] In the second quarter, the statistical effect (base effect, working-day effect) may have also led to lower industrial production.

In the second quarter, in line with faster growth in imports compared to exports, changes in volumes led to a decrease in trade surplus, which was offset somewhat by the improvement in the terms of trade (Chart 4). The volume effect, linked to the import demand from the dynamic investment growth observed in the second quarter and the moderate industrial production, had an adverse effect on the trade balance. By contrast, the terms of trade measured on an annual basis, following a material deterioration in the previous quarter, made a minor positive contribution to the change in the goods and services balance, attributable to the relative price changes of machinery and equipment, which however was partly offset by the rise in commodity prices.

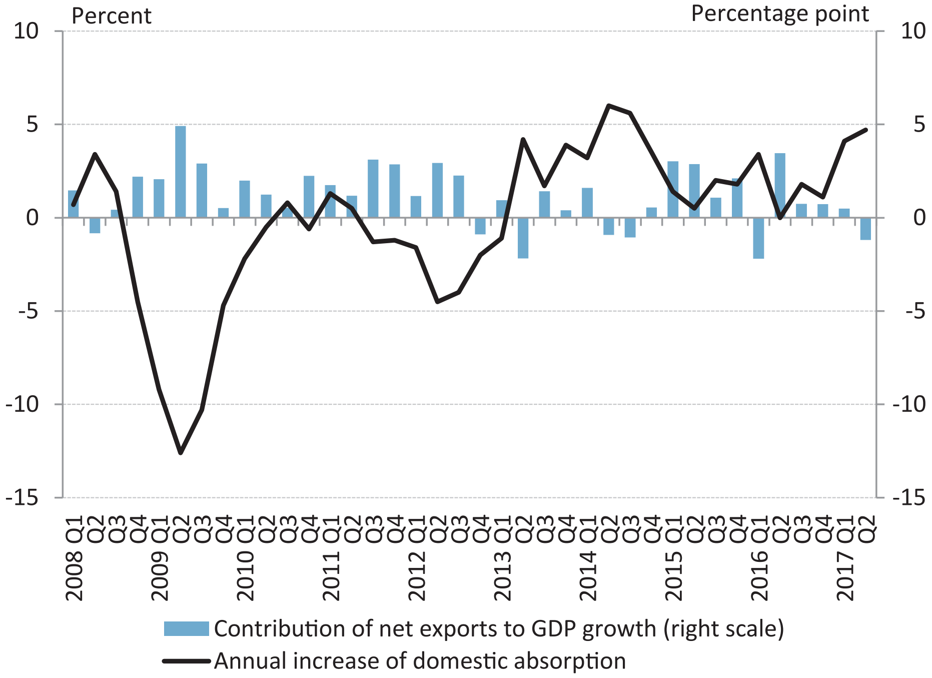
Chart 4: Developments in the balance of trade factors according to GDP (year-on-year)



Source: HCSO

In the second quarter, the annual growth rate of domestic absorption continued to increase, while net exports curbed GDP growth (Chart 5). In the second quarter of 2017, rising household consumption and the dynamic growth in gross fixed capital formation resulted in faster GDP growth, while the changes in inventories and net exports curbed growth mildly. The expansion of household consumption was primarily linked to the increase in real wages, while investment growth was mostly supported by infrastructure development, home construction and investments related to logistics services, mostly financed from EU funds. In line with the deceleration in export dynamics and increasing domestic demand, in the second quarter net exports – similarly to the situation observed with the substantial growth in domestic absorption in 2014 – made a negative contribution to the growth in GDP.

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



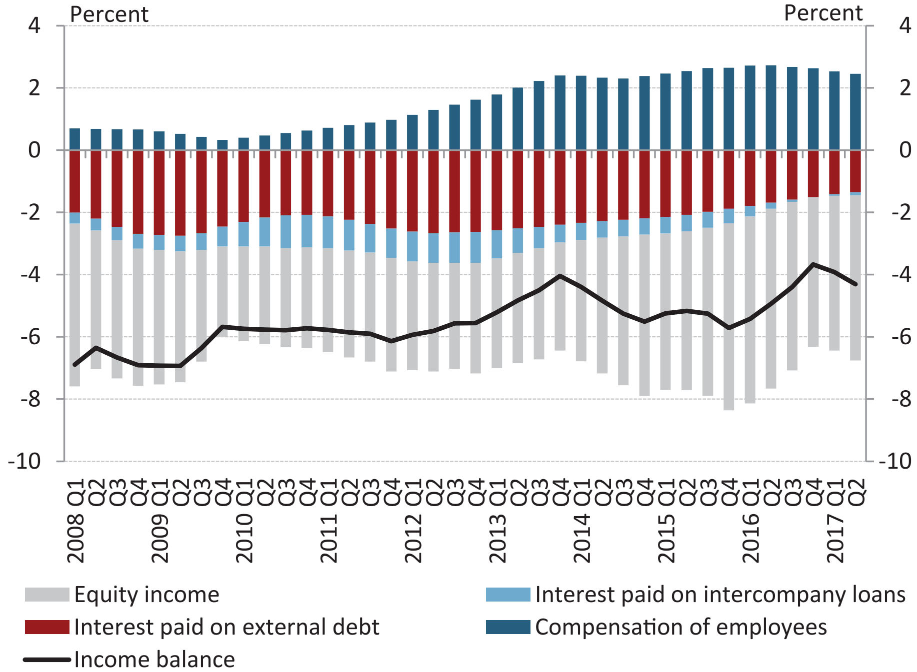
Source: HCSO

1.2 Income balance

The four-quarter income balance deficit increased slightly in the first half of 2017, after the decline observed in 2016 (Chart 6). The estimates related to the 2016 income balance are replaced by the actual data from the corporate questionnaires in the September data publication.[2] According to the data, in 2016 the income balance deficit fell moderately short of the preliminary disclosed data (for more details, see the box and the special topic). After the decrease observed last year, the income balance deficit rose slightly in the first half of 2017, primarily owing to the rising profits of foreign-owned companies. In addition, the decrease in the wage incomes of residents working abroad for a period shorter than one year (which is partly attributable to the fall in the number of commuters) also pointed to an increase in the income balance deficit. The low-yield environment observed in recent years and the fall in gross external debt both supported the decline in the interest balance of foreign and inter-company loans; however, the dynamics of this has decelerated.

[2] The profits of foreign-owned companies, as well as the reinvested income shown in the income balance, are based on an estimate for 2017, which will be replaced by actual figures based on corporate surveys together with the publication in September 2018.

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



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

Box 1: Revision of the balance of payments

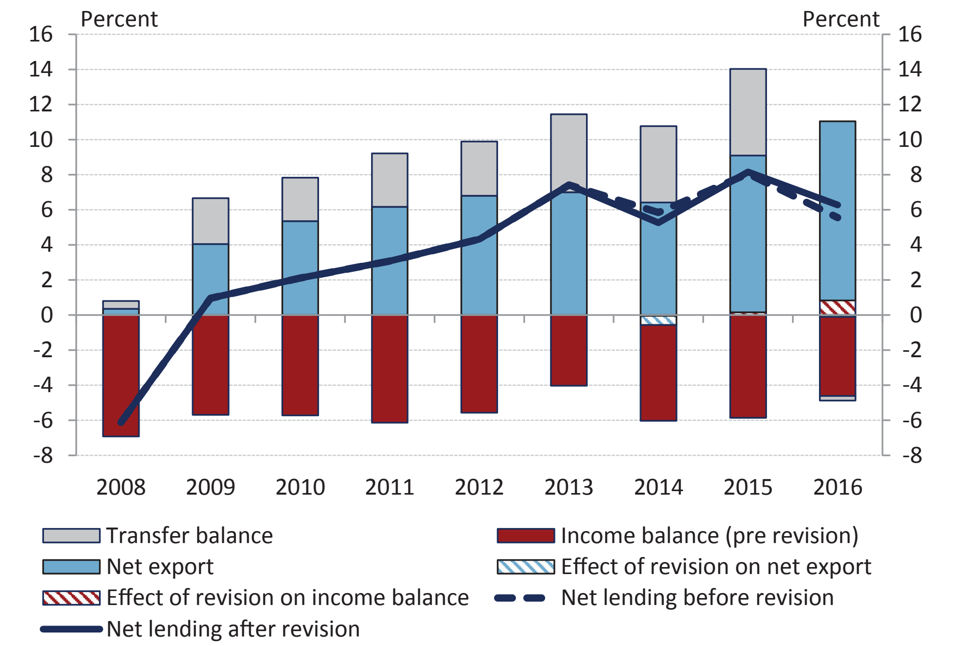
In the publication on the balance of payments, the balance of payments figures were modified retrospectively, as result of which 2016 net lending increased by 0.8 percent of GDP compared to the previously published figure. Much of data included in the balance of payments can be regarded as preliminary data until the September data publication: among others, the annual figures related to the profits of foreign-owned companies are disclosed in the September data publication. Thus, the profit figures for 2016 first appeared in the present balance of payments, published on 20 September 2017, as part of the revision. In addition, the goods and services balance also changed, along with a minor change in the income of employees temporarily working abroad, which also influences the picture we had so far on external balance. The most important changes are as follows:

– The size of the goods and services balance was mainly modified by the regular revisions related to the national accounts, which also have an impact on net lending. This shift reduces the balance of net exports, and thereby net lending, to a larger degree in 2014 and to a smaller degree in 2016.

– According to the questionnaire-based actual figures on corporate profits, in 2016 the profit balance of foreign-owned companies decreased to an even larger degree than previously estimated, falling short of the earlier estimate by roughly EUR 0.9 billion. This was almost equally attributable to the lower profits of foreign-owned companies operating in Hungary and to the higher profits realised on the outward investments of residents. Profits falling short of the earlier estimate reduce the income balance deficit, and thereby in 2016 this increased the economy's net lending (see details below). On the other hand, the effect of this is reduced slightly by the modest increase in net FDI inflow.

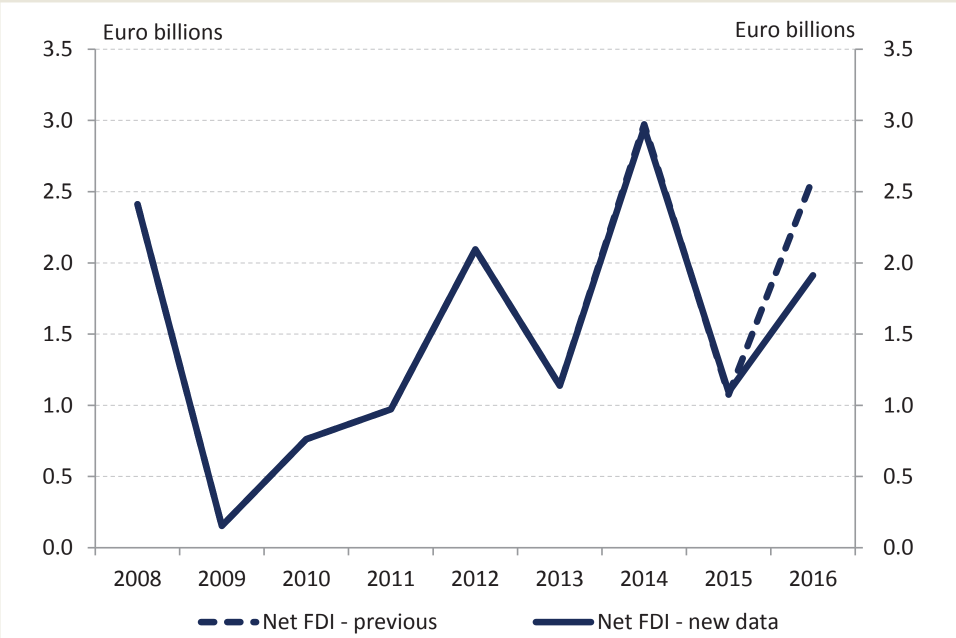
On the whole, based on the real economic transactions, compared to the preliminary published data, net lending decreased by 0.6 percent of GDP in 2014 and was up 0.8 percent of GDP in 2016. Based on the quarterly data, net lending decreased slightly in early 2017, with a modest surplus on the goods and services balance.

Chart 7: Impact of the revision on the income balance and net lending, GDP-proportionate values



As a result of the revision of the balance of payments, net FDI inflow in 2016 fell short of the preliminary data release by EUR 0.7 billion. Since there was only a slight change in the dividend data related to 2016, the lower profit of foreign-owned companies entailed a decrease in the reinvestments of incomes – i.e. incomes not paid out as dividends – resulting in a lower FDI inflow. As a result of this, net FDI inflow in 2016 amounted to EUR 1.9 billion. Despite the downward revision of the data, the rise in FDI (Chart 8) exceeds the value observed in previous years. The lower profit of foreign-owned companies reduces the income balance deficit in the real economy approach and FDI in the financing approach, and thus the economy's net lending rose in both approaches.

Chart 8: Impact of revisions on FDI



The revisions in the first quarter of 2017 mostly related to the goods and services balance, which reduced the errors of the balance of payments. As a result of the revisions, the goods and service balance surplus decreased by roughly EUR 0.3 billion in the first quarter. According to the financing approach, the outflow of debt liabilities slightly increased. Thus on the whole, the difference in net lending under the two approaches of the balance of payments decreased by EUR 0.4 billion in the first quarter of the year.

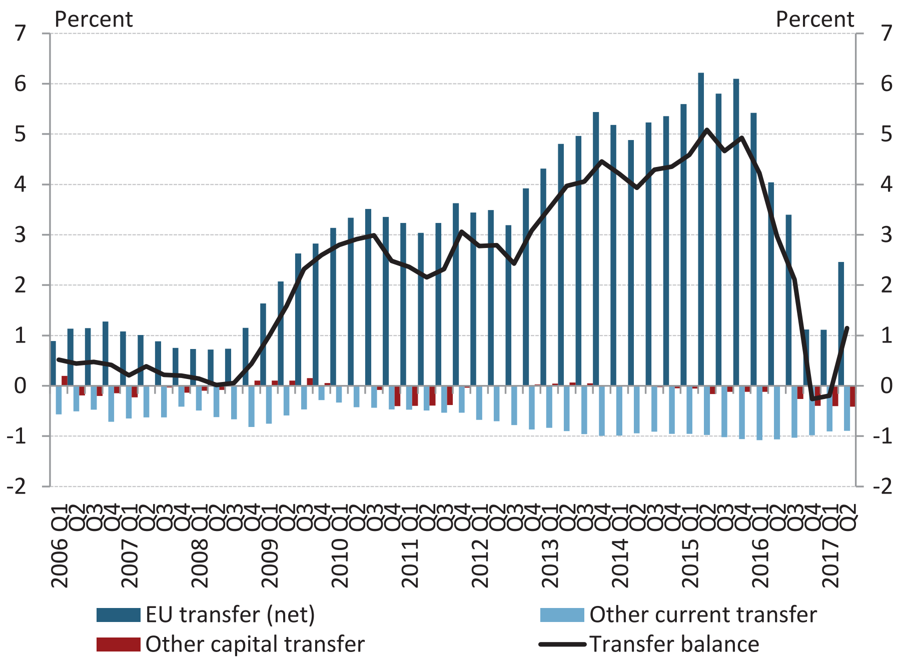
Table 1: Impact of the revisions on the components of net lending (EUR billions)

	2014	2015	2016	2017. Q1
I. Change in net lending from real economy's side (1+2+3)	**-0.6**	**0.1**	**0.8**	**-0.3**
1. Balance of goods and services	-0.5	0.0	-0.1	-0.3
2. Income balance	0.0	0.2	0.9	0.0
3. Transfer balance	0.0	-0.1	0.0	0.0
Current account	**-0.6**	**0.1**	**0.8**	**-0.3**
II. Change in net lending from financing side -(5+...+8)	**-0.2**	**0.0**	**0.7**	**0.1**
5. Foreign direct investment	0.0	0.0	0.7	0.0
6. Portoflio equity	0.0	0.0	0.0	0.0
7. Financial derivatives	0.0	0.0	0.0	0.0
8. Net debt	-0.2	0.0	0.0	0.1
Net errors and omissions (I.-II.)	***-0.4***	***0.2***	***0.1***	***-0.4***

1.3 Transfer balance

Following the moderate inflow of EU funds observed in the previous quarters, the absorption of EU transfers increased substantially in the second quarter, as a result of which the transfer balance improved considerably (Chart 9). The absorption of EU transfers – after the closing of the 2007-2013 programming period – declined substantially in the previous quarters, which caused the transfer balance to fall sharply. In the second quarter, the use of the funds from the new programming period increased quickly from the low level observed in the previous quarters; however, the four-quarter value still fell significantly short of the average recorded in earlier years. In the second quarter, the increase in the transfer balance affected both the current and the capital transfers. Based on the four-quarter values, net current transfers from the EU and net capital transfers amounted to EUR 1 billion and EUR 1.9 billion, respectively; more than two-thirds of the latter related to the second quarter. The positive effect on net lending of the EU funds was reduced further in the second quarter by the outflow of other transfers.

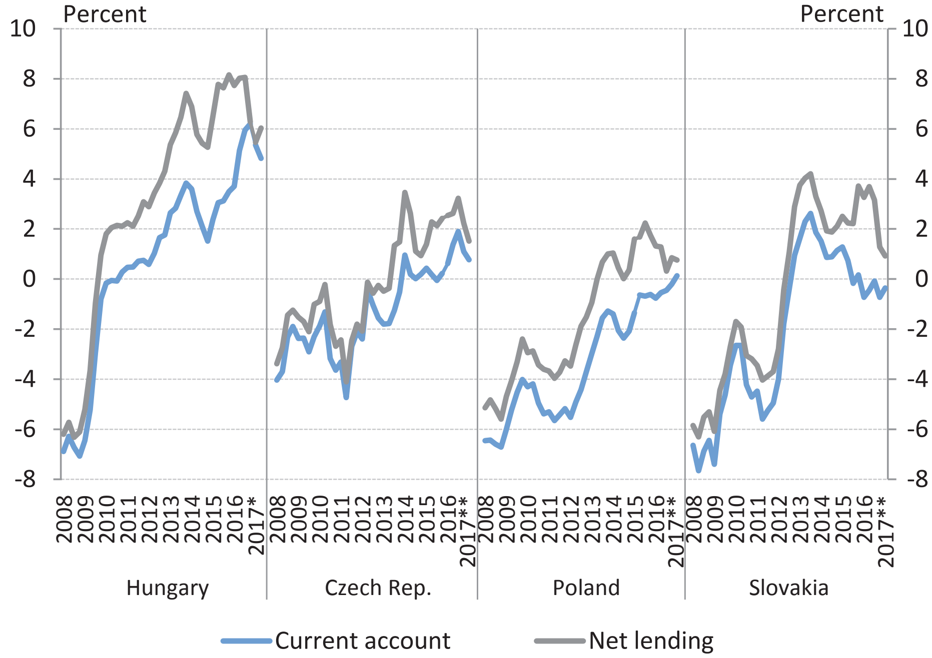
Chart 9: Four-quarter changes in the items of the transfer balance (as a percentage of GDP)



1.4 Regional outlook

Hungary's net lending still substantially exceeds the values observed in the region (Chart 10).[3] The absorption of EU funds decreased significantly in the countries of the region after the end of the 2003-2007 programming period, which usually entailed a fall in the net lending of the countries. In 2016, the largest decline was observed in Hungary and Slovakia, which was attributable to the larger volume of funds drawn down in previous years. As a result of the moderate absorption of EU funds, in the past quarters the difference between the net lending and current account of the countries of the region narrowed substantially, but as a result of the anticipated expansion in the absorption of funds the capital account of the countries under review may increase again.

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



* Data on Hungary are up to the second quarter of 2017

**Data on the countries of the region are available up to the first quarter of 2017

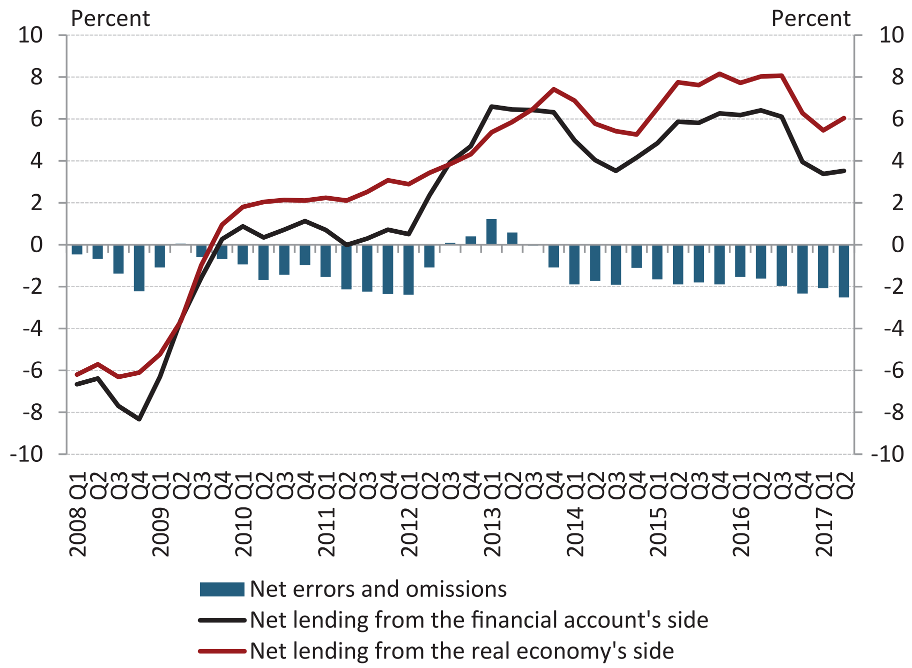
[3] In compiling the report, the second-quarter balance of payments data from the countries in the region were not yet available.

2. FINANCING APPROACH

Calculated on the basis of the financial account, four-quarter net lending rose slightly in the second quarter. Compared to the first quarter, the accelerating outflow of funds was primarily linked to the decline in net external debt, but an outflow in net FDI was also observed. The structure of the outflow of debt liabilities was similar to that of the first quarter: the government and the corporations reduced their net external debt, while the banking sector increased its debt. The fall in the net external debt of the general government was mostly attributable to the absorption of EU transfers, along with the drop in non-residents' government securities holding. The banking sector's gross debt continued to increase, while its external assets also rose, albeit to a smaller degree.

In the second quarter of 2017, the four-quarter net lending according to the financing approach amounted to 3.5 percent of GDP, following a moderate increase (Chart 11). This means that – in annual terms – the decrease in Hungary's external liabilities fall short of net lending calculated using the real economy approach by 2.5 percent of GDP.[4] However, it should be noted that the divergence of the two indicators is essentially typical for the Hungarian economy, and similar developments can be observed in the countries of the region as well.

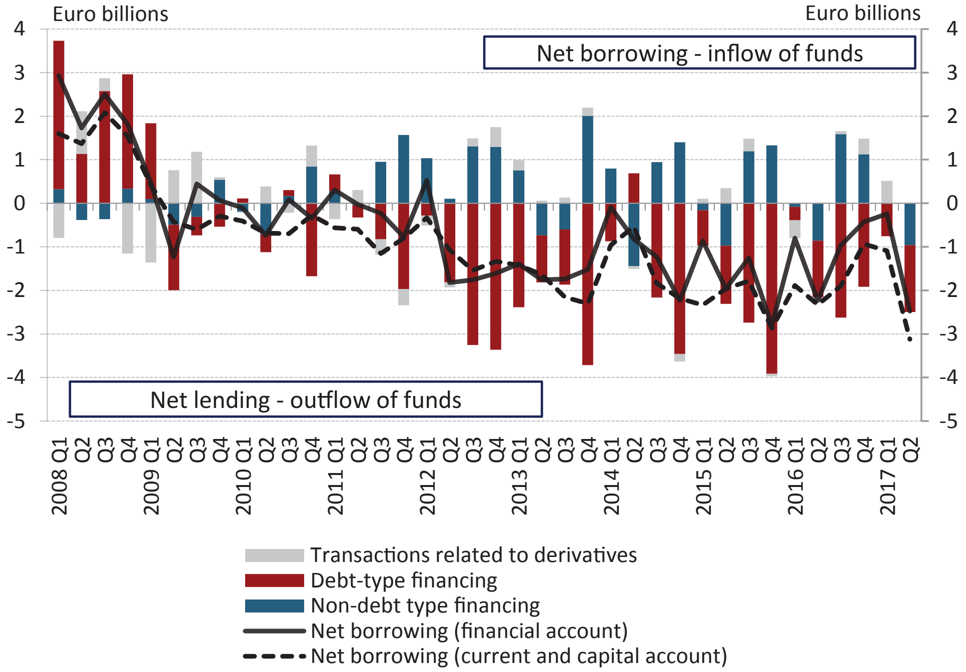
Chart 11: Two types of net lending and "Net errors and omissions"
(four-quarter values as a percentage of GDP)



Unadjusted net lending from the financing side was around EUR 2.5 billion, after a substantial quarter-on-quarter increase (Chart 12). The outflow of funds is the result of the decrease in both the debt and non-debt liabilities, with the first falling by EUR 1.5 billion and the latter decreasing by EUR 1 billion, in line with the usual seasonal trends.

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

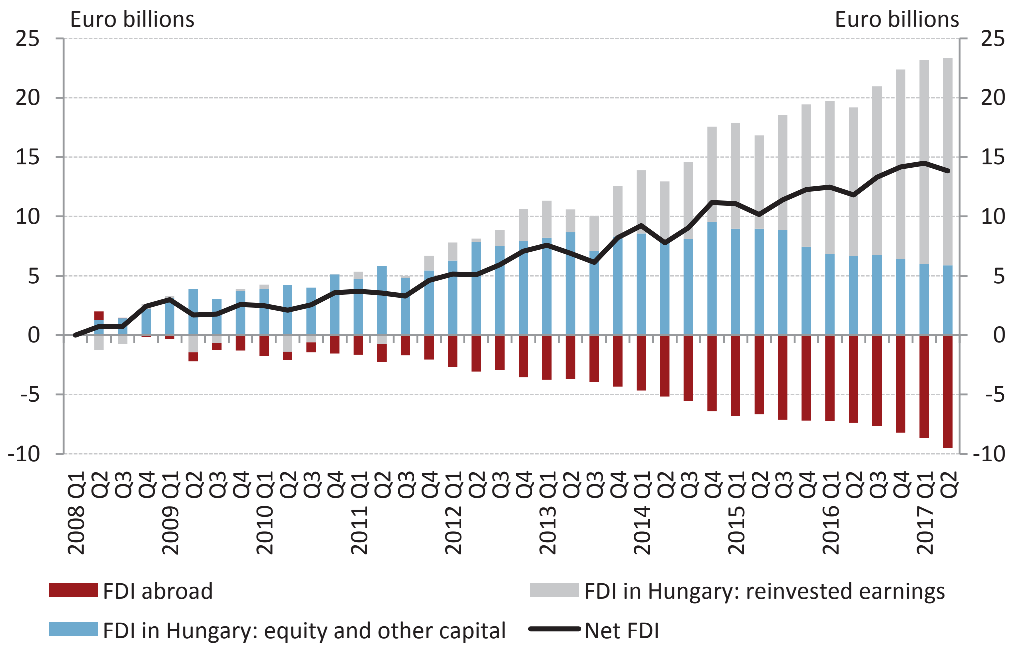
Chart 12: Structure of net lending (unadjusted transactions)



2.1 Non-debt liabilities

In the second quarter of 2017, the value of net FDI in Hungary decreased by roughly EUR 650 million (Chart 13). In order to eliminate the distorting effects, it is advisable to examine the values net of the capital-in-transit transactions and the restructuring of the asset portfolio. In the second quarter, the net FDI outflow amounted to EUR 650 million, which was primarily linked to the growth in outward investments. Investments by non-residents in Hungary rose slightly in the second quarter, while the decrease in participations resulting from dividend payments was offset by the increase in reinvested earnings and intercompany loans. Outward investment by residents increased substantially in the second quarter, primarily owing to a capital increase by a large Hungarian corporation in its foreign subsidiary. The change in the capital stock of the net portfolio also pointed to a decrease in non-debt liabilities, which was attributable to the rise in residents' foreign assets.

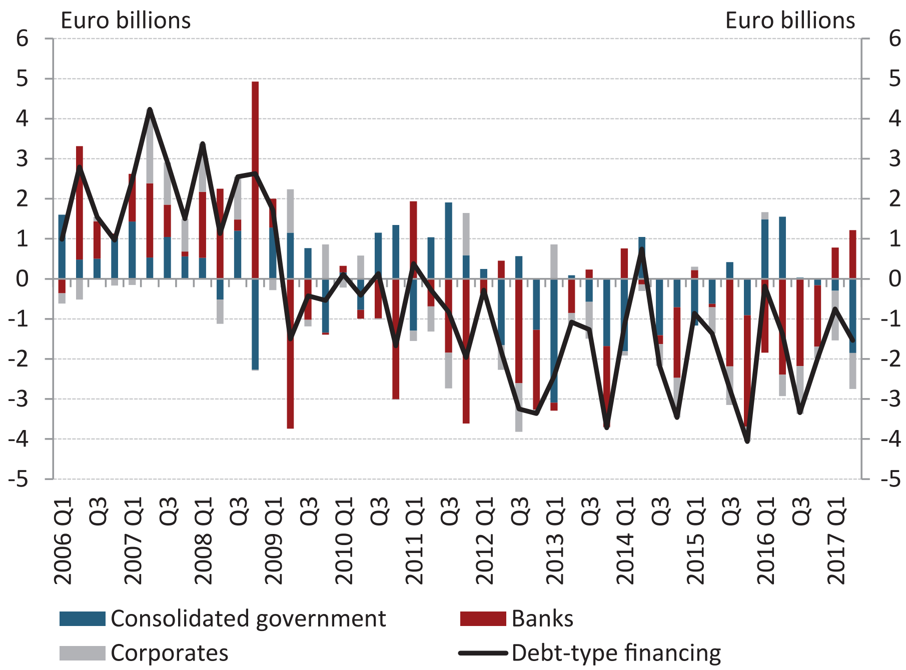
Chart 13: Developments in FDI without capital-in-transit transactions (cumulative transactions)



2.2 Debt liabilities

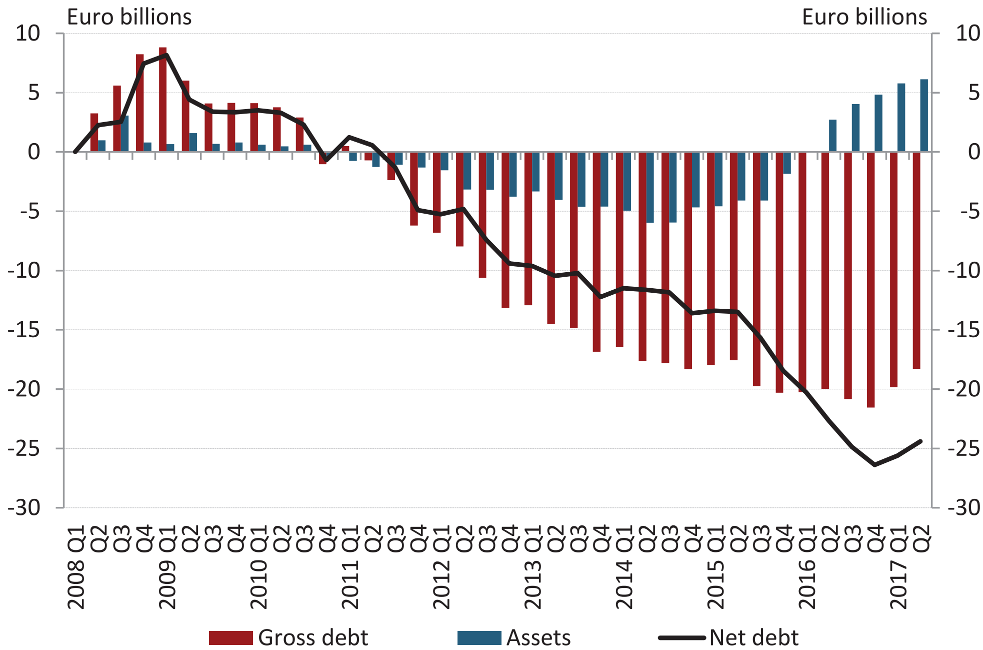
Based on transactions, in the second quarter of the year, the decrease in Hungary's external debt accelerated, supported by the debt outflow of the general government and corporations, while the net external debt of the banking sector increased (Chart 14). While in 2016 the net external debt of the banks and the general government increased, as a result of the central bank instruments related to the conversion of foreign currency loans into forints, this process turned around in 2017. Similarly to the first quarter, the banking sector's net external debt continued to rise, while that of the general government fell substantially. The latter was attributable to the inflow of EU transfers, along with a substantial decrease in the government securities holdings of non-residents. In addition, the adjustment of non-financial corporations continued and the net external debt of enterprises dropped further, similarly to the trends observed last year.

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



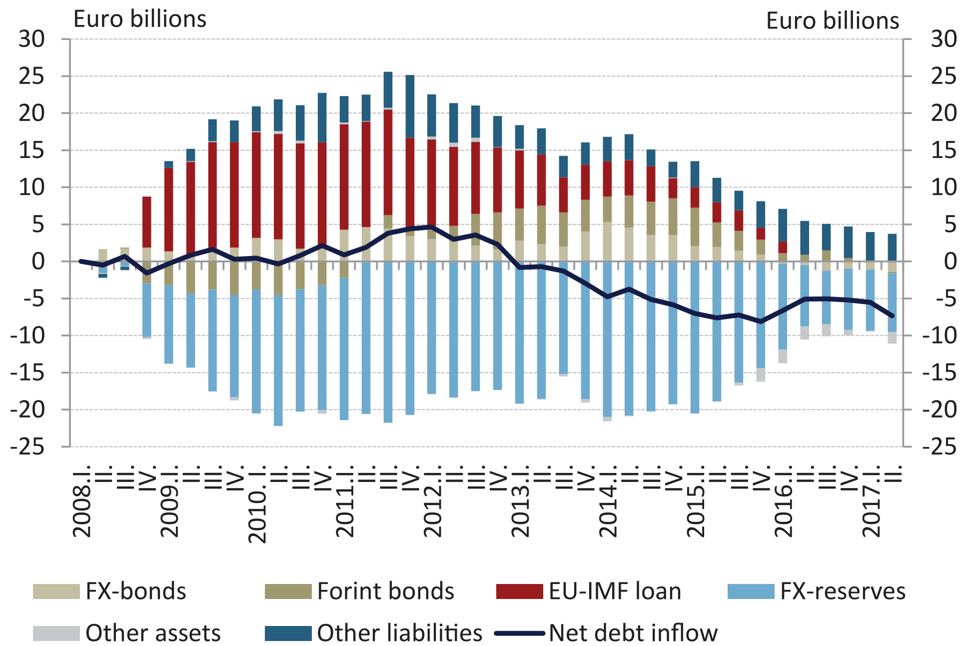
After the increase recorded in the first quarter, the net external debt of the banking sector continued to rise, with liabilities rising faster than external assets. External assets showed an increase of roughly EUR 0.3 billion in the second quarter – falling short of the level recorded in the first quarter – which was still mostly attributable to the maturity of the foreign exchange swaps related to the conversion of foreign currency loans into forint. The significant decrease in banks' external liabilities – a trend seen since 2015 – halted in the previous quarter, followed by a rise of EUR 1.6 billion in the second quarter, the degree of which is similar to that observed in the first quarter. Only a small part of this (EUR 0.2 billion) can be linked with the borrowing of foreign loans, while the larger part thereof is attributable to the rise in customer deposits. As a result of these developments, banks' second-quarter external asset-liability structure developed in such a way that the volume of external liabilities exceeded the volume of assets, and thus banks' net external debt once again became moderately positive (for more details, see the section on debt ratios). On the other hand, the composition of the banking sector's external liabilities showed a favourable picture: after the rise in the first quarter, short-term liabilities once again decreased moderately, and thus the growth is primarily attributable to the increase in long-term liabilities.

Chart 15: Developments in the external debt and receivables of the banking system (cumulative transactions)



The net external debt of the general government consolidated with the MNB decreased by almost EUR 2 billion in the second quarter, which is partly attributable to the increase in receivables related to EU transfers and the fall in the government securities holdings of non-residents (Chart 16). As a result of the decrease in foreign exchange reserves related to the conversion of foreign currency loans into forints, the net external debt of the general government consolidated with the MNB increased somewhat following the substantial decrease in 2016, but in the last half-year it once again moved on a declining path. As a result of transactions, foreign exchange reserves decreased slightly in the reporting quarter, which was mostly attributable to the foreign currency financing of the general government and the maturity of the swaps linked to the conversion into forints (for more details, see subsection 3.3). By contrast, the inflow of EU transfers and the decrease in non-residents' government bond holdings reduced the net external debt of the general government.

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



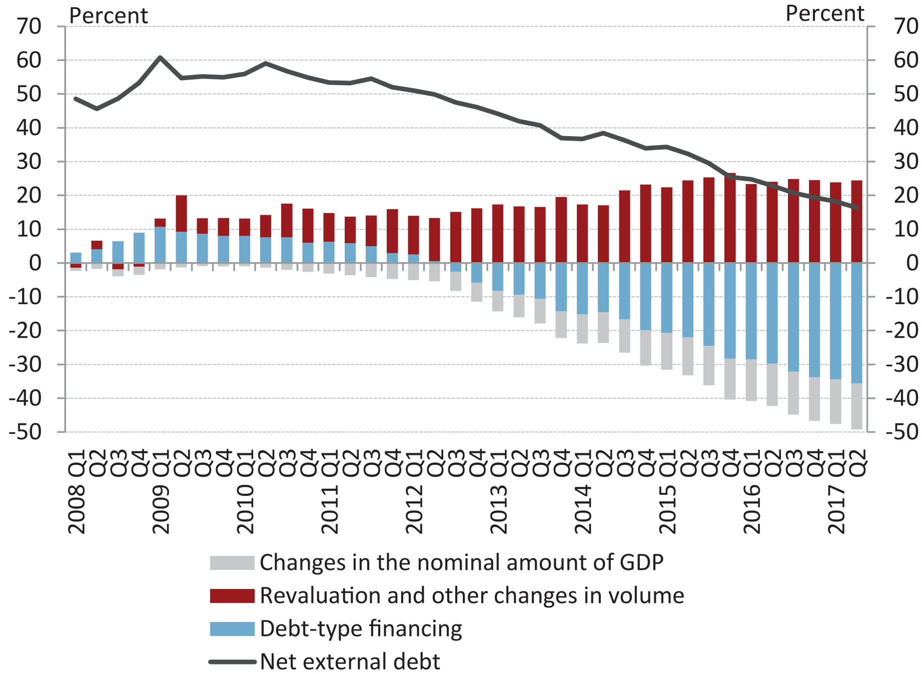
3. DEVELOPMENTS IN DEBT RATIOS

The key debt ratios for the assessment of Hungary's external vulnerability continued to fall in the second quarter of 2017. Net external debt and gross external debt both declined by almost 2 percentage points, with the net ratio at 16.4 percent of GDP and gross external debt falling to below 67 percent of GDP. The decline in net external debt was achieved amidst a more substantial outflow of debt liabilities, but GDP growth and revaluation effects also provided moderate support for the fall in the ratio. In line with the financing processes, in terms of the sectors the net external debt of the consolidated general government and non-financial corporations declined, while the net external debt of the banking sector rose. As a result of the rise in the banking sector's external liabilities, the sector's external debt once again exceeded the banks' stock of external assets. The decrease in debt liabilities contributed to the decline in the debt ratio of corporations, as well as of the consolidated general government. As regards GDP-proportionate gross external debt, almost all of the decline in the second quarter related to the consolidated general government, while the gross external debt of the private sector remained more or less constant – the fall in the debt of corporations was offset by the rise in banks' debts. Hungary's short-term external debt fell by EUR 0.6 billion to EUR 19.8 billion. Although the level of foreign exchange reserves dropped during the quarter, it still exceeds significantly the level expected and deemed sound by investors.

3.1 Developments in net and gross external debt

Hungary's net external debt decreased in the second quarter of 2017 again, which was attributable to the outflow of debt liabilities, as well as GDP growth and revaluation effects (Chart 17). The ratio, which is important in terms of the country's external vulnerability, dropped to 16.4 percent of GDP by the end of June. The decline in the debt ratio was supported by all three factors, i.e. the outflow of debt liabilities, growth in nominal GDP and the exchange rate revaluation of portfolios. While the appreciation of the forint exchange rate against the euro only had a minor effect on net external debt (the debt denominated in euro was more or less offset by the almost identical level of exchange reserves), the appreciation of the forint against the dollar reduced the ratio significantly. On the other hand, the repricing of the government securities stock, resulting from the falling yields, hampered the decrease in the debt ratio.

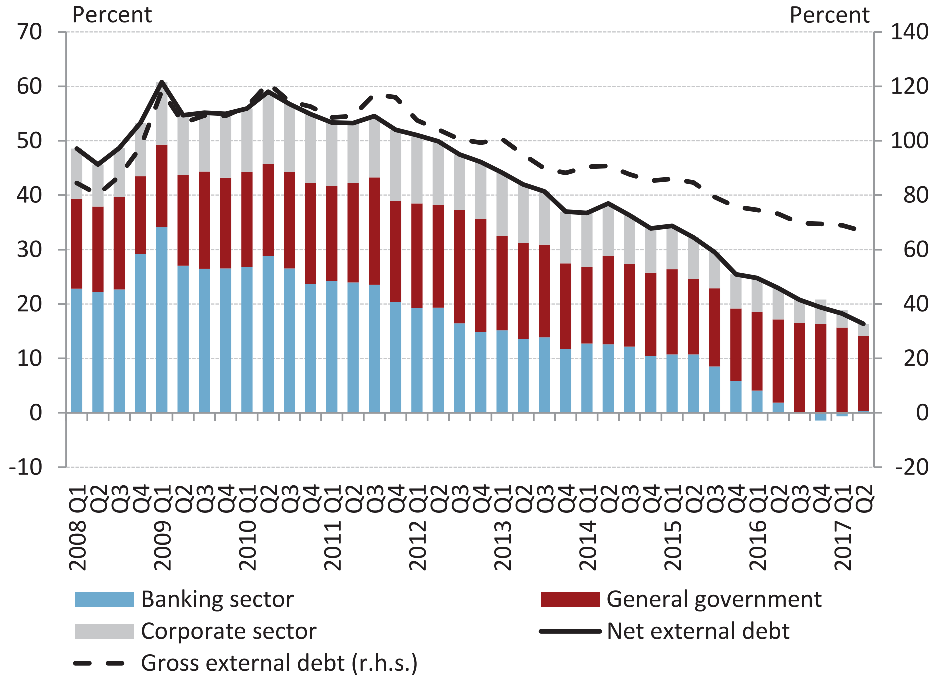
Chart 17: Components of changes in net external debt*
(cumulated, GDP-proportionate values, end-2007 = 0)



Similarly to the previous quarter, the fall in net external debt was linked to the general government and the corporate sector, while the net external debt of banking sector rose (Chart 18). The decrease in debt liabilities contributed to the decline in the debt ratio of corporations, as well as of the consolidated general government. Despite the increase in EU transfers, observed in the transactions, the external assets of the general government remained almost constant due to the revaluation of the foreign exchange reserves, and thus the decline in the ratio can be primarily explained by the fall arising from the sale of government securities by non-residents and revaluation due to the appreciation of the forint exchange rate. On the other hand, the decrease in Hungary's net external debt was curbed by the renewed growth in the banking sector's net external debt, similarly to the first quarter.

At the end of the second quarter of 2017, after declining by almost two percentage points, gross external debt dropped to below 67 percent of GDP (Chart 18). This decline in the debt ratio was mainly supported by the outflow of debt liabilities, but GDP growth and the appreciation of the forint exchange rate against the US dollar also made a material contribution to the decrease in the ratio. Of the sectors, the gross external debt of the consolidated general government declined by almost 2 percent of GDP, while that of the private sector remained at roughly the same level: the rise in the banking sector's external liabilities was offset by the decrease in corporations' gross external debt. The gross external debt fell to a larger degree than observed at the net ratio, which was essentially attributable to the larger revaluation of the external liabilities – exceeding that of external assets – as well as to the maturity of the government's foreign currency bond.

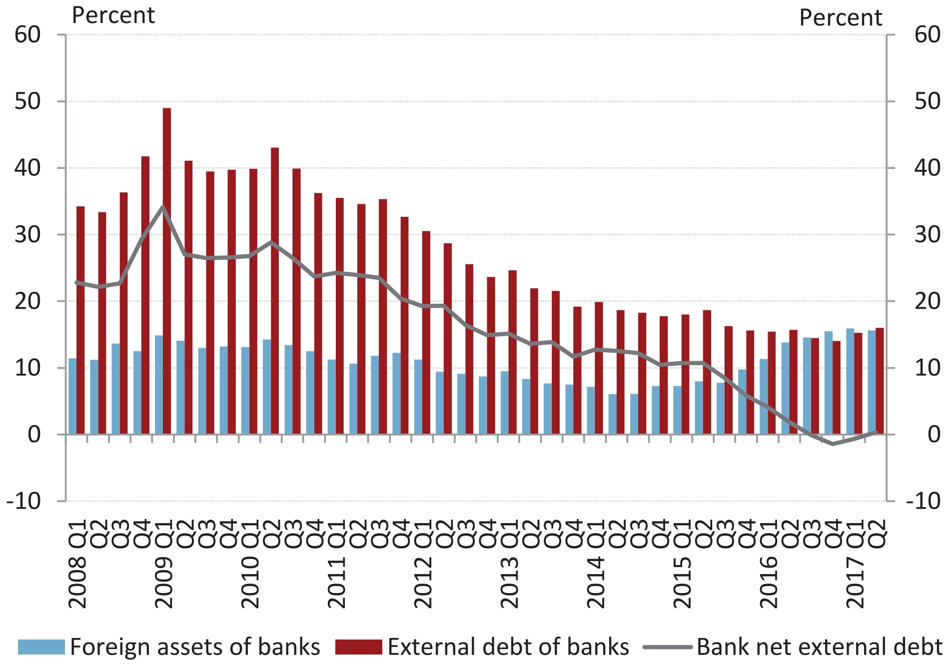
Chart 18: Net external debt by sectors and gross external debt (relative to GDP, excluding intercompany loans)



After the first quarter, the banking sector's net external debt increased again, and consequently the sector's external debt once again exceeds the level of its external assets (Chart 19). The decline in the banking sector's net external debt in 2015 and 2016 changed to a rise in 2017: in addition to the growth in gross debt, the moderate decrease in external assets[5] also resulted in a higher debt ratio. The rise in the sector's external liabilities was primarily attributable to the increase in deposits placed by non-residents in Hungarian banks. However, the rise in banks' GDP-proportionate net external debt as a result of transactions was partially offset by the appreciation of the forint exchange rate and the increase in GDP. On the other hand, as a result of the growth in external liabilities, the sector's net external debt once again became positive, i.e. banks' external liabilities exceeded the external asset portfolio of the sector.

[5] The growth in external assets as a result of transactions was more than offset by the revaluation effect.

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



3.2 Developments in short-term external debt

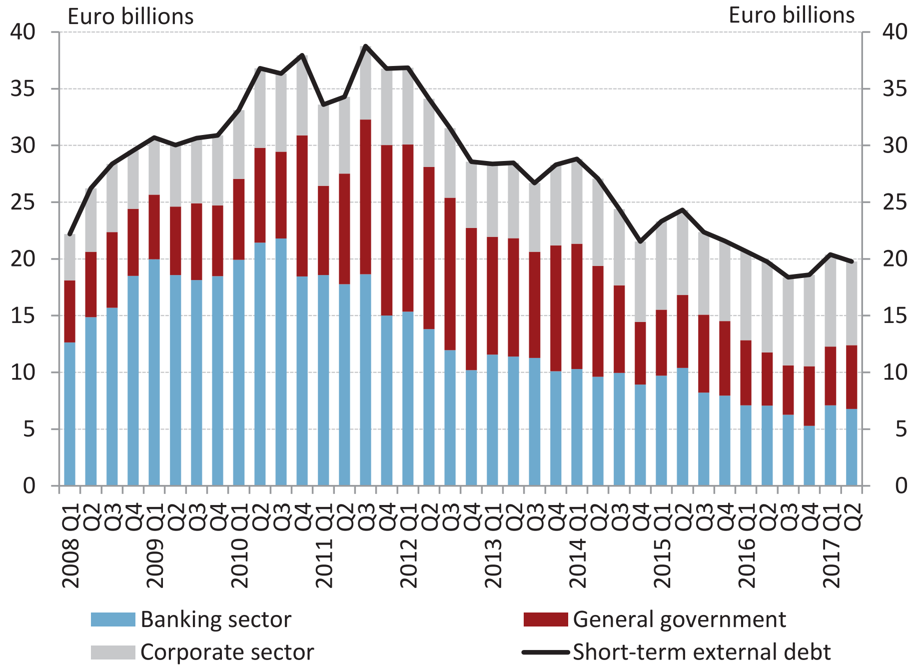
At the end of the second quarter of 2017, after a fall of roughly EUR 0.6 billion, short-term external debt amounted to EUR 19.8 billion (Chart 20). The decrease in short-term external debt is the combined result of contrasting processes: the larger decrease in the corporations' short-term external debt and a smaller decline in the banking sector's short-term external debt was partially offset by the increase in the short-term external debt of the consolidated general government.

- In the second quarter, the short-term external debt of the *consolidated general government* rose by almost EUR 0.4 billion, which was attributable to the growth in amortising debt, linked with the maturity of a foreign currency bond in 2018. The sector's external debt according to the original short-term maturity has not changed, while this was achieved as result of opposite processes. The decrease in the margin accounts of the Government Debt Management Agency – hedging the US dollar exposure – was offset by the rise in non-residents' holdings of discounted Treasury Bill.

- In the second quarter, the *banking sector's* short-term external debt based on residual maturity fell by EUR 0.3 billion to EUR 6.8 billion. The decrease was attributable to external debt with originally short-term maturity, which was partially offset by the rise in the sector's amortising debt, mostly related to securities.

- The *corporate* sector's short-term external debt decreased by almost EUR 0.7 billion during the quarter, which is attributable to the larger decrease in the sector's amortising debt (EUR 0.6 billion) and to a smaller decrease in its external debt with originally short-term maturity (EUR 0.1 billion).

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



3.3 Developments in foreign exchange reserves and reserve adequacy

In the second quarter of 2017, the level of foreign exchange reserves decreased; the decline in the reserves was attributable, amongst other things, to the net foreign currency financing of the government and the foreign currency expenditures of the Government Debt Management Agency and the Hungarian State Treasury. At the end of June 2017, international reserves amounted to EUR 23.5 billion, down EUR 0.9 billion on the level from end-March 2017. Changes in foreign exchange reserves were influenced by a number of factors, of which the key items increasing the reserves were as follows:

- As a result of the *net foreign currency financing of the Government Debt Management Agency*, foreign exchange reserves declined by roughly EUR 470 million. In the quarter under review, an international foreign currency bond, denominated in pound sterling, expired in a value exceeding EUR 730 million, while the maturity of the fourth series of the foreign currency bonds for households (Premium Euro Hungarian Government Bond) in April amounted to more than EUR 120 million. On the other hand, the quarterly Premium Euro Hungarian Government Bond and residence bond issues increased the reserves by almost EUR 390 million.

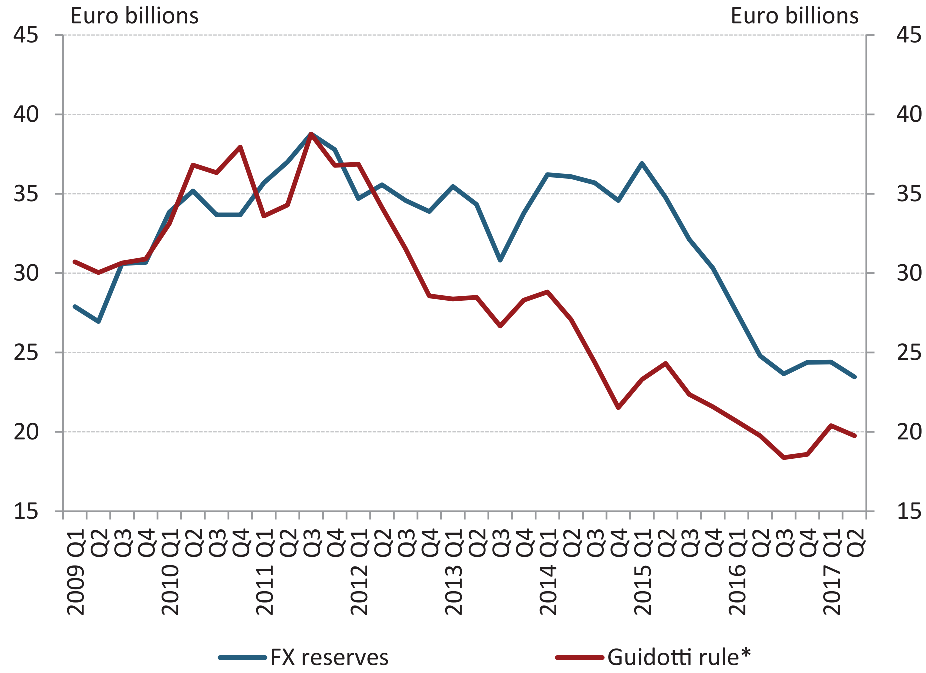
- *The maturity of the swap facilities related to the conversion of households' foreign currency loan into forints* in June and the loans granted within the framework of Phase 3 of the foreign currency pillar of the Funding for Growth Scheme reduced reserves by EUR 200 million and EUR 60 million, respectively.

- *Other foreign exchange transactions of the Hungarian State Treasury and the Government Debt Management Agency* represented another item which decreased foreign exchange reserves by more than EUR 500 million. The *revaluation* resulting from the depreciation of other currencies against the euro reduced foreign exchange reserves by more than EUR 500 million.

- The MNB has held *forint liquidity-providing foreign exchange swap tenders* since October 2016. The growth in the outstanding swap assets increased the reserve level by almost EUR 1 billion in the second quarter.

In addition to the reduction in foreign exchange reserves, short-term external debt declined by EUR 0.6 billion by the end of the second quarter, and thus the volume of foreign exchange reserves still considerably exceeded the level expected by investors. Although foreign exchange reserves declined compared to the end of last quarter, due to the decrease in the short-term external debt – considering the Guidotti-Greenspan rule, closely followed by the central bank and investors – the foreign exchange reserves of EUR 23.5 billion, recorded at the end of the first half-year of 2017, still significantly exceed the volume of short-term external debt, which amounts to EUR 19.8 billion. The short-term external debt of the banking sector and corporations decreased during the quarter, but the impact of this was partially offset by the rise observed at the general government. The room for manoeuvre over the Guidotti indicator was roughly EUR 3.7 billion at the end of the second quarter, which is a safe level.

Chart 21: Short-term external debt and the stock of foreign exchange reserves of the Hungarian economy



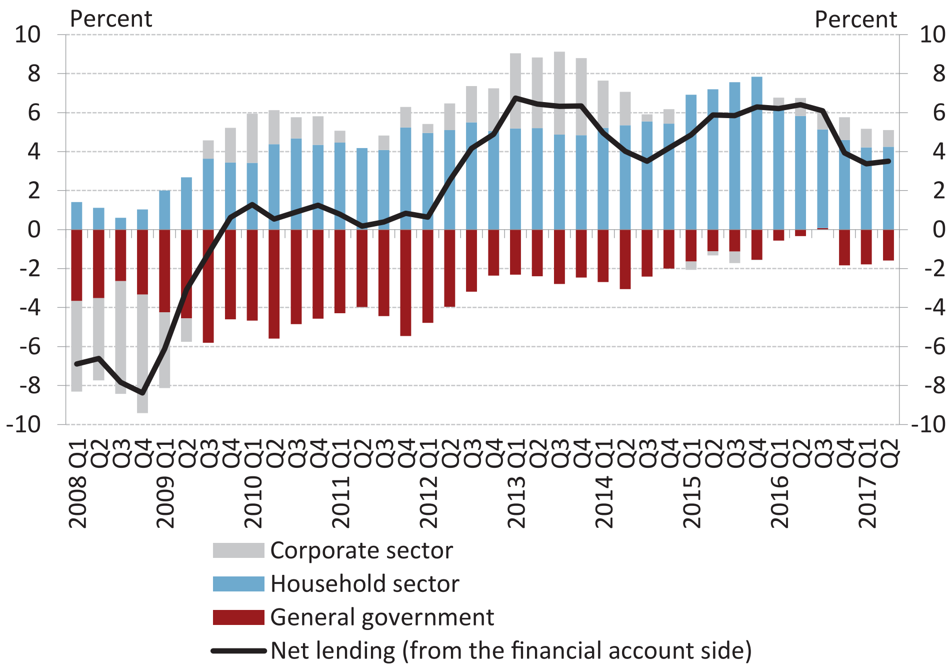
* Guidotti rule: short-term external debt based on residual maturity.

4. SECTORS' SAVINGS APPROACH

In the second quarter of 2017, net lending according to economic sectors' savings moderately increased and amounted to around 3.5 percent of GDP. The rise was linked to the decrease in general government net borrowing, while households' net lending – after a continuous decrease since early 2016 – has not changed materially. On the other hand, based on the seasonally adjusted data, households' net financial savings slightly increased, which can be explained by the growth rate of assets outstripping that of loans. Households' forint and foreign currency deposits expanded dynamically during the quarter, which may be attributable to the rising agricultural subsidies in the case of forint and to the appreciation of the forint exchange rate in the case of foreign currency. Despite the maturity of a large volume of household government securities in the second quarter, households' net holdings of government securities continued to increase moderately, which still strongly supports the government's domestic financing. In addition, households' portfolio of government securities based on maturity also changed positively in the first half of the year, which reduces the economy's external vulnerability.

In the second quarter of 2017, the economy's net lending based on the sectors' saving increased slightly, which can be primarily attributed to the decrease in the general government's net borrowing (Chart 22). The moderate net borrowing of the consolidated general government can essentially be explained by the rising fiscal revenues linked to the expansion of consumption and higher employment. The corporate sector's net lending remained more or less steady, as the combined result of rising investments and declining inventories. After a continuous decrease observed from early 2016, households' four-quarter net lending has not changed materially in the second quarter of 2017 and was above 4 percent of GDP.

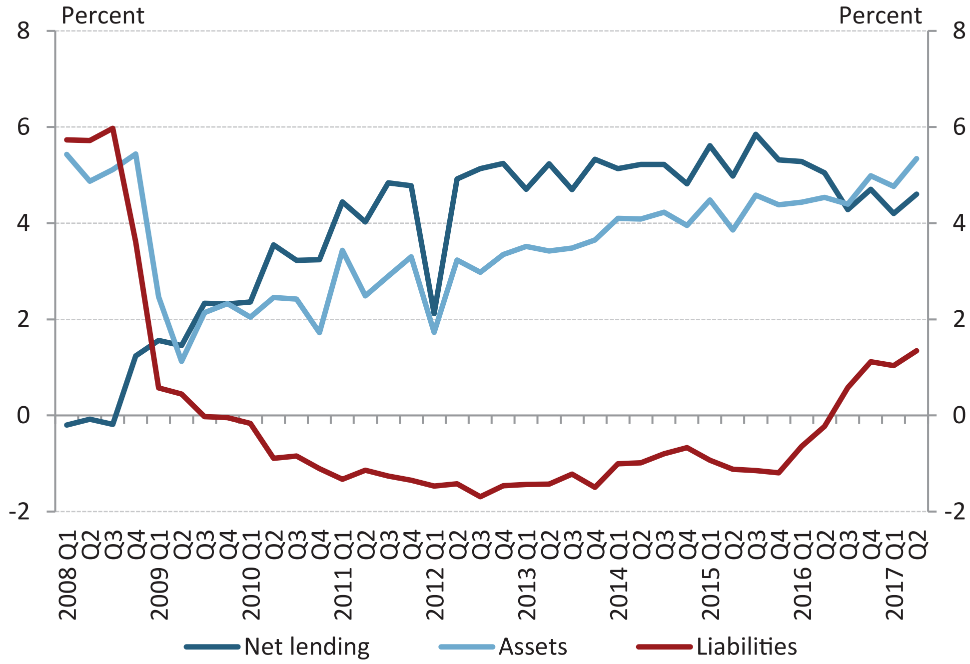
Chart 22: Net lending by sectors (four-quarter data relative to GDP)



* Under general government we present the net borrowing according to the financial accounts. Corporate was determined on the basis of the residual principle.

The underlying trends show that households' seasonally adjusted net financial savings rose in the second quarter, which is attributable to the growth rate of assets outstripping that of loans (Chart 23). Seasonally adjusted net new borrowing continued to rise in the second quarter of 2017, reaching almost 1.5 percent of GDP, which is attributable to the fact that in conjunction with steady growth in the household housing loan portfolio, the stock of other loans – mostly due to the FGS and land purchase loans granted to the self-employed – also rose substantially. Households' financial instruments rose at an even higher rate – exceeding 5 percent of GDP – in the second quarter, attributable to the strong increase in forint and foreign currency deposits, and to modest growth in securities savings.

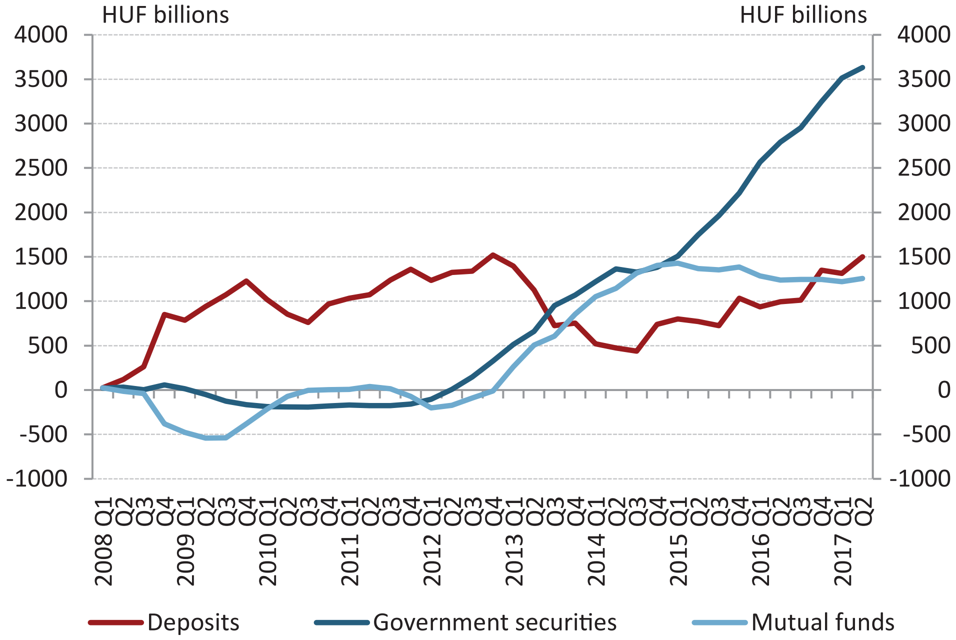
Chart 23: Net lending of households (seasonally adjusted revised* values, as a percentage of GDP)



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

The growth in households' holdings of government securities was more moderate in the second quarter than previously observed, but households' demand for government securities still strongly supports the internal financing of the general government (Chart 24). The continuous growth seen since 2012 in households' holdings of government securities continued in the second quarter of 2017, as a result of which the portfolio rose to over HUF 4,500 billion by June. Despite the large volume of government securities expiring in the second quarter, the portfolio continued to increase, i.e. households are rolling over their government securities holdings independently of the volume of expiries. In addition, the trend that started in the previous quarter continued, according to which households' demand for government securities – in line with the intentions of the Government Debt Management Agency – is shifting from short-term papers towards longer-term securities. The positive change in the maturity structure of households' government securities portfolio reduces the rollover risk, thereby decreasing the vulnerability of the economy. Deposits increased dynamically, which may be attributable, in the case of forint deposits, to the rising agricultural subsidies received from the EU and to the appreciation of the forint exchange rate in the case of foreign currency deposits.

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



5. DEVELOPMENTS IN THE PROFIT OF FOREIGN-OWNED CORPORATIONS AND BANKS

This special topic provides a detailed presentation of the earnings realised by foreign-owned companies in 2016. Based on the actual data replacing the previous estimates, the profit of foreign-owned companies declined in 2016, but is still considerable. This decline was attributable to a number of idiosyncratic factors, accompanied by the trend that the companies reinvested more than half of their earnings in Hungary again, while dividend payment dropped. The breakdown by sector demonstrates that in most of the larger sectors the profit has increased slightly or not changed significantly, and the decline in profits is primarily attributable to the decrease in the profit of companies rendering other, auxiliary business services. The income balance deficit was also reduced by the fact that the profit of companies owned by residents, but operating abroad rose substantially after the decline observed in 2015. While in 2015 the profit/loss items outside of current operating performance represented a substantial profit for the companies, in 2016, similarly to former years, these items generated significant losses. Thus, although according to the current operating performance the companies' profit decreased only slightly, between 2015 and 2016 the after-tax profit of foreign-owned companies, also including the exchange rate fluctuations, fell by more than 15 percent of GDP. In a regional comparison, the Hungarian return on FDI is similar to that in Slovakia and Poland, but falls short of the Czech value. On the other hand, it should be noted that in Hungary foreign-owned companies use a larger part of their earnings for reinvestment than for dividend payments, which is unprecedented in the region. The profit of foreign-owned companies plays a key role in the trends of the GNI-GDP difference among the European countries – the difference between the two indices rises in parallel with the growth in net foreign direct investment.

5.1 Introduction

In the current special topic in the Report on the Balance of Payments, we present the profit of foreign-owned companies and banks. In the September data publication, the estimates for the 2016 profit are replaced by actual data based on questionnaires on the corporate and bank earnings, and thus in the current special topic of the Report on the Balance of Payments we present the profit of foreign-owned companies and banks. In the balance of payments, the income of the foreign-owned corporate sector is based on estimates until the data publication in September following the reporting year. This is replaced upon the September data reporting by actual data calculated on the basis of the questionnaires prepared on the basis corporate and bank incomes.[6] Accordingly, upon receipt of the questionnaires in September it is worth reviewing the profitability of the foreign-owned corporate sector more thoroughly. In the present publication, the actual data – which is relevant in terms of the net profit included in the income balance – fell slightly short of the preliminary estimate, which is partly attributable to one-off effects, and partly to the profitability of Hungarian-owned companies operating abroad rising to its historic high. It should be noted that the balance of payments statistics contains the profit/loss of the corporate sector related to the current operating performance, as part of which the one-off profit/loss items are eliminated from the after-tax profit/loss of the sector. This is due to the fact that according to the methodology,[7] the profit/loss realised outside the current operating performance – for example, stemming from exchange rate revaluation – within the transactions of the corporate sector, is not included in the balance of payments. As regards the structure of this section, we first review the income position of foreign-owned companies and banks and then examine the factors underlying the fall in the 2016 profit. Thereafter, we present the companies' profit realised in the ordinary course of business, as well as their profit after tax (Section 5.5). Finally, we analyse the developments in the profit of foreign-owned companies operating in Hungary in a regional and also in European Union comparison, as well as the impact of the size of the foreign-owned corporate sector on the difference between GNI and GDP.

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

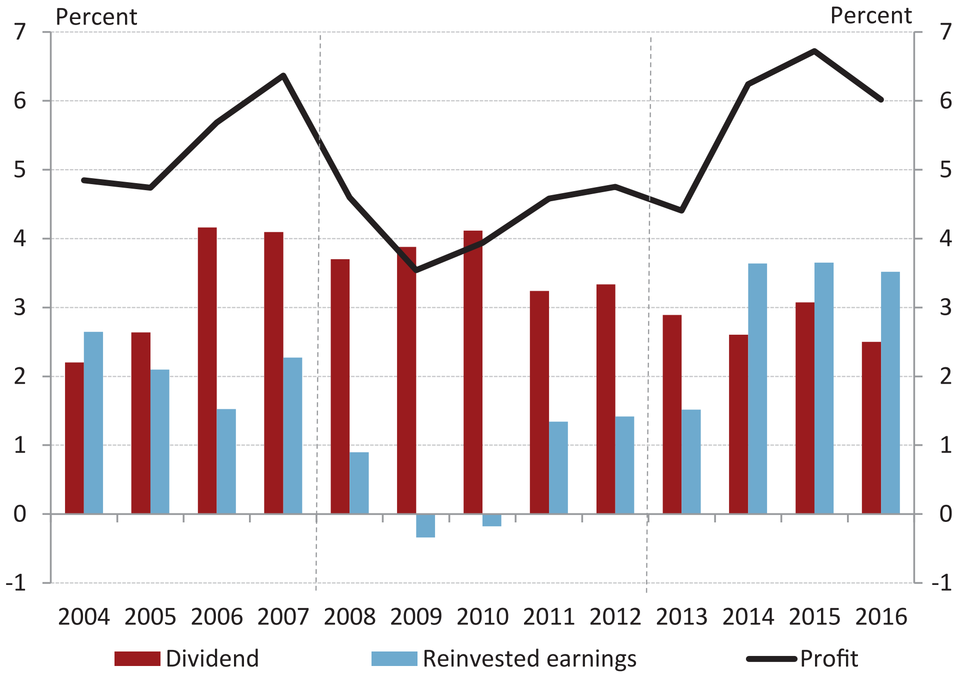
In 2016, the profit of foreign-owned companies and banks declined to almost 6 percent of GDP, but this nevertheless can still be deemed substantial. Similarly to the previous years, the trend that more than half of the income generated

[6] For more details see: Hungary's Balance of Payments and International Investment Position Statistics, MNB (2014)

[7] Balance of Payment Manual, 6th edition

by the foreign-owned corporate sector was invested in Hungary, continued.[8] [9] Due to the crisis, by 2009-2010 the profit of foreign-owned companies as a percentage of GDP fell from the previously typical level of 6 percent to less than 4 percent, which was reflected by a major decrease in reinvested earnings, while dividend payments remained roughly the same. The decline in reinvestments may have been attributable to the fact that after the crisis growth prospects worsened, and the liquidity needs of the parent companies may have also diverted processes toward higher dividend payments. On the other hand, from 2014, due to the growth in profit and moderate dividend payments, reinvestments rose considerably, which – in addition to the absorption of EU funds – may have contributed to the expansion in corporate investment. The dynamic growth in exports may have also contributed to the increase in the profitability of foreign-owned companies, while the decrease in 2016 was mostly attributable to a single industry, which showed a major increase in former year (see more details below). Thus, the profit of foreign-owned companies declined to 6 percent of GDP, the larger part of which the companies still invested in Hungary. A substantial part of foreign companies' profit (over 90 percent) can be linked to non-financial corporations.

Chart 25: Utilisation of income of foreign-owned companies and banks[10] (as a percentage of GDP)



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

The corporate profit rate exceeded that of the banks to a larger degree than in the previous year and it already resembles the pre-crisis times, while the dividend ratio of companies and banks is still low. Before the crisis, the profit calculated as a percentage of foreign direct investments was around 10 percent at non-financial corporations and around 14 percent at the banks. By contrast, during the crisis companies' profit as a percentage of their FDI stocks declined significantly, and a similar process could not be observed at the banks in the first years of the crisis. On the other hand, the banks' profit substantially declined in 2012 and fell below corporate profits. As regards the banks, it should be noted that their dividend ratio falls short of that of the companies, i.e. banks usually reinvest the larger part of their profit in Hungary. This may be attributable to the fact that the foreign owners of banks had to raise capital in the domestic banks to make up for the losses suffered during the crisis, part of which was covered from the profit. In

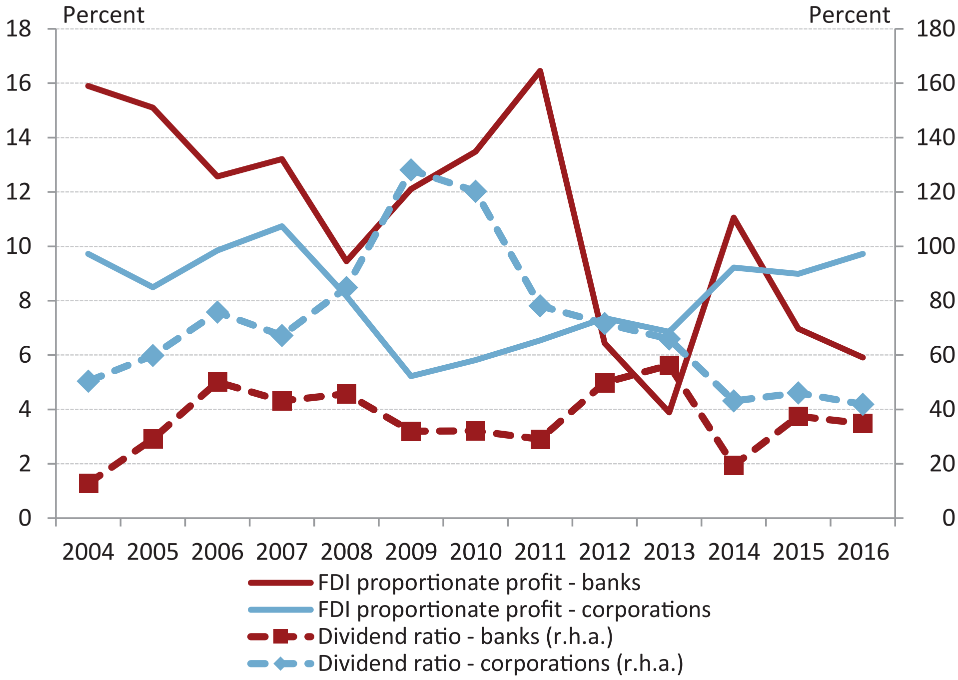
[8] Since reinvested earnings represent the difference between the profit and the dividends, the applied COPC adjustment and the management of the superdividend have a major impact on the value of reinvested earnings (for more details, see the July 2017 Report on the Balance of Payments).

[9] It should be also noted that the companies usually declare 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.

[10] 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 current operating performance concept (COPC). However it can be presumed that the income not related to the current operating performance increased after the crisis, and thus the times series presumably remains comparable with the previous periods. It may represent an additional break that from 2013 superdividends are eliminated from foreign profit, which thereafter are recognised as capital withdrawal rather than as dividend payment, and thus influences the distribution of corporate profit between dividend payment and reinvestment.

the early years of the crisis corporate profit declined substantially, close to 5 percent; however, since then it showed a gradual increase and by 2016 it once again came close to the pre-crisis level of 10 percent (Chart 26). In parallel with this, the corporate dividend ratio has been gradually decreasing since the crisis and in the last three years it was around 40 percent. The underlying reason for this may be that with the improving growth prospects and rising corporate profits, foreign owners, anticipating an increase in the expected profits, tend to reinvest an increasing part of their realised 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

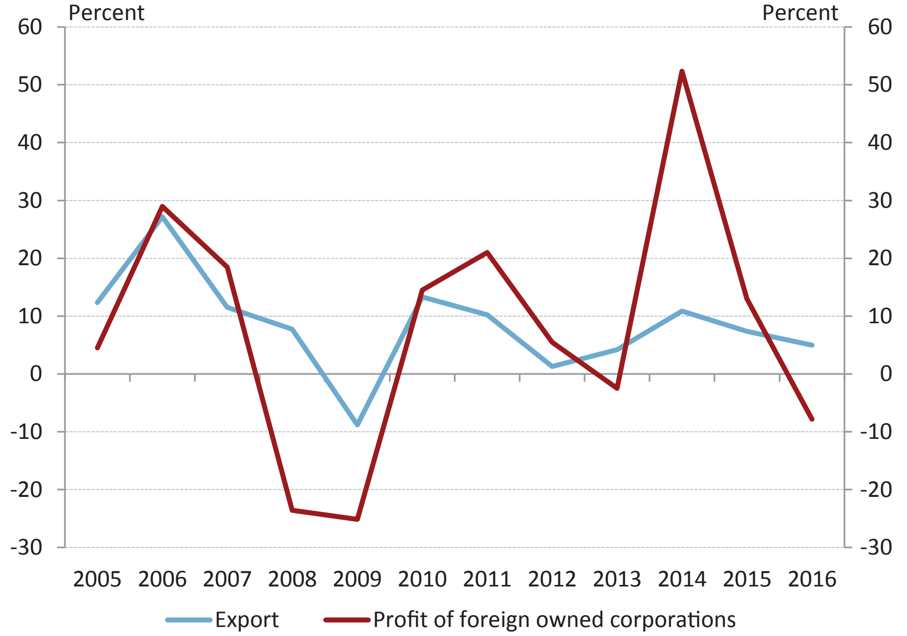


Note: The profit ratio is a value calculated from the year-end FDI stock.

5.4 Factors underlying developments in corporate profits

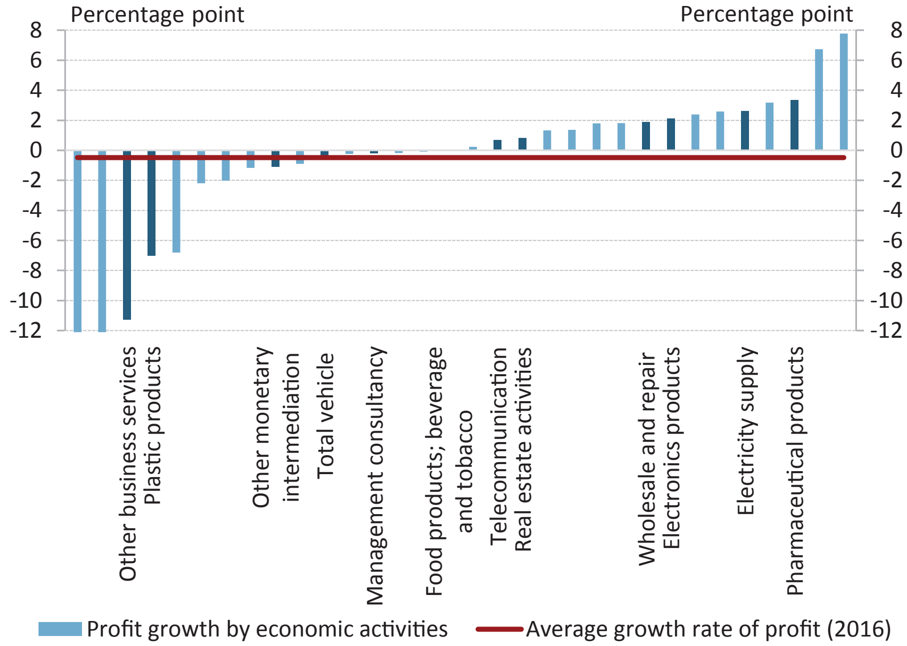
The increase in the profits of foreign-owned companies in 2016 – in line with the deceleration of the growth rate in exports – has declined, which may have been also attributable to one-off factors. Since a large part of foreign-owned companies are active in exports, it may be justified to compare the profit of foreign-owned companies with the export performance. While in recent years the growth in the profit of foreign-owned companies accelerated similarly to the export performance, in 2015-2016, in line with the deceleration in export growth, the dynamics of corporate profits also showed a decline (Chart 27). On the other hand, a single sector, where the profit decline amounted to almost HUF 400 billion, made a major contribution to the negative growth rate in the foreign-owned companies' profit.

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



Of the larger sectors, the largest degree of profit decrease occurred among companies rendering other auxiliary business services, while the profit as a percentage of FDI increased or did not change much in most sectors with major capital investments. The foreign-owned companies' return on FDI declined by 0.5 percentage point between 2015 and 2016. In most of the sectors with sizeable foreign investment (where foreign direct investment exceeds EUR 2 billion) – apart from two exceptions – corporate profit either has not changed materially or some minor growth has been recorded. On the other hand, in two sectors (in other business services and manufacturing of rubber and plastic products) a major decline was recorded in the profit ratio as a percentage of FDI stock. In the case of other business services, this is attributable to a major fall in profit, where the sale of a branch of a multinational corporation in 2015 may have played a key role. In the case of manufacturing of rubber and plastic products, the capital invested rose by HUF 250 billion to one and a half times its former size, while the profit of the sector has not changed significantly. The rise in capital invested may have been mostly attributable to a tyre factory investment in Hungary with foreign background, which will presumably become profitable only in the coming years. It should be noted that the realised profit rose in several key sectors, usually reflected not only in the figures expressed as a percentage of FDI stock, but also in the nominal figures (Chart 28).

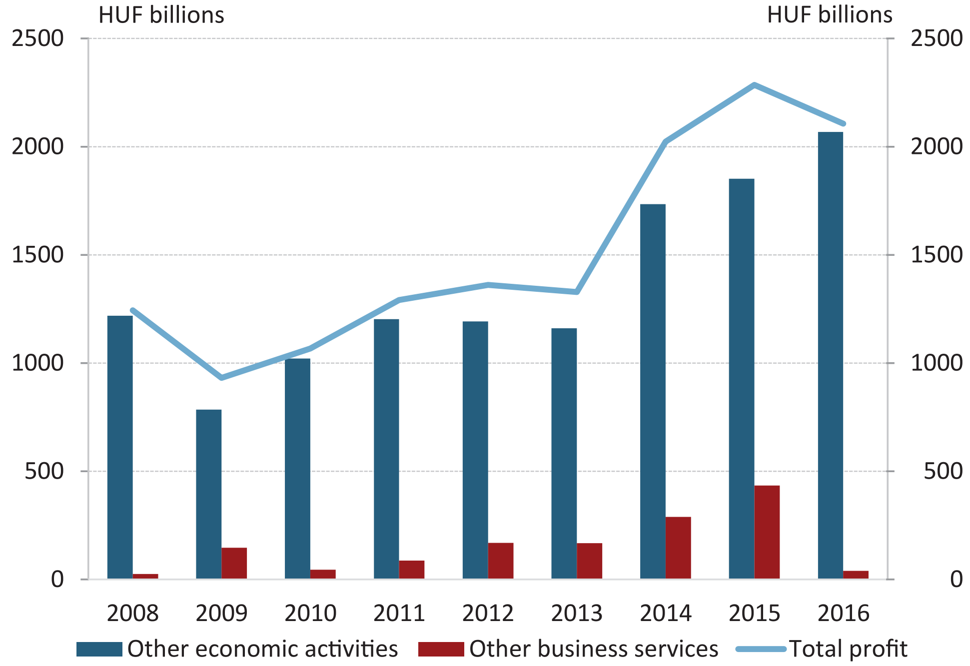
Chart 28: Growth in foreign-owned companies' return on FDI in certain sectors in 2016



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

The decline in the profit of foreign-owned companies in 2016 was linked almost in full to companies rendering other auxiliary services, while the profit of the other sectors continued to rise. In 2014 and 2015, most industries – including companies rendering other auxiliary services – were characterised by rising profits, while in 2016 this sector recorded a major – over HUF 400 billion – decline. The sell-off[11] at the end of 2015 – which gave rise to a major COPC correction – may have also contributed to this. Meanwhile, the profit of other sectors continued to increase in 2016, but was not able to offset the decline observed in other auxiliary services, and thus on balance the profit of foreign-owned companies decreased in 2016.

Chart 29: Profit of foreign-owned companies

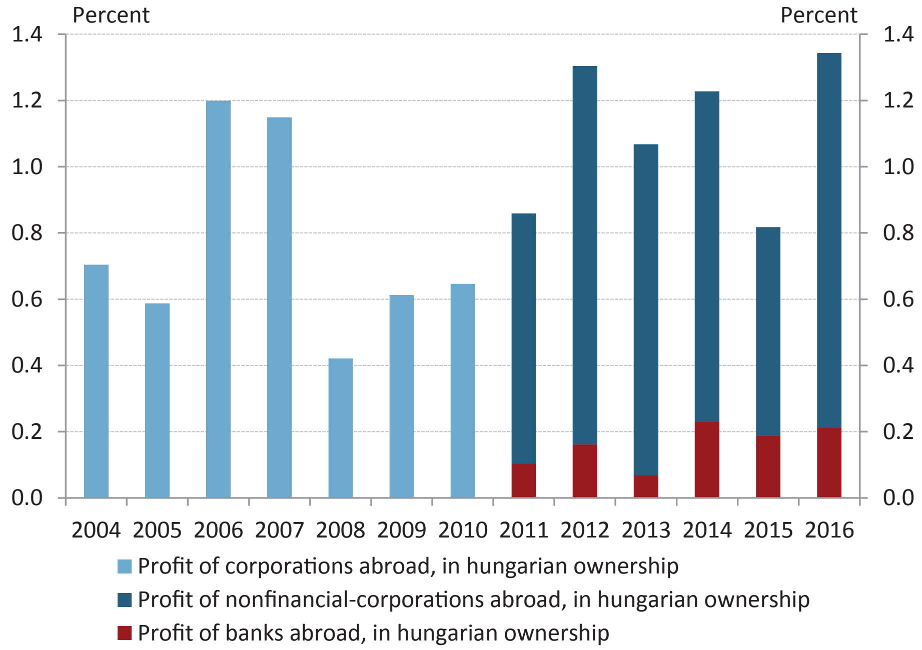


The substantial growth in the profit of Hungarian-owned companies operating abroad also contributed to the decrease in the deficit of the net profit balance, influencing net lending. Upon analysing the balance of payments, not only the earnings of foreign-owned companies operating in Hungary are to be considered within the income balance,[12] but also the profit of Hungarian-owned companies operating abroad. This value reduces the deficit of the income balance, as it represents an income for companies operating in Hungary. While in 2015 the profit of companies operating abroad – mostly linked to non-financial corporations – dropped by almost one-third, in 2016 growth exceeding this rate was observed, and hence it rose to an unprecedented level. This may have also been attributable to the fact that due to the intensification of the conflict that broke out between Russian and Ukraine in 2014, companies operating abroad may have realised a loss in 2015, the effect of which may have been mitigated by 2016.

[11] For more details, see the October 2016 Report on the Balance of Payments, and the MNB's press release in September 2016 on the balance of payments data release.

[12] Based on analytical considerations, in the income balance we present the primary incomes, save for the other primary incomes, which in the former statistics formed part of the unreciprocated transfers, and hence we state them in the transfer balance.

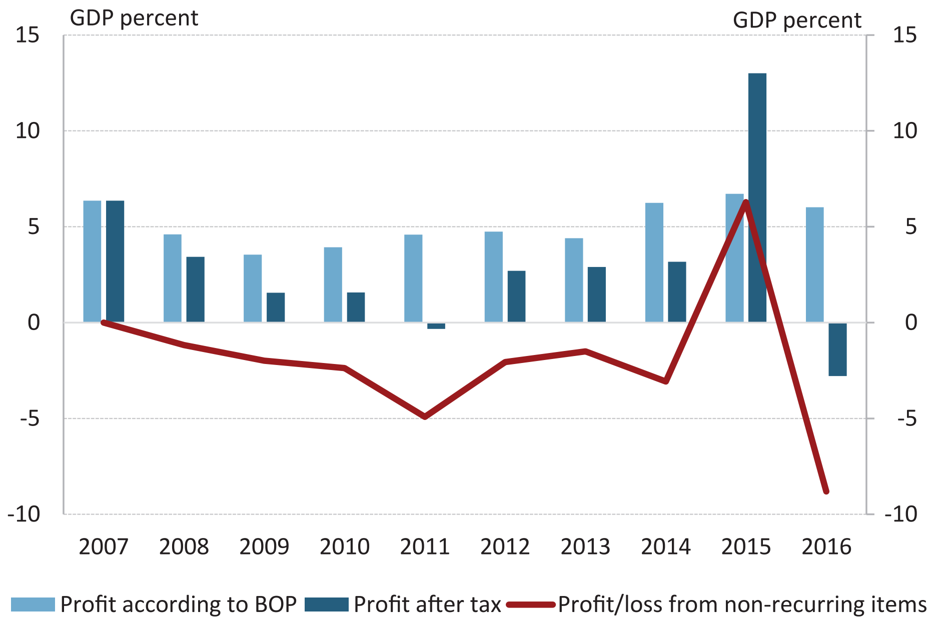
Chart 30: Profit of companies owned by residents, operating abroad (as a percentage of GDP)



5.5 After-tax profit of foreign-owned corporations

In the balance of payments, the profit of foreign-owned companies has dropped slightly compared to the value recorded in 2015, while a substantial decline was registered in after-tax profit, which was negative in 2016 (Chart 31). The balance of payments contains only the portion of foreign-owned companies' profit that relates to their current operating performance and eliminates extraordinary, one-off items. Recently, for corporations such one-off impacts included the losses from exchange rate revaluation and for credit institutions the early repayment at a preferential exchange rate and the settlements related to household FX loans, and in 2015 the sale of a branch of multinational company operating in Hungary at an extraordinarily high price. Similarly to after-tax profit, the profit stated in the balance of payments declined in the post-crisis period, followed by a rise in recent years. On the other hand, the profit – realised as part of current operating performance – stated in the balance of payments is much more stable, while the after-tax profit, which also contains one-off items, is more volatile: in 2015 one-off items increased the profit of the corporate sector, whereas in 2016 these items reduced it, as a result of which it declined by roughly 15 percent of GDP between the two years. This implies that, for analytical purposes, the use of the profit stated in the balance of payments may be justified. Since these items usually – with the exception of 2015 – reduced the profit of corporations, net lending in the balance of payments was lower than it would be when considering the after-tax profit of foreign-owned companies. That is, while in 2016 the profit/loss of foreign-owned companies stated in the balance of payments amounted to around 6 percent of GDP, the value of the after-tax profit was almost -3 percent, i.e. to a large degree the 2016 loss of the corporate sector was linked to one-off items. The difference between the two indicators had been usually negative in the past, but the value thereof was around -3 percent of GDP on average. By contrast, in 2016 the degree of this was close to -9 percent of GDP. This one-off loss can be partly linked to the adjustment of the unusually high profit of more than 6 percent of GDP, which was realised outside of current operating performance in 2015.

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

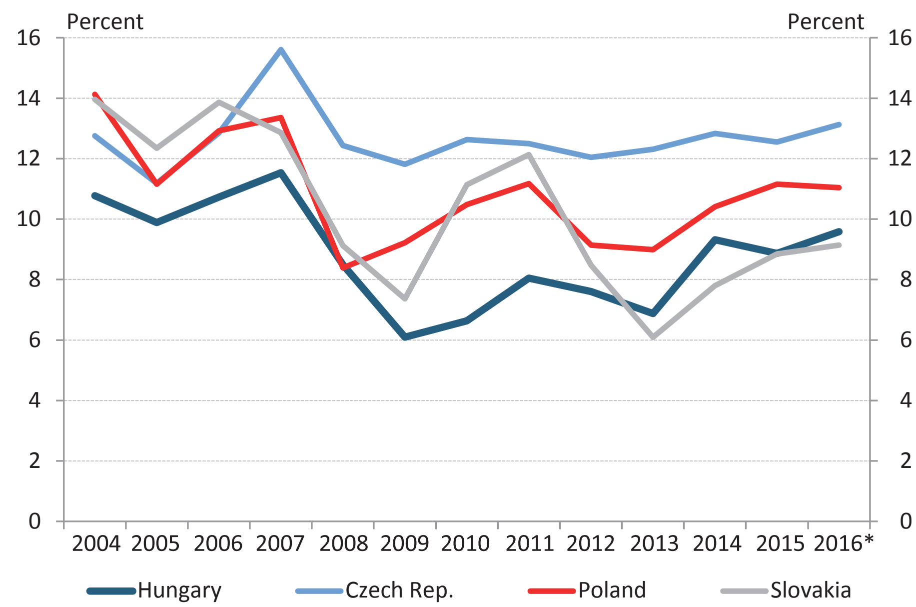


* The profit realised by foreign-owned corporations has a negative impact on the income balance, in line with the income balance of the balance of payments.

5.6 International comparison

The return on FDI observed in Hungary in recent years lags behind the average of the region (Chart 32). In a regional comparison, the return on foreign direct investments should be compared to the value of the return on capital invested. Based on the time series, it can be stated that while in the Czech Republic the return was above 12 percent in recent years, it was lower than that in the other countries of the region. The synchronous movement of the ratios implies that the development in the regional rates of return are significantly influenced by international developments. After the post-crisis decline, between 2011 and 2013 foreign corporations' return on FDI declined in Slovakia, Hungary and Poland, followed by a moderate increase. On the other hand, the return on FDI realised by foreign corporations operating in the Czech Republic steadily exceeds that observed in the other countries of the region.

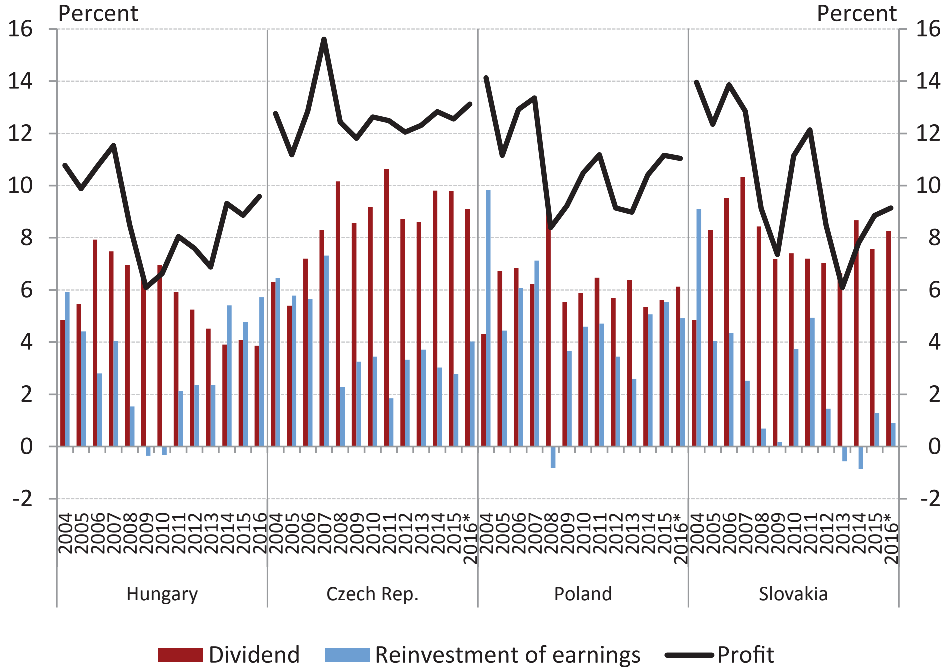
Chart 32: Return on FDI equity investment
(value of profit realised on the FDI stock relative to total FDI stock)



Source: Eurostat
* The 2016 value in the countries of the region is presumably an estimate only.

Foreign-owned companies reinvest more than half of their profits in Hungary, which is an extraordinarily high value among the countries of the region (Chart 33)**.** In most countries of the region the return on FDI has not changed much. On the other hand, whereas in Hungary there was a trend decrease in dividend payments since 2010, they rose in the other countries. As a result of this, reinvestment by foreign-owned companies operating in Hungary rose in 2016, following the trend observed in the past years, and still exceed the degree of dividend payments,[13] which is not typical for the other countries of the region.

Chart 33: Breakdown of FDI earnings in the countries of the region
(as a percentage of FDI equity)

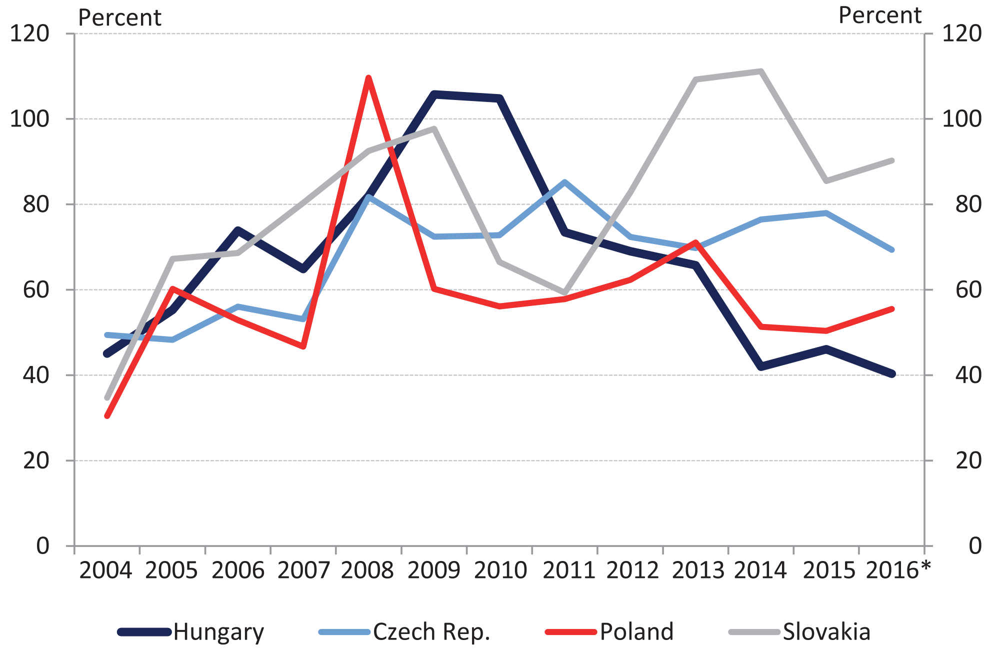


Source: Eurostat
The 2016 value in the countries of the region is presumably still an estimate.

Within the region, the profit-proportionate dividend payments are the lowest in Hungary, reflected in the high value of reinvestment. In the countries of the region, dividend payments as a percentage of profits already increased before the crisis, peaking in the years of the crisis, and in addition to Hungary, it exceeded 100 percent for a short period in Poland as well, meaning that foreign-owned companies paid dividends to their foreign shareholders not only from their profit of the year, but also from the retained earnings accumulated from the profit of former years. The underlying reasons for this may have been the increased funding requirements of the foreign parent companies during the crisis, as well as the decline in regional growth prospects. It should be also noted that the dividend ratio decreased in recent years in all countries of the region, but the lowest value was recorded in Hungary. Thus, it is foreign-owned companies operating in Hungary that reinvest the largest part of their earnings.

[13] Superdividends could 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 profit, while it reduced that of dividends. Hence, this may also contribute to the higher reinvestment, as a percentage of profits, by foreign-owned companies operating in Hungary.

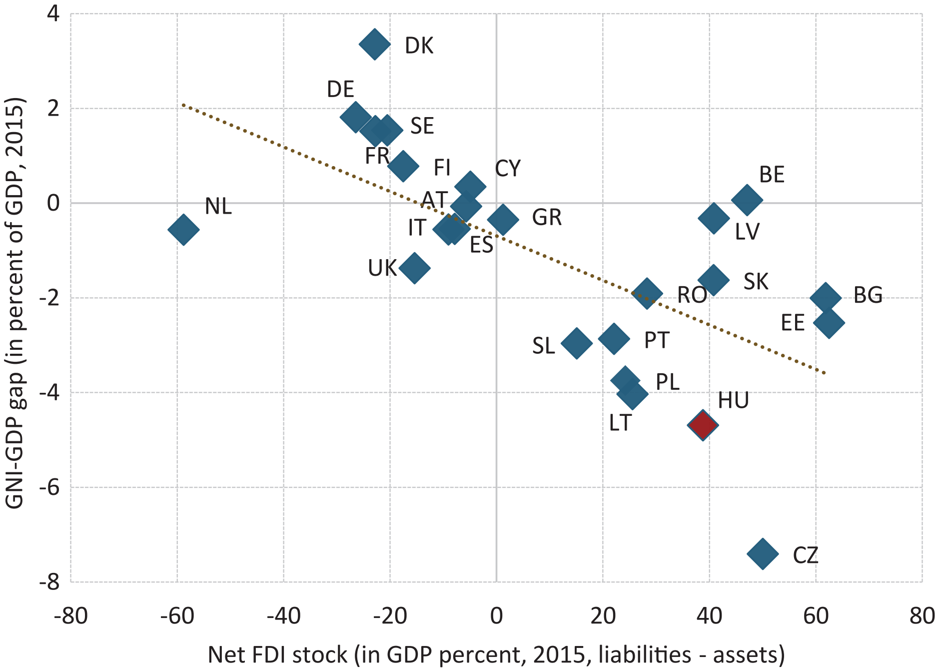
Chart 34: Ratio of dividend payments to total profit



Source: Eurostat
* The 2016 value in the countries of the region is presumably an estimate only.

The difference between the gross national income (GNI) and the gross domestic product (GDP) is connected to the net value of foreign direct investments (Chart 35). The difference between the gross national income and gross domestic product comprises the income payments related to the non-resident sector. The largest part of this is represented by interest payments related to the non-resident sector and the profit of foreign-owned companies. Examining the countries of the European Union, the difference between GNI and GDP is strongly influenced by developments in net FDIs. The countries where the net FDI stock is negative (i.e. the country's corporate ownership abroad exceeds the foreign-owned companies in the given countries) usually receive higher income from abroad than they pay (i.e. GNI exceeds GDP). Examples of this include several euro-area countries, such as Denmark, Germany and France. It can be generally stated that the GNI-GDP difference of the member states that joined the EU earlier is close to zero or positive. This correlation is presumably attributable to the maturity of the economies: in these countries the higher GDP facilities investments abroad to a larger degree. By contrast, in the countries that joined the EU in 2004 or later, foreign direct investments significantly exceed the investments of residents abroad, in parallel with which the GNI value falls short of GDP on average by roughly 3 percent of GDP. Compared to the average correlation, the GNI-GDP difference is higher both in Hungary and in the Czech Republic. The underlying reason for this is that in Hungary interest payment is higher due to the external debt that exceeds that of the countries of the region, while in the Czech Republic it is due to the higher profit margin (presented earlier) of foreign companies.

Chart 35: Correlation between the GNI-GDP gap and net FDI in the EU countries*



Source: Eurostat

* Due to absence of data Croatia is not included in the chart, while Ireland, Luxembourg and Malta were left out due to their outliers.

LIST OF CHARTS

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 2017

Print: Prospektus–SPL consortium

H-8200 Veszprém, Tartu u. 6.

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