



REPORT ON THE BALANCE OF PAYMENTS



2019
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 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 developments 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: Anna Boldizsár, Zsuzsa Nagy-Kékesi, Balázs Kóczyán, Péter Koroknai, Dániel Simon, Balázs Sisak and Márton Varga. The Report was approved for publication by Márton Nagy, Deputy Governor.

This Report is based on information pertaining to the period ending 20 September 2019.

Summary

Following a slight decline, the four-quarter value of Hungary's **net lending** amounted to 1.6 percent of GDP in 2019 Q2. With this figure, the net lending of the Hungarian economy continues to exceed the level observed in the countries of the region. The development of the current account is driven by the **steadily growing export sales and imports** related to the robust **investment** trend.

From the perspective of real economy transactions, the decline in net lending is explained by the structural change in the economy — which forms the basis for long-term growth — i.e. the strong expansion of investments, and the import demand associated with capacity increases. As a result, the **rate of investments** rose above 27 percent of GDP, reaching a historically high level. The transfer balance remained practically unchanged in parallel with the persistently high absorption of EU transfers. Looking at the other components of net lending, the surplus of the services account remains significant, while the income account deficit continued **to fall** in 2019 Q2 again, which is still attributable to the decrease in interest expenditure paid abroad.

As a result of the revision carried out simultaneously with the quarterly data release, the 2018 current account deficit is around 0.5 percent of GDP. The lower current account balance was attributable to various factors. First, in connection with the revision of annual GDP, the trade balance contracted. Second, the balance of secondary incomes (unrequited current transfers) also fell due to the change in the estimation methodology for remittances by those working abroad. Third, the income account deficit is also slightly higher: the income of foreign-owned companies operating in Hungary was somewhat higher than the estimate, and the income of those working abroad for less than one year also fell slightly. However, the decline in the 2018 figure of the current account due to the revision did not lead to any major weakening in net lending, as companies' investments abroad boosted the capital account balance significantly. The revision lowered the two external balance indicators for previous years as well, but did not affect the decline in the external debt indicators observed in the past years.

Based on financing data, the **four-quarter borrowing requirement corresponded to 0.5 percent of GDP**, resulting from a decline in outflows of debt-type liabilities and significant inflows of non-debt liabilities. **Looking at the quarterly data, the structure of external liabilities changed compared to the previous quarters:** partly due to the dividend disbursements typical of Q2, **foreign direct investment declined, and in parallel with that, the debt-type liabilities of the economy increased slightly, following considerable declines in debt in the previous quarters.** The net inflow of debt-type liabilities was mainly related to non-residents' government securities purchases, while the banking sector reduced its external debt further.

Following a nearly continuous decline since mid-2011, net external debt rose slightly in 2019 Q2, mainly due to repricing effects, and amounted to 8.8 percent of GDP. The growth in debt liabilities only played a marginal role in the increase, which was more or less offset by the nominal GDP growth. The rise in the debt ratio is mainly attributable to the revaluation of stocks: the **fall in the yield of government securities raised the indicator by roughly 0.7 percentage point** in Q2. Although the **fall in yields is favourable in respect of sustainability**, it also increases the value of government securities held by non-residents, thus increasing the external debt ratios as well. Over the rest of the year, the temporary increase should be offset by the expected decline in net external debt in 2019, in line with the stable net lending position. Gross external debt fell to 56.2 percent of GDP. Banks' and companies' debt reduction also contributed to the decline. **Short-term external debt, which is of key importance in terms of the country's external vulnerability, was down by nearly EUR 1.6 billion to EUR 17.8 billion**, which is mainly attributable to the decline in short-term external debt based on original maturity. Accordingly, **the level of foreign exchange reserves still substantially exceeds** what is expected and considered safe by investors.

The **sectoral savings also show a structure which supports a dynamically growing economy.** In line with the robust investment activity, the decline in the net saving position of the Hungarian economy **is attributable to the fall in the four-quarter net position of the private sector** in 2019 Q2 as well, while the disciplined fiscal policy resulted in a further decrease in the government's net borrowing. Households' net financial savings remains high, which was supported by the

introduction of the 'Magyar Állampapír Plusz' security. The structure of households' retail government securities portfolio shifted towards longer-term securities, due to the issuance of the new government security (MÁP+).

As a special topic, we analysed **the income of foreign-owned corporations operating in Hungary**. Based on the actual data, foreign-owned corporations' profit as a proportion of GDP **declined slightly**. In parallel with the decline in profit, **the value of dividends paid to owners remained unchanged**, and thus the drop in income was reflected in a decrease in reinvestments. In spite of the decrease, **reinvestments remain at a high level**: foreign-owned companies still invested nearly 70 percent of their earned income in Hungary, which is **one of the highest figures in a regional comparison**. The slight decline in the profits of foreign-owned companies operating in Hungary **was reflected in the minor decrease in the difference between GNI and GDP as well**: on the whole, the Hungarian GNI–GDP gap corresponds to the average of the region.

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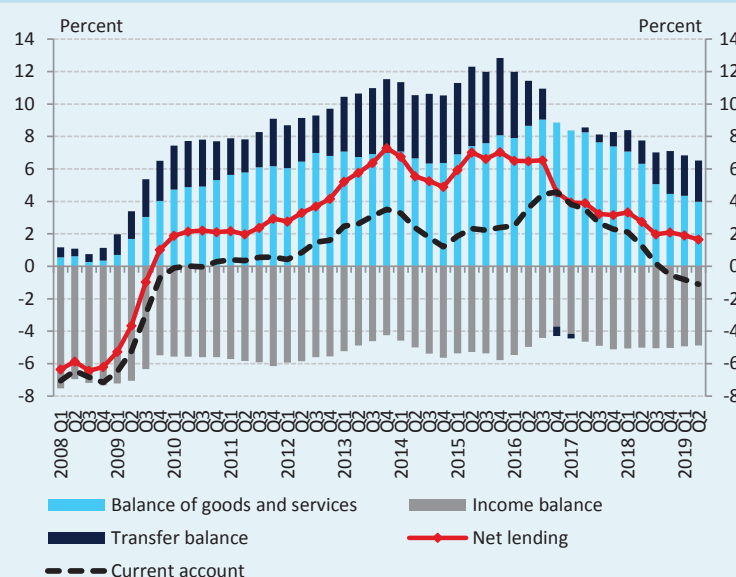
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1 Real economy approach

According to the real economy approach, in 2019 Q2 the four-quarter net lending of the Hungarian economy and the current account deficit amounted to 1.6 percent and 1.1 percent of GDP, respectively. The changes in Hungary's external balance indicators continue to be in line with the developments observed in the region, and in terms of net lending Hungary is among the leaders in the region. The decline in net lending was a result of the continued decrease in the trade balance, while the transfer balance remained practically unchanged in parallel with the steadily high absorption of EU transfers. The rise in the goods deficit and the decrease in the services account surplus contributed to the decline in the trade surplus in 2019 Q2 to a larger and a smaller degree, respectively. The decline in net exports in Q2 is attributable to the fact that the decrease in the growth rate of exports exceeded that of imports. The changes in export dynamics reflected the effect of the slower expansion in industrial production. The balance-deteriorating effect of the worsening in the terms of trade ceased to exist during the quarter. As a result of the decline in interest expenditure paid to abroad, the deficit on the income balance continued to decrease.

In 2019 Q2, Hungary's four-quarter net lending according to the real economy approach and the current account deficit amounted to 1.6 percent of GDP and 1.1 percent of GDP, respectively (Chart 1). According to unadjusted quarterly data, net lending in Q2 was EUR 760 million, as a result of the EUR 880 million surplus of the capital account reduced by the slight current account deficit of around EUR 120 million. The rise in the four-quarter current account deficit and the decline in net lending were primarily attributable to the continued decrease in the trade surplus.

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



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

Box 1: Revision of the balance of payments

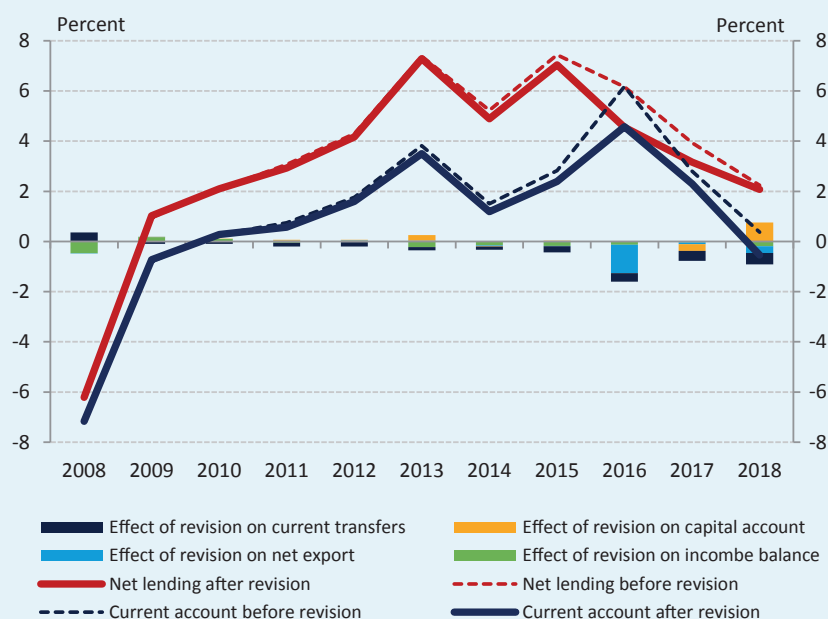
As a result of the revisions, the balance of payments data were amended retroactively in the data release of the balance of payments (Chart 2). Upon the release of the Q2 balance of payments data the MNB also published the revisions carried out in previous years' data. In addition to the usual revisions, the September 2019 data release also contained a so-called benchmark revision performed on the basis of the joint recommendation of the European Statistical System (ESS) and the European System of Central Banks (ESCB). In this revision, every five years the whole retrospective data series can be modified in order to publish the longest possible, consistent macroeconomic time series. Accordingly, this is when it also becomes possible to trace back estimates, data corrections and methodological

changes beyond the regular, normal revision periods, as far back as 1995. In addition, as part of the revision we obtained the final annual figures for the 2018 corporate income data with the September data release (for more details see the special topic). The most important changes relating 2018 are the following:

- The biggest change is related to the secondary incomes (previously unrequited current transfers), which lowered the balance (EUR 600 million), stemming from the fact that within the framework of the benchmark revision the HCSO elaborated a new estimation methodology for the accounting of the income of those working abroad, the related transfers and the data of remittances.
- The goods and services balance declined by EUR 350 million, which first appeared in the balance of payments statistics.
- The income balance decreased by EUR 260 million, due to various factors. First, the previously estimated data for the 2018 profits of foreign-owned companies operating in Hungary were replaced by actual figures on the basis of corporate questionnaires, according to which slightly higher corporate income added to the income account deficit compared to previous indications. Second, also due to the change in the estimation methodology concerning the income of those working abroad, the income of those working abroad for less than one year also declined slightly.
- The exceptional revenue surplus of non-produced, non-financial assets related to companies' investments abroad did not affect the current account, but caused a major positive shift (EUR 1 billion) in the capital account.

Accordingly, on the whole, the current account balance showed a deficit of 0.5 percent of GDP in 2018, while due to the positive shift in the capital account the net lending remained around the previously indicated 2 percent.¹

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



As a result of the revision of the balance of payments, the financing side also changed, but on the whole there was a considerable decline in 'Net errors and omissions'. With the September revision, the data of the balance of payments statistics regarding foreign-owned companies' profits changed because of the received corporate questionnaires as well, which also has an impact on the value of foreign direct investment. In view of the actual corporate income data, the 2018 balance of foreign direct investments fell slightly. At the same time, net FDI inflows were considerably

¹ The revision in order to create conformity with the financial and non-financial accounts reduced the two external balance indicators concerning the previous years as well.

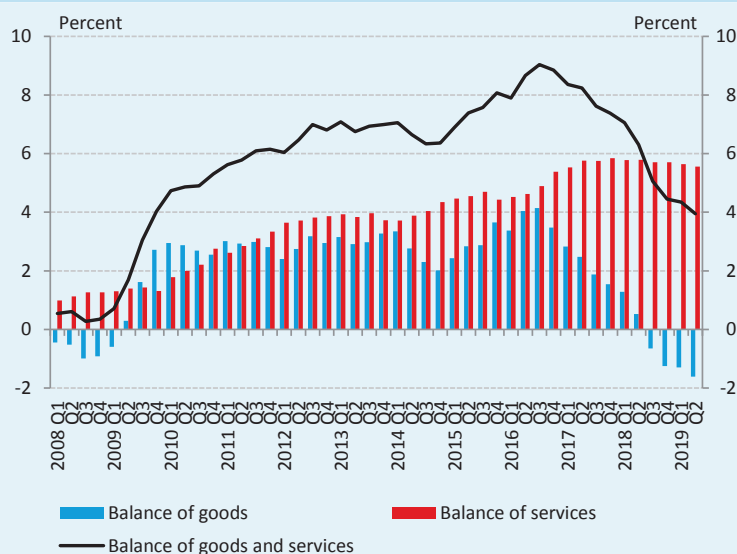
reduced by new information received about corporate investments abroad. Accordingly, on aggregate, net FDI inflows were down by EUR 0.9 billion to EUR 2.8 billion, which is still higher than the values observed in the previous years. A new estimation methodology for foreign households' investments in real estate was also worked out within the framework of the benchmark revision. The estimation on the basis of the new data source increased net FDI inflows by some EUR 0.2 billion annually for the period between 2008 and 2018. At the same time, the revision did not affect the debt indicators of the country. As a result of the revisions, 'Net errors and omissions' in the balance of payments statistics dropped significantly (by more than EUR 1 billion as an average of the past three years). In 2019 Q1, the net lending calculated using the top-down approach declined by EUR 0.3 billion due to the revision, with contributions from the decrease in all the three components. The net lending using the bottom-up approach also changed to a similar degree, which was attributable to a slight decline in the outflow of debt-type liabilities and a modest increase in FDI inflows.

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

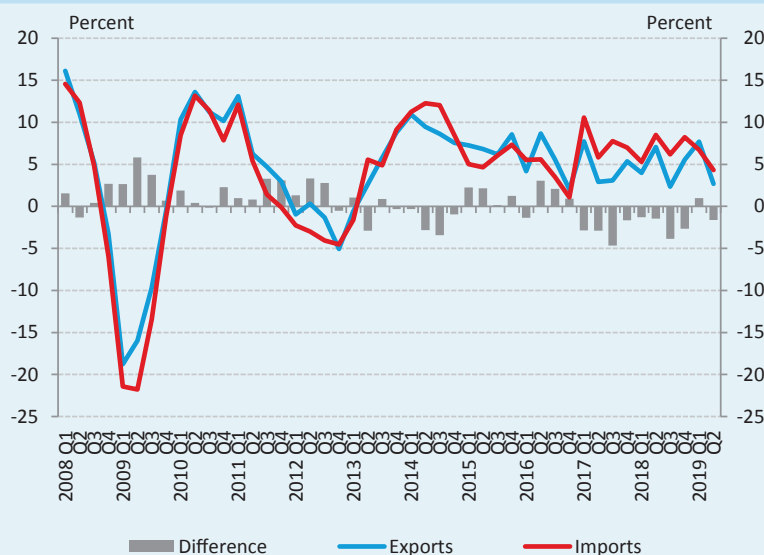
	2015	2016	2017	2018	2019. Q1
I. Change in net lending from real economy's side (1+2+3)	-0.4	-1.8	-0.9	-0.2	-0.3
1. Balance of goods and services	0.0	-1.3	-0.1	-0.3	-0.1
2. Income balance	-0.2	-0.2	0.0	-0.3	-0.1
3. Transfer balance	-0.2	-0.4	-0.8	0.4	-0.1
Current account	-0.5	-1.8	-0.6	-1.2	-0.3
II. Change in net lending from financing side (5+...+8)	-0.2	-0.3	-0.6	1.0	-0.2
5. Foreign direct investment	-0.2	-0.3	-0.3	0.9	-0.1
6. Portfolio equity	0.0	0.0	0.0	0.0	0.0
7. Financial derivatives	0.0	0.0	0.0	0.0	0.0
8. Net debt	0.0	0.0	-0.3	0.2	-0.1
Net errors and omissions (I.-II.)	-0.2	-1.5	-0.3	-1.2	-0.1

1.1 Trade balance

In 2019 Q2, the trade surplus declined further, but it remain significant as a result of the surplus of the services balance (Chart 3). The downward trend in the trade balance since the beginning of 2017 continued in 2019 Q2 as well, and thus its four-quarter value amounted to roughly 4 percent of GDP. The 0.4 percentage point drop in the trade surplus was mainly attributable to the decrease in the goods balance and to a lesser degree to the decline in the services balance. In Q2, the goods deficit reduced the trade surplus by 1.6 percent of GDP, while the services surplus amounted to 5.6 percent of GDP. Accordingly, the services sector is still an important contributor to the trade surplus.

Chart 3: Developments in the balance of trade and its components (four-quarter values as a percentage of GDP)

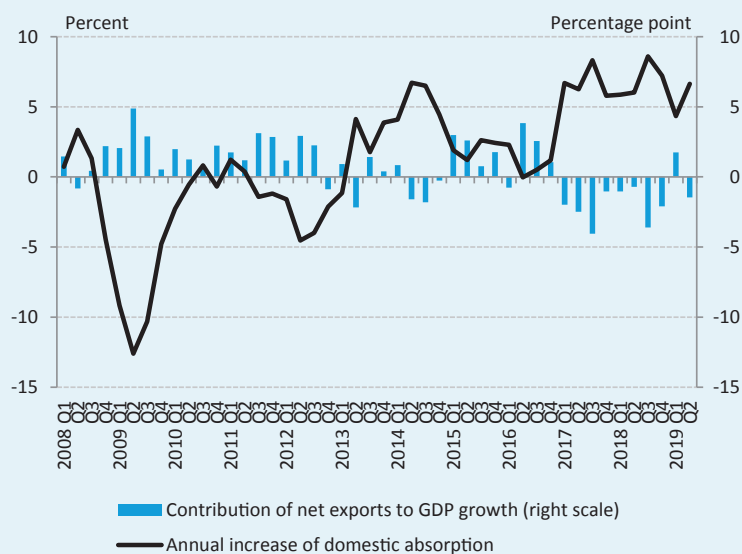
In 2019 Q2, export growth decelerated to a larger degree than import growth, and consequently in real terms imports grew faster than exports again (Chart 4). Due to the change in inventories, the increase in the real growth rate of exports in 2019 Q1 turned into deceleration in Q2. The decline in the annual growth rate of goods exports occurred in parallel with slower expansion in industrial production, with contribution by a calendar effect as well. As a result of a decelerating but continued expansion domestic demand items (investment, consumption) that fuel import needs, the real growth rate of imports also declined, but nevertheless exceeded the dynamics of exports.

Chart 4: Annual real growth in exports and imports

Source: HCSO, MNB.

After a slowdown in the previous quarter, the annual growth rate of domestic absorption increased again, while net exports reduced growth (Chart 5). In 2019 Q2, household consumption continued to increase (at a lower rate compared to previous quarters), and the investment of sectors also expanded dynamically, which was reflected in a rise in domestic absorption. Both the dynamic growth in construction output and investment in machinery for capacity expansion in the manufacturing subsector contributed to the rise in investment. Imports expanded in parallel with the increase in domestic demand items. The rate of expansion exceeded the growth in exports, and thus the contribution of net exports to growth was negative in Q2.

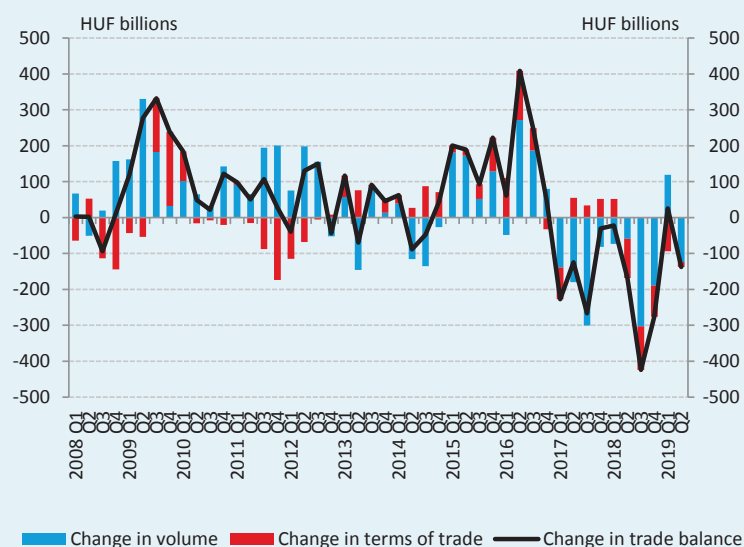
Chart 5: Annual growth rate of domestic absorption and contribution of net exports to GDP growth



Source: HCSO.

The decline in the trade surplus in 2019 Q2 is attributable to the change in volume; the change in the terms of trade did not significantly affect the balance. While from 2018 as a result of the rising oil prices the deterioration in the terms of trade had a considerable negative impact on the trade balance, this impact ceased by 2019 Q2, i.e. price changes no longer had a major effect on the trade surplus. The impact of the change in volume that reduces net exports, which has been prevailing for more than two years with the exception of 2019 Q1, also remained in place in 2019 Q2 (Chart 6).

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

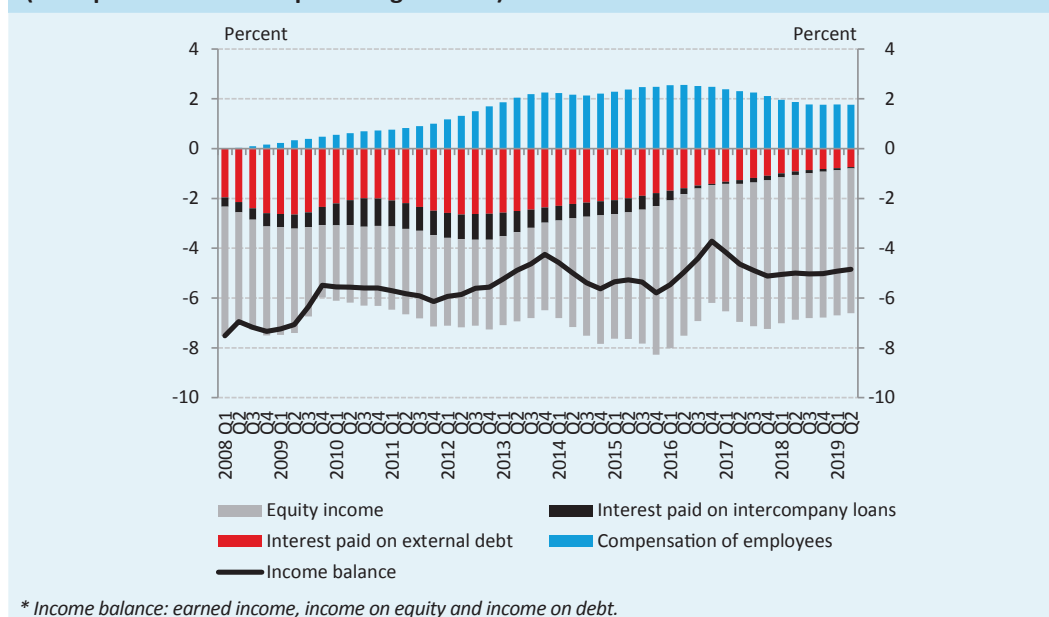


Source: HCSO.

1.2 Income balance

The decline in the deficit on the income balance continued in 2019 Q2 as well, which was still the result of the decrease in interest expenditure paid to abroad (Chart 7). In 2019 Q2, the income deficit dropped to 4.9 percent of GDP. Within the income balance, the largest item is foreign-owned companies' income related to equity: this item consistently showed a deficit of around 5.8 percent of GDP. The decline in the compensation of employees observed since 2016 turned into stagnation in Q2, and accordingly this item continued to significantly improve the income balance (by 1.8 percent of GDP). In line with the still low interest rate environment and the improvement in external debt indicators, net interest expenditure on foreign loans and intercompany loans continued to fall (the sum of these two items is already less than 1 percent of GDP compared to nearly 4 percent in 2012), thus also resulting in an improvement in the income balance as a whole.

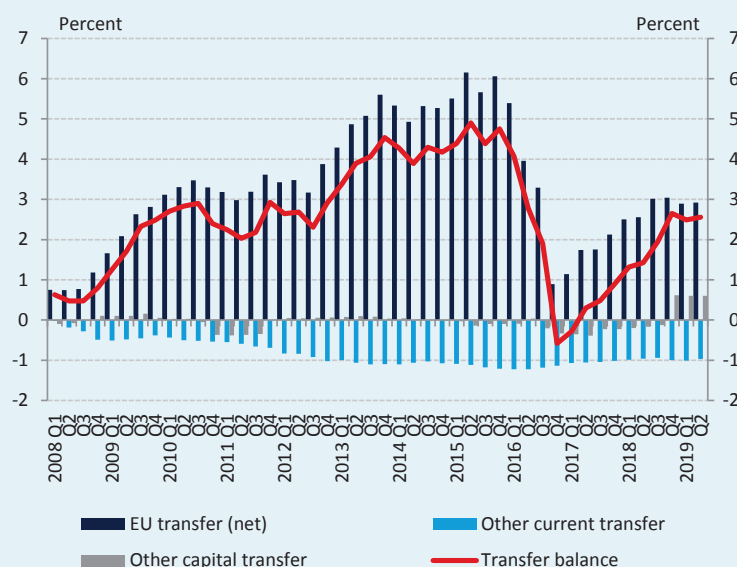
Chart 7: Developments in the items of the income balance*
(four-quarter values as a percentage of GDP)



1.3 Transfer balance

As a result of the stable absorption of EU funds, the transfer balance surplus remained almost unchanged, amounting to 2.6 percent of GDP in Q2 (Chart 8). In 2019 Q2, the absorption of EU funds stabilised at a relatively high level, i.e. close to EUR 1.2 billion, which was reflected in the nearly unchanged transfer balance. The net EU transfer absorption observed in recent quarters, which amounts to between 2.5–3 percent of GDP annually, continues to contribute significantly to sustaining Hungary's favourable external balance position. The balance of other current transfers and other capital transfers remained practically unchanged during the quarter.

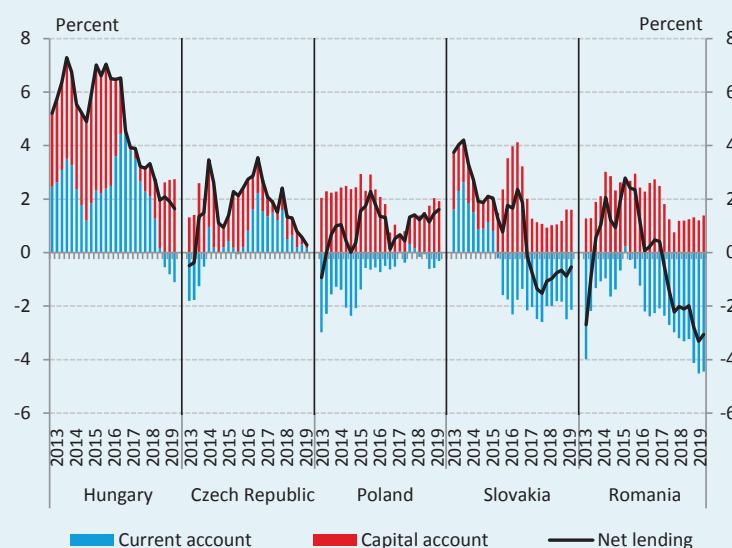
**Chart 8: Four-quarter developments in transfer balance items
(four-quarter values as a percentage of GDP)**



1.4 Regional review

The net lending of the Hungarian economy continues to exceed the levels observed in the countries of the region, primarily owing to the significant surplus of the capital account, whereas the current account balance is around the average in the region (Chart 9). External balance indicators have typically declined in the region since 2016: In Romania, the four-quarter current account deficit already exceeds 4 percent of GDP, while in Poland the deterioration in the current account balance is roughly offset by the improvement in the capital account (presumably related to EU transfers). Although both indicators improved to some extent in Slovakia, the current account shows a significant deficit of around 2 percent of GDP in this country as well. In spite of the decline observed in Hungary, its net lending continued to exceed the level typical of the region, which was attributable to the considerable surplus of the services account and the high surplus of the capital account.

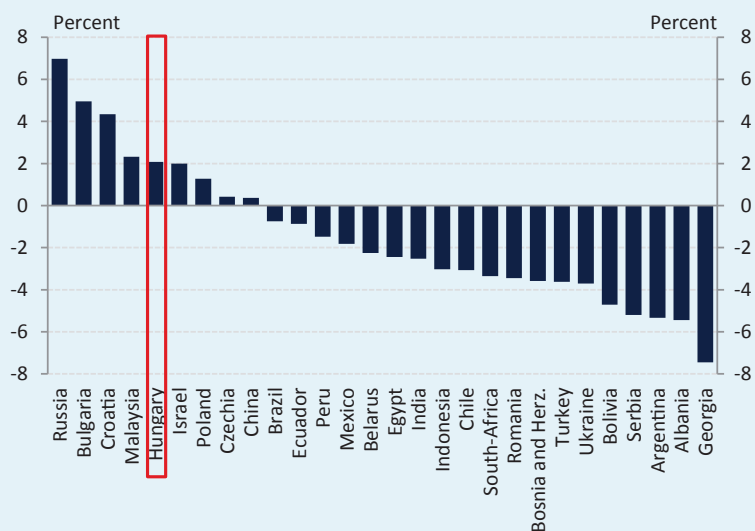
Chart 9: Four-quarter net lending in the region (as a percentage of GDP)



Sources: MNB, Eurostat.

Box 2: Net lending of the economy in an international comparison

The data for 2018 show that the net lending of the Hungarian economy is high compared to other emerging economies. In 2018, most emerging economies increased their foreign liabilities, by more than 2 percent of the GDP. In contrast to that, some (usually European) economies in 2018 posted a net lending position. In addition to the European economies, the same can be said for China which has a strong net exporting position, as well as for the large oil exporter Russia.

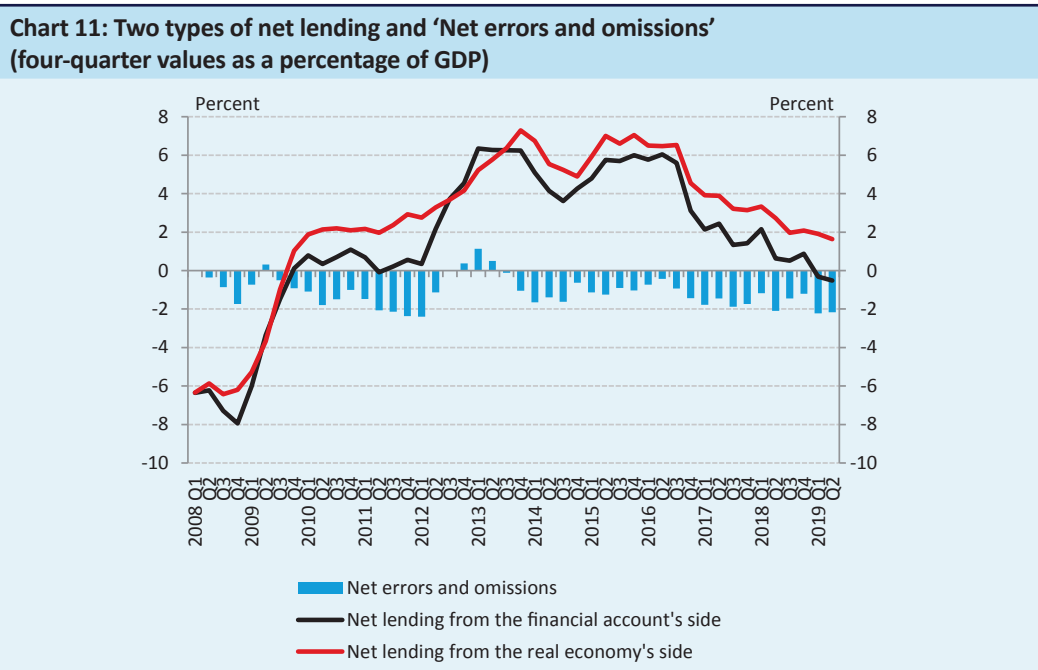
Chart 10: Net lending in emerging economies (2018)

Source: IMF, MNB, own calculation.

2 Financing approach

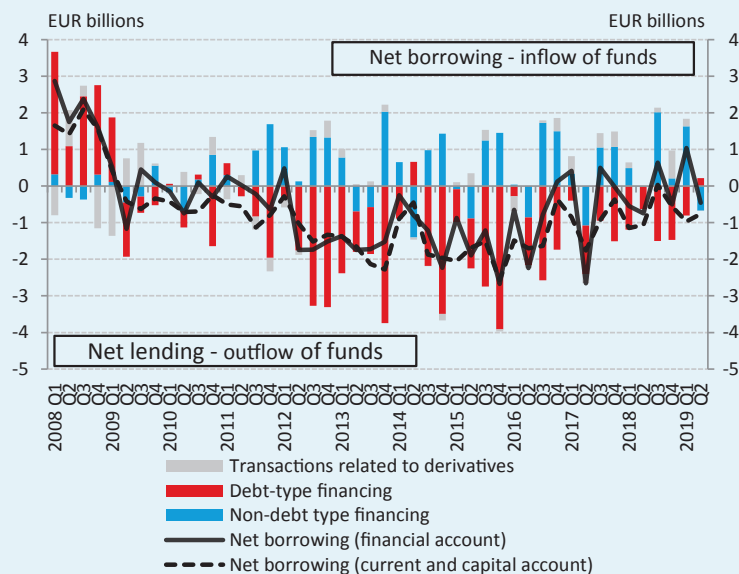
The four-quarter borrowing requirement calculated on the basis of the financial account amounted to 0.5 percent of GDP in Q2. Against the background of lower outflows of debt-type liabilities and significant inflows of non-debt liabilities, at the beginning of this year the four-quarter indicator turned into net borrowing, which increased further in Q2. According to the quarterly indicator, the borrowing requirement fell considerably, which was explained by the lower net FDI inflows due to dividend disbursements. In Q2, as opposed to the declines observed in the previous quarters, debt-type liabilities increased slightly, which was attributable to the rising net external debt of the general government, and within that to the decreasing FX reserves as well as non-residents' increasing government securities holdings. By contrast, the net external debt of the private sector fell considerably, related to banks' lower short-term external debt.

According to financing data, in 2019 Q2 the four-quarter net borrowing of the economy increased further, exceeding 0.5 percent of GDP (Chart 11). By contrast, the four-quarter net lending according to the real economy approach continued to show a surplus, in spite of a slight decline. It is true for both Q1 and Q2 that although the financing items show foreign fund inflows, the combined current and capital account balance continues to show a surplus.² In the first two quarters of this year, net errors and omissions was around its historical average and amounted to approximately 2 percent of GDP.



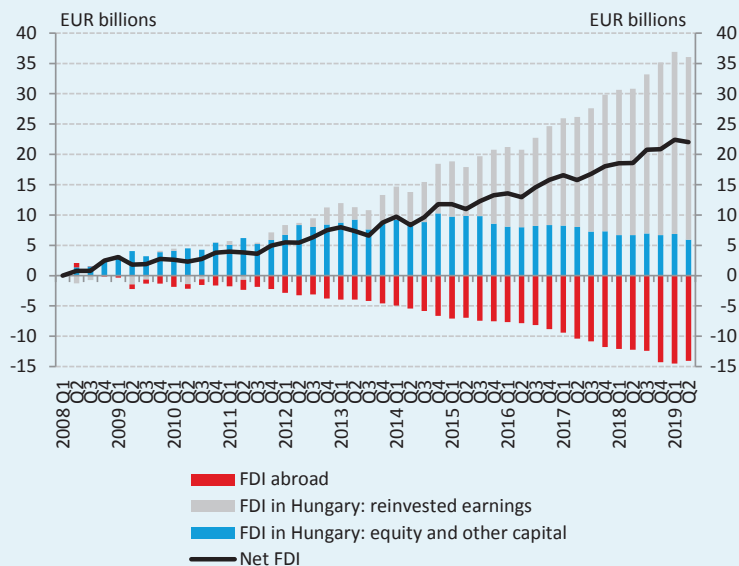
The higher four-quarter value of the net borrowing calculated based on the financial account was primarily attributable to the decline in FDI-type funds in relation to dividend disbursements (Chart 12). The rise in debt-type liabilities was not significant: it amounted to roughly EUR 220 million. At the same time, non-debt liabilities fell sharply in Q2, which was mostly related to the usual annual dividend disbursements, while it had an opposite effect that Hungarian companies' investments abroad also decreased. Accordingly, the net decline in non-debt external liabilities was around EUR 700 million, which corresponds to the average of the values observed for the same periods of previous years.

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

Chart 12: Structure of external financing (unadjusted transactions)

2.1 Non-debt liabilities

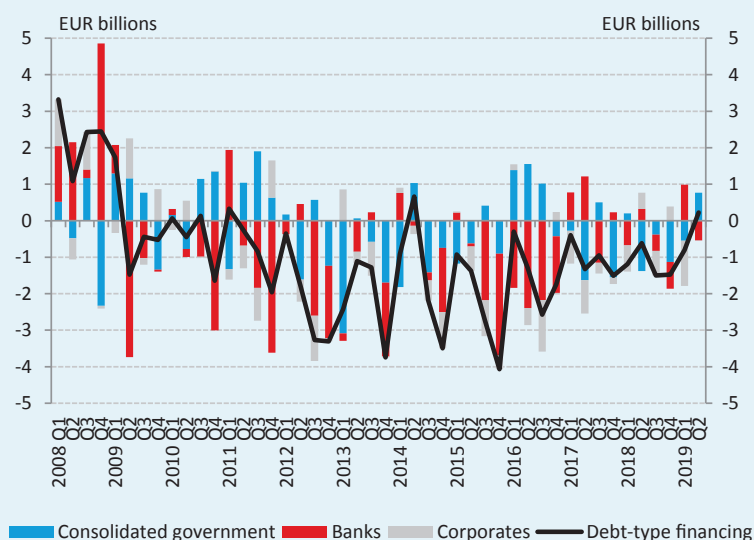
As a result of foreign-owned companies' usual dividend disbursements, FDI-type funds were lower in Q2 (Chart 12). On the basis of data net of capital-in-transit transactions and asset portfolio rearrangements, foreign direct investments fell by roughly EUR 400 million in Q2, while Hungarian companies' investments abroad also decreased.

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

2.2 Debt liabilities

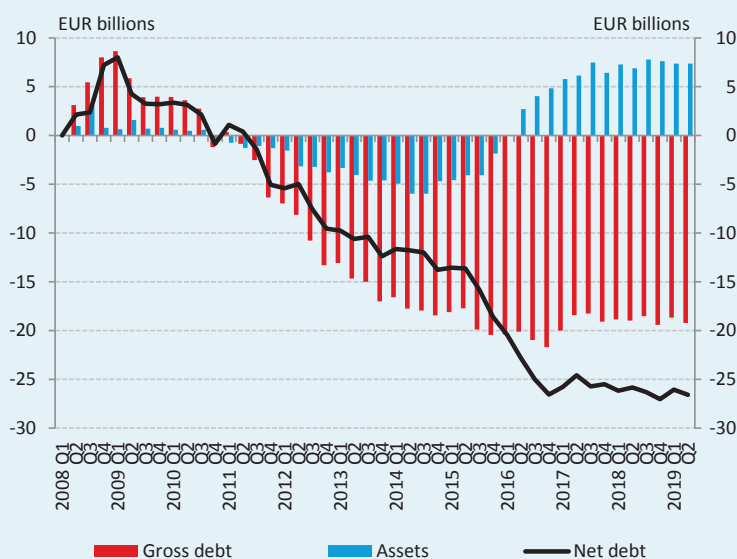
In Q2, as a result of transactions, the stock of debt liabilities increased, which was completely related to the state, while the net external debt of the private sector fell (Chart 14). The nearly EUR 800 million rise in the net external debt of the consolidated general government was partly attributable to the FX reserves (which declined in relation to the decrease in the forint liquidity providing swap holdings) and partly to non-residents' government securities purchases. The net external debt of the banking sector fell by more than EUR 500 million as a result of the decline in external liabilities. There was no major change in the net external debt of the corporate sector.

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



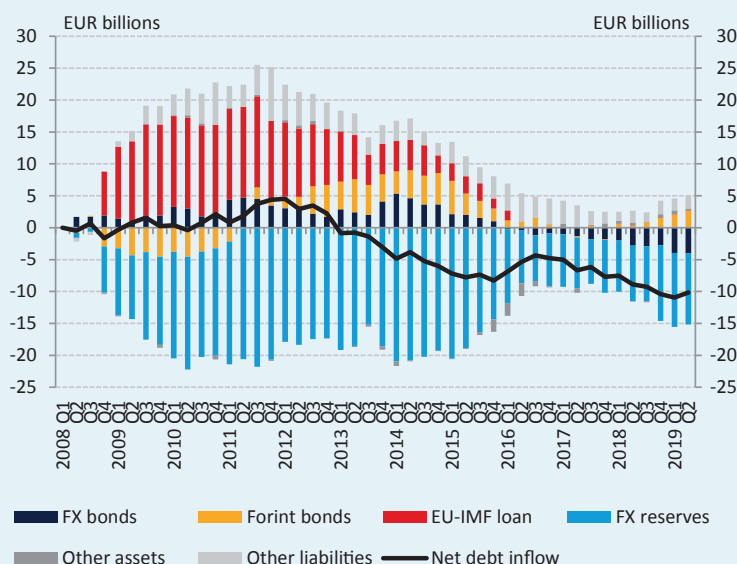
Banks' net debt outflows resulting from transactions amounted to EUR 540 million, which was entirely related to the reduction of external liabilities, while the stock of receivables remained practically unchanged in Q2 (Chart 15). The decline in banks' gross external debt was attributable to the reduction of short-term liabilities, while long-term liabilities were slightly higher. The decrease in banks' external liabilities may have been related to the declining central bank FX swap holdings.

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



The increase in the debt-type external liabilities of the consolidated general government including the MNB was attributable to the decline in FX reserves and to non-residents' growing HUF-denominated government securities holdings (Chart 16). In relation to this, the net external debt of the general government rose by nearly EUR 800 million in Q2. Non-residents' government securities purchases concerned long-term HUF-denominated government securities, while non-residents' short-term HUF-denominated government securities holdings remained practically unchanged. In Q2, non-residents' FX bond holdings declined further by some EUR 100 million, which was partly financed from the increase in households' government securities holdings.

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

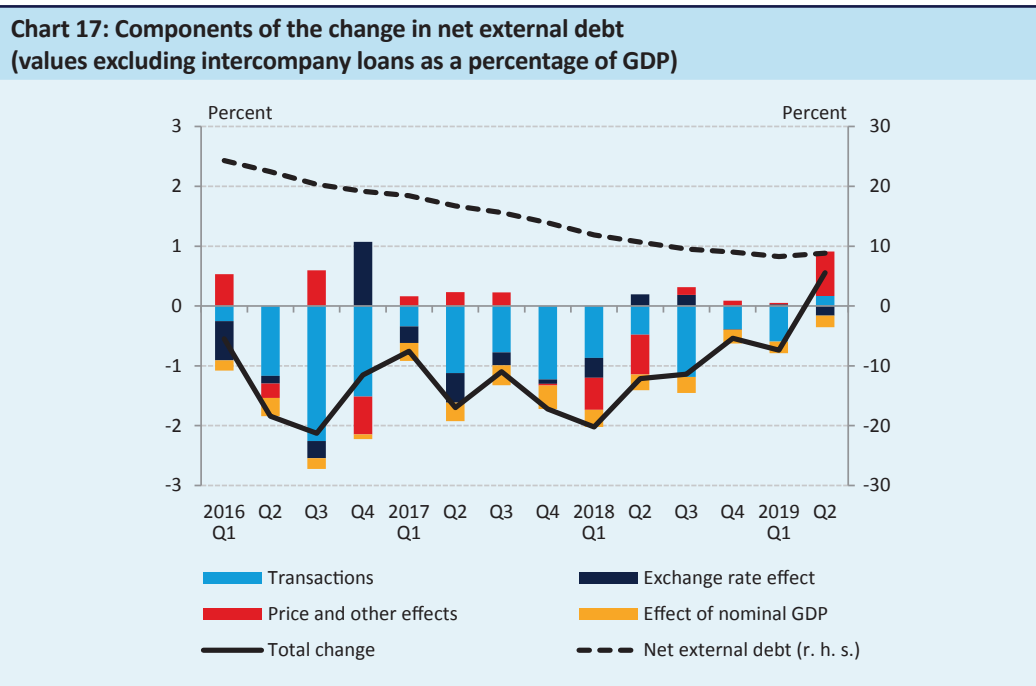


3 Developments in debt ratios

Gross external debt continued to fall in 2019 Q2, while net external debt edged slightly higher. Gross external debt sank to 56.2 percent of GDP by the end of the quarter, whereas the net indicator stood at 8.8 percent of GDP. The rise in net external debt was mainly the result of the revaluation of stocks, stemming from a decrease in yields. In addition, debt inflows resulting from transactions also raised the indicator to some extent. The effect of these factors was partly offset by the expansion in nominal GDP and strengthening of the forint against the US dollar, which worked towards a decline in the debt ratio. The rise in net external debt was related to the general government and was attributable to the revaluation of the stock, in addition to non-residents' government securities purchases and the decline in foreign exchange reserves. The net external debt of the banking sector fell in parallel with lower external liabilities. In contrast to the net indicator, gross external debt continued to decline, also supported by a decrease in the banking sector's external liabilities and in the corporate sector's commercial loans. Short-term external debt dropped EUR 1.6 billion to EUR 17.8 billion, which was mainly attributable to a decrease in short-term external debt based on original maturity. The level of foreign exchange reserves continues to significantly exceed the level expected and considered safe by investors.

3.1 Developments in net and gross external debt

The net external debt of the economy rose by 0.5 percentage point in 2019 Q2, primarily as a result of revaluation effects. The indicator stood at 8.8 per cent of GDP at the end of the quarter. The rise in net external debt mainly resulted from the revaluation of the stock due to lower yields, which added 0.7 percentage point to the debt ratio. In addition, to a lesser degree (by 0.2 percentage point), the inflow of debt-generating liabilities also contributed to the higher net external debt. Nevertheless, the impact of the above factors was partly offset by strong growth in nominal GDP and appreciation of the forint against the US dollar, each of which cut the indicator by 0.2 percentage point (Chart 17).

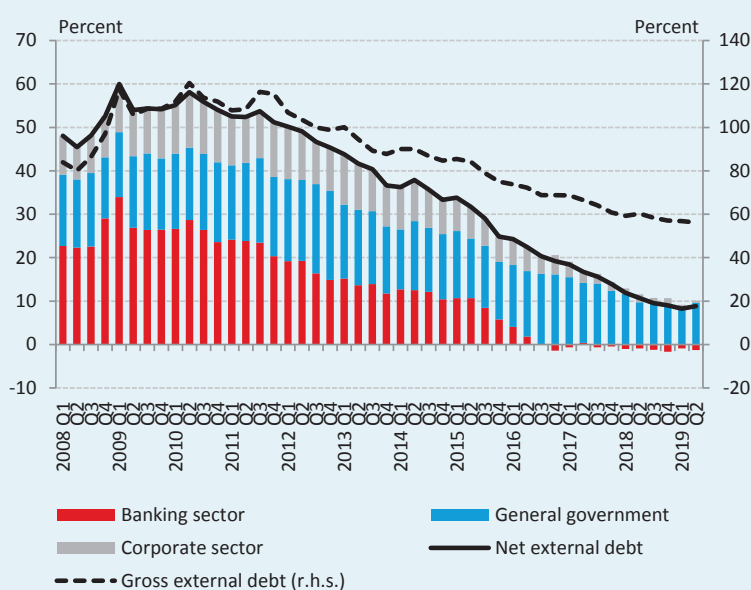


The rise in net external debt was related to the general government and was partly offset by the decline in the debt of the banking sector (Chart 18). The increase in the net external debt of the general government resulted from non-residents' net government securities purchases as well as the effect of the revaluation of debt, driven by the decline in yields observed in Q2. In addition, the increase in the debt of the general government was also attributable to the decline in FX reserves, which was mostly related to the decrease of nearly EUR 850 million in the forint liquidity swap instrument provided by the MNB to the banking sector. At the same time, this had a neutral effect on the net external debt of the economy as a whole, as in line with the decline in the swaps, the FX liquidity flowing out of the FX reserves went to the banking sector, which reduced the net external debt of banks. There was no major change in the net external debt of

companies in the quarter under review: the decline in the sector's gross external debt as a result of transactions was offset by the decrease in external assets due to revaluation effects. The net external debt of the private sector amounted to –0.8 percent of GDP at the end of Q2, i.e. the private sector's external assets continue to exceed its external liabilities.

Hungary's gross external debt-to-GDP ratio continued to decline during the quarter and amounted to 56.2 percent of GDP at the end of June. The improvement in the indicator was primarily related to the lower debt of the banking sector, which was partly allowed by the use of FX assets originating from the maturity of the forint liquidity providing swaps. The banking sector's debt reduction lowered the gross external debt-to-GDP ratio by 0.7 percentage point. Due to non-residents' government securities purchases and revaluation effects, the gross external debt-to-GDP ratio of the general government increased by 0.4 percentage point, which was smaller than the rise in the net indicator, also reflecting the effect of the decline in FX reserves. The decrease in corporate debt cut the gross debt ratio by 0.4 percentage point, which was attributable to the drop in the sector's commercial loans.

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

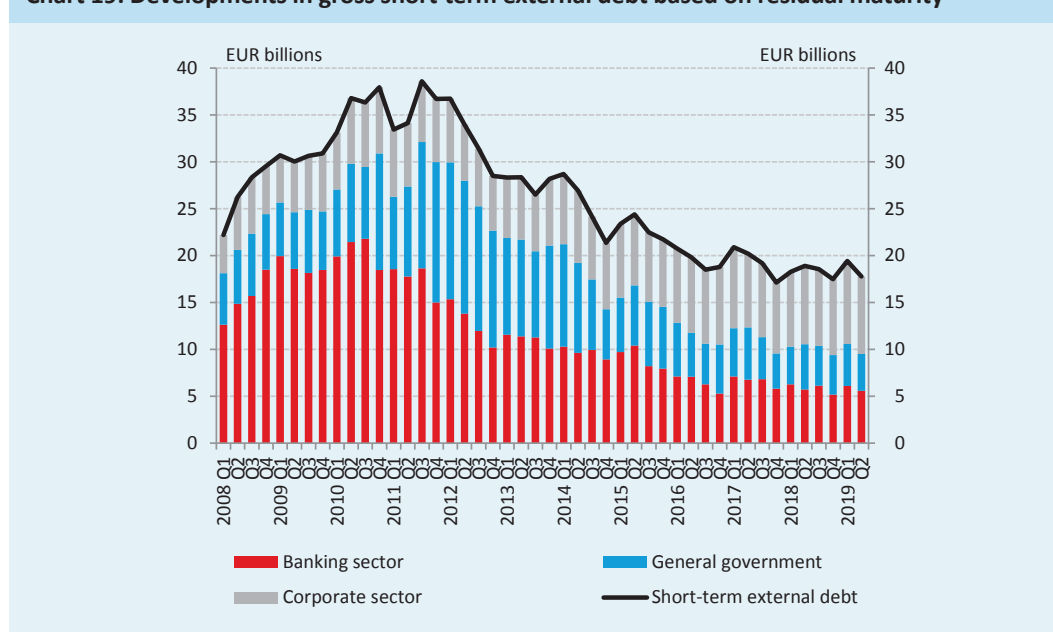


3.2 Developments in short-term external debt

At end-June 2019, following a decline of roughly EUR 1.6 billion, Hungary's short-term external debt amounted to EUR 17.8 billion (Chart 19). The decline in short-term external debt³ affected all three sectors, and its amount (EUR 0.5 billion) was similar in each sector. The banking sector's short-term external debt fell by EUR 0.5 billion, mainly owing to short-term external debt based on original maturity. The drop of EUR 0.5 billion in the short-term external debt of the general government is mainly related to the shortening of the maturity of debt: the portion of government securities maturing within a year held by non-residents declined due to bond maturities. Finally, corporations' short-term external debt also declined by nearly EUR 0.5 billion, which is mainly attributable to the fall in commercial loans outstanding.

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

Chart 19: Developments in gross short-term external debt based on residual maturity



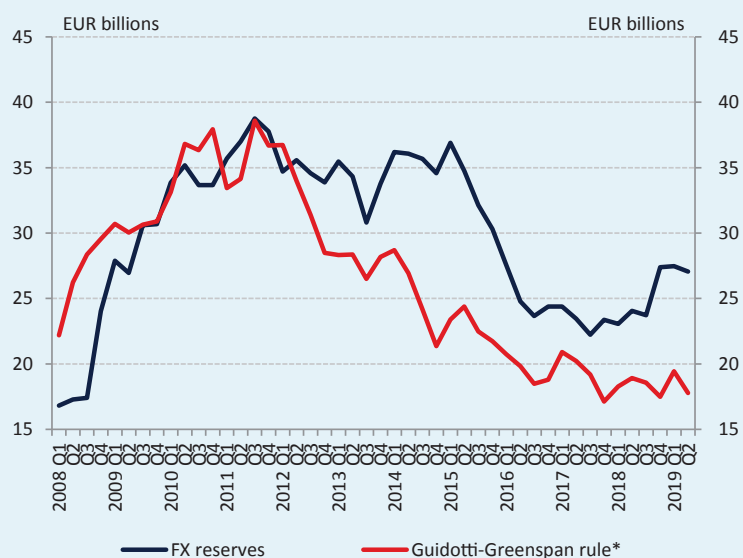
3.3 Developments in foreign exchange reserves and reserve adequacy

In 2019 Q2, the level of FX reserves declined slightly, which was primarily attributable to fiscal expenditures in foreign exchange and monetary policy operations. At end-June 2019, international reserves amounted to EUR 27.1 billion, representing a decline of EUR 0.4 billion compared to end-March 2019. The following were the main items influencing the changes in FX reserves:

- *EU funds* received were the main contributors to the higher FX reserves. In Q2, transfers amounted to a total EUR 1.1 billion, and thus nearly EUR 1.9 billion was disbursed in H1.
- *Net foreign currency financing of the Government Debt Management Agency (ÁKK)* reduced the level of reserves by some EUR 190 million in total. In April 2019, a renminbi bond worth EUR 130 million with an original maturity of 3 years matured. In addition, FX bond repurchases and FX debt repayments contributed to the decline in the level of reserves.
- Starting from the beginning of April 2019, the MNB reduced its *forint liquidity providing FX swaps*, as a result of which the FX reserves declined by EUR 850 million by end-June.
- *FX expenditures of the Hungarian State Treasury (MÁK)* reduced the FX reserves by EUR 420 million.

Against the background of the slight decline in FX reserves and further decrease in short-term external debt, the level of FX reserves continued to considerably exceed the level expected by investors (Chart 20). Based on the Guidotti–Greenspan rule, which is closely followed by both the central bank and investors, the foreign exchange reserves of EUR 27.1 billion at end-June 2019 significantly exceeded the level of short-term external debt, which amounted to EUR 17.8 billion. In parallel with the small decline in FX reserves, short-term external debt fell by EUR 1.6 billion in Q2. Accordingly, based on the Guidotti–Greenspan rule, FX reserves at end-June 2019 exceeded the short-term external debt by roughly EUR 9.3 billion, which still represents a safe level.

Chart 20: Short-term external debt and FX reserves of the Hungarian economy



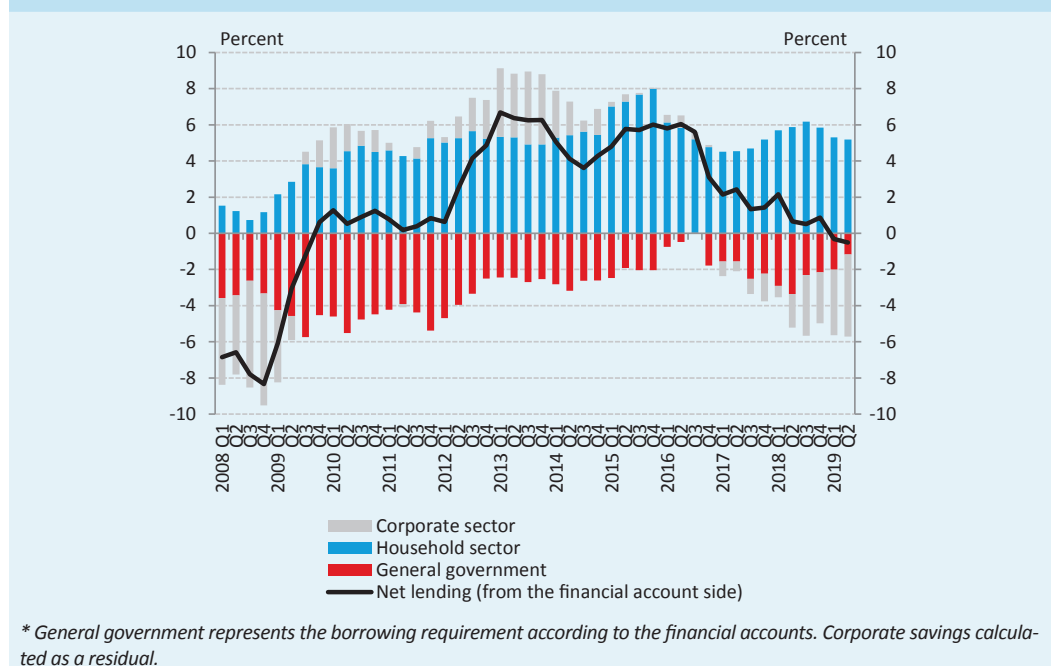
* Guidotti-Greenspan indicator: short-term external debt based on residual maturity.

4 Sectors' savings approach

According to the savings approach, in 2019 Q2 the decline in the net lending of the Hungarian economy was once again attributable to the decrease in the net position of the private sector, while the government's net borrowing continued to fall. The expansion in corporate net borrowing was the result of the high investment activity and strong wage outflows. Households' net financial savings increased, primarily due to stronger accumulation of financial assets, while loans rose slightly. In the quarter under review, households' government securities holdings expanded considerably. In addition, vulnerability risks were also mitigated by the fact that households preferred to purchase long-term securities, which can also be explained by the issuance of the new retail government security.

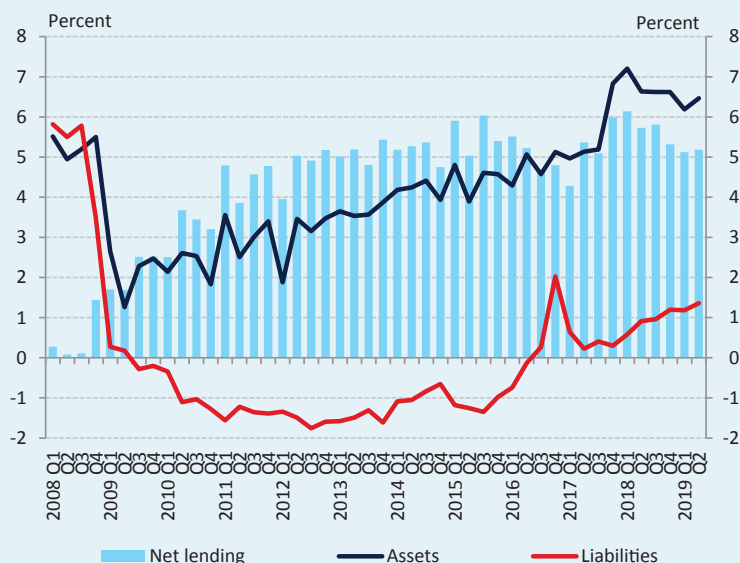
According to the savings of sectors, in 2019 Q2 the four-quarter net borrowing of the Hungarian economy increased further and exceeded 0.5 percent of GDP (Chart 21). This also means that – mainly due to the corporate sector's increasing investment activity – at an annual level the financial savings of households were unable to cover the net borrowing of the government and corporations. Declining significantly, four-quarter government net borrowing amounted to 1.2 percent of GDP. The sharp decline in the budget deficit mainly stemmed from the dynamic growth in revenues from taxes on consumption and labour. The expansion in corporate net borrowing is still attributable to the increase in investment and the rise in wage outflows. Households' four-quarter net saving position was stable at above 5 percent of GDP, which is explained by the relatively high gross savings. The still high level of accumulation of financial assets is in line with the strong wage dynamics, while households' borrowing increased to some extent compared to the previous quarter.

Chart 21: Net lending of sectors* (four-quarter values as a percentage of GDP)



Showing a slight increase, households' net financial savings according to seasonally adjusted underlying developments were above 5 percent of GDP in Q2 (Chart 22). Following a small increase compared to the previous quarter, households' seasonally adjusted net borrowing was around 1.4 percent of GDP in Q2, which was attributable to a larger degree to an expansion in housing loans and to a lesser degree to the growth in consumer loans. Households' gross accumulation of financial assets according to the underlying trends amounted to 6.5 percent of GDP in Q2, with the rise in government securities as the main contributor.

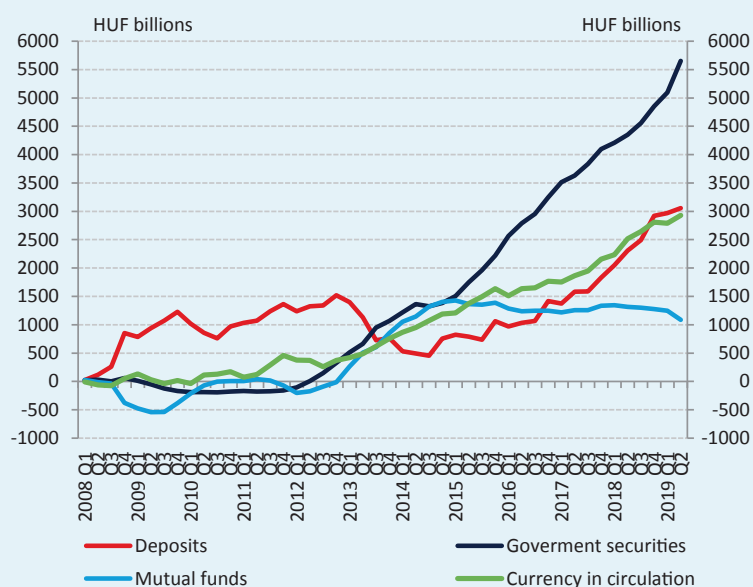
Chart 22: Net lending of households
(seasonally adjusted revised* values, as a percentage of GDP)



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

In Q2, government securities holdings grew to the largest degree. Additionally, households' gross financial asset accumulation was characterised by an expansion in liquid investment instruments (Chart 23). Household demand for government securities continued to grow dynamically in the quarter under review, and total holdings exceeded HUF 6,800 billion at the end of the quarter. The household sector's short-term retail government securities holdings declined, while the growth in holdings of long-term securities reached a historical high, which can be explained by the issuance of the Hungarian Government Bond Plus. Accordingly, retail government securities continue to play an important role in financing the state from domestic sources. In Q2, the sector's cash holdings increased in parallel with an expansion in overnight deposits. As in the previous quarters, the holdings of mutual fund shares, which are less liquid, declined further, which was primarily attributable to the withdrawal of funds – presumably in order to have resources to purchase the new government security – from the bond mutual funds that hold government securities and from other investment funds.

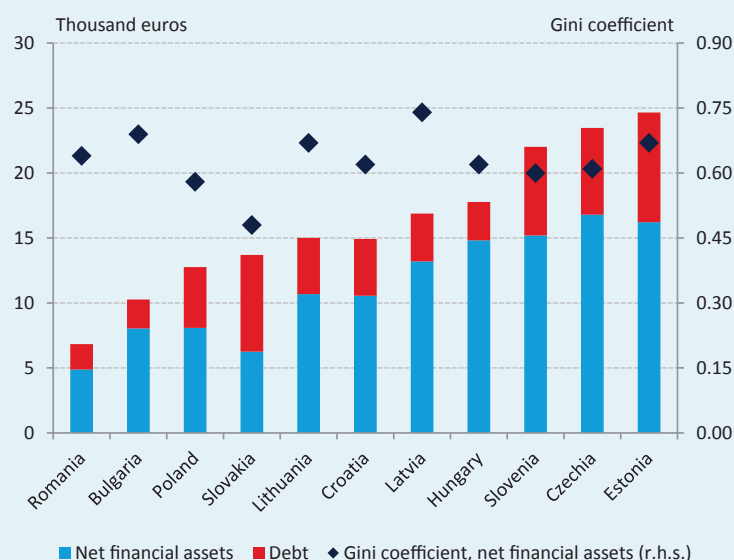
Chart 23: Developments in households' key financial assets (cumulative transactions)



Box 3: Hungarian households' financial wealth in European comparison

Hungary was one of the best countries in the region in terms of per capita financial wealth. The recently published Allianz Global Wealth Report 2019 provided a detailed analysis of the developments in financial savings of the countries of the world.⁴ According to this study, the increase in Hungarian households' savings in the past quarter was reflected in the accumulation of financial wealth, while indebtedness also declined markedly as a result of the adjustment following the crisis. Due to these two developments, the per capita net financial wealth of Hungarian households is one of the highest in the region. Per capita net financial wealth was close to or exceeded EUR 15,000 in Hungary, Slovenia, the Czech Republic and Estonia, while it does not even reach EUR 5,000 in Romania, which is the poorest. Per capita gross financial wealth was the highest in Estonia, but the indicator was above EUR 20,000 in the case of both Slovenian and Czech households. On average, Hungarian households had financial assets worth nearly EUR 18,000, which significantly exceeded most of the regional figures. Hungarian households' debt is estimated to correspond to 16 percent of the gross financial wealth, which is well below Slovakia's 54 percent and is even less than the 30 percent average of the countries of the region.

Disparity is greater in the Baltic and Balkan states; in this respect Hungary is in the middle of the field. The Gini coefficient shows how even the distribution of the financial wealth across the various strata of households is. A lower indicator means that the distribution of wealth is more even, i.e. large differences between the households with high financial wealth and ones with low financial wealth are less typical. According to the Gini coefficient, disparity is the highest in Latvia, but the indicators for Estonia, Lithuania and Bulgaria are also considered high. The indicator is around 60 percent in the majority of the Visegrád countries, more or less corresponding to the average of the countries under review. Of the countries of the region, the distribution of financial wealth across the various households is the most even in Slovakia.

Chart 24: Financial wealth and debt in the countries of the region (2018)

Source: Allianz Global Wealth Report 2019.

⁴ https://www.allianz.com/content/dam/onemarketing/azcom/Allianz_com/economic-research/publications/specials/en/2019/AGWR_2019.pdf

5 Income of companies in foreign ownership

The special topic of the Report on the Balance of Payments deals with changes in earnings realised by foreign-owned companies in 2018. Based on the actual data, the profits of foreign-owned companies as a percentage of GDP fell slightly in 2018. In conjunction with this decreasing profit, the amount of the dividends paid to the owners remained constant, and thus the decline in earnings was primarily reflected by the fall in reinvestments. Despite the decline, the degree of reinvested earnings is still high: foreign companies continued to invest almost 70 percent of their earned income in Hungary. In a breakdown by sectors, while the profit ratio of banks rose moderately in line with the expanding lending activity and the improving macroeconomic environment, the profit ratio of non-financial corporations declined. In previous years, the dividend as a ratio of banks' profit fell short of that of corporations, but this trend changed in 2018: accordingly, it was the corporations that reinvested a larger part of their profits in Hungary. As regards the industries, in 2018 the return on equity of foreign-owned companies declined in all major industries. In 2018, the after-tax profit of corporations was of similar degree as the income according to the 'current operating performance concept' shown in the balance of payments. The income balance deficit was increased by the fact that the profit of companies owned by residents and operating abroad decreased following the growth observed in previous years. In 2018, the profitability of non-resident companies moderately decreased in the countries of the region as well – similarly to Hungary – and thus the level observed in Hungary still outstrips the average of the neighbouring countries. As regards the dividend payment ratio, dividend payment is the lowest in Hungary among the countries of the region, which also means that the reinvestment ratio is the highest in Hungary. The moderate decline in the profit of foreign-owned companies operating in Hungary was also reflected in the modest narrowing of the GNI-GDP gap: on the whole, the Hungarian GNI-GDP gap is in line with the regional average.

5.1 Introduction

In the September balance of payments data release, the previous, estimate-based data on corporate incomes in 2018 are replaced by actual data based on the incoming annual data reporting. In the balance of payments, following the reporting year until the Q2 data publication, the income of the corporate sector is based on estimates, which are replaced in the September data reporting by actual data based on the questionnaires regarding corporate and bank incomes.⁵ Accordingly, data concerning the profitability of the corporate sector is first available in the September data reporting. Based on the statistics, the balance of profits in the income account slightly exceeded the preliminary estimate, which was mostly attributable to the fact that the income of foreign companies owned by residents decreased to a larger degree – the impact of this was mitigated by the fact that the profitability of foreign-owned companies slightly fell short of the expectations. The balance of payments statistics contains corporate income related to current operating performance, excluding non-recurring items, i.e. one-off profit/loss items. According to the methodology of the balance of payments,⁶ the profit/loss realised outside the current operating performance – for example, on exchange rate revaluation – is not considered as part of the incomes and thus it is stated among changes in stock and in the financial account. In this section, we first review the incomes of foreign-owned non-financial corporations and banks, and then examine the background of the changes in profits in 2018. Thereafter, we present the profit/loss realised by companies according to the current operating performance concept – shown in the balance of payments – as well as their after-tax profit/loss (Section 5.5). Finally, we analyse the changes in the profits of foreign-owned companies and the GNI-GDP gap also in a regional comparison.

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

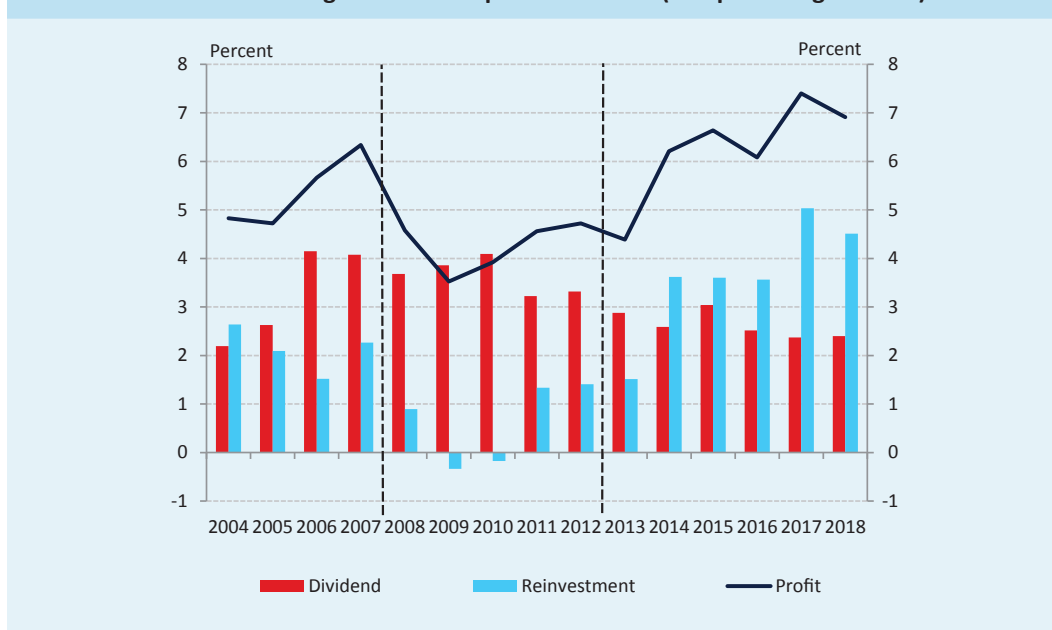
In 2018, the balance of the income of foreign-owned companies declined close to 7 percent of GDP, which may still be deemed historically high. In conjunction with decreasing profit, the amount of the dividends paid to the owners remained constant, and thus the decline in earnings was primarily reflected in the lower reinvestments: despite the drop, the degree of reinvestments is still high. In the post-crisis years, foreign companies' profit as a proportion of GDP fell below 4 percent from the previously typical 5-6 percent, which may have been attributable to a substantial degree to the deceleration in domestic and external demand. Despite the declining profits, dividend payments of foreign companies

⁵ For more details, see Hungary's Balance of Payments and International Investment Position Statistics, MNB (2014)

⁶ Balance of Payment Manual, 6th edition

remained close to 4 percent of GDP, and thus almost the entire earned income was paid out as dividends.⁷ This may have been attributable to the sharp deterioration in growth prospects after the crisis and to the liquidity needs of the parent companies. Since 2014, in line with faster economic growth, the value of foreign companies' earned income also rose. However, the higher income was still accompanied by moderate dividend payments, which substantially increased the value of reinvestments. In addition to EU funds, the high level of reinvestments may have also played a major role in the dynamic expansion in corporate investments in recent years. External demand, which also facilitated the dynamic expansion in exports, may have also supported the increase in foreign-owned companies' profitability. In 2018, the income of foreign-owned companies fell moderately, but it still amounts to almost 7 percent of GDP, roughly 70 percent of which the companies continued to invest in Hungary.⁸ A substantial part of foreign companies' profit/loss (over 95 percent) was generated by the non-financial corporations.

Chart 25: Utilisation of foreign-owned companies' income⁹ (as a percentage of GDP)



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

While the profitability ratio of banks rose moderately in line with the strengthening lending activity and the improving macroeconomic environment, the profitability ratio of non-financial corporations fell slightly. Before the crisis, the profit of corporations calculated as a percentage of FDI equity was around 10 percent, while that of banks was close to 13 percent. After the outbreak of the crisis, the profitability of non-financial corporations significantly declined, while that of banks decreased to a larger degree only in 2012, which caused the profitability ratio of banks to fall below the corporate profit ratio. In 2018, foreign banks' profitability according to the current operating performance concept was close to 9 percent, after a moderate rise. The favourable ratio recorded in the past two years is attributable to banks' balance sheet cleaning and to the upswing in lending in line with the economic cycle. In 2009, the profits of non-financial corporations fell considerably, followed by a gradual rise from 2013, finally exceeding the pre-crisis level, increasing to nearly 12 percent. In 2018, the ratio fell slightly, which may have been partly attributable to the robust increase in wages (Chart 26).

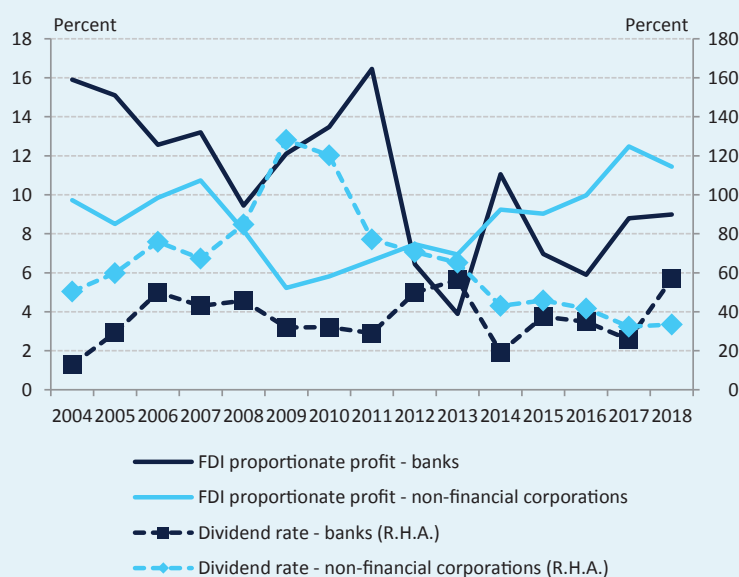
⁷ It should be also noted that companies usually vote on and pay dividends from their previous year's profit, and thus in fact the dividend payments of the given year should be compared to the previous year's profit. However, since the stocks included in the balance of payments data are influenced by the transactions of the year in question, we show the profit of that year together with the dividend payments for the same year.

⁸ Since reinvested earnings are the difference between the profit earned and 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).

⁹ 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 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 foreign profit, and have been recognised as capital withdrawal rather than as dividend payment, and thus it influences the distribution of corporate profit between dividend payment and reinvestment.

The dividend ratio of non-financial corporations is still historically low; however, dividend payments by banks rose to a high level, i.e. to nearly 60 percent. In the previous years, the dividend ratio of banks fell short of that of corporations, but this trend turned around in 2018: it was the corporations that invested a larger part of their profits in Hungary. The higher dividend ratio of banks may be due to the fact that the capital injections for the losses suffered during the crisis were no longer necessary, and thus it was possible to pay a higher ratio of the profit as dividend. The dividend ratio of non-financial corporations has been gradually declining since the crisis: in 2018 it stabilised at nearly the level recorded in 2017, i.e. around 35 percent. The underlying factors of the high reinvestment ratio may include the favourable growth prospects and the anticipated further rise in incomes: with a view to realising higher future profit, foreign owners invest a larger portion of their earned income in Hungary.

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

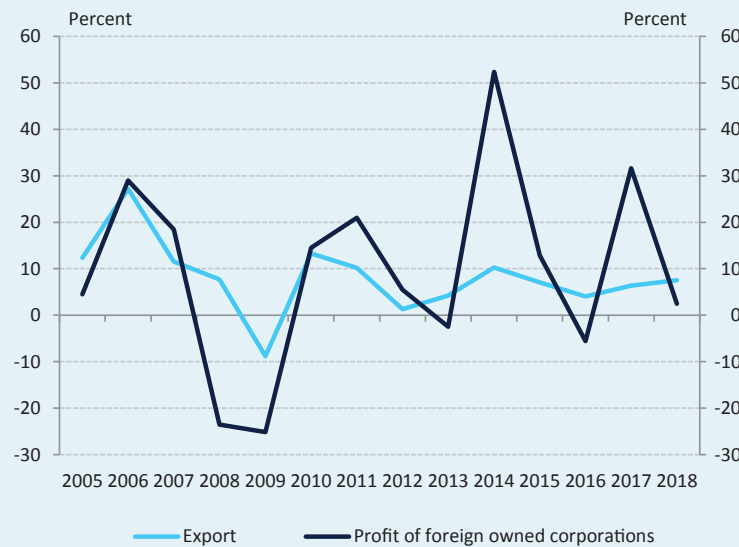


Note: The profit ratio is a value calculated from the year-end stock.

5.4 Factors underlying developments in corporate profits

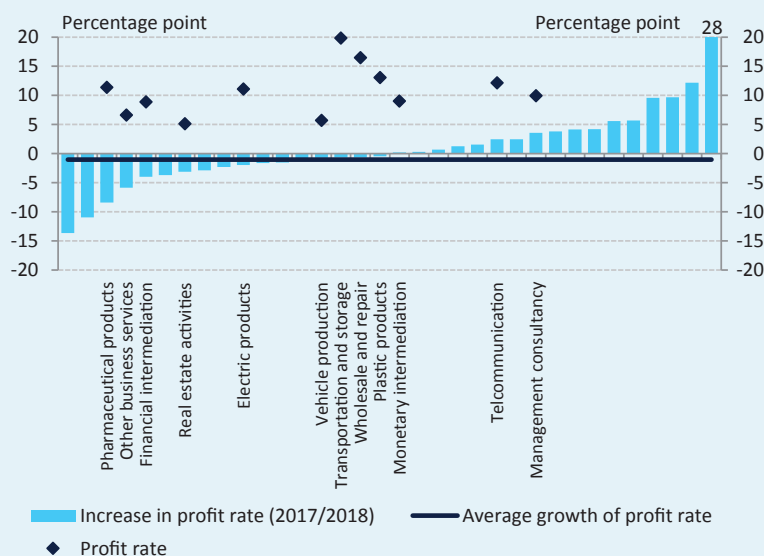
The rise in corporate profits, which lags significantly behind the level recorded last year, was realised in conjunction with slightly higher growth in exports – in 2018 the two growth rates were roughly identical. Since a large part of foreign-owned companies are active in exports, it is justified to compare the profit of foreign-owned companies with export performance. While formerly co-movement was very tight, after 2013 export growth has only tended to be an indicator for the direction of corporate profitability: the decoupling was mostly attributable to idiosyncratic factors (Chart 27). In 2018, this correlation weakened further: export growth accelerated moderately, while the growth in the profitability of corporations lagged behind that of last year. The smaller degree of increase in corporations' income – and thus the opposite process – may have been also attributable to the fact that in 2017 corporations realised exceptionally high income due to the restructuring of a few multinational companies. On the whole, although the growth rate of the two indicators still differs, the degree of the difference was already smaller in 2018.

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



In 2018, return on equity declined in some of the key sectors, of which pharmaceutical production and real estate transactions – which showed improving profitability in the previous year – are worth highlighting, while the profitability of other business services and financial intermediation also declined substantially. Following the average rise of almost 4 percentage points registered in the previous year, foreign-owned companies' profitability as a proportion of FDI equity declined on average by 1 percentage point between 2017 and 2018. Although the ratio of loss-making and profitable sectors was roughly half-and-half (Chart 28), in most of the sectors with major foreign investment exceeding EUR 2 billion, corporate profit declined (moreover, there were two larger sectors where the decline exceeded 5 percentage points). Thus, on the whole, the average profit ratio of foreign companies operating in Hungary fell close to 11 percent in 2018, which, however, still exceeds the level that characterised the previous years. It is also worth noting that the profit ratio of vehicle manufacturing, the sector with the highest foreign investment, also declined moderately, the level of which thus became one of the lowest among the sectors with major foreign investment.

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

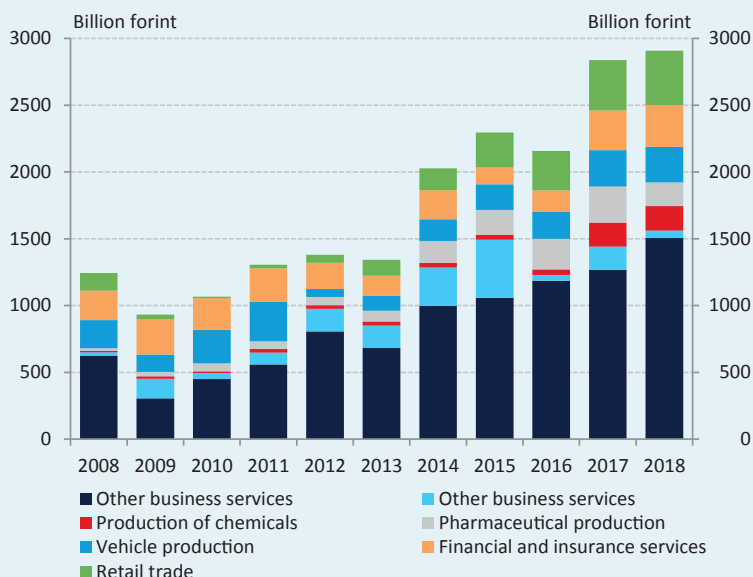


Note: The sectors with FDI stock over EUR 2 billion were specified by name.

Profits on foreign direct investment are relatively concentrated: almost half of the profit was generated by six sectors.

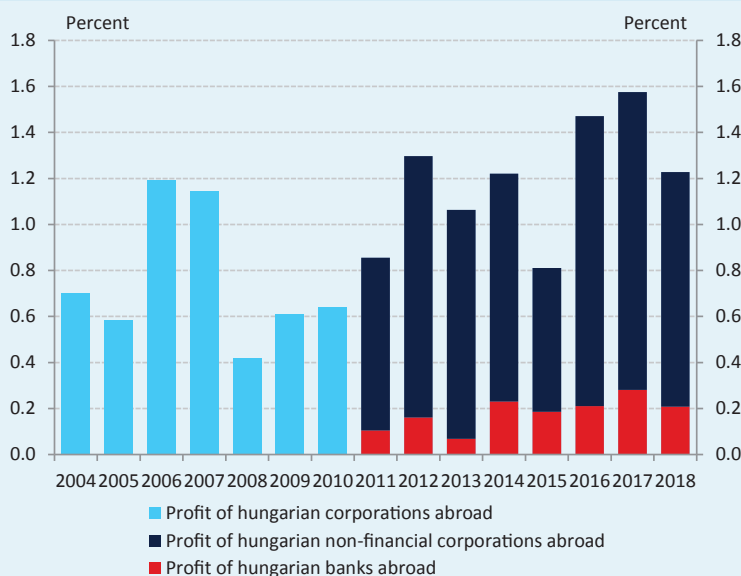
In 2017, the rise in corporate profits affected a wide range of sectors, where the six largest industries showed outstanding profitability. By contrast, in 2018 the income of sectors with smaller capital invested rose to a larger degree, while – due to the deteriorating profitability of pharmaceutical production and other business services – the share of the six largest sectors within total profits declined. Nevertheless, the income of large sectors still accounts for almost half of the total profit of foreign companies operating in Hungary, which can be regarded as relatively high concentration.

Chart 29: Profit of foreign-owned companies



The net value of the income balance is also influenced by the profit of the foreign subsidiaries of resident companies, the decline in which pointed to a rise in the deficit in 2018. In addition to the income of foreign companies operating in Hungary, the profits of companies operating abroad and owned by residents must also be taken into account in the income balance of the balance of payments.¹⁰ The value of this as a percentage of GDP declined significantly in 2018, falling by almost 0.4 percent of GDP from the relatively high level recorded in 2017. The decline in income was connected to both banks and non-financial corporations operating abroad.

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

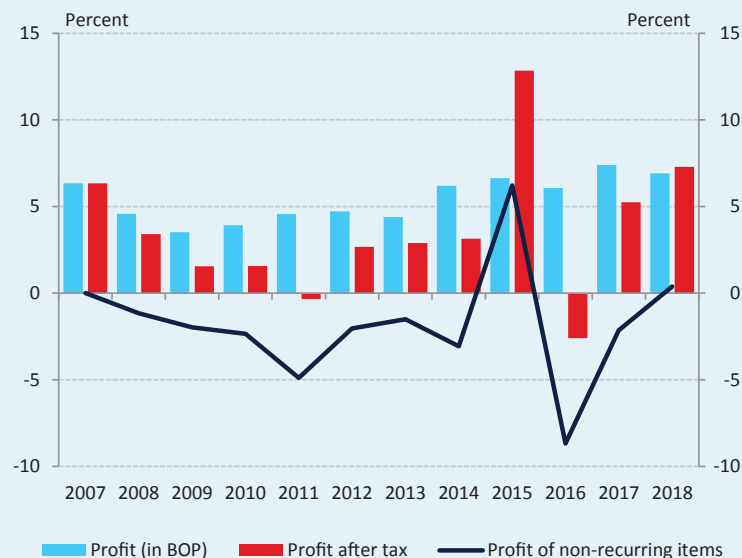


¹⁰ Based on analytical considerations, in the income account we present the primary incomes, except for other primary incomes, which in the previous statistics formed part of current transfers, and thus we state them in the transfer balance.

5.5 After-tax profit of foreign-owned corporations

In 2018, the after-tax profit of corporations was of similar degree as the income according to the 'current operating performance concept' shown in the balance of payments. At the same time, this also means that, compared to 2017 and in contrast to the income as a proportion of GDP stated in the balance of payments, the after-tax profit continued to rise, due to the elimination of one-off items that generated a loss on the whole in 2017 (Chart 31). In line with international standards, statistics include foreign-owned companies' profits according to the current operating performance concept, i.e. the one-off, typically revaluation-related items are excluded,¹¹ and thus the profit – according to the current operating performance concept – shown in the balance of payments is much more stable. Since the crisis, items outside current operating performance have typically reduced corporate profits, and thus the exclusion of these items resulted in higher income (and thus higher reinvested earnings) and a higher deficit of the income account in the balance of payments statistics. The 2015 and 2016 outliers of one multinational company operating in Hungary strongly influenced the after-tax profit/loss figures, while the income stated in the balance of payments, eliminating one-off items, was stable. In 2017, the difference between the two indicators returned to the value observed after the crisis resulting from the (one-off) losses (linked to the exchange rate developments), i.e. around 2 percent of GDP. Thereafter in 2018 there were no such one-off, high-value items outside current operating performance that significantly influenced income, and thus the after-tax profit and the balance of payments profit based on current operating performance reached similar levels. However, the dynamics of the two indicators developed differently: while income as a proportion of GDP, stated in the balance of payments, decreased slightly, the after-tax profit on foreign capital investments rose considerably in 2018 as well, and it already exceeds the pre-crisis level.

Chart 31: Profit* from the 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 income balance of the balance of payments.

5.6 International comparison

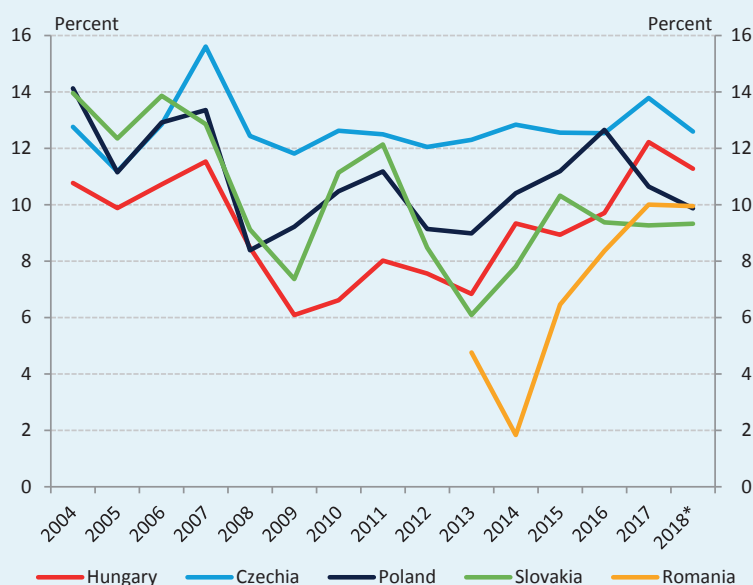
Following the growth recorded in previous years, the profitability observed in Hungary in 2018 decreased slightly, similarly to most of the countries in the region, but it still exceeds the average of the neighbouring countries. The return on foreign direct investments in the region should be analysed based on the profit compared to capital invested. Previously, this indicator showed substantial co-movement in the countries of the region, suggesting that international trends have a significant effect on profitability. Following the crisis – and after a minor adjustment between 2011 and 2013 – the ratio of

¹¹ Such one-off impacts at corporations are the losses from exchange rate revaluation and at credit institutions the early repayment at preferential exchange rate or the settlements related to household loans.

foreign companies' income compared to FDI equity declined in Hungary, as well as in Slovakia and Poland. However, since then the return on foreign direct investments rose in all countries of the region, due to which the Hungarian profit ratio – despite the moderate decline recorded in 2018 – already reached the pre-crisis values and exceeds the level registered by Slovakia and Poland. Based on preliminary data, in 2018 the rate of return continued to decline in Poland, which thus fell to the level of the Romanian and Slovakian indicators. The profit of foreign companies operating in the Czech Republic continued to substantially exceed the levels observed in other countries of the region.

Chart 32: Return on FDI equity investment

(value of the profit realised on the FDI stock relative to total FDI stock)

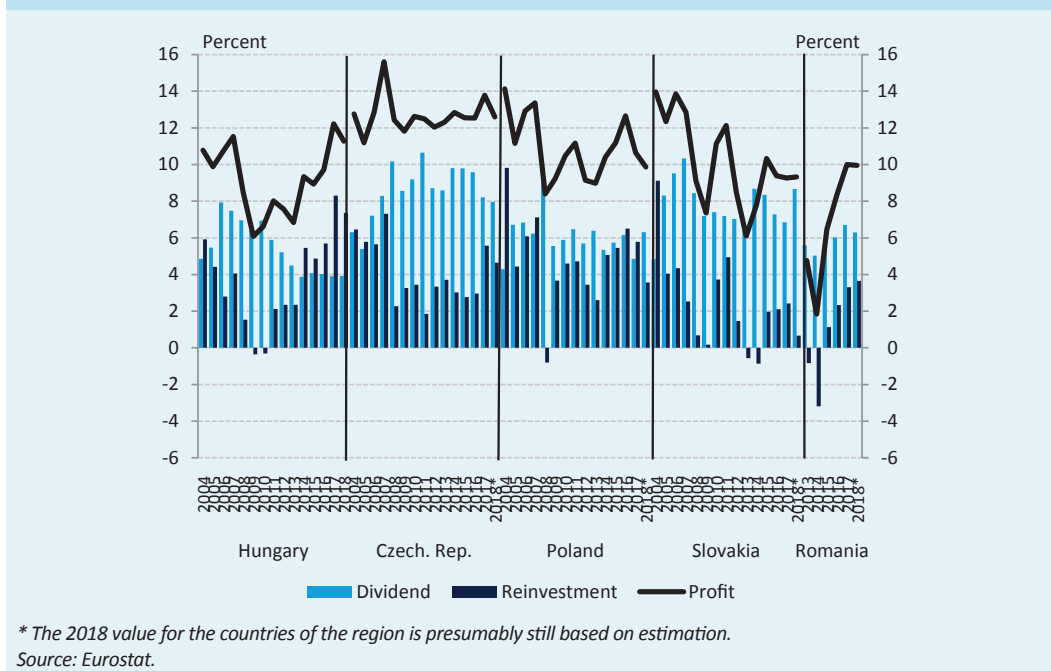


*The 2018 value for the countries of the region is presumably an estimate only.
Source: Eurostat.

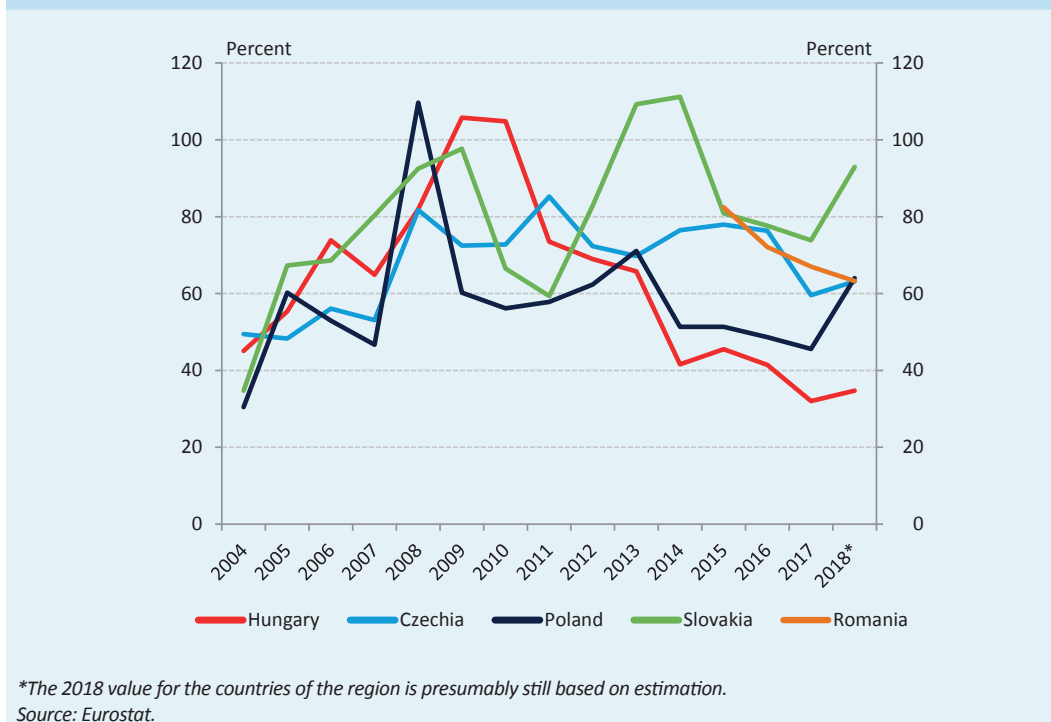
In Hungary, foreign-owned companies reinvest two-thirds of their profits, putting Hungarian companies at the forefront of the countries in the region (Chart 33). While the increase in profits was accompanied by higher dividend payments in the region, in Hungary over the past ten years or so dividend payments as a proportion of capital declined.¹² Based on preliminary data, the ratio of dividend payment rose in Poland and Slovakia, while it declined moderately in the Czech Republic and Romania. Since in most of the countries of the region corporations' return on equity declined or stagnated, reinvestments typically decreased. Although the reinvestments of foreign-owned companies operating in Hungary also fell, at a regional level reinvestments by foreign-owned companies in Hungary are still the highest, exceeding the degree of dividend payments,¹³ which is not typical of the other countries of the region.

¹² However, as of 2013 the accounting of superdividend disbursements in Hungary may have played a role in this.

¹³ The treatment of superdividends could also increase reinvested earnings as a percentage of profit, because through reducing the profit it raises the role of the reinvested earnings as a percentage of income, while it reduces that of dividends. Thus it may also contribute to the higher reinvestment, as a percentage of profits, by foreign-owned companies operating in Hungary; as regards other countries of the region no information is available whether they take into consideration the IMF recommendations related to the application of superdividends.

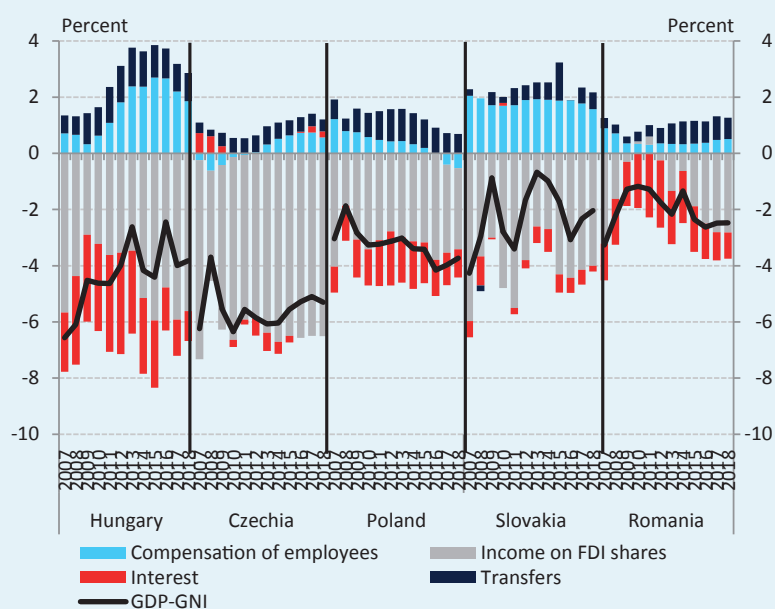
Chart 33: Breakdown of FDI earnings in the countries of the region (as a percentage of FDI equity)

Dividend disbursement as a proportion of income is still the lowest in Hungary within the region, which is reflected in the high value of reinvestments (Chart 34). Foreign companies' dividend payments as a proportion of income increased prior to and in the first couple of years of the crisis, peaking in 2009-2010. Due to the increasing liquidity needs of foreign parent companies resulting from the crisis and to the deterioration in the region's growth prospects, for a short time companies also paid dividends to their foreign owners from the reinvested earnings accumulated from the profit of previous years not only in Hungary, but in Poland and Slovakia as well. From the middle of the decade, the dividend payment ratio declined in each country of the region, with the largest decrease registered in Hungary. In 2018, foreign companies paid a mere 35 percent of their income earned in Hungary as dividends. It also means that reinvestment by foreign-owned companies is the highest in Hungary.

Chart 34: Ratio of dividend payments to profit

Following a moderate decline, the Hungarian GDP-GNI gap was near the regional average in 2018 (Chart 35). The difference between the gross domestic product (GDP) and the gross national income (GNI), i.e. the GDP-GNI gap develops as a result of the aggregation of the payments of income to the non-resident sector. The factors of the indicator include interest payments related to the non-resident sector, the net profit of foreign companies, compensation of employees abroad and foreign transfers.¹⁴ In the region, foreign direct investments tend to considerably exceed residents' investments abroad; therefore, the value of the GNI is also lower than the value of the gross domestic product. The offsetting items include the net income of employees working abroad and the EU transfers, which typically reduce the GDP-GNI gap in the countries of the region. Following the crisis, owing to the improving profitability of corporations, the outflow of profits related to shareholdings considerably rose in the countries of the region, which was partially offset in most countries, including Hungary, by the increasing compensation of employees working abroad and the inflow of transfers. In addition, the continuously decreasing interest expenses also contributed strongly to the reduction of the GDP-GNI gap. In 2018, the income of foreign companies fell in Poland and Slovakia, similarly to Hungary, accompanied by decreasing interest expenses. Despite the declining compensation of employees working abroad (which was even negative in Poland), this resulted in moderately declining GDP-GNI gaps in these countries. In the Czech Republic, the GDP-GNI gap widened slightly due to the lower compensation of employees, while in Romania no material change was registered in the indicator.

Chart 35: Decomposition of the difference between GNI and GDP (as a percentage of GDP)



**The 2018 value for the countries of the region is presumably still based on estimation.
Source: Eurostat.*

¹⁴ Meaning the transfers recognised under primary incomes.

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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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