REPORT ON THE BALANCE OF PAYMENTS

2021
OCTOBER

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

Letters 27
Gábor Bethlen

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

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

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

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

The Report is based on information pertaining to the period ending 20 September 2021.

Summary

The **external balance indicators of** the Hungarian economy **improved** in 2021 Q2. The **current account deficit was moderate,** while the **net lending of the economy rose** to 1.1 percent of GDP. The c**ountries of the region are also characterised by net lending,** which even exceeds the Hungarian figure in the Czech Republic and Poland, while net borrowing remained high only in Romania.

Hungary's **external balance strengthened** by mid-2021, **as the economy emerged from the negative economic impacts of the pandemic and implemented reopening.** This trend, attributable to **the expansion of the trade balance** supported primarily by the increasing services balance as well, was also reflected in **the exceptionally strong growth contribution of net exports,** which was curbed by the effect of the deteriorating terms of trade resulting from higher oil prices. **The decline in the compensation of employees working abroad and the lower absorption of EU transfers in the second quarter versus the previous quarter slightly curbed** the rise in the external balance indicators.

As a result of the data revision carried out simultaneously with the quarterly data release, the **current account deficit-to-GDP ratio increased by 1.5 percentage point in 2020** compared to the previous release. The higher income of **foreign-owned companies operating in Hungary compared to previous estimates** caused a lower balance, the impact of which was further amplified by the HCSO **reducing last year's trade surplus** in its annual GDP revision. In parallel with the upward revision in foreign companies' income, reinvested earnings in Hungary also increased, and consequently **the volume of net FDI inflow exceeded EUR 2 billion last year.**

According to the **financial account,** due to the usual dividend payments in Q2 and continued Hungarian portfolio equity investments abroad, net **non-debt funds decreased** during the reference quarter, in conjunction with an **inflow of debt liabilities.** The inflow of debt liabilities was **partly linked to banks' rising liabilities** and **partly to the consolidated general government;** the latter was dominated by the decline in foreign exchange reserves, as use of the central bank's euro liquidity providing swaps exceeded the volume registered in March.

Net external debt amounted to 8.9 percent of GDP at the end of Q2, with most of the rise linked to the **banking sector, along with a contribution by the increasing ratio of the general government,** while the strong growth in nominal GDP curbed the rise in this indicator as a percentage of GDP. Compared to the end of the year, the central bank's euro liquidity providing swaps did not change the level of net external debt, but resulted in a shift in the debt ratio between the banking sector and the government. At the end of June 2021, **gross external debt** fell to **58 percent of GDP,** reflecting the decline in non-residents' forint government securities holding, the fall in outstanding debt resulting from revaluation and growth in GDP. **International reserves continued to significantly exceed the level expected** and deemed safe by investors, by almost EUR 9 billion.

Examining the balance positions according the sectors' savings approach, following the significant rise observed in previous quarters, the **net borrowing of the general government declined.** The lower budget deficit is attributable to the **increasing tax revenues** resulting from economic reopening and the **absence of the high pandemic related expenses** incurred last year. In parallel with this (presumably also due to reopening), the **private sector's net financial savings decreased moderately.** However, within this, the rise in **households' government securities holdings remained strong,** which represents a **positive** trend **in terms of external vulnerability.**

As a special topic, we analysed the income of foreign-owned corporations operating in Hungary. According to incoming data, **foreign-owned companies' profits as a proportion of GDP continued to fall** in 2020. However, despite the negative impacts of the pandemic, the rate of the decline was **substantially smaller than that observed during the 2008 crisis.** As the volume of dividends paid to owners as a percentage of GDP did not change compared to previous year, the fall in revenues was reflected in **lower reinvested earnings.** The amount of such earnings **remains high:** foreign-owned companies continued to reinvest more than half of their income in Hungary, which is **significant in a regional comparison as well.** The **fall in the profit of foreign-owned companies affected a wide range of the sectors:** it was particularly tangible in sectors connected to tourism, while the profit ratio of vehicle manufacturing, with the highest share of foreign direct investment, increased somewhat in 2020, despite the spring lockdowns and supply constraints.

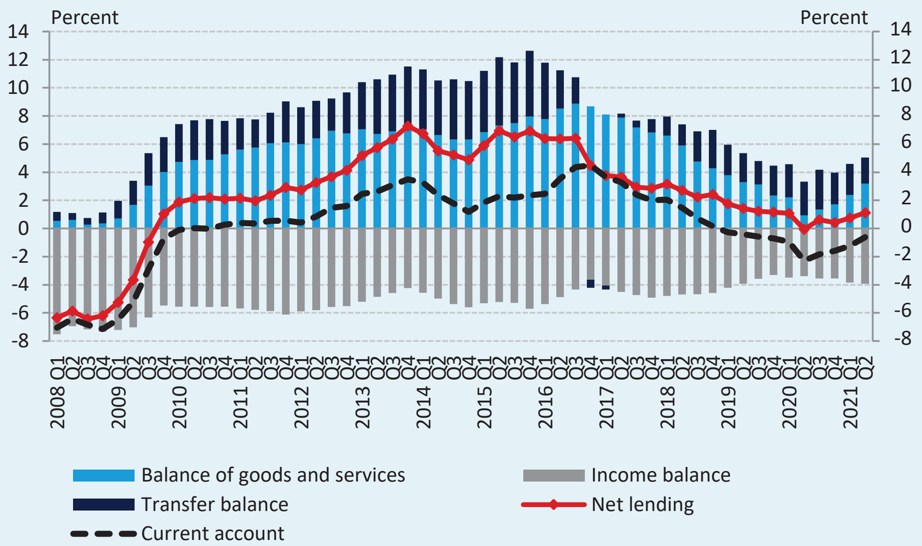
Content

1 Real economy approach

According to the real economy approach, Hungary's four-quarter net lending amounted to 1.1 percent of GDP in 2021 Q2, while the current account showed a small deficit. The improvement in external balance indicators was mainly attributable to a rise in the trade surplus, linked to the services balance, while the moderate increase in the deficit of the income balance had an opposite effect. The improved trade balance was also supported by net exports' much higher contribution to economic growth than observed in previous quarters, while the change in the terms of trade partially offset the favourable impact of the volume changes. In some of the countries in the region the rise in net lending halted in early 2021, while the size of the external balance indicators of the Hungarian economy corresponds to the average of the countries in the region.

According to the real economy approach, in 2021 Q2 Hungary's four-quarter net lending amounted to 1.1 percent of GDP, while the earlier current account deficit of over 1 percent fell to 0.6 percent of GDP (Chart 1). According to unadjusted quarterly data, net borrowing amounted to around EUR 320 million in Q2, as a result of a current account deficit of EUR 775 million, which was partially offset by a capital account surplus of more than EUR 450 million. The rise in four-quarter net lending was mainly driven by the higher trade balance, while the decrease in the surplus on income balance deficit had an opposite effect..

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

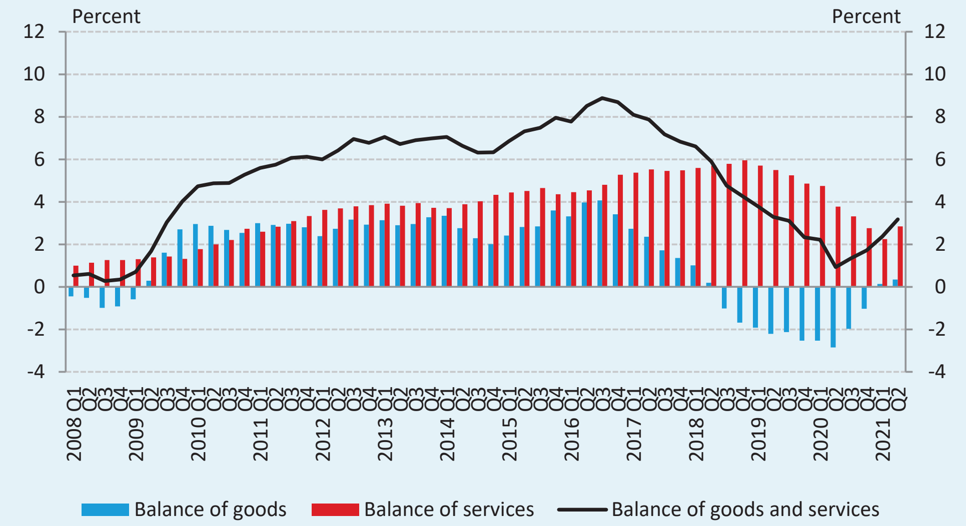


** Income balance: earned income, income on equity and income on debt. Transfer balance: sum of the capital account and other primary and secondary income.*
Unless otherwise indicated, the source of the charts is the MNB.

1.1 Trade balance

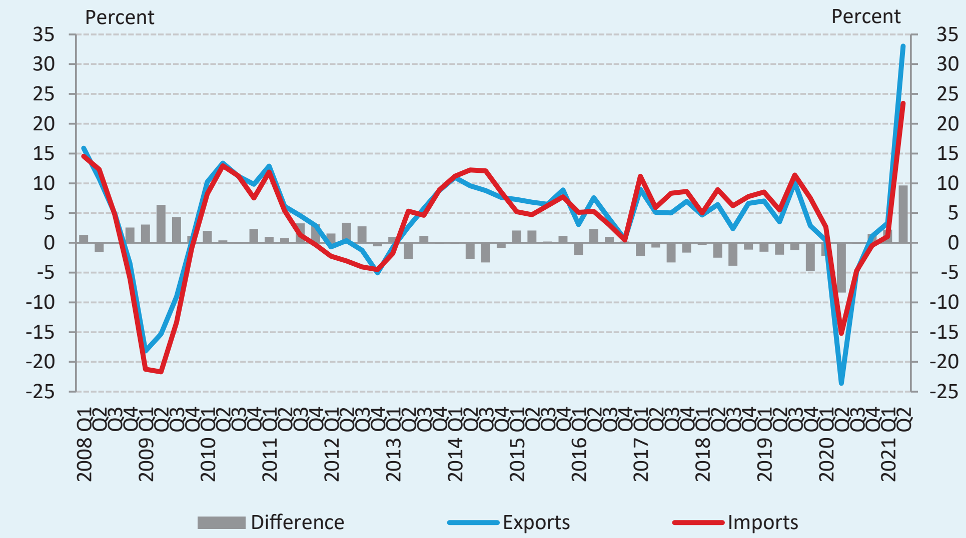
The four-quarter trade surplus continued to rise in 2021 Q2. This was primarily due to the increase in the services balance, linked to the reopening of the economy, supported by the modest rise in the goods balance (Chart 2). The trend decline in the trade balance lasting for almost four years – attributable to the change in the dynamics of the goods balance – halted in 2020 Q2 and since then, owing to the turnaround in the goods balance, the trend was once again able to rise, followed by a favourable change in the downward trend in the services balance in 2021 Q2 as well. After the fall registered in previous years, the goods balance as a percentage of GDP turned into a surplus from the beginning of 2021, and thus made positive contribution to the level of the trade balance. The services balance surplus, which plays a key role in the trade surplus, fell to close to 2 percent by 2021 Q1 from the 5-6 percent level of previous years. In the second quarter, however, it rose again to nearly 3 percent, in parallel with the renewed economic recovery and the lifting of restrictions. Tourism and transportation services, which have a major weight within the services balance, contracted significantly as a result of the pandemic, but recovery also commenced in these sectors in the second quarter.

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



Export growth surged in 2021 Q2, while import performance rose significantly, but expanded more slowly than exports (Chart 3). In line with the major downturn seen a year ago and continued growth in industrial production, annual real growth in exports reached 33 percent, significantly exceeding the rate registered in the previous quarter. In addition to the boom in exports, imports also rose significantly, registering robust year-on-year growth of 22 percent in the second quarter. In addition to exports' demand for imports, after reopening, the recovery of the previously moderate household consumption also contributed to the rapid import growth. The difference between the growth in exports and imports increased to almost 10 percent in 2021 Q2, due to the dynamic growth in exports.

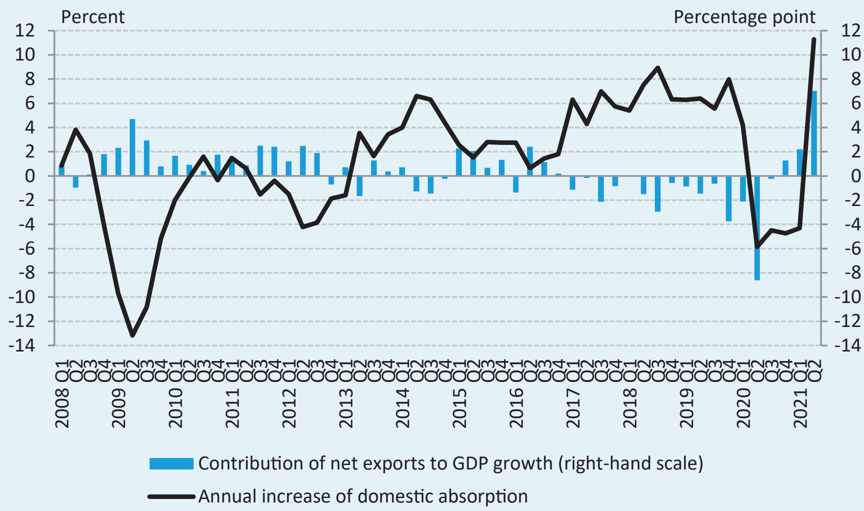
Chart 3: Annual real growth in exports and imports



Source: HCSO and MNB.

The annual growth rate of domestic absorption rose significantly in 2021 Q2, while the growth contribution of net exports was substantially higher versus previous quarters (Chart 4). Within the items of domestic absorption, household consumption grew dynamically in the second quarter compared to the previous, extremely large decline due to the strict lockdowns connected to the pandemic; on the other hand, the moderate decline in public consumption somewhat mitigated the impact of the growth in household consumption. In addition, in contrast to previous quarters, annual growth in investments also supported growth substantially. In addition to the annual growth in domestic absorption items, with elimination of the decline from a year ago from the base, net exports also provided strong support to GDP growth in 2021 Q2, as its growth contribution was the highest in the past decade.

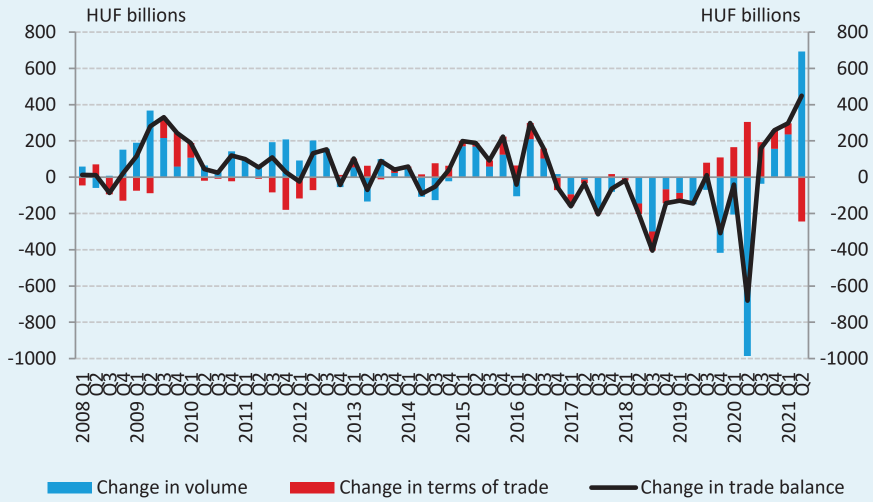
Chart 4: Annual growth rate of domestic absorption and contribution of net exports to GDP growth



Source: HCSO.

The favourable developments in the trade balance in 2021 Q2 stemmed primarily from volume changes, but this impact was mitigated by the deterioration in the terms of trade. The growth contribution of net exports also reflected the fact that the combined balance of export and import volumes considerably improved the trade balance in the second quarter. By contrast, following a positive impact on the balance in the previous quarters, the terms of trade deteriorated in the second quarter due to the sharp rise in oil prices, which curbed the increase in trade surplus (Chart 5).

Chart 5: Developments in the balance of trade factors according to GDP (year-on-year)

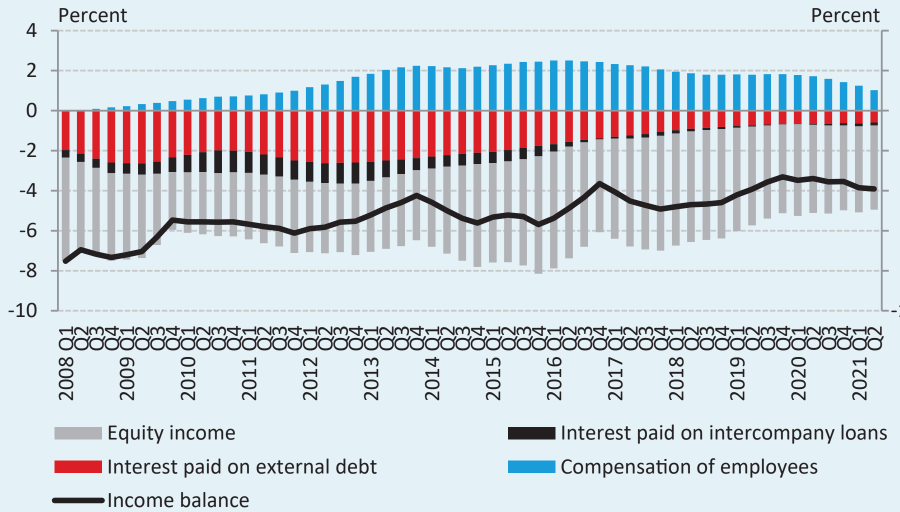


Source: HCSO.

1.2 Income balance

The income balance deficit continued to rise moderately in 2021 Q2, which was primarily linked to the decline in the income of Hungarian employees abroad, while the fall in foreign companies' dividend incomes and the interest balance of foreign loans prevented stronger growth in the deficit (Chart 6). By 2021 Q2, the four-quarter income balance deficit has risen from the relatively stable level of around 3.5 percent in previous quarters to 3.9 percent of GDP, essentially reflecting the combined result of two factors. On the one hand, employees' income from abroad – presumably as a result of the restrictions during the pandemic – fell to an even larger degree than before and amounted to only 1 percent of GDP (compared to the its pre-pandemic value of 1.8 percent), thereby contributing to the increasing income balance deficit. In the second quarter, reopening of the economy did not yet influence the balance of employees' income from abroad, and this factor is only expected to have gradual impact on such income. On the other hand, foreign companies' dividend income[1] and interest paid on foreign loans, representing a higher weight within the income balance, declined moderately compared to 2020, somewhat mitigating the stronger growth in the income balance deficit.

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



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

1 We only have limited quarterly data concerning the profits of foreign-owned companies. Therefore, the information on profit outflows is based on estimates until the receipt of the corporate questionnaires in September of next year. For more details, see the publication 'Methodological notes to the balance of payments and international investment position'.

Box 1: Revision of the balance of payments

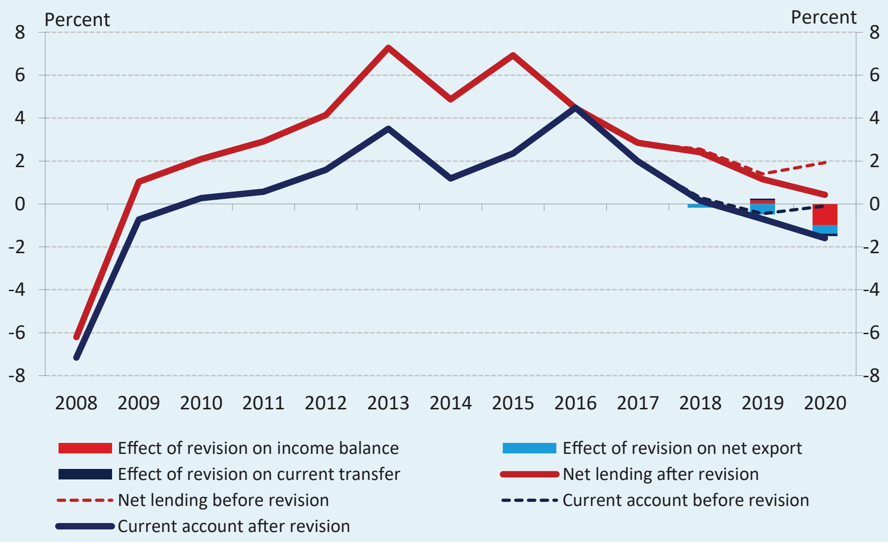
As a result of revision, the data disclosed in the balance of payment changed retrospectively: the balance of payments data shows higher deficit and, due to this, higher inflow of funds than previously (Chart 7). With the release of the Q2 balance of payments data, the MNB also published the revision of the previous years' data, as usual. The revision was partly attributable to the fact that the 2020 corporate income data (for more details, see the special topic) became known after receiving the corporate questionnaires, at the time of the September data release, and on the other hand the balance of net exports and current transfers has also changed. The changes affecting 2020 are summarised below:

- The biggest change is linked to the smaller income balance (EUR 1.3 billion lower), which is attributable to the fact that the estimates for the 2020 profit of foreign-owned companies operating in Hungary were replaced by actual data based on the corporate questionnaires. According to this – despite the impacts of the coronavirus pandemic – there was only a small decline in the profit of corporations, and it exceeded previous expectations, which increased the income balance deficit.
- Compared to previous indications, net exports declined by EUR 0.5 billion, which was related to the revision of foreign trade data – primarily connected to those included in the goods balance – carried out by the HCSO and part of this change appeared in the balance of payments statistics for the first time.
- The decline in current transfers in the amount of roughly EUR 0.2 billion almost exclusively affected the unrequited current transfers.

As a result, the current account balance declined by roughly EUR 2 billion in 2020 compared to the previous data release, thus amounting to -1.6 percent of GDP. The net lending of the economy changed to a similar degree, with its value falling to 0.4 percent of GDP in 2020.

In 2021 Q1, both net lending calculated from the real economy side and the current account balance declined by EUR 0.4 billion as a result of the revision, primarily due to the higher profits of foreign-owned companies.

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



As a result of the revision of the balance of payments, the financing side changed to a similar degree as the real economy, primarily due to the higher FDI inflow. Some of the changes affecting the current account entail a change of the same size on the financing side as well. With the previously mentioned higher profit of foreign-owned companies, assuming unchanged dividends declared payable, corporations' reinvested earnings rose, and through that net FDI inflow of the economy increased. While the data for 2020 previously showed relatively moderate net FDI inflows in 2020, according to the actual figure inflows reached EUR 2.2 billion. As based on the latest data other financing items have not changed significantly, net lending calculated from the two approaches changed to a similar degree. Accordingly, the "balance of net errors and omissions", showing the difference in the balance of payments statistics between the two approaches, has not changed significantly.

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

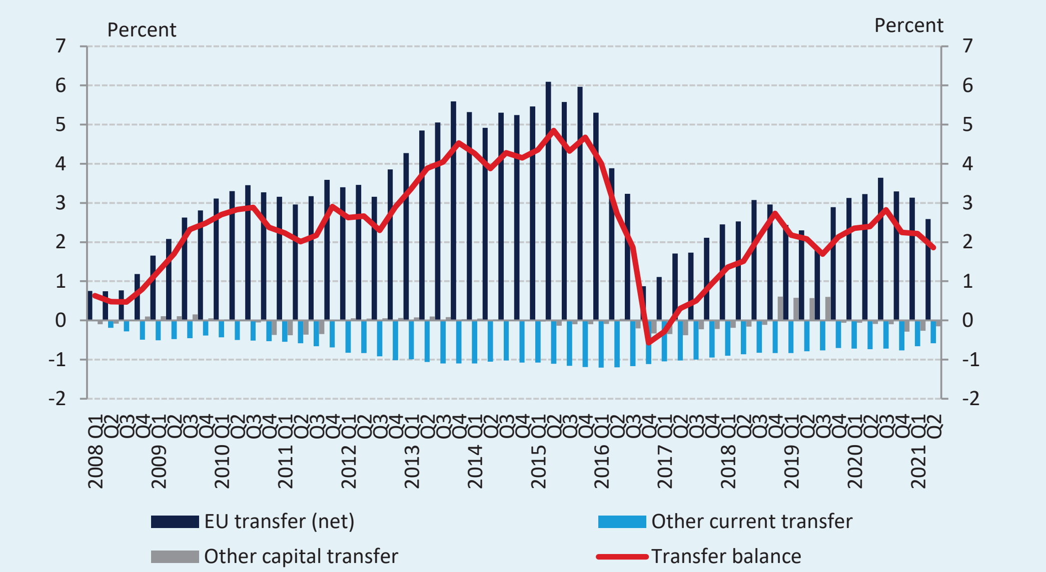
	2018	2019	2020	2021 Q1
I. Change in net lending from real economy's side (1+2+3)	**-0.2**	**-0.4**	**-2.0**	**-0.4**
1. Balance of goods and services	-0.2	-0.7	-0.5	0.0
2. Income balance	0.0	0.2	-1.3	-0.3
3. Transfer balance	0.0	0.1	-0.2	-0.1
Current account	***-0.2***	***-0.4***	***-2.0***	***-0.4***
II. Change in net lending from financing side (5+…+8)	**0.2**	**0.1**	**-2.1**	**-0.3**
5. Foreign direct investment	0.2	0.2	-2.0	-0.3
6. Portoflio equity	0.0	0.0	0.0	0.1
7. Financial derivatives	0.0	0.0	0.0	0.0
8. Net debt	0.0	-0.1	-0.1	0.0
Net errors and omissions (I.-II.)	***-0.4***	***-0.4***	***0.1***	***-0.1***

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

1.3 Transfer balance

In 2021 Q2, the transfer balance surplus as a percentage of GDP amounted to 1.9 percent of GDP, which is lower than the level observed in previous quarters. Nevertheless, the transfer balance surplus continues to contribute strongly to maintaining Hungary's favourable external balance position (Chart 8). In 2021 Q2, based on the four-quarter data, the net inflow of EU funds amounted to 2.6 percent, which fell short of the average of the previous quarters. However, in parallel with this, other current and capital transfers reduced the transfer balance to a lesser degree than before. The income of those employed abroad for a short time declined due to the pandemic, and thus the amount of taxes and contributions paid abroad also decreased within the other current transfers item, which contributed modestly to the improvement in the transfer balance, but was unable to completely offset the fall in the net inflow of EU funds.

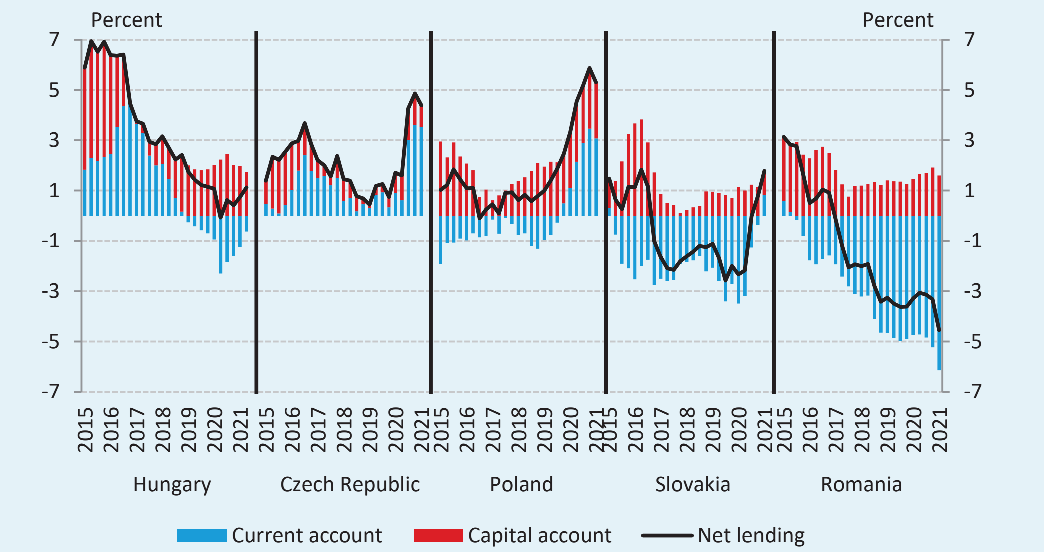
Chart 8: Four-quarter developments in the items of the transfer balance (four-quarter values as a percentage of GDP)



1.4 Regional comparison

As a result of the third wave of the pandemic in spring 2021, the formerly favourable external balance trends halted in some countries in the region; nevertheless, Romania is still the only country that is characterised by net borrowing (Chart 9). Comparability with the countries of the region is limited by the fact that in the case of the neighbouring countries data are only available until the end of 2021 Q1. As a result of the third wave of the coronavirus, in 2021 Q1 a minor decline was observed in the previously dynamically improving net lending of the Czech Republic and Poland, due to the decline in the current and capital account surplus. The Polish and Czech indicators exceeding 4 percent of GDP are still outstanding in the region. In Slovakia, due to the improvement in the current account, the external balance indicator rose further in the first quarter, while in Hungary – where the Q2 data is also available – the improving trends are due to the significant decline in the current account deficit, while the impact of this was slightly mitigated by the moderate decline in the capital account. Strong growth in net borrowing continued in Romania, rising to 4.5 percent of GDP in 2021 Q1 compared to 3-3.3 percent registered in the previous year, with the underlying reason being the high current account deficit owing to the large budget deficit.

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



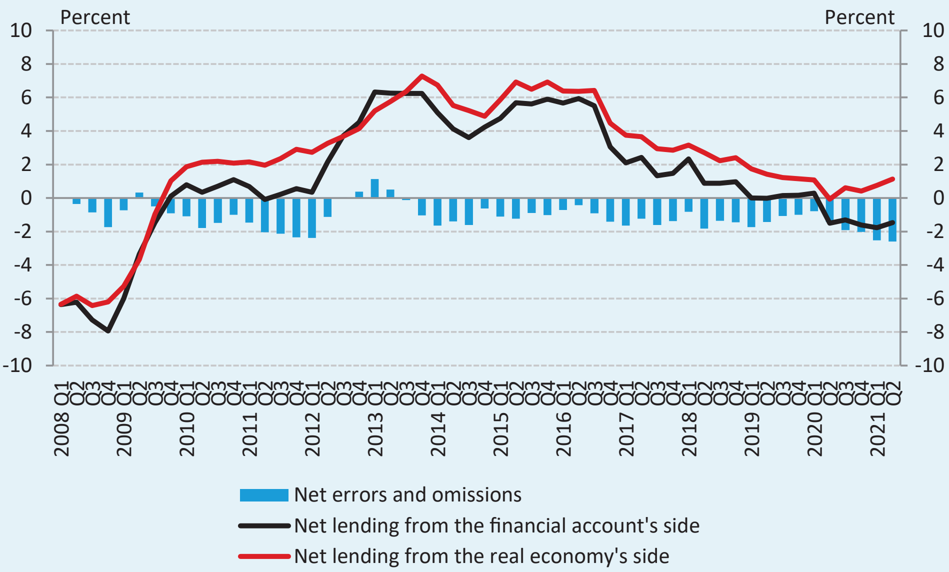
Source: MNB, Eurostat. Q2 data were available only for Hungary.

2 Financing approach

The four-quarter net borrowing of the financial account declined moderately in the second quarter. The quarterly net borrowing, which exceeds that of the previous period, is the combined result of the inflow of debt liabilities and the fall in net non-debt liabilities. Net FDI funds dropped slightly due to the usual dividend payments in the second quarter. Net portfolio equity and mutual fund holdings declined further due to transactions, albeit the dynamics slowed down somewhat. The inflow of debt liabilities was partly linked to the consolidated government and partly to the banking sector. The government's increasing net debt was attributable to the decline in foreign exchange reserves. The declining foreign exchange reserve was mostly due to the fact that the use of the central bank's euro liquidity providing swaps exceeded the volume registered at the end of March. Banks' increasing net debt was mostly connected to growth in liabilities.

According to the financing side data, in 2021 Q2 the economy's four-quarter net borrowing declined slightly (Chart 10). In line with rise in the four-quarter external balance position calculated based on the real economy approach, the inflow of funds declined somewhat on the basis of the financing side as well. On the whole, this means that the amount of the difference between the four-quarter external balance indicators ("Net errors and omissions")[2] has stabilised at roughly 2.5 percent of GDP and thus still moderately exceeds the average of previous years.

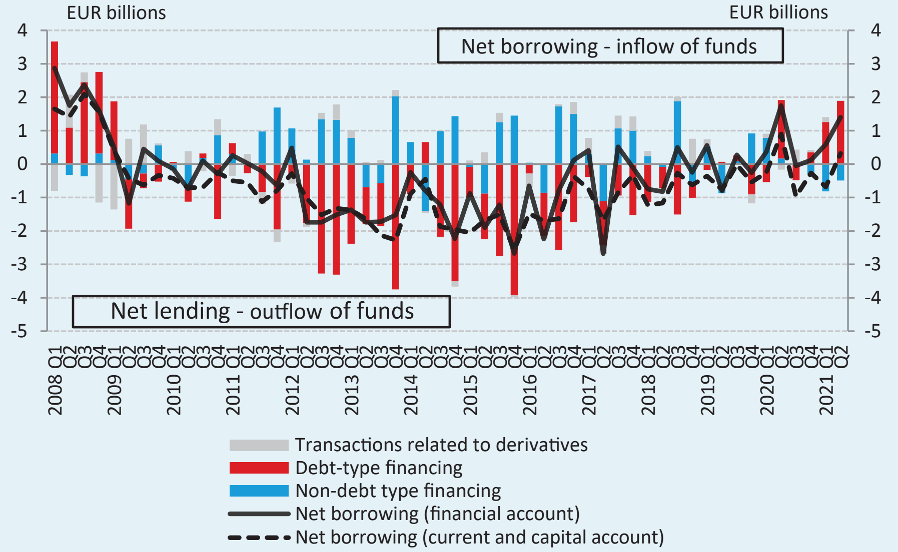
Chart 10: The two types of net lending (four-quarter data as a percentage of GDP)



According to the quarterly data, the economy's net borrowing in Q2 rose above EUR 1 billion, i.e. the economy's net external liabilities increased significantly (Chart 11). The net inflow of funds observed in the second quarter of the year – similarly to the previous two quarters – once again related to debt liabilities. Net outstanding debt rose by roughly EUR 1.9 billion due to transactions, representing an increase compared to the previous quarters. In conjunction with a minor outflow of net foreign direct investments (connected to dividend payments), net portfolio investments also declined further, which together caused non-debt liabilities to decrease. The combined result of the foregoing is the development of significant net borrowing based on the financial account.

2 Developments in the balance of payments can also be described in terms of the financing of real economy transactions. The financial account shows what kinds of transactions affecting net financial worth were used by resident economic agents to finance real economy transactions. While data derived from the real economy approach and the financing approach should be identical in theory, differences are likely to arise in practice due to non-integrated data sources, incomplete observation and the different treatment of exchange rates, as indicated by the category "Net errors and omissions".

Chart 11: Structure of net lending (unadjusted transactions)

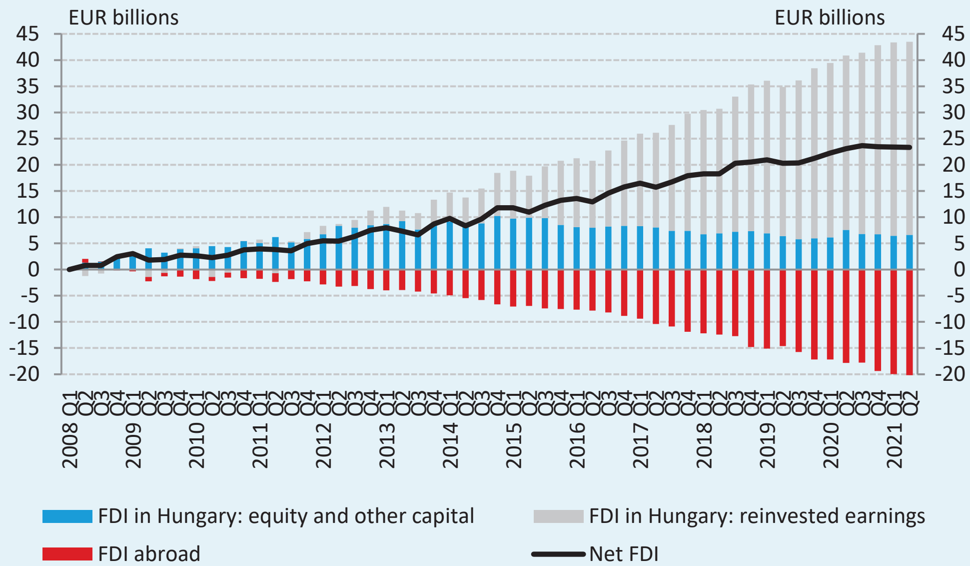


The fundamental development – from an economic viewpoint – of the debt is not influenced by the conversion between unallocated and bullion balances, and thus this effect has been excluded from the charts in this report.

2.1 Non-debt liabilities

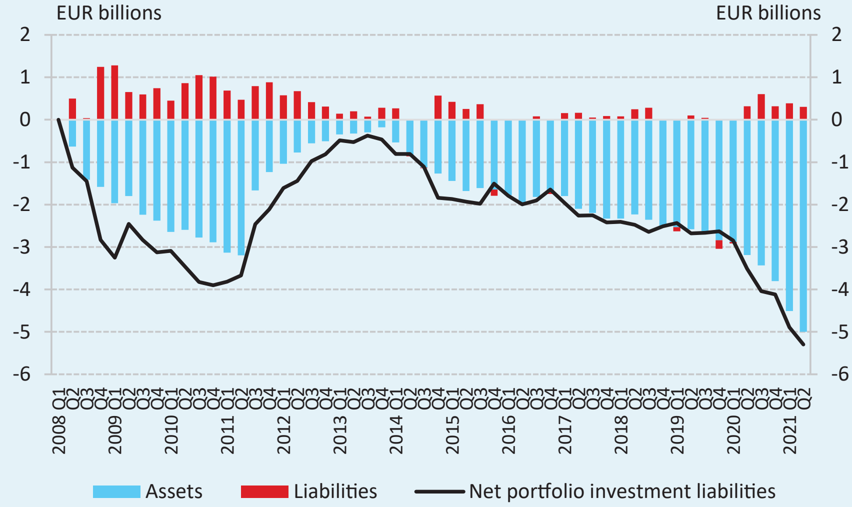
The stock of net foreign direct investments fell slightly in 2021 Q2 (Chart 12). Based on data excluding capital-in-transit transactions and portfolio restructuring, net FDI outflows amounted to EUR 0.1 billion in Q2. During the period, the equity investments of foreign companies in Hungary were reduced significantly by the usual dividend payments, while the inflow of intercompany loans had the opposite effect. Hungarian direct investments abroad slightly exceeded the inflow of FDI, and thus net foreign direct investments declined moderately in Q2.

Chart 12: Developments in FDI excluding capital-in-transit transactions (cumulative transactions)



Due to higher Hungarian investments abroad, net portfolio equity investments continued to decline, albeit at a smaller rate than in the first quarter (Chart 13). In Q2, the outflow of non-debt liabilities (EUR 0.4 billion) was mostly attributable to the fall in net portfolio investments. Non-residents' holdings of Hungarian equities and mutual fund shares rose by almost EUR 0.1 billion due to transactions. In parallel with this, residents substantially increased their holdings of foreign equities and mutual fund shares, with the growth in this item amounting to almost EUR 0.5 billion altogether. This may have been due to the fact that domestic investors may have regarded the falling foreign stock exchange prices resulting from the pandemic as a good entry point.

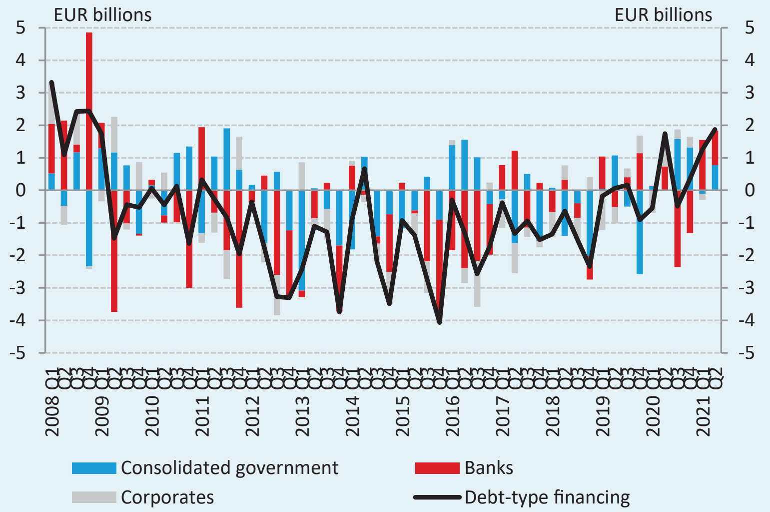
Chart 13: Developments in net portfolio equity and mutual fund share liabilities (cumulative transactions)



2.2 Debt liabilities

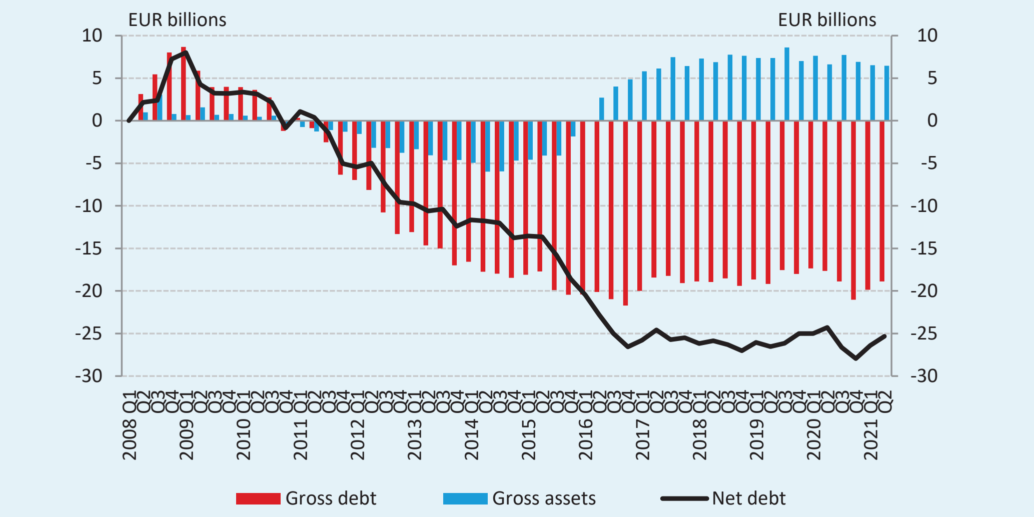
In the second quarter, the net external debt of the economy rose significantly due to transactions, linked to the banking sector and the general government (Chart 14). In Q2, the net external debt of banks as a result of transactions increased by some EUR 1.1 billion and the indicator for the general government including the MNB by EUR 0.8 billion. The growth in the general government's net external debt was mainly driven by the drop in foreign exchange reserves. While banks' net external debt rose, there was no major change in the net external debt of the corporate sector, since the sector's foreign liabilities and assets increased to a similar degree.

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



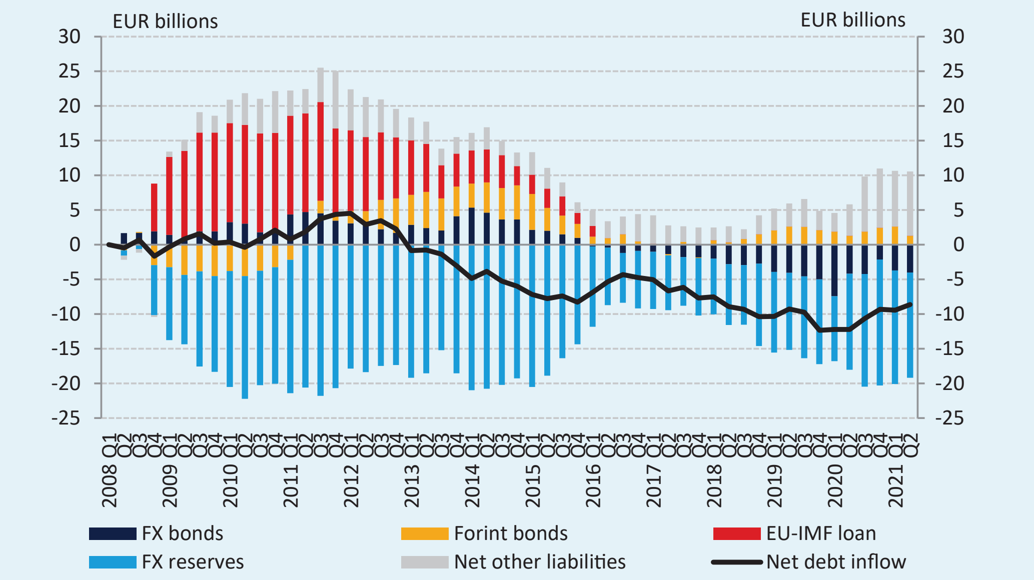
The banking sector's net external debt increased substantially in Q2, primarily linked to growth in liabilities (Chart 15). The rise of EUR 1.1 billion in the net indicator was equally attributable to the growth in banks' liabilities of EUR 1 billion and the fall in external assets of roughly EUR 0.1 million. The growth in external liabilities mostly related to a domestic state-owned bank, which issued long-term international bonds in the second quarter.

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



The net external debt liabilities of the consolidated general government including the MNB rose significantly, increasing by roughly EUR 0.8 billion in Q2 (Chart 16). The rise in the net external debt of the government was mostly attributable to the drop in foreign exchange reserves, mainly because at the end of June the central bank's foreign currency liquidity providing swap contracts exceeded the level of previous quarter. It should be noted that the central bank's outstanding swap contracts had a neutral effect on the net external debt at national economy level, as the foreign currency liquidity obtained from the central bank improved the banks' indicator. On the other hand, non-residents' decreasing long-term forint and foreign currency government securities holding significantly reduced the government's net external debt.

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



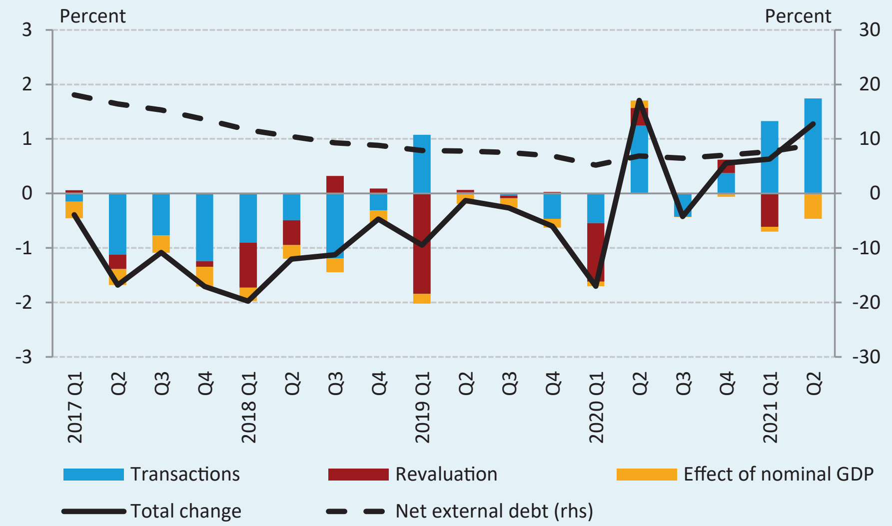
3 Developments in debt ratios

According to the underlying trends, Hungary's net external debt amounted to 8.9 percent of GDP at the end of June 2021. The rise in the debt ratio was linked to banks to a larger degree and to the general government to a smaller degree, while the corporate sector's ratio declined moderately. The strong growth in nominal GDP partially offset the impact of the debt inflow in the second quarter, thus curbing the rise in the indicator as a percentage of GDP. Following a decline of 1.5 percentage point, gross external debt amounted to almost 58 percent of GDP at the end of June 2021. The improved indicator reflected the fall in non-residents' forint government securities holding, the decline in outstanding debt due to revaluation and the growth in GDP. Hungary's short-term external debt amounted to roughly EUR 22 billion, while the balance of international reserves was close to EUR 31 billion at the end of the quarter. Accordingly, international reserves still significantly exceed the level expected and deemed safe by investors.

3.1 Developments in debt indicators

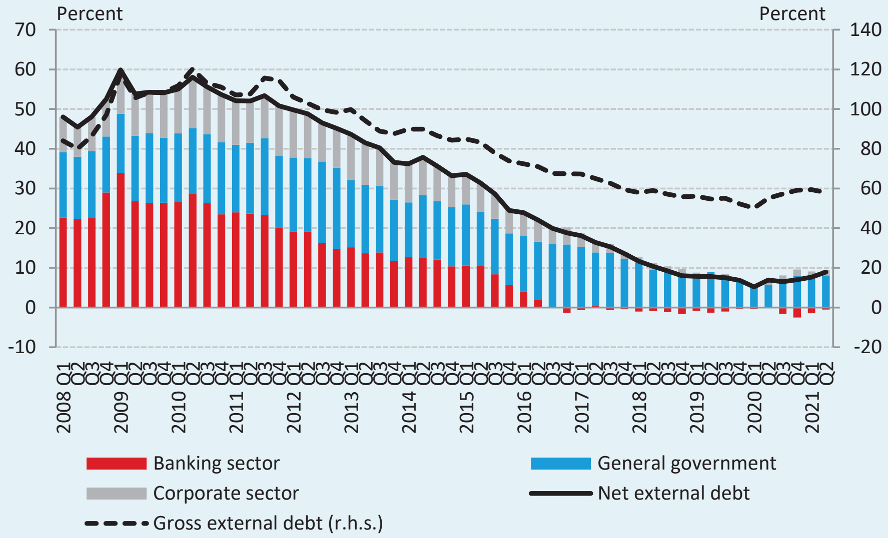
Based on the underlying trend, net external debt amounted to 8.9 percent of GDP in Q2, following a moderate rise. The increase in the indicator stemmed primarily from the inflow of debt liabilities, while growth in nominal GDP reduced the ratio (Chart 17). On the whole, the revaluation of outstanding stocks had no effect on the indicator, which develops as the combined result of opposite effects. On the hand, due to the rising yields, the price of government securities held by non-residents decreased, and thus – by reducing the outstanding debt – this improved the indicator. However, on the other hand, this effect was offset by the lower volume of foreign exchange reserves, revalued as a result of the strengthening of the forint exchange rate against the major currencies. At the national economy level, foreign currency assets exceed foreign currency liabilities, and thus the appreciation of the forint exchange rate – i.e. the strengthening of the forint during the reference quarter – increases the net debt ratio.

Chart 17: Composition of the change in net external debt (net of intercompany loans, as a percentage of GDP)



The increase of 1.3 percentage point in the net external debt-to-GDP ratio was caused by the net debt inflow of the general government and the banks (Chart 18). The banking sector's net debt ratio rose by almost 1 percent of GDP, but still remained negative, i.e. banks' stock of external assets exceeds their external liabilities. The rise in the indicator was essentially linked to the increase in banks' external liabilities, while the sector's foreign receivables fell slightly. The net external debt of the consolidated government including the MNB rose by 0.5 percent of GDP, which was mostly attributable to the drop in international reserves, while the decline in non-residents' forint government securities holding improved the debt ratio. The primary underlying reason for the decline in international reserves was that at the end of the quarter the central bank's euro liquidity providing outstanding swap contracts exceeded those in the previous quarter by roughly EUR 2.5 billion and the fall in forint liquidity providing swaps also reduced the foreign exchange reserves to a lesser degree. On the other hand, the changes in the central bank's outstanding swap contracts had neutral effect on net external debt at the level of the national economy, since – in contrast to the foreign exchange reserve reducing effect – it improved the banking sector's ratio. Corporations' net external debt as a percentage of GDP improved slightly, rising by 0.1 percent of GDP and reflecting stable net debt stocks resulting from a similar growth in nominal external assets and liabilities and growth in nominal GDP.

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



Hungary's gross external debt decreased to 58 percent of GDP at the end of the second quarter. The decrease in the government's gross external debt contributed to the decline in the debt ratio, while the private sector's indicator moderately rose. The fall in non-residents' holding of forint government securities fostered a decrease in the gross external debt of the consolidated general government including the MNB, which was partly offset by the higher use of the central bank's euro liquidity providing instrument compared to the end of 2020. In addition, as a result of the rising yields and the strengthening of the forint against the major currencies, the revaluation effect also reduced external liabilities and thus – together with the strong GDP growth – contributed to the decline in the general government gross debt ratio.

The moderate rise in the private sector's gross liabilities was the combined result of the growth in banks' gross external debt and the fall in the corporate sector's indicator. The rise in the banking sector's external liabilities was attributable to the growth in the sector's short-term and long-term outstanding debt. A foreign currency bond issue by a bank in Q2 also contributed to the rise in long-term external liabilities. It should be noted that the currency obtained through the central bank's euro liquidity providing swap instrument may have curbed the growth in the sector's gross external debt. The moderate decline in corporations' gross external debt may reflect the rise in liabilities due to transactions – linked to commercial loans – which was more than offset by the impact of GDP growth and the revaluation of outstanding foreign currency debt resulting from the strengthening of the forint.

3.2 Foreign exchange reserves and reserve adequacy

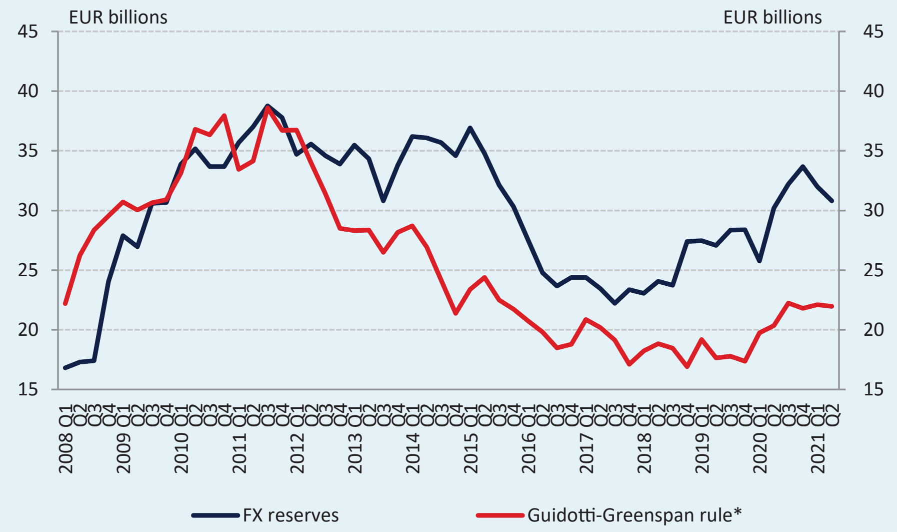
Compared to March 2021, the level of FX reserves decreased by EUR 1.2 billion in 2021 Q2, amounting to EUR 30.8 billion at the end of June 2021. The development of reserves was affected by various factors, the most important of which were the following:

- The *net FX financing of the Government Debt Management Agency (ÁKK)* reduced reserves by EUR 0.3 billion in total,
- The reserve reducing effect of the *Hungarian State Treasury's foreign currency* transactions amounted to almost EUR 0.3 billion.
- The change in the stock of the forint liquidity providing FX swap instrument reduced the reserve level by EUR 0.6 billion.

- *The reserve-increasing effect of EU funds was nearly EUR 0.6 billion,* resulting primarily from the payment of performance-based invoices of the 2014-2020 EU programming period.
- The balance of the *euro liquidity providing swap instrument* and the international *repo drawdowns* reduced reserves compared to the end of March 2021.

At the end of the second quarter of 2021, the MNB's international reserves exceeded the level of short-term external debt, which is closely monitored by investors, by nearly EUR 9 billion. At end-June 2021, international reserves and short-term external debt amounted to EUR 30.8 billion and EUR 22 billion, respectively. The slight rise in short-term external debt in the second quarter occurred in parallel with the rise in the banking sector's and private sector's short-term external debt and the fall in the short-term debt of the consolidated general government including the MNB. Accordingly, the leeway above the Guidotti–Greenspan indicator stood at EUR 8.8 billion (Chart 19).

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



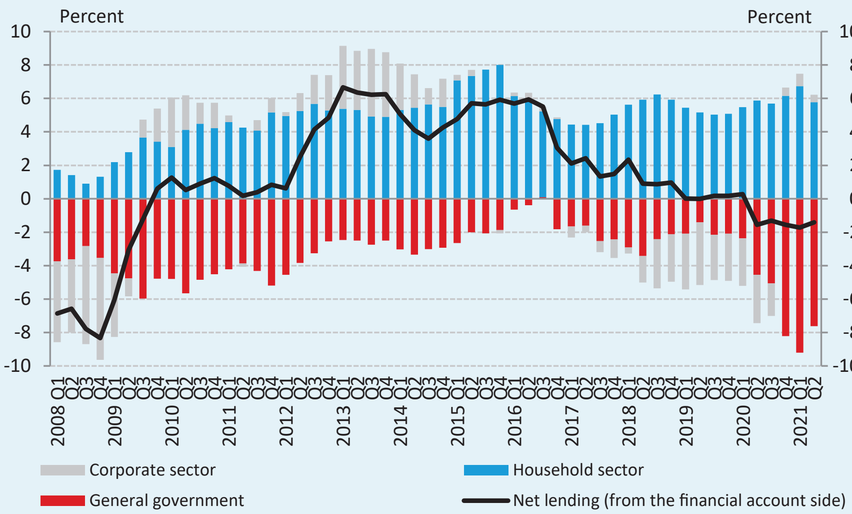
** Guidotti–Greenspan indicator: short-term external debt based on residual maturity.*

4 Sectors' savings approach

Examining the external balance positions based on the sectors' savings approach, the rise in the economy's net lending can be explained with the decline in the general government's net borrowing after a steady rise observed in previous quarters. The lower budget deficit may be linked to the positive impact of economic reopening in 2021 Q2, in contrast to the full lockdown one year ago. On the other hand, in parallel with this, the private sector's spending also increased significantly, resulting in a fall in its net savings. Growth in households' government securities holding remained strong within households' savings.

According to the sectors' savings trends, the moderate rise in net lending reflects the fall in the general government's net borrowing, in parallel with the decline in the private sector's position (Chart 20). The decline in the general government's four-quarter net borrowing reflects a major fall in the deficit compared to one year ago: in contrast to the falling revenues resulting from the pandemic and the costs of pandemic control measures last year, tax revenues increased this year, in parallel with the reopening of the economy. However, this impact was more or less offset by the fall in private sector's net savings: reopening considerably increased domestic absorption, which reduced households' four-quarter net savings to below 6 percent of GDP. Corporations' net lending also declined moderately, which may have been partly attributable to the rising investment activity resulting from the restart of projects temporarily suspended due to the pandemic.

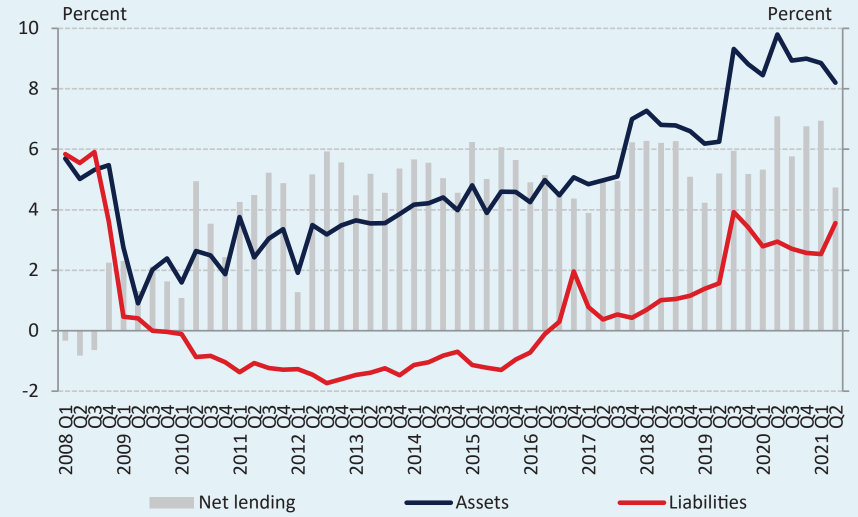
Chart 20: Net lending of specific sectors* (four-quarter values as a percentage of GDP)



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

In 2021 Q2, the decline in households' net financial savings resulted from the combined effect of moderate growth in financial assets and a rise in net new borrowing (Chart 21). The underlying reasons for the slowdown in households' accumulation of financial assets included the pick-up in household consumption, in line with the reopening of the economy and investment activity, also fostered by the home improvement programme. In parallel with the gradual lifting of the anti-pandemic restrictions and the easing of the pandemic, households' forced savings declined. The growth in households' net new borrowing as a percentage of GDP was primarily linked to prenatal baby support loans and housing loans. The new housing subsidies available from 2021 also substantially boost the growth in households' credit demand and investment activity.

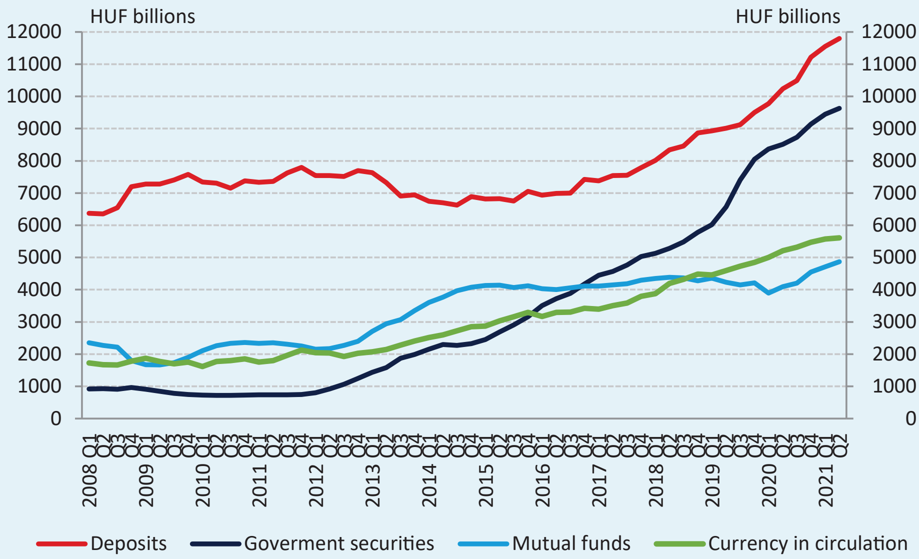
Chart 21: Net lending of households (seasonally-adjusted and corrected* values, as a percentage of GDP)



** 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 adjusted separately.*

Liquid forms of savings still enjoy priority in households' asset allocation decisions; however, consideration of the yield advantage of certain investment opportunities is becoming increasingly important (Chart 22). Current account deposits grew steadily, expanding by almost HUF 300 billion, while demand for cash was moderate in Q2: on the one hand, merchants with online cash register are obliged to provide customers with electronic payment options from 2021, and on the other hand during the pandemic contactless payments became increasingly popular. In addition, the opportunity cost of holding cash is increasing in a higher inflationary environment, fostering a fall in cash savings and a rise in demand for investments offering yield advantage. The growth in households' financial assets in investment funds observed in previous quarters accelerated moderately, while households' net equity purchases were similar to that of the previous quarter. Households' government securities purchases slowed down somewhat, but the volume of HUF 190 billion remains significant. The Hungarian Government Security Plus (MÁP+) scheme remains the most popular, with its stock increasing by more than HUF 260 billion in Q2. On the other hand, the PMÁP stock rose moderately, expanding by HUF 12 billion, while the decline in securities with shorter maturity (1MÁP, KTJ+, 2MÁP) continued. Overall, the growth in households' government securities holding continued to support the financing of the government from internal funds.

Chart 22: Developments in households' key financial assets



5 Income of foreign-owned companies

The special topic in the Report on the Balance of Payments discusses developments in the income of foreign-owned companies. Based on the incoming actual data, the profit of foreign-owned companies as a percentage of GDP decreased further in 2020, but the rate of decline fell short of that observed after the 2008 financial crisis. The lower profit was reflected in the fall in reinvestments, the rate of which, however, remains high, in line with the much higher profit-to-GDP compared to 2008-2009: despite the pandemic and the resulting economic downturn, foreign-owned companies continued to invest the larger part of their realised income in Hungary. Foreign-owned companies' profitability typically fell in the main sectors. The largest fall was registered in the sectors engaged in tourism and transportation (e.g. air transport), which were hit hardest by the pandemic. The decline in the income balance deficit resulting from corporate profits was partly offset by the fact that as a result of the pandemic situation, the profit of companies owned by residents, but operating abroad, also declined. As a result of the pandemic, the income-to-equity ratio also fell significantly in most regional countries, while the dividend payment ratio in Hungary remains low in a regional comparison. The GNI-GDP gap remained broadly unchanged as both wages and profit of foreign-owned companies decreased. In 2020, the Hungarian GNI-GDP gap broadly corresponded to the Czech and Polish figure.

5.1 Introduction

In the September balance of payments data release, the previous, estimation-based data for corporate income in 2020 are replaced by actual figures on the basis of the received annual data reports.[3] According to the data, the balance of profits in the income account was higher than the preliminary estimate. The difference is mainly attributable to the fact that the profit-to-GDP ratio of foreign-owned companies operating in Hungary declined only moderately in contrast to the larger decline expected due to the economic downturn resulting from the pandemic and the sharp contraction in export revenue. The change in corporate profitability can also be deemed rather small in light of the experiences from the previous financial crisis: the ratio as a percentage of GDP declined only by 0.4 percentage point in 2020 compared to a decline of 1.7 percentage points in 2008, which may be attributable to several factors. On the one hand, the economic recovery from the recession caused by the pandemic was much faster, partly due to the nature of the pandemic and partly due to Hungary's much stronger fundamentals. On the other hand, the fall in production was due to temporary supply constraints rather than to a general and protracted fall in demand, as a result of which the level of industrial production and goods exports already reached the pre-pandemic level by the end of 2020. Thirdly, the largest decline was registered in the profit of the "accommodation services and catering" sector, which was hit hardest by the lockdowns; however, foreign ownership is relatively low in this sector, and thus its effect was felt in the total profit of foreign-owned companies to a lesser degree. Finally, the weakening of the forint may have also mitigated the decline in the profit of foreign-owned companies primarily producing for export.

In relation to corporate profit – as discussed in the special topic – it is important to know that it contains the corporate income related to current operating performance, excluding outliers, i.e. one-off profit or loss items, shown in the balance of payments statistics. Based on the methodology of the balance of payments,[4] the profit/loss realised outside current operating performance (for example, from exchange rate revaluation) does not form part of the incomes. Profit or loss items stemming from sources like this are stated among changes in stock – not due to transactions – or in the financial account. In the first subsection, we present the changes in the income of foreign-owned companies and the absorption of it as shown in the balance of payments. After that, we first review the incomes of foreign-owned non-financial corporations and banks, and then examine the background of the changes in profits in 2020. Following the presentation of corporations' profit or loss, shown in the balance of payments, and their after-tax profit or loss, in the final subsection we end this special topic in the current Report on the Balance of Payments by presenting a regional comparison.

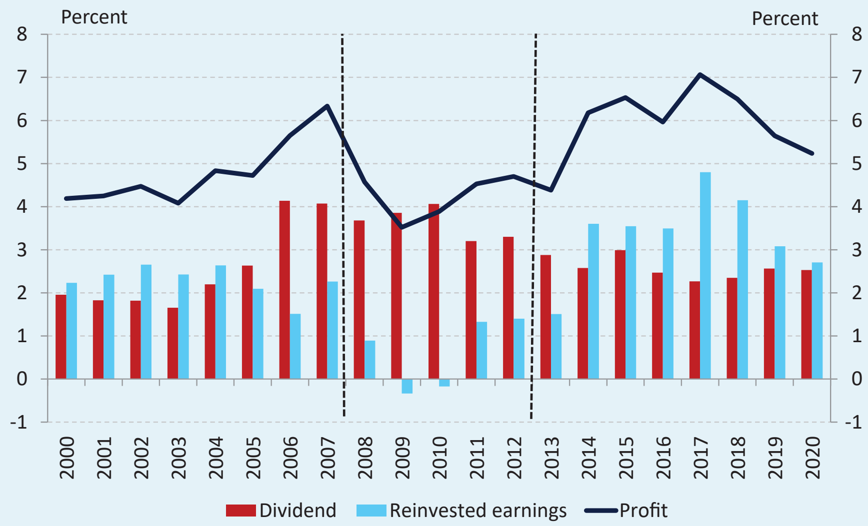
3 For more details, see: Hungary's balance of payments and international investment position statistics, MNB (2014).

4 Balance of Payment Manual, 6th edition

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

In 2020, the balance of foreign-owned companies' equity income fell to nearly 5 percent of GDP. As the volume of dividends paid to owners stagnated at last year's level, the drop in income was primarily reflected in lower reinvestments. During the 2008-2009 crisis, the profit of foreign-owned companies as a proportion of GDP fell in parallel with the slowdown in demand. However, since 2013, the value of foreign-owned companies' income produced has also become higher, in line with the acceleration of economic growth. At the same time, the higher income was accompanied by subdued dividend disbursements,[5] significantly raising the value of reinvestments, and thus of FDI inflows as well. In addition to EU funds, the high level of reinvestments has played a major role in the dynamic expansion in corporate investment in recent years. External demand, which also facilitated the dynamic expansion in exports, contributed to the increase in foreign-owned companies' profitability as well. However, in the years since the 2017 record, the profit of foreign-owned companies has declined, falling further in 2020 as a result of the pandemic, to reach nearly 5 percent of GDP; however, foreign-owned companies paid the same volume of dividends even in the context of declining profitability, and thus the dividend-to-profit ratio rose to 48 percent, slightly exceeding the level of 45 percent observed a year ago. In parallel with this, the level of reinvestments declined recently, amounting to only 2.7 percent in 2020.[6] A substantial portion (more than 94 percent) of foreign-owned companies' profits was produced by non-financial corporations.

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



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

The profit ratio of both banks and non-financial corporations declined in the deteriorating macroeconomic environment resulting from the pandemic. Prior to the 2008-2009 crisis, the value of companies' and banks' profits calculated as a percentage of their FDI equity was close to 10 percent and 13 percent, respectively. Following the outbreak of the crisis,

5 It should be noted that in the balance of payments statistics dividend payments exceeding the profit of the reference year are not shown in the income balance, since it is recognised as disinvestment in the financial account. The degree of such is reflected in the extremely high dividends, which came close to EUR 3 billion in 2020, thereby substantially exceeding the range of EUR 0.8-1.9 billion of 2013-2019. Furthermore, it was also particularly high, EUR 5.7 billion, in 2021 Q1. The outstandingly high dividends paid in 2020 and 2021 may have been strongly attributable to the dividend payments by a multinational corporation operating in Hungary, which formerly had not paid any dividend to its owner for a longer period, and thus this dividend payment also reflects the profit generated in previous years.

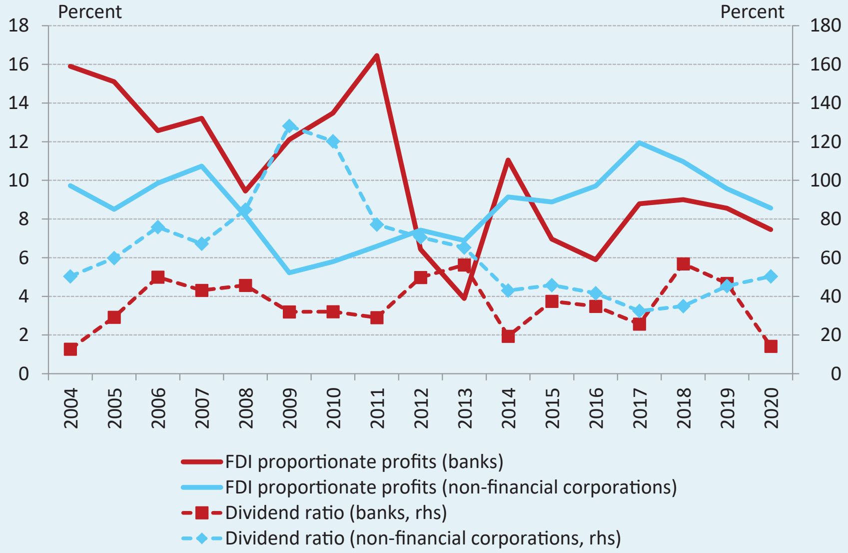
6 Since reinvested earnings, related to the normal business operations, are the difference between the profit earned and the dividends paid, the applied COPC adjustment and the treatment of superdividends have a major impact on the value of reinvested earnings (for more details, see the July 2017 Report on the Balance of Payments).

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

the profit rate of non-financial corporations declined, but that of banks decreased to a greater degree only in 2012, and thus the profit rate of banks became lower than that of companies. The profit ratio of foreign banks from current operating performance rose close to 9 percent in the period of 2017-2019, while it fell below 8 percent in 2020. The relatively favourable ratio observed in past years was attributable to the cleaning of banks' balance sheet and the surge in lending in line with the economic activity cycle; however, this positive trend halted due to the onset of the pandemic. After the financial crisis, by 2017 the profit of non-financial corporations gradually rose to nearly 12 percent; however, thereafter it repeatedly started to decline due to the high wage outflow and strong investment spending. Then, in 2020 it decreased further, falling to nearly 8.5 percent, due to the restrictions and lockdowns related to the pandemic and the lost output due to interruptions in the production chains (Chart 24).

In 2020, the dividend ratio of non-financial corporations increased slightly compared to the historically low level of recent years, while dividend payments by banks plunged to a fifteen-year low. Until 2019, the reinvestment ratio was high in both sectors, which may have been attributable to the favourable growth prospects and an expected further rise in incomes. However, in 2020 – i.e. the first year of the pandemic – the behaviour of two sectors developed differently: while dividend payments by banks fell to a multi-year low, the dividend ratio of non-financial corporations increased further to around 50 percent, in line with the rising trend of the past few years. The latter may have been attributable to the fact that with a view to improving the liquidity position of parent companies in the worsening economic environment and due to the more moderate investment intentions in conjunction with the unfavourable prospects, income flowed from the subsidiaries to the foreign parent companies. On the other hand, banks' declining dividend payment is attributable to a regulatory decision: in March 2020, the MNB's Financial Stability Council tried to mitigate the impacts of the state of emergency resulting from the pandemic on the financial intermediary sector by adopting a comprehensive package of policies, one measure of which was the temporary restriction on dividend payments, meant to strengthen the liquidity and financial situation of the domestic banking sector. [8]

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



Note: FDI proportional to income is a value calculated from the year-end stock.

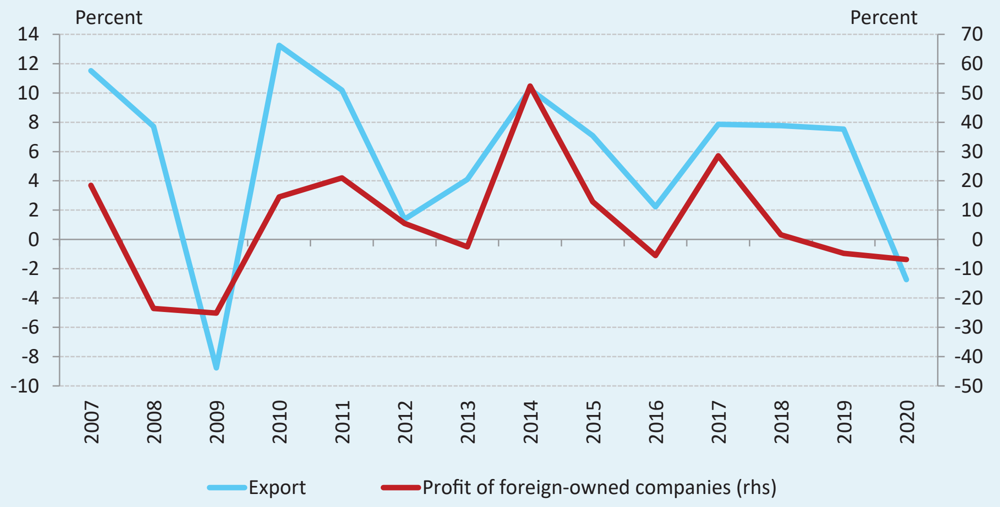
5.4 Factors underlying developments in corporate profits

Despite the economic downturn and plunging exports, the profit of the corporate sector declined only moderately in 2020. Since many of the foreign-owned companies are active in the export-oriented sector, and based on past experiences as well, it is justified to compare foreign-owned companies' profit to export performance. While formerly there was a tight co-movement, from 2018 a major difference has developed between export dynamics and corporate profitability (Chart 25). In 2020, the pandemic caused export dynamics to plunge across the world, and the Hungarian indicator

8 The MNB adopted a number of measures to support the operation of banks

was in the negative range last observed during the 2008 crisis. On the other hand, the profit of corporations has not declined to a similarly large degree as observed back then. In part, this may be due to the fact that the fall in exports related to tourism only had a marginal effect on the profit of foreign-owned companies, due to the low foreign ownership.

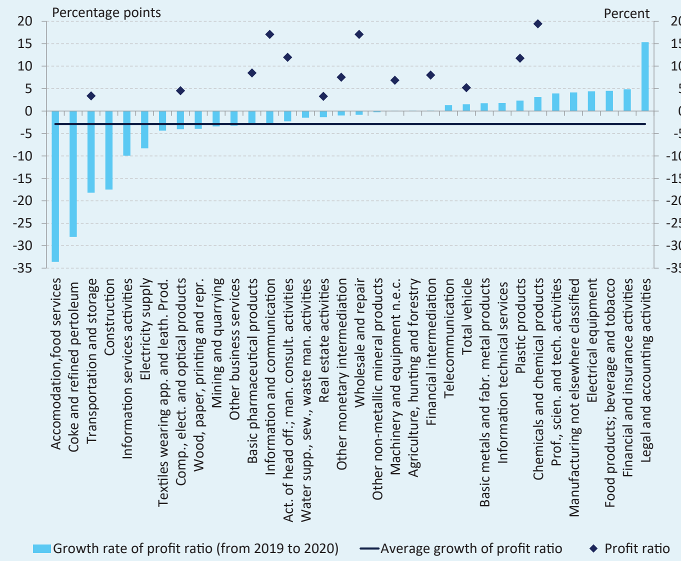
Chart 25: Profit of foreign-owned companies (in HUF) and developments in exports (change compared to the previous year)



In 2020, the return on equity typically declined in the major industries, of which transportation and storage should be mentioned in the first place, while in terms of the smaller sectors accommodation services and catering were hit hardest by the anti-pandemic restrictions. The profit ratio of foreign-owned companies as a percentage of FDI, calculated by industries, fell by roughly 3 percentage points on average between 2019 and 2020 (due to the decline in the profit of low-weight sectors, the degree of the decline slightly exceeds the aggregated figure applicable to the entire sector). Contrary to the previous year, profit tended to decline rather than rise in most sectors (Chart 26), and corporate profits dropped in most sectors with high invested foreign capital exceeding EUR 2 billion (indeed, there was one major sector as well where the fall exceeded 18 percentage points). On the other hand, looking at profits as a percentage of outstanding stock there were also sectors that managed to increase their profits: of the larger sectors it was primarily the rubber, plastic and chemical sectors' profitability that registered growth, while within the smaller sectors the increase in profitability was achieved primarily by the legal and accounting sector, and insurance activity.

Apart from accommodation and catering services (the backbone of tourism), the largest decline in profit margins among foreign-owned corporations in 2020 was suffered by the oil refining, transport and warehousing (including air transport) and construction sectors, also largely related to the impact of the pandemic. Nevertheless, the average profit ratio of the larger foreign companies operating in Hungary was still around 9-10 percent in 2020, which corresponds to the level a year ago. In 2020, the profit of vehicle manufacturing sector, with the highest foreign investment, increased slightly despite the fall observed in the previous crisis, the lockdowns in spring and the supply constraints. The moderate rise is presumably attributable to the fact that the level of industrial production and exports already started to recover in the second half of the year; however, the profit ratio of around 5 percent in vehicle manufacturing continues to be relatively low among the sectors with major foreign direct investments.

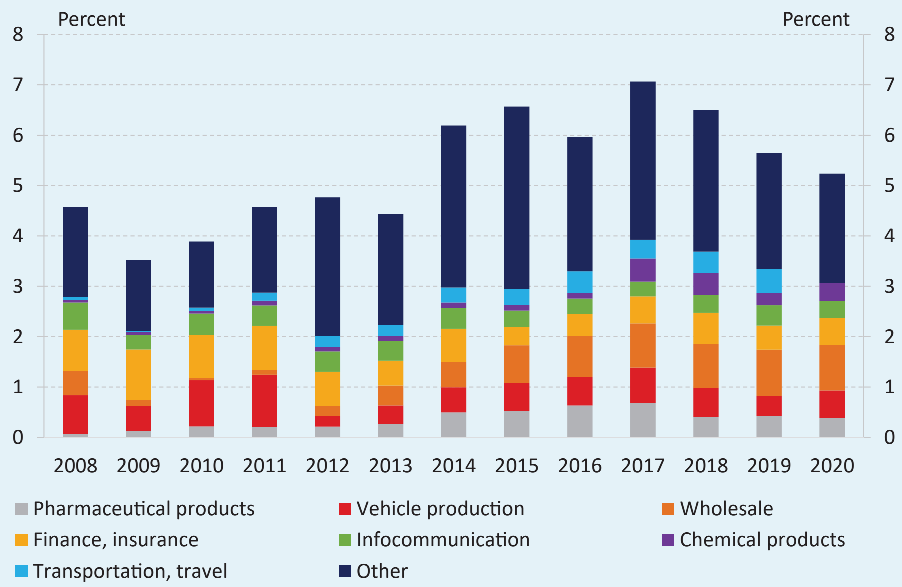
Chart 26: Growth in the profit of foreign-owned corporations as a proportion of FDI in selected sectors in 2020



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

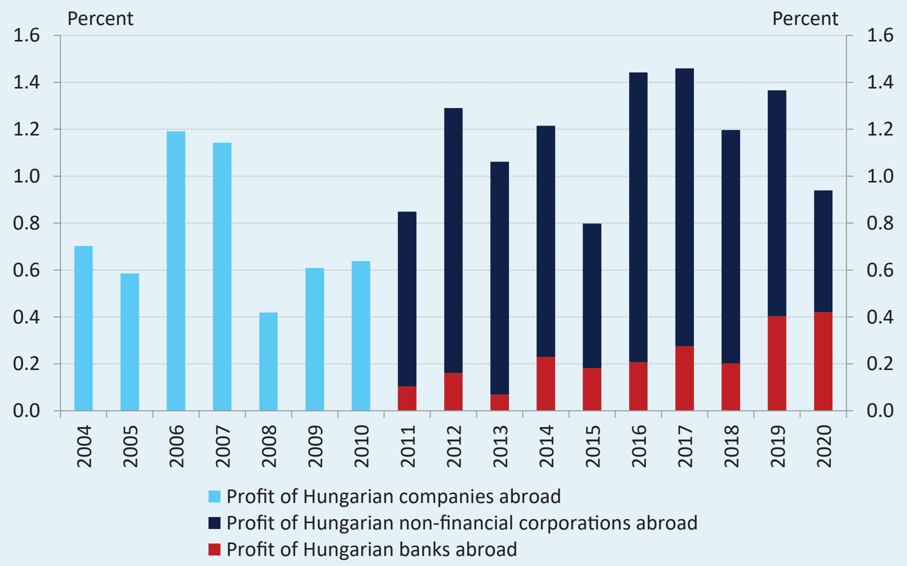
Foreign-owned companies' profit on FDI is relatively concentrated: six sectors account for nearly 60 percent of the profit. Until 2017, the rise in the profit of foreign-owned companies affected a wide range of sectors, with the largest sectors showing particularly high profitability. The erosion of GDP-proportionate profit in 2018-2019 also affected many sectors: it impacted other, smaller industries as well, in addition to the sectors with the highest weight in terms of income. In 2020, however, there was a relatively significant shift in the profitability of sectors compared to recent years: the profitability of the chemical and transport equipment, financial and insurance sectors increased slightly, while the profitability of information and communication decreased compared to the previous year, while the profitability of transport and tourism fell to zero, more than offsetting the performance gains of the aforementioned sectors. In addition, the profitability of smaller sectors outside the major industries continued to decline, but their share within total profits remained unchanged at around 40 percent, i.e. the income of the major industries still account for around 60 percent of the total profits of foreign companies operating in Hungary, which represents a relatively high concentration.

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



In parallel with a decline in the income of foreign-owned companies operating in Hungary, the profit of resident companies' foreign affiliates also fell in 2020. In addition to the income of foreign companies operating in Hungary, the profits of companies operating abroad and owned by residents also have to be taken into account in the income account of the balance of payments.[9] Starting from a relatively high level in 2017, as a proportion of GDP these profits declined significantly in 2018, before rising slightly again in 2019, as the profit of foreign subsidiaries doubled compared to the average of previous years. In 2020, the profit of resident companies realised abroad fell significantly, contracting by 0.4 percentage point as a percentage of GDP, which developed in the context of banks' steadily high profit (twice as much as in previous years), while the profitability of non-financial corporations operating abroad declined considerably.

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



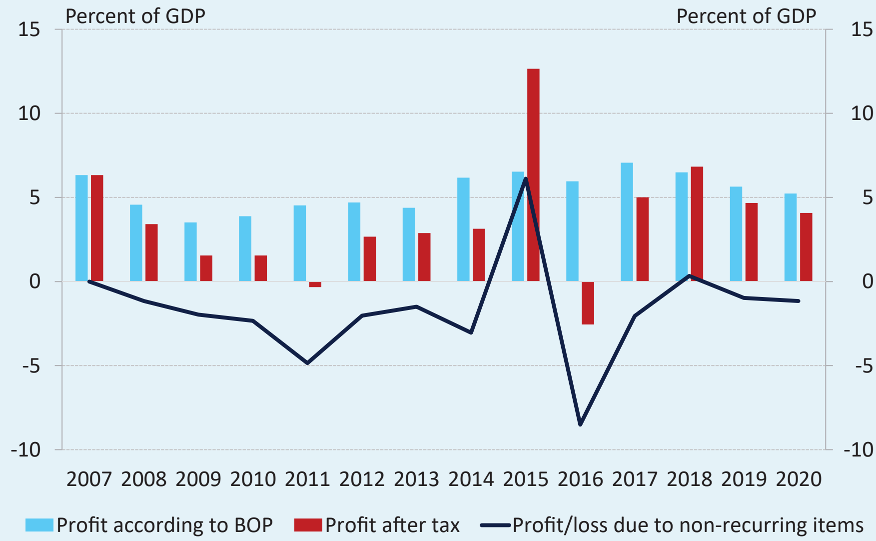
5.5 After-tax profit of foreign-owned companies

Similarly to income from "current operating performance", shown in the balance of payments, the after-tax profit of corporations also fell slightly in 2020, and thus the gap between the two indicators – mostly attributable to one-off items – stabilised at the low level of previous year (Chart 29). In line with international regulations, the statistics presenting the balance of payments show only foreign-owned companies' profit/loss according to the current operating performance concept. This means that one-off effects, which are typically related to revaluation, are excluded,[10] and thus the profit/loss – according to the current operating performance concept – in the balance of payments is much more stable. For example, in 2015 and 2016, the outlier profitability data of a multinational corporation operating in Hungary strongly affected the after-tax profit figure, while the income in the balance of payments, eliminating one-off items, was stable. The data available since 2008 show that items outside the current operating performance typically reduced the profit of corporations, and thus the elimination of these items in the balance of payments statistics led to higher income (and thus higher reinvested earnings given the size of the dividend payment realised) and a larger deficit on the income account. The difference between the two indicators was relatively small, i.e. there was no one-off, high-amount non-recurring item that could have affected the income significantly, and thus the after-tax profit/ loss and the profit/loss according to the current operating performance concept shown in the balance of payments differed by merely 1 percent of GDP. In 2020, the after-tax profit shown in the balance of payments (related to current operating performance) and as a percentage of GDP both fell moderately: the former amounted to 5.2 percent and the latter to 4.1 percent of GDP.

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

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

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

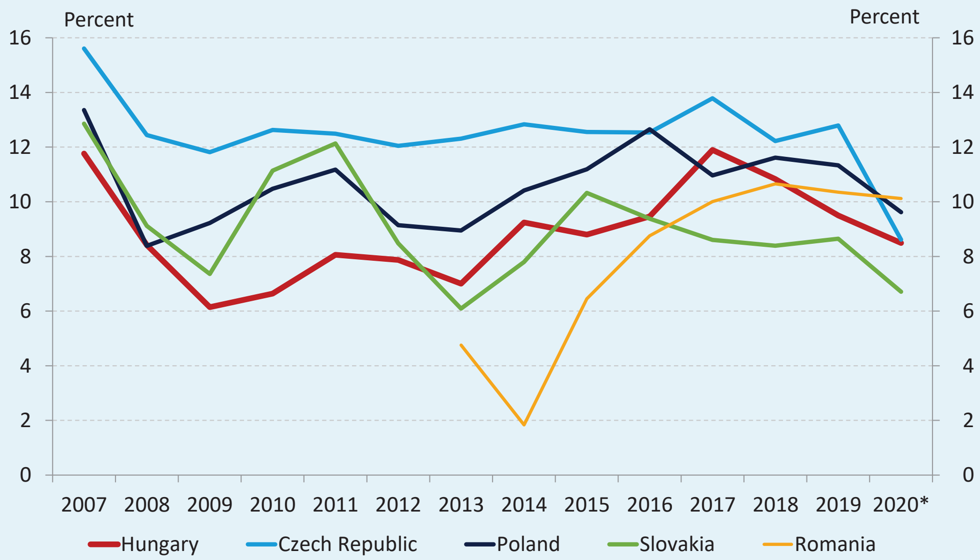


** The profit realised by foreign-owned corporations has a negative impact on the income account, in line with the income account of the balance of payments.*

5.6 International comparison

In 2020, the profitability of foreign companies declined in all of the countries in the region, presumably owing to the impacts of the pandemic. In the countries of the region, the profitability index showed a high degree of co-movement in the years following the financial crisis, likely due to the significant impact of international external trends. The ratio of foreign companies' income to FDI shares declined in several countries in the region after the 2008 crisis and started to rise from 2013. In 2020, however, the pandemic worsened the situation of the corporate sector on both the demand and supply sides, which reduced profits. In 2020, the biggest decline in profits – according to the current estimate, which presumably contains no actual data yet – was suffered by foreign companies operating in the Czech Republic, with their profitability falling to the level observed in Hungary of around 8.5 percent. The indicator remains the lowest for foreign companies in Slovakia, where profitability fell below 7 percent.

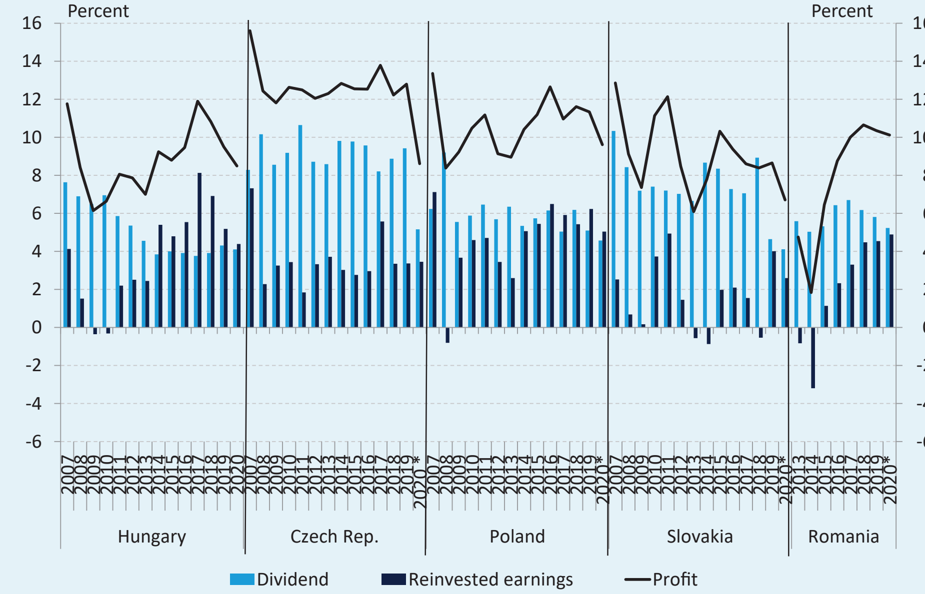
Chart 30: Return on FDI equity investment (value of the profit realised on the FDI stock relative to total FDI stock)



*Source: Eurostat. *The 2020 value for the countries of the region is presumably an estimate only.*

In the Czech Republic and Romania, foreign-owned companies responded to the fall in their profitability by reducing dividends, while in the rest of the countries a decline in reinvestments was observed (Chart 31). While previously an increase in profits typically entailed an expansion in dividend payments in the countries of the region, in the past ten years the ratio of dividend payment to equity stabilised at a low level in Hungary.[11] Preliminary data show that dividend payments in the Czech Republic fell sharply in 2020, while reinvested earnings were similar to those in previous year – the fall in dividend payments may have been largely due to the European Central Bank and the European Systemic Risk Board's proposed dividend cap on the banking system, while the Czech Republic has a much higher share of foreign-owned banks in the banking sector than Hungary (around 90 percent). In Romania, while dividends declined slightly, the volume of reinvestments as percentage of FDI increased moderately. By contrast, in Hungary, Poland and Slovakia, foreign companies responded to the decline in their profitability by reducing their reinvested earnings, with the largest decrease in Slovakia, which typically has a lower reinvestment rate. In Hungary, despite the decrease, the reinvestment rate remains high.[12]

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



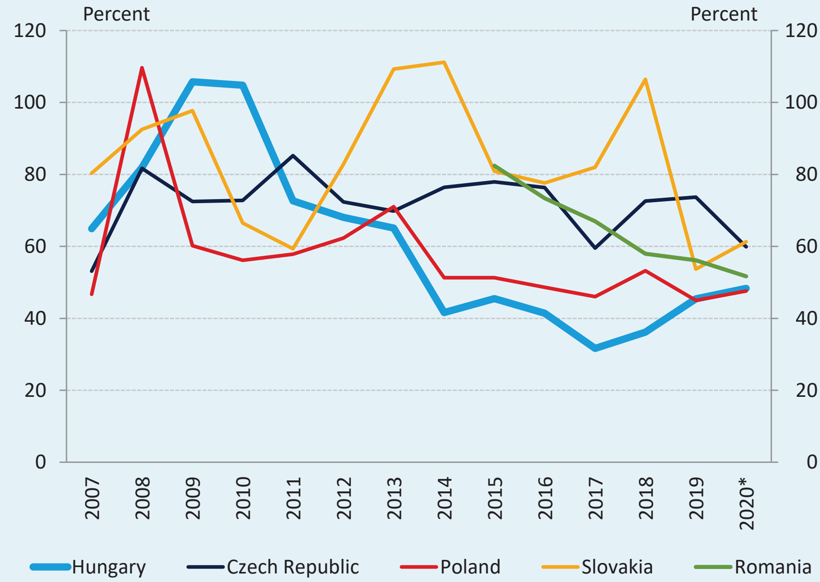
*Source: Eurostat. *The 2020 value for the countries of the region is presumably still based on estimation.*

In 2020, the gap between the dividend payment ratios in the countries of the region narrowed further, while Hungary still has one of the lowest ratio (Chart 32). Before 2009-2010, dividend payments by foreign corporations as a percentage of income steadily increased. As a result of the increased liquidity demand of foreign parent companies due to the crisis and of the decline in the growth prospects of the countries of the region, corporations in several countries also paid dividends to their foreign owners from the retained earnings accumulated from previous years' profits. The dividend payout ratio declined in all the countries from the middle of the decade, dropping to the greatest degree in Hungary, where foreign-owned corporations disbursed a mere 32 percent of their earned income as dividends in 2017. After 2018, in the case of foreign subsidiaries in Hungary the declining trend observed until then turned around and the dividend-to-income ratios started to rise slowly. In 2020, due to the different dividend payment patterns in the countries of the region – and the dividend cap in the Czech banking sector with high ratio of foreign-owned banks – the gap between the ratios narrowed, but it is still the lowest in Hungary and in Poland.

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

12 The treatment of superdividends may also increase reinvested earnings as a percentage of profit, because by reducing the profit it raises the role of the reinvested earnings as a percentage of income, while it reduces that of dividends. Hence, this may also contribute to the higher reinvestment, as a percentage of profits, by foreign-owned companies operating in Hungary. With regard to other countries of the region, no information is available whether they take into account the recommendations of the IMF concerning the application of superdividends.

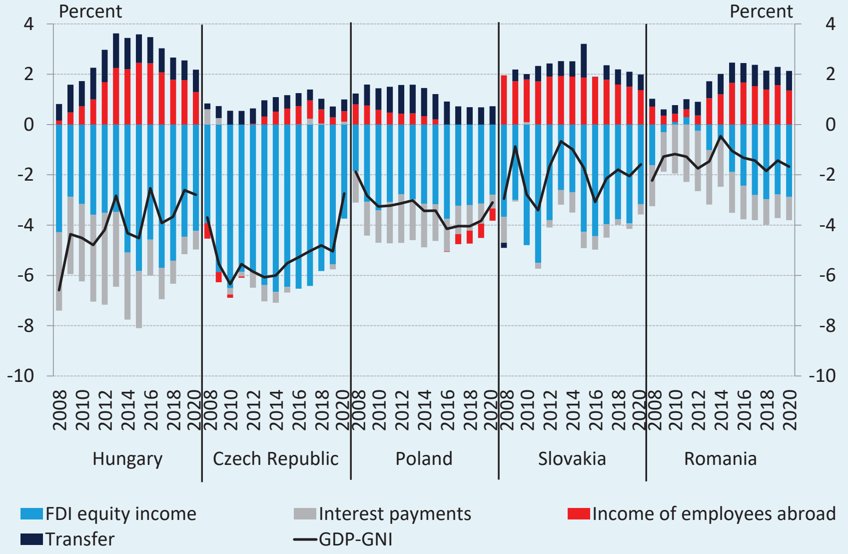
Chart 32: Ratio of dividend payments to profit



*Source: Eurostat. *The 2020 value for the countries of the region is presumably still based on estimation.*

In 2020, Hungary's GDP-GNI gap was still broadly unchanged, remaining close to the Czech and Polish average (Chart 33). The difference between gross domestic product (GDP) and gross national income (GNI), i.e. the GDP–GNI gap, is the result of summing up the income payments vis-à-vis the rest of the world. The factors of the indicator are: interest payments related to the non-resident sector (interest) net profit of foreign-owned companies (income on FDI shares), income of people employed abroad (wage) and foreign transfers (recognised among primary incomes). In view of the significant FDI in the countries of the region, the value of income is below the value of the gross domestic product. At the same time, the net income of people employed abroad and EU transfers typically reduce the difference between GDP and GNI in the countries of the region. Following the 2008 crisis, as a result of companies' improving profitability, profit outflows related to equity increased considerably in the countries of the region, which was partly offset by the rise in the income of those employed abroad and transfer inflows. In addition, the steady decline in interest expenditures also contributed significantly to the narrowing of the GDP–GNI gap. In 2020, the impact of the declining profit of foreign companies in Hungary and decreasing interest expenses was offset by the fall in the income of those employed abroad, and thus the indicator remained broadly unchanged. Of the countries of the region, the GDP-GNI gap decreased to the largest degree in the Czech Republic, which is primarily attributable to the large fall in the profit balance of foreign-owned companies, presumably resulting from the impacts of the coronavirus. In Poland and Slovakia, profits decreased only to a smaller degree, as a result of which the gap between the two economic indicators also declined only moderately. On the other hand, in contrast to the larger part of the region, the profit balance remained broadly unchanged in Romania, and thus the GDP-GNI gap widened slightly, amidst a minimal fall in foreign wages and rising profit.

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



*Source: MNB, HCSO, Eurostat. *The 2020 value for the countries of the region is presumably still based on estimation.*

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.

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