



30 June 2006

PRESS RELEASE

Hungary's balance of payments: 2006 Q1

- Consistent with its method of releasing and revising balance of payments data, on 30 June 2006 the MNB is publishing 2006 Q1 statistical data for the first time, simultaneously with publishing revised 2005 Q3–Q4 data.
- The off-shore status of special purpose entities, established earlier, ceased to exist on 31 December 2005. From January 2006, the MNB has been compiling Hungary's balance of payments and external balance sheet including data on special purpose entities, in accordance with international methodological standards. The overall data, calculated using this method, allow for international comparisons of statistics as well as for analyses of mirror statistics. The MNB continues to treat these statistics, i.e. which exclude SPEs' flow and stock data, as readily interpretable in economic terms. In defining the range of special purpose entities, the MNB cooperates with the CSO. For more details, see the methodological notes at the end of this press release.

In this press release, Hungary's balance of payments is presented excluding data on special purpose entities, in accordance with past practice. However, Hungary's balance of payments and external balance sheet are available on the Bank's website both excluding and including SPE data. From 2006 Q1, table of quarterly time series continues with data excluding those of special purpose entities.

According to quarterly data, Hungary's net financing capacity (i.e. its combined current and capital account balance), calculated using the top-down approach, barely changed in 2006 Q1 relative to the previous quarter, showing a deficit of EUR 1,282 million. After adjusting for seasonal effects, Hungary's net external financing requirement amounted to EUR 1,457 million, or 6.4% of GDP. Expressed in domestic currency, the net financing capacity amounted to HUF -327 billion in Q1. The net external financing requirement, derived as the combined current and capital account balance using the bottom-up method, was the equivalent of -8.4% of GDP, broadly unchanged from the previous quarter.¹

¹ The financing capacity, calculated in a bottom-up approach, was EUR -1,756 million. Not seasonally adjusted, it amounted to EUR -1,902 million. The difference between the two figures, calculated using the two methods, is shown in errors and omissions in the balance of payments.

Chart 1

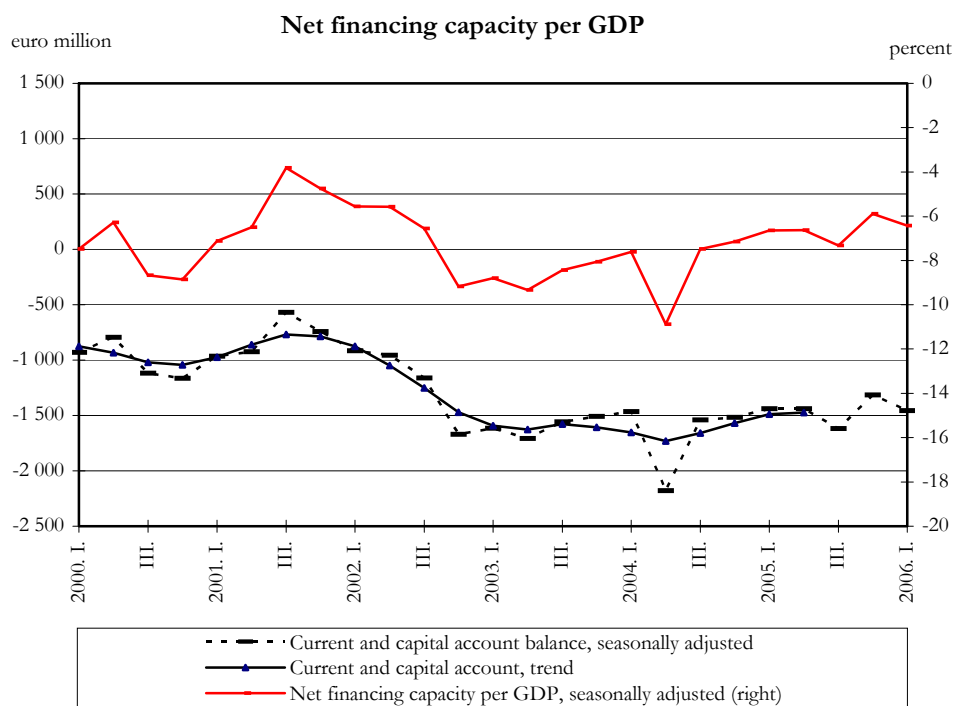
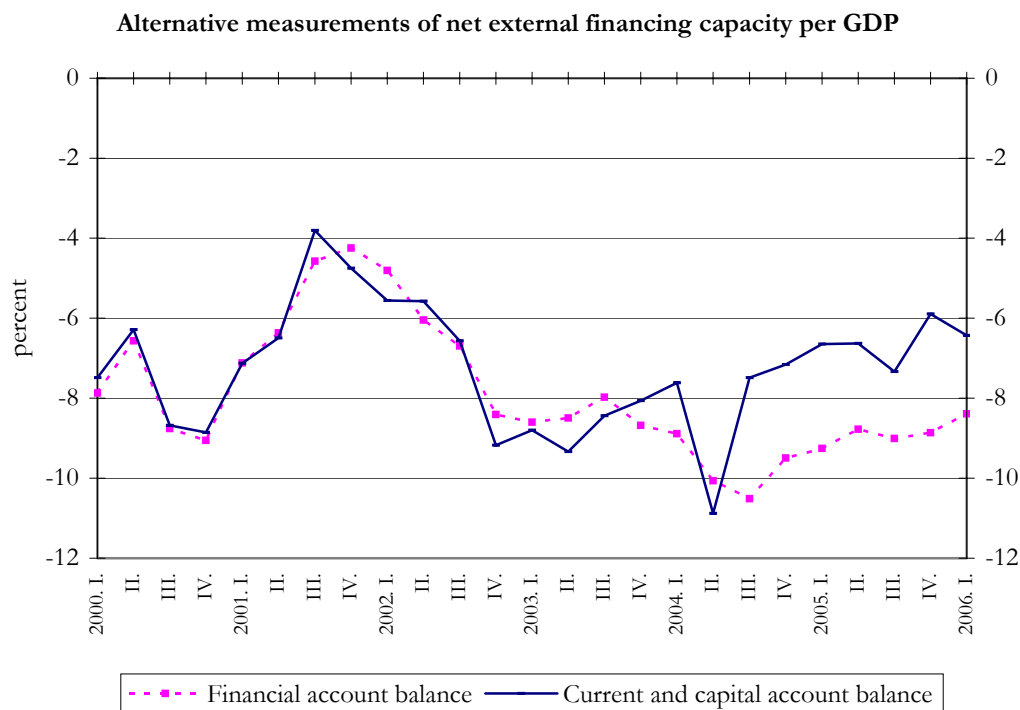


Chart 2

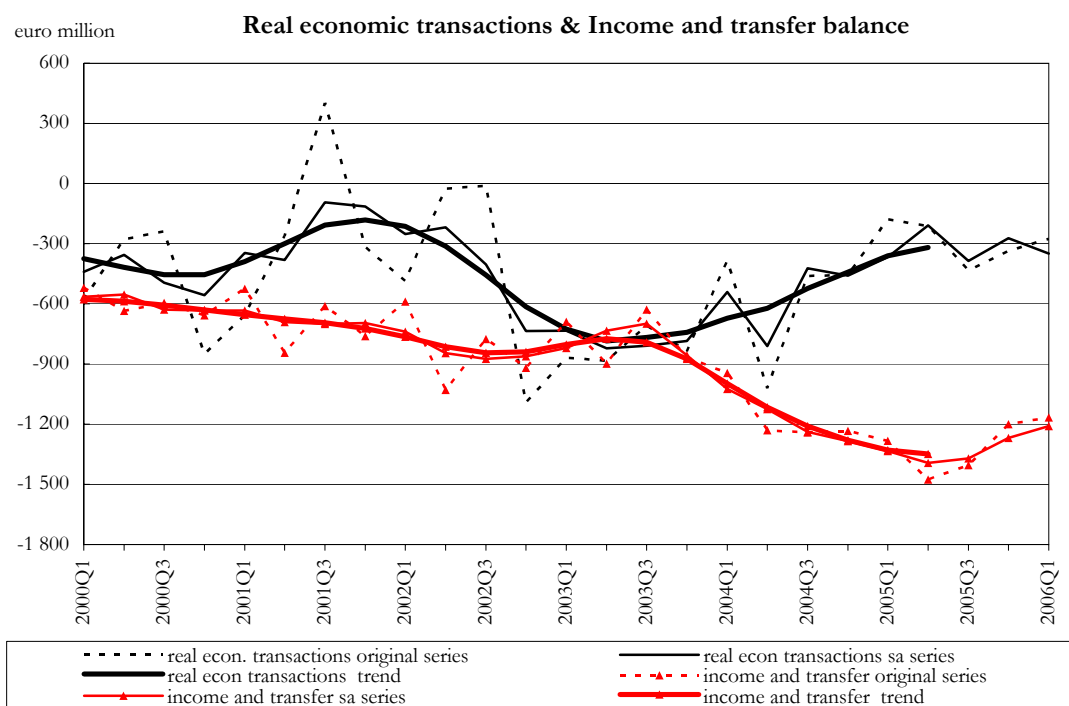


In 2006 Q1, the external financing requirement, calculated in the top-down approach, was the result of stable developments in the balance of real economic transactions, income as well as current and capital transfers relative to the previous quarter.

The current account deficit amounted to EUR 1,442 million in 2006 Q1. After adjusting for seasonal effects, the deficit was EUR 1.636 million.

The deficit on income and current transfers amounted to EUR 1,166 million in Q1. After adjusting for seasonal effects, the deficit was EUR 1,209 million. The balances of income and current transfers were broadly comparable with the previous quarter.

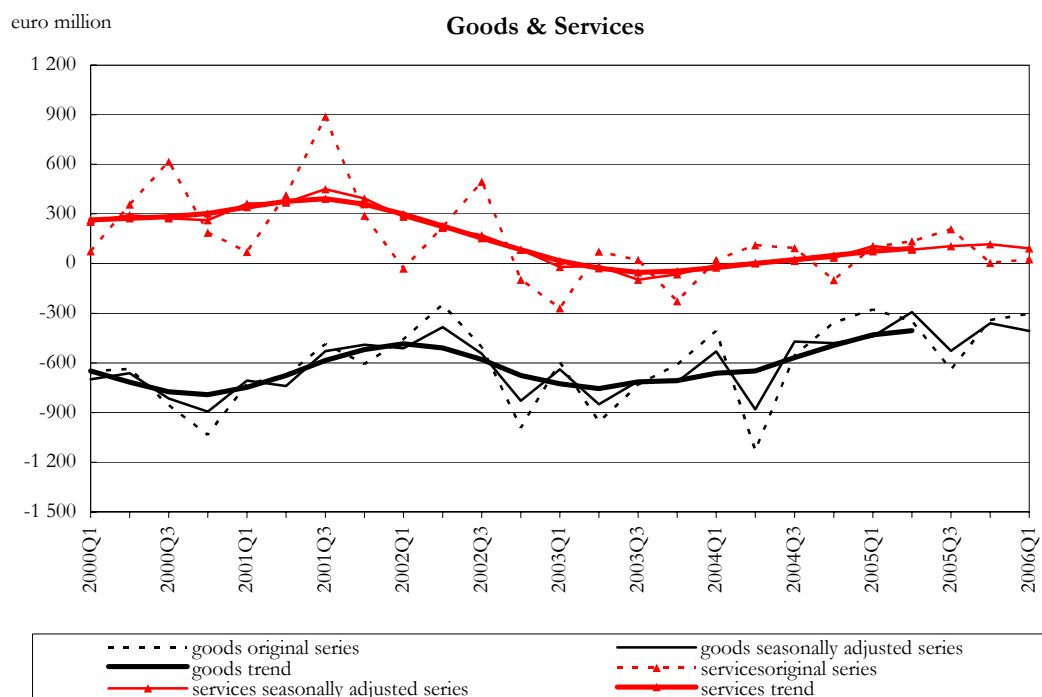
Chart 3



The deficit on trade in goods has barely changed in the past 12 months, amounting to EUR 407 million in 2006 Q1.

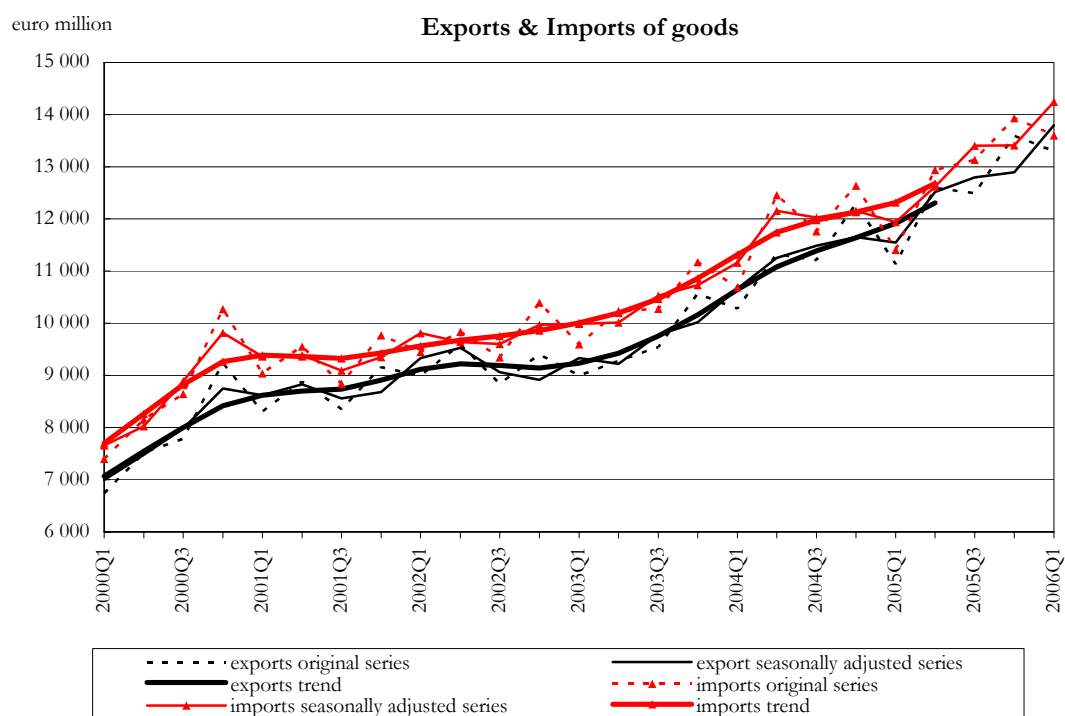
The services account surplus, seasonally adjusted, was EUR 91 million in Q1, less than in the previous quarter.

Chart 4



In 2006 Q1, the seasonally adjusted values of exports and imports both increased robustly. The value of exports was EUR 13.8 billion, the value of imports being EUR 14.2 billion.

Chart 5



Within services, the seasonally adjusted travel surplus was EUR 276 million and the deficit on other services was EUR 255 million. The travel surplus remained largely unchanged in

comparison with the previous quarter, explained by declines in both revenue and expenditure. Other service revenue fell in comparison with 2005 Q4, while expenditure continued to rise steadily. Overall, the deficit on other services was higher than in the previous quarter.

Chart 6

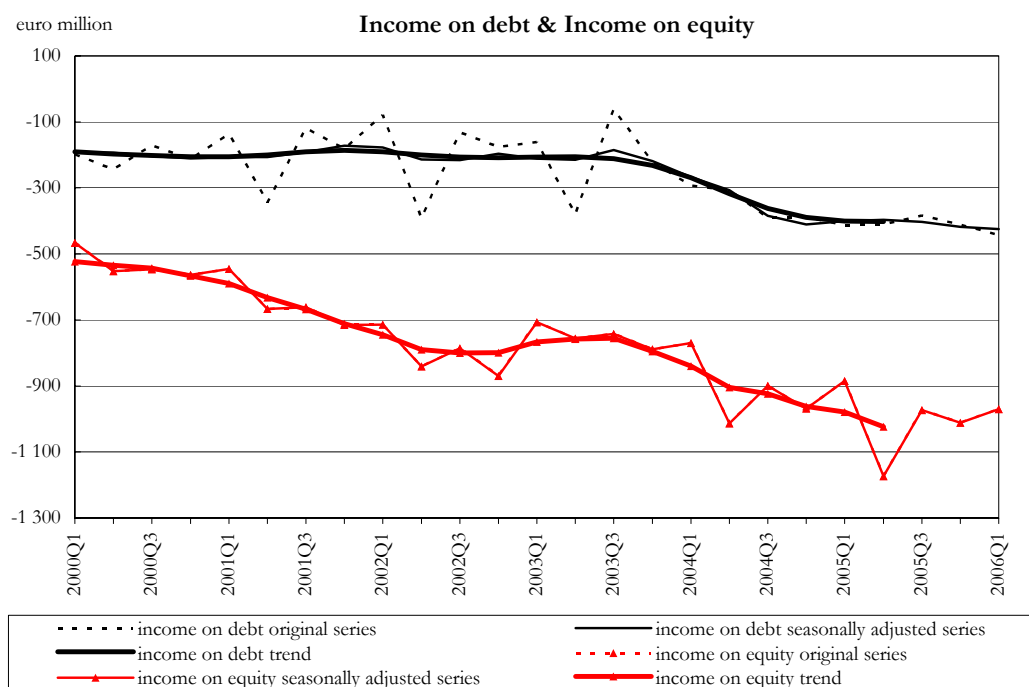


Chart 7



Developments in the balances on the income and transfer account were shaped by movements in income on equity and income on debt. In 2006 Q1, the seasonally adjusted deficit on income on debt amounted to EUR 425 million, and negative income on equity was EUR 970 million.²

Chart 8



The surplus on current transfers amounted to close to EUR 217 million in the review period.

The dates of actually drawing on EU funds explain the quarterly differences between the amounts recorded in the balance of payments. However, Hungary's GNI-proportionate contribution to the EU budget is recorded in equal amounts. Consequently, developments in the quarterly balance cannot be considered a trend effect.

Recorded as current transfers, the amount of transfers received from EU institutions was some EUR 206 million higher than Hungary's contribution to the Community budget in 2006 Q1. The balance of capital transfers to and from EU institutions showed a surplus of nearly EUR 75 million.

Inward and outward non-debt capital transactions showed a net inflow of EUR 1,483 million in 2006 Q1. The value of direct investment in equity capital, including reinvested earnings, was the balance of outward transactions by Hungarian residents in the amount of EUR 216 million and inward transactions by non-residents in the amount of EUR 1,523 million. Portfolio investment transactions in equity securities showed a net inflow of EUR 175 million in the quarter under review.

Central bank foreign exchange reserves amounted to EUR 17.8 billion at end-March 2006. Whole-economy gross foreign debt was EUR 3.1 billion higher than at the end of 2005 Q4. Gross foreign debt, including other investment capital recorded within direct investment, rose by EUR 6.2 billion in the period. Hungary's net foreign debt rose by EUR 1.0 billion, and by EUR 1.8 billion including other investment capital recorded within direct investment. Non-residents'

² This time series does not show seasonal patterns, consequently, the seasonally adjusted value equals the not seasonally adjusted value.

holdings of forint-denominated government securities amounted to EUR 10.7 billion at the end of March 2006, EUR 0.4 billion higher than at the end of 2005 Q4.

Table 1
Stock of Foreign debt of Hungary as of end of period

	2005	2006 Q1
III. Gross foreign debt, Total Economy (S.1) /1	57.7	60.8
II. Net foreign debt, Total Economy (S.1) /1	24.9	25.9
I. Gross foreign debt, Total Economy (S.1) (A+B) /2	68.3	74.5
A: General government and Central bank (S.13+S.121)	26.9	29.7
A.1. o/w.:debt denominated in HUF /3	10.9	11.5
B. Private sector (S.1-S.13-S.121)	41.4	44.8
II. Net foreign debt, Total Economy (S.1) (A+B) /2	30.4	32.2
A: General government and Central bank (S.13+S.121)	10.4	11.3
A.1. o/w.:debt denominated in HUF /3	10.6	11.2
B. Private sector (S.1-S.13-S.121)	20.0	20.9

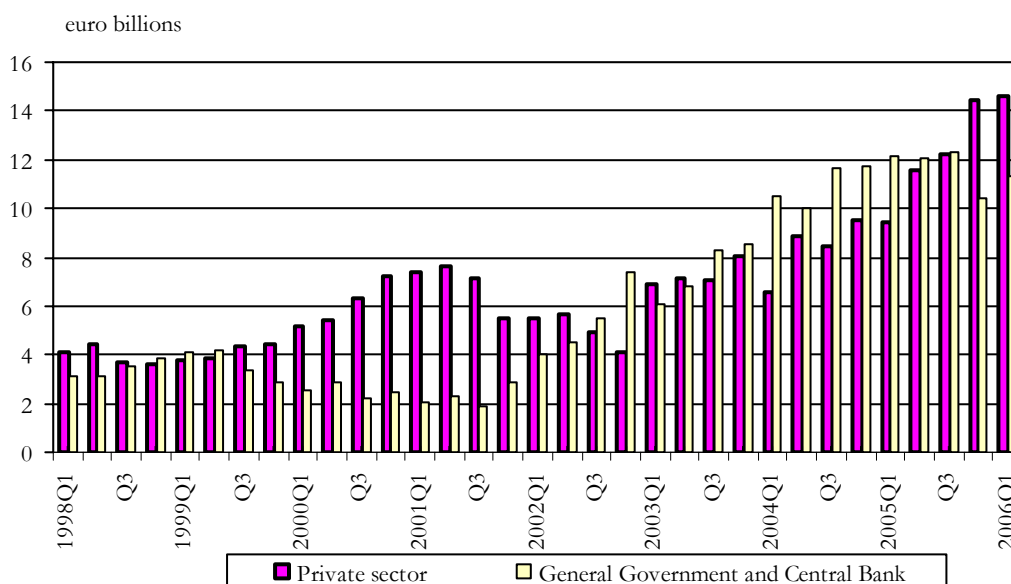
/ 1 Excluding other investment capital recorded within direct investment.

/ 2 Including other investment capital.

/ 3 Securities + other.

Note: Due to rounding, sub-totals may not add to total.

Chart 9
Net foreign debt of Hungary, 1998–2006*



* Excluding other investment capital recorded within direct investment.

Whole-economy net debt was EUR 25.9 billion at end-March 2006 (29.4% as a proportion of GDP). Including other investment capital recorded within direct investment, Hungary's net debt amounted to EUR 32.2 billion (36.6% of GDP). At the end of 2006 Q1, the net debt of general government and the MNB was EUR 0.9 billion higher than at the previous quarter's end.

Table 2
Balance of payments, Hungary

euro million

	2004					2005					2006
	Q. I.	Q. II.	Q. III.	Q. IV.	Q.I-Q.IV.	Q. I.	Q. II.	Q. III.	Q. IV.	Q.I-IV.	Q. I.
1. Goods, net	-408	-1133	-555	-358	-2453	-279	-347	-642	-342	-1610	-302
1.1. Exports	10277	11318	11208	12279	45083	11127	12594	12492	13592	49805	13298
1.2. Imports	10685	12451	11763	12637	47536	11405	12942	13134	13934	51415	13600
2. Services and income, net	-1010	-1177	-1167	-1421	-4776	-1174	-1425	-1124	-1388	-5111	-1357
2.1. Services*, net	22	112	93	-99	127	101	134	208	5	448	27
2.1.1. Exports	1952	2158	2465	2085	8660	2180	2440	2761	2539	9921	2117
2.1.2. Imports	1930	2046	2372	2184	8533	2080	2306	2553	2535	9473	2090
2.2. Income, net	-1032	-1289	-1260	-1322	-4903	-1274	-1559	-1332	-1393	-5558	-1384
2.2.1. Income on debt, net	-293	-307	-390	-388	-1379	-413	-411	-384	-411	-1618	-442
2.2.2. Income on equity, net	-770	-1013	-900	-968	-3651	-885	-1173	-973	-1011	-4042	-971
2.2.3. Compensation of employees, net	31	31	30	35	126	23	24	25	29	102	29
3. Current transfers	88	59	19	88	254	-9	83	-71	193	195	217
4. Current account balance	-1330	-2252	-1704	-1690	-6976	-1462	-1689	-1837	-1537	-6525	-1442
5. Capital account balance	-54	2	177	135	260	171	183	78	279	711	161
6. Net external financing capacity (4+5)	-1384	-2249	-1527	-1556	-6716	-1291	-1506	-1760	-1258	-5814	-1282
7. Non debt creating financing, net	781	-129	1389	1249	3290	111	-1405	1896	2810	3411	1482
7.1. Abroad, net	-316	-217	-67	-224	-824	-483	-570	-12	-146	-1211	-216
7.1.1. Equity capital	-215	-175	59	-96	-427	-479	-706	-60	-85	-1329	-150
7.1.2. Reinvested earnings	-101	-41	-127	-128	-397	-4	136	48	-61	118	-67
7.2. In Hungary, net	775	-11	1358	1160	3281	769	-536	1361	3511	5104	1523
7.2.1. Equity capital	237	464	327	55	1082	313	354	339	2431	3437	944
7.2.2. Reinvested earnings	538	-474	1031	1105	2199	456	-890	1021	1080	1667	579
7.3. Portfolio investment, equity securities, net	322	98	99	314	833	-175	-299	547	-555	-482	175
*- o/w: Travel, net	300	315	232	116	962	299	231	319	236	1085	301
credit	767	874	1061	562	3265	844	867	1082	640	3433	609
debit	468	560	829	446	2302	545	636	763	404	2347	308

Note: Due to rounding, sub-totals may not add to total.

Table 3
Balance of payments, Hungary (seasonally adjusted data) ^{a)}

euro million

	2004				2005				2006
	Q. I.	Q. II.	Q. III.	Q. IV.	Q. I.	Q. II.	Q. III.	Q. IV.	Q. I.
1. Goods, net	-531	-880	-472	-482	-439	-292	-528	-360	-407
1.1. Exports	10664	11249	11485	11648	11546	12516	12800	12894	13800
1.2. Imports	11159	12151	12022	12154	11939	12619	13404	13411	14246
2. Services and income, net	-1117	-1130	-1306	-1299	-1250	-1316	-1288	-1299	-1371
2.1. Services	-9	5	15	36	105	84	106	117	91
2.1.1. Travel, net	299	275	242	210	267	225	284	270	276
credit	904	853	850	888	940	875	847	766	713
debit	586	580	631	596	637	626	573	529	477
2.1.2. Other services, net	-260	-221	-191	-164	-180	-115	-163	-180	-255
credit	1240	1298	1387	1417	1477	1583	1645	1738	1700
debit	1577	1611	1602	1605	1628	1674	1807	1826	1865
2.2. Income, net	-1108	-1135	-1321	-1335	-1355	-1400	-1394	-1417	-1462
2.2.1. Income on debt, net	-267	-307	-384	-411	-400	-396	-403	-418	-425
2.2.2. Income on equity, net	-770	-1013	-900	-968	-885	-1173	-973	-1011	-971
2.2.3. Compensation of employees, net	34	32	31	29	26	26	26	26	29
3. Current transfers	84	45	26	98	-14	70	-64	203	213
4. Current account balance	-1489	-2022	-1811	-1640	-1650	-1500	-1843	-1532	-1636
5. Capital account	-54	2	177	135	171	183	78	279	161
6. Net external financing capacity	-1466	-2179	-1541	-1517	-1440	-1440	-1620	-1316	-1457

* * * * *

The Bank will release data on Hungary's balance of payments and international investment position for 2006 Q2 as well as balance of payments and IIP statistics for 2005 on 30 September 2006.

* * * * *

a) Methodological notes to seasonal adjustment:

The method used to seasonally adjust the sub-components of the current account as follows:

The components of the current account are seasonally adjusted using the SEATS TRAMO software, within the Demetra interface, in line with the recommendations of Eurostat.

The effects of *holidays* are eliminated using a built-in variable designed for holidays in Hungary; the *working-day effect* is eliminated using two regression variables.

Of the various *outliers*, the software identifies additive outliers, pertaining to one period, and transitory changes, pertaining to several periods.

Consistent data are available from 1995. The Bank, therefore, revises data for the period beginning with that year. In order to minimise revisions, the same model setting is being used for one year. The press releases include a five-month moving average of the seasonally smoothed data, with diminishing weights proceeding symmetrically on both sides of the centre ($Y_t = 1/9 * X_{t-2} + 2/9 * X_{t-1} + 3/9 * X_t + 2/9 * X_{t+1} + 1/9 * X_{t+2}$), instead of the trend calculated by the programme.

The balance outcomes are seasonally adjusted using the indirect method. This means that the seasonal effects are eliminated from the sub-components, and the balances and the aggregates are derived from the seasonally adjusted data. Consequently, the seasonally adjusted current account balance outcomes can be reproduced from the seasonally adjusted data of the sub-accounts.

Notes to the press release and the tables:

- 1 The codes attached to the names of the sectors and sub-sectors (e.g. S.121) refer to the corresponding groups of the classification generally used in international practice. The definitions of the individual sectors can be found on the Bank's web site at Financial Data...Statistical Releases, 'Sector classification in the MNB's statistical press releases from June 2001' (www.mnb.hu).
- 2 In conformity with the data dissemination standards of the IMF, the MNB will publish data on external debt in a new composition among the statistical times series on its website, beginning with the release of 2003 Q2 data. The difference between gross foreign debt, published earlier on a regular basis, and the new category of debt is that the latter does not group liabilities arising from financial derivatives into the elements of debt. In the following, both data will be published on the Bank's website, accompanied by references to the relevant types of debt.

MAGYAR NEMZETI BANK
STATISTICS

Methodological notes

to recording data on flows and stocks of special purpose entities (SPEs)³

in the balance of payments from 1 January 2006

Under an amendment to the Corporate Taxes Act in November 2002 effective from 1 January 2003, enterprises with off-shore status cannot be established in Hungary and the existing off-shore firms must be transformed into normal businesses by 1 January 2006 the latest. In the case of these transformed businesses, however, the Bank continues to apply the earlier recording approach, irrespective of the change in legal status, provided that the core activities of firms have remained broadly unchanged.

According to the international statistical recommendations, an off-shore firm is resident in the country in which it is registered, similarly to any other enterprise. Accordingly, data on flows and stocks of these enterprises must be recorded on a gross basis, as these overall figures allow for international comparisons of statistics and for bilateral comparisons. However, the data on enterprises playing a role in the intermediation of substantial financial resources within groups of company distort the statistics underlying the real economic and financial processes of the national economy. The reason for this is that these firms set up business in a given country in order to exploit taxation advantages; they play an intermediary role within a given group of company due to channelling funds (the direction and size of which are controlled by their parents), rather than being a target for direct investment (net flows on various financial instruments are close to zero taking a longer period). The problems related to recording special purpose entities conducting business abroad in the balance of payments are as follows:

Current account

By definition, enterprises operating abroad have only marginal, if any, links to domestic economic processes. In most cases they play a passive intermediary role in transactions, with their earnings from transactions with residents being negligible. In principle, their activities influence the current account balance calculated on an accruals basis, although only the gross figures. Nevertheless, recording their activities raises difficulties in a number of respects:

- Corporate sector profits/losses remain estimates based on domestic income processes until September of the year following the reference year. As there is little relationship between the financial results of these companies and domestic economic processes, they are not included in the earnings estimates. However, a significant portion of revenues originating from abroad (e.g. their interest income and expenses) are immediately recorded in the current account, and therefore the balance becomes distorted.
- Important economic information can be obtained by disaggregating the current account into the real economic as well as the transfer and income accounts, and by decomposing the income account into interest, dividend and reinvested earnings. The activities of SPEs also cause distortions to these indicators.

Financial account

One major characteristic of SPEs is that they channel relatively large funds. Consequently, recording their transactions particularly strongly increases the gross figures of the financial

³ Enterprises pursuing passive functions abroad and engaged in channelling funds.

accounts. The roles that debt generating and non-debt instruments play in the current account balance are of special importance in terms of financing it. Decision makers, investors and rating agencies treat this information as highly important in regard to the vulnerability of the forint and the sustainability of external equilibrium. Consequently, the problem arises when the assets and liabilities of an SPE are not in the same instrument category. Recording SPE data causes problems in a number of respects:

- Enterprises pursuing activities abroad may cause distortions to the percentage shares accounted for by debt generating and non-debt financing.
- The size of direct investment inflows is an important issue with regard to assessing developments in external balance and the business cycle.

From January 2006, based on economic considerations, the Bank continues to distinguish between data on flows and stocks of SPEs and to compile the balance of payments and the external balance sheet excluding SPEs. Nevertheless, the Bank compiles the balance of payments and the external balance sheet including SPEs, in accordance with the international statistical recommendations. (However, no estimates of SPEs' reinvested earnings and dividends are provided – reported data will only be included in the annual statistics.)

In defining the range of special purpose entities, the MNB cooperates with the CSO. Of the indicators available, only those are used to compile the registry which capture the major characteristic feature of these firms, namely, that basically they pursue their activities abroad and their linkages to the domestic economy are marginal:

- In their balance sheets, the weight of real assets is negligible relative to that of financial assets, with the latter consisting mainly of shares, long-term loans and securities.
- Their sales are made up primarily of export revenue.
- Numbers of staff are very low (90%–95% of firms employ staffs of maximum 2).
- Their material costs are negligible.
- The name of a firm refers to the 'off-shore type' of activity.

In Hungary there are 768 active enterprises which can be grouped into special purpose entities. The flows and stocks of these enterprises vis-à-vis non-residents are very large. As recording SPE data would cause a significant distortion to the contents of the various economic categories, the Bank publishes Hungary's balance of payments excluding SPE data in the press release. However, the Bank's website and reports to international institutions contain Hungary's balance of payments and external balance sheet including SPE data, in accordance with international methodological standards.

Effect of recording SPE transactions on external balance sheet data

	EUR billion		per GDP, %	
	excluding SPEs	including SPEs	excluding SPEs	including SPEs
FDI in Hungary	60,9	103,5	69,2	117,6
FDI abroad	12,8	60,1	14,5	68,3
Net external liabilities	84,8	79,7	96,3	90,5
Net external debt including FDI other capital	32,2	2,5	36,6	2,8
Net external debt excluding FDI other capital	25,9	25,6	29,4	29,1