MAGYAR NEMZETI BANK

REPORT ON THE BALANCE OF PAYMENTS

APRIL
2017

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

Letters 27
Gábor Bethlen

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

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

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

This analysis was prepared by the MNB's Directorate Monetary Policy and Financial Market Analysis under the general guidance of Barnabás Virág, Executive Director in charge of Monetary Policy and Lending Incentives. Contributors: Dániel Babos, Anna Boldizsár, Gabriella Csom-Bíró, Orsolya Csortos, Bence Gerlaki, Zsuzsa Kékesi, Balázs Kóczián, Péter Koroknai and Balázs Sisak. The Report was approved for publication by Deputy Governor Márton Nagy.

This Report is based on information pertaining to the period ending 23 March 2017.

SUMMARY

The external vulnerability of the Hungarian economy continued to decline in 2016. The current account advanced to a historic high of nearly 5 percent of GDP, while net lending fell owing to the temporary decline in EU transfers. However, Hungary's external savings position remains significant, which – in addition to the larger-than-usual net inflow of direct investments – supported a considerable decline in the external debt ratios in 2016. In our report, in addition to the usual quarterly processes, we also analyse 2016 as a whole and in our special topic we discuss the Hungarian developments in a regional context.

Developments in the real economy moved on a dual trend, as the surplus on the current account balance continued to increase, while net lending declined. In addition to the balance of trade surplus and the favourable changes in the income balance deficit, drawdowns of funds fell significantly with the closing of the EU's previous budgetary cycle, which caused a considerable decline in the transfer balance. **The surplus on the balance of trade rose to a historic high, exceeding 10 percent of GDP**, owing to a decline in GDP-proportionate imports due to lower public investments, along with the high services balance and strong improvement in the terms of trade. Although the increase in the volume of Hungarian exports slowed during 2016, the share of the Hungarian economy in the export market continued to grow. **Net lending was also boosted by a modest downward shift in the income balance deficit**, which was also supported by both the gradual decline in external debt and falling yields.

The lower use of EU transfers was also reflected in net lending, which fell as a result of financing items. The lower outflow of funds resulted from the ongoing significant decline in external debt amounting to EUR 7 billion, and a net FDI inflow of EUR 3 billion, which considerably exceeded the previous year's value. The net external debt of banks and companies continued to decline in 2016, but in contrast to the previous years, the net external debt of the government rose. At the same time, it is important to highlight that – due to maturing foreign currency bonds and the sale of government bonds by non-residents – the downward trend in the government's gross external debt continued in 2016. The sale of government bonds by non-residents is accompanied by unbroken strong domestic demand from banks, supported by household demand and the self-financing programme. In addition to the funds from the considerable deposits of the private sector, **the extremely large reduction in banks' debt** was also driven by the foreign currency liquidity received from the central bank related to the forint conversion. In parallel with this, these foreign currency transactions also contributed to the increase in the government's net debt through the reduction of foreign currency reserves. The decline in bank's funds mainly materialised in the short-term segment, and thus the maturity structure once again changed favourably.

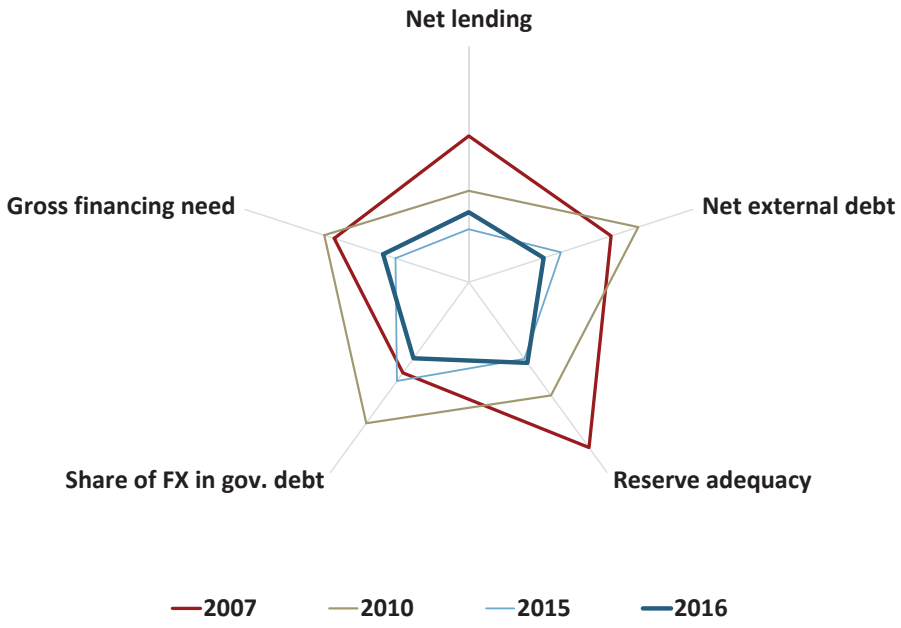
The adjustment of external debt ratios which are of key importance in terms of Hungary's vulnerability continued in 2016, in line with the considerable net lending. Net external debt fell to nearly 18 percent of GDP, down by almost 7 percentage points compared to end-2015. Due to the continuing deleveraging of balance sheets in certain sectors, the **net external debt of the private sector continued to fall, mainly due to the banking system.** This was primarily reflected in the rising assets of foreign banks, the volume of which already exceeds the external debt of banks. In addition to net external debt, the gross indicator also dropped considerably, falling to below 69 percent of GDP, as a result of the decrease in the government's gross external debt, supported by the self-financing programme. **The downward trend in GDP-proportionate gross government debt and within that in the foreign currency ratio, as well as in the proportion of foreign ownership within government debt observed since 2011, continued in 2016:** by the end of 2016, the foreign ratio had fallen to below 40 percent, and the foreign currency ratio (which had reached a record high of 50 percent at the end of 2011) had fallen to below 25 percent, which played strong role in the improvement in Hungary's credit rating. **The decline in external vulnerability was also bolstered by the further reduction in short-term external debt based on residual maturity**, which fell to EUR 18.4 billion by the end of 2016. Accordingly, Hungary's gross borrowing is expected to be lower in 2017 than it was in 2016, but foreign funds will be continuously required for the renewal of Hungary's maturing foreign debt. Despite the downward trend mainly stemming from the forint conversion and self-financing programme, the level of foreign currency reserves continues to substantially exceed the level expected by investors.

Examined from the point of view of the sectors' savings, the decline in net lending can be primarily attributed to the fall in the private sector's financial savings, while the government's net borrowing fell to a historically low level of

1.3 percent of GDP annually. The net lending of the corporate sector ebbed to almost zero by the end of 2016, while the decline in households' net financial savings continued, in line with rising consumption. In addition to the reduction in corporate income and transfers received, a mild increase in accumulation expenses at the end of the year also contributed to the drop in private sector net lending, while in the case of households the recovery in lending and the improving income and labour market perspectives also played a role. Households' robust demand for government bonds continued in 2016, which reduced reliance on capital inflows by further increasing the sector's role in the financing of public debt. The rise in budgetary income in parallel with the increase in wages and consumption, as well as the reduction of expenses related to the declining interest expenses and moderate public investments, also contributed to a low annual general government deficit.

In 2016, external balance developments in Hungary fundamentally shifted in a favourable direction (Chart 1: values closer to the centre – in practical terms, the closing of the "net" – signal lower vulnerability from the given indicator). Due to the temporary decline in EU transfers, the country's net lending fell, which resulted in a slightly less favourable ratio for both net and gross borrowing compared to the previous year's figures. Nonetheless, the net position is still very considerable (and is also high by regional standards), and thus net and gross debt ratios continued to decline. Gross borrowing may fall again in 2017, and the growth in 2016 can basically be traced back to the lower net lending stemming from falling EU transfers. In addition to the high household savings and the MNB's self-financing programme, the significant purchases of domestic government bonds continued, leading to a further decline in the foreign currency ratio of government debt. Despite the fall in foreign currency reserves, reserve adequacy did not change considerably: the reserves of EUR 24.4 billion at the end of 2016 still exceed the short-term external debt by more than EUR 6 billion and outperform the Guidotti-Greenspan rule closely monitored by investors.

Chart 1: Stylised depiction of Hungary's external balance position



Note: The chart presents the difference of individual indicators from the long-term average scaled by dispersion; smaller values indicate the strengthening of the fundamental (e.g. lower borrowing).

In the **special topic** presented in this April Balance of Payments Report, **we analyse the data of the Hungarian balance of payments in an international comparison. The net lending of the Hungarian economy continued to rank among the highest in an EU-level comparison in 2016.** Hungarian net lending remained at the forefront, despite the fact that the surplus on the transfer balance fell significantly in 2016, which can be explained by the extremely high trade balance surplus, also supported by the **service balance which was high even in a regional comparison**. Meanwhile, external debt continued to fall more intensely than in the regional countries, as a result of which both **net external debt and net external liabilities dropped to the level of the Slovak and Polish figures. Although the level of gross external debt also fell, it remains higher than in the other countries of the region.** At the same time, gross financing need based on original maturity was once again the lowest among the countries of the region in 2016.

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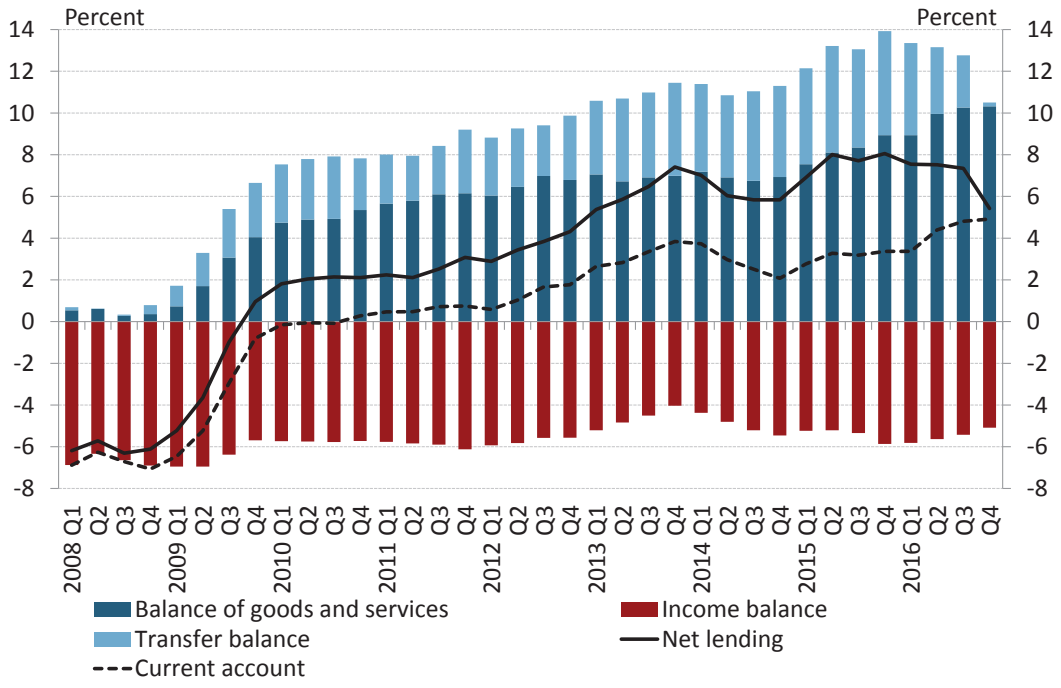
1. REAL ECONOMY APPROACH

The surplus on the current account of the Hungarian economy increased to nearly 5 percent of GDP, but due to the decline in EU transfers, net lending shrank to 5.4 percent of GDP in 2016, as this reduction in the transfer balance was not offset by the trade balance surplus or the favourable changes in the income balance deficit. The increase in the balance of trade surplus to a historic high of over 10 percent of GDP can be linked to declining imports, in line with lower investments (attributable mainly to the public sector), the high services balance and the significant improvement in the terms of trade. With closing the previous budgetary cycle of the EU, the use of funds fell significantly, resulting in the decrease in the transfer balance. The net lending was boosted by a modest downward shift in the income balance deficit, which was also supported by the gradual decline in external debt and falling yields.

Based on the real economy approach, in 2016 Q4 the four-quarter net lending of the Hungarian economy amounted to 5.4 percent of GDP (Chart 2). According to the seasonally unadjusted figures, net lending in Q4 amounted to EUR 750 million, with surpluses of almost EUR 700 million and EUR 50 million on the current and capital accounts, respectively. Four-quarter net lending fell to 5.4 percent of GDP at the end of the year, as a result of the current account surplus increasing to a historic high of nearly 5 percent and the strong decline in the capital account. The trade balance surplus increased to over 10 percent of GDP (and thus remains the most significant item supporting the robust net lending), but – in line with the major decline of inflow of EU funds – the transfer balance fell to 0.2 percent of GDP by the end of 2016. In addition to this, similar to previous quarters, the income balance continued to improve modestly, as the four-quarter indicator fell to 5.1 percent of GDP.

Chart 2: Developments in net lending and its components* (four-quarter values as a percentage of GDP)

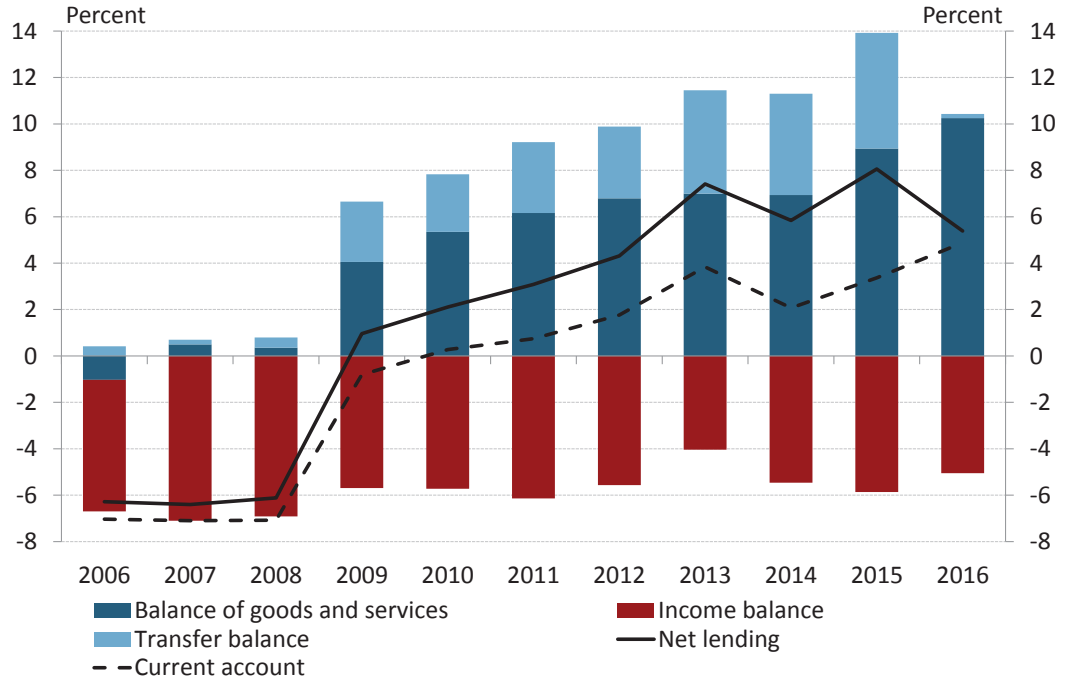


Source: All charts by the MNB unless otherwise indicated.

In 2016, Hungary's net lending fell compared to the previous year, but the current account surplus increased to a previously unseen level. The reduction in net lending was caused primarily by the significant decline in transfer balance, which was partially counterbalanced by the goods and services balance, which increased to a historical high. The surplus on the transfer balance fell to 0.2 percent of GDP at the close of the EU's 2007-2013 budgetary cycle in 2015, which is significantly lower than the previous year's value. The close of the EU's budgetary cycle reduced net lending mainly via the capital account, but only slightly impacted the current account balance. On the other hand, considering the entire year, changes in the trade balance and income balance improved net lending. The goods and services balance surplus can be explained by goods imports declining in GDP-proportionate terms and the high services balance. The income balance deficit improved further compared to the previous year,

which was fundamentally supported by the low yield environment and declining interest payment as a result of lower gross external debt.

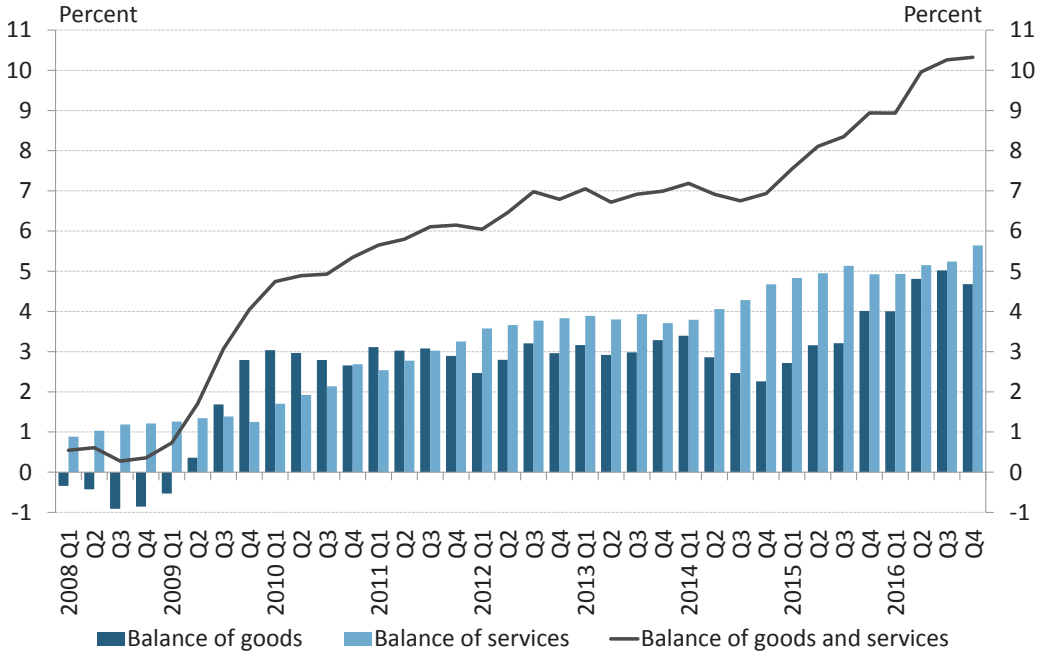
Chart 3: Developments in net lending and its components* (annual values as a percentage of GDP)



1.1. Trade balance

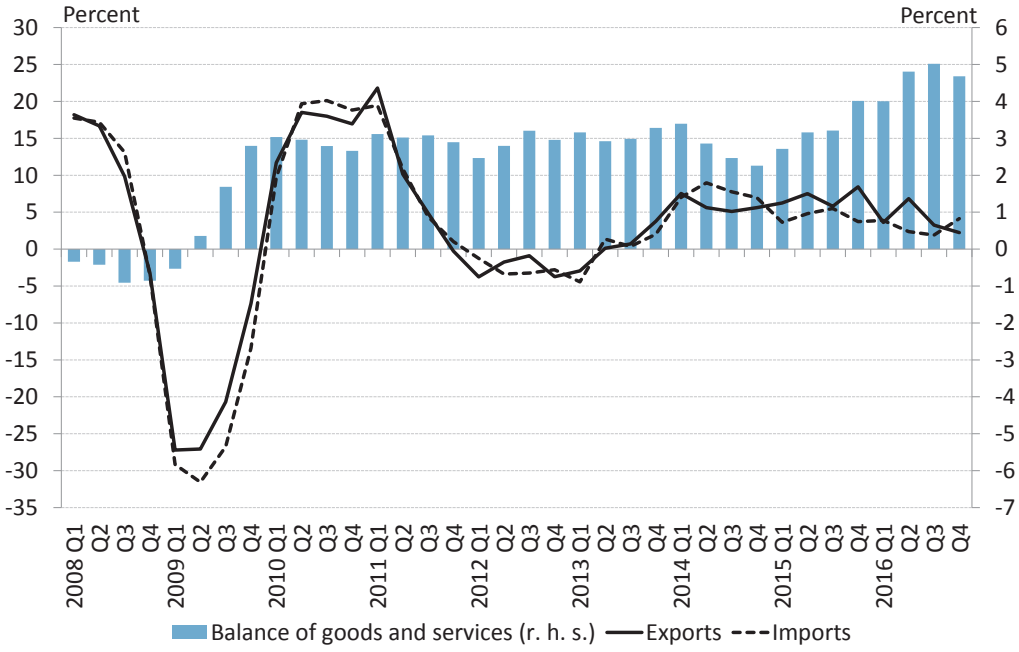
In 2016 Q4, the balance of trade of the Hungarian economy stabilised at a high level of more than 10 percent of GDP. Following the dynamic increase in the surplus on the goods and services balance seen since the end of 2014, it amounted to over 10 percent of GDP in the past three quarters (Chart 4). The modest volume growth in Q4 occurred in parallel with a downward shift in the goods balance and an upward shift in the services balance. In addition to the strong increase of household consumption, rising imports of fuel may have also played a role in the drop in the goods balance surplus, as well as the fact that in Q4 the terms of trade improvement characteristic of previous quarters no longer supported the surplus on the balance of trade. Overall, the dynamics of industrial production slowed down in 2016 compared to previous years, mainly due to moderate external demand, and within that to the structural changes in the German economy, which is Hungary's main external trade partner. By contrast, the moderate level of import-intensive investments – impacting mainly the public sector – continued to support high net exports. Overall, at the end of the year, based on four-quarter data, the goods balance fell to 4.7 percent of GDP. In parallel with this, in Q4, the services balance increased to over 5.6 percent of GDP, primarily supported by service centres (shared service centres) operating in Hungary, tourism and the balance of transport services.

Chart 4: Developments in the balance of trade and its components (four-quarter values as a percentage of GDP)



At the end of 2016, the growth in the goods balance was lower than the growth in the import volume, and accordingly four-quarter net goods exports fell slightly. In the first three quarters, exports grew faster than imports, which was reflected also in the increase in the goods balance surplus (Chart 5). On the other hand, at the end of the year – due to rising demand for imports in line with the steep rise in inventories and decelerating exports in parallel with waning external demand – the goods balance surplus declined, but it still exceeds the level of 2015.

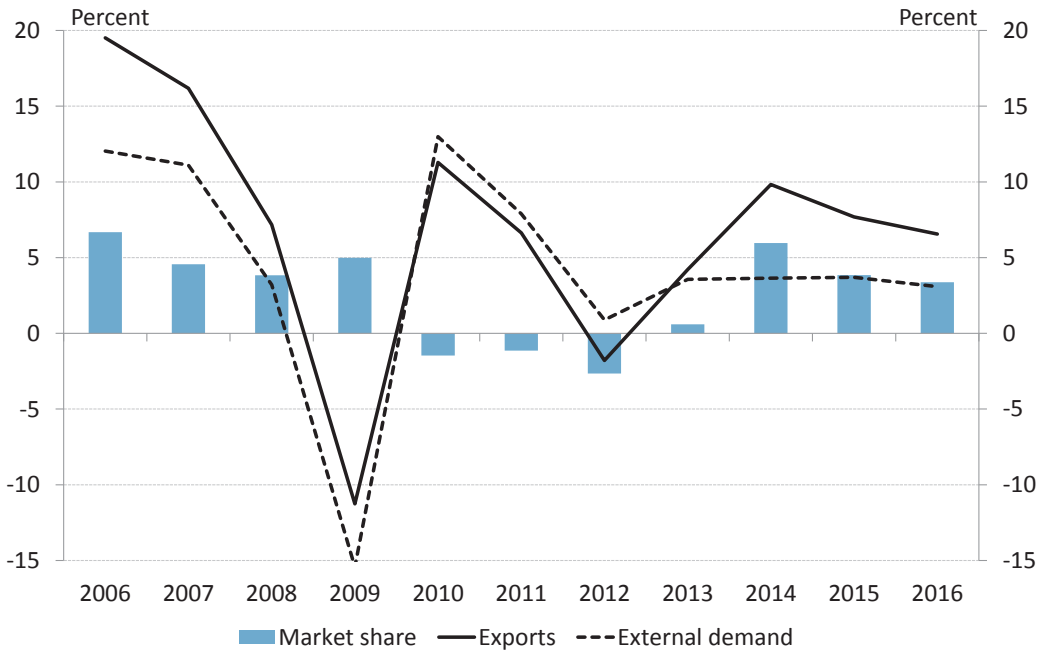
Chart 5: Change in the volume of exports and imports of goods (annual growth rates) and the trade balance (four-quarter values as a percentage of GDP)



Hungary's export volume continues to grow faster than its markets, as a result of which Hungary's export market share increased further (Chart 6.). External demand continued to decelerate, and this can be traced back to numerous factors. In recent years, there has been a structural change in Germany (which is Hungary's most important export partner), as growth shifts increasingly towards domestic consumption instead of export sales. In addition to this, the slower-than-expected growth in China and the Eurozone may have hampered export demand. In parallel with the slowdown in Hungary's

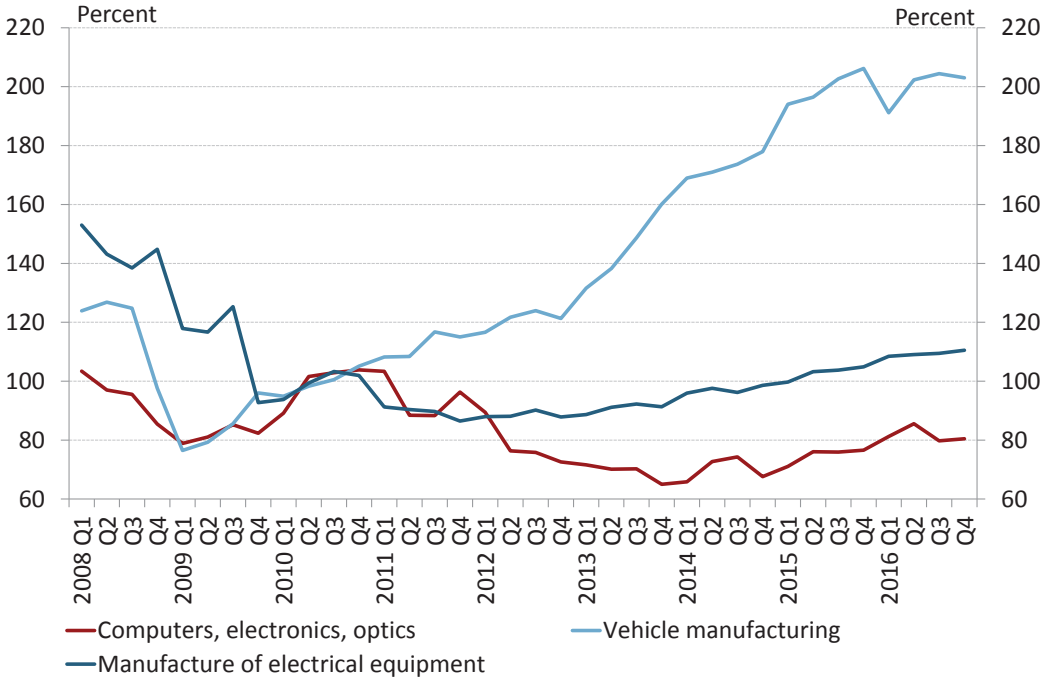
markets, Hungarian export also exhibited slower growth. However, the Hungarian export continues to expand more rapidly than its markets, and therefore Hungary's export market share continued to grow in 2016.

Chart 6: Real growth of exports and external demand and developments in Hungary's export market share



Compared to the previous year, the goods balance surplus increased to a lesser degree in 2016, with the production of other industries also contributing to this, in addition to the stagnation of the automotive industry which had previously shown rapid growth (Chart 7). Automotive production, which has a significant weight, stabilised in 2016 – due to Audi's change of model at the beginning of the year, and thus despite the earlier dynamic growth, automotive production only boosted the goods balance surplus to a minor degree in 2016. At the same time, the moderate increase in the electronics sector and the manufacture of electrical equipment sector seen in 2015 continued in 2016, which supported the growth in the export volume.

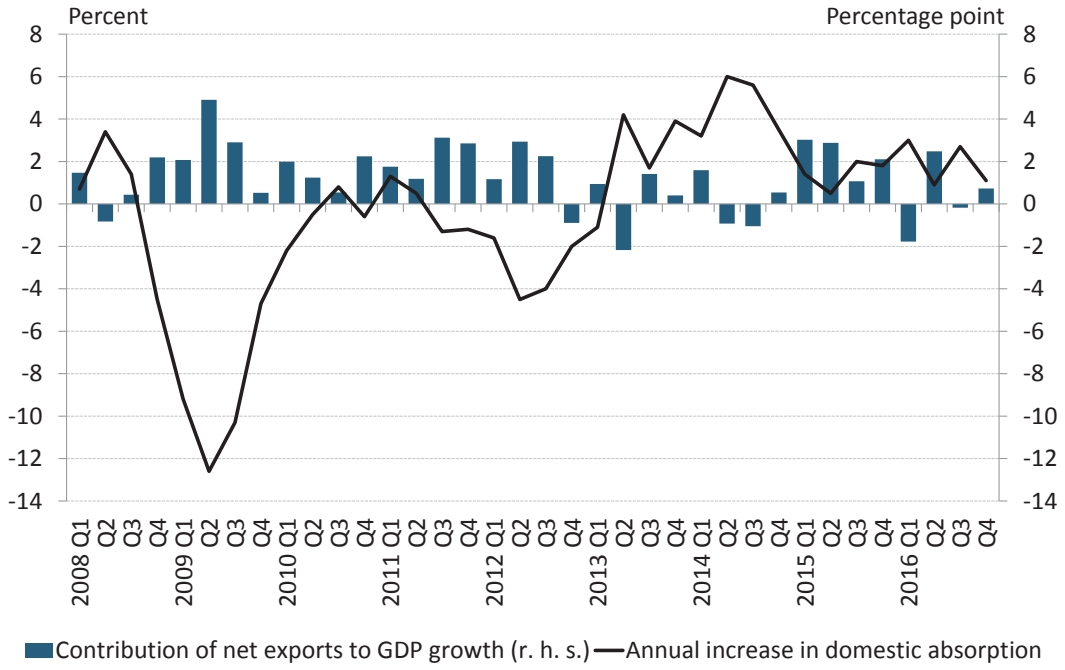
Chart 7: Developments of industrial production in the key sectors (2010 = 100)



Source: HCSO.

In 2016, as a result of the downtrend in investments and the rising volume of consumption, domestic absorption continued to increase, while the contribution of net exports to economic growth fell, in line with weaker external demand and lower industrial production. In 2016, net exports continued to contribute favourably to GDP growth (Chart 8), which can be explained mainly by the import content of investments falling due to the lower use of EU transfers, while – in line with slower growth in domestic industrial production (and within that mostly automotive production)– the contribution of exports to GDP also shrank. Domestic absorption contributed positively to growth throughout the year, but the fall in investments – characteristic for the entire year – made its effect felt here.

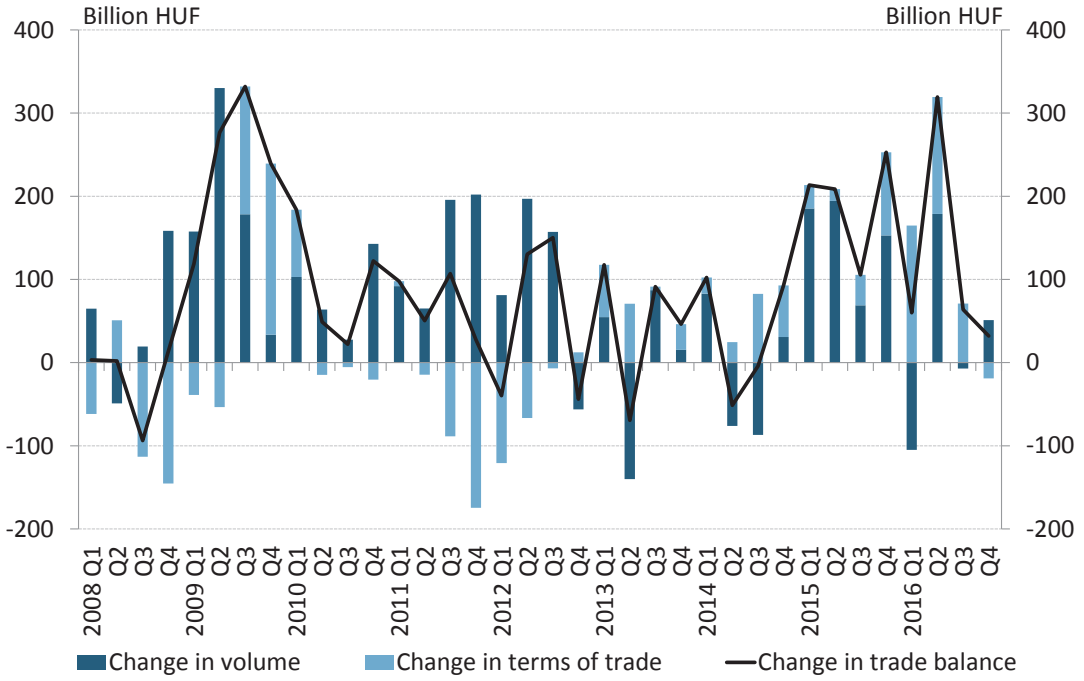
Chart 8: Annual rate of increase in domestic absorption and contribution of net exports to GDP growth



Source: HCSO.

The trade surplus continued to grow during the year, with the terms of trade initially making a strong contribution to this, but then contributing to a decreasing degree in the second half of the year, due to rising energy prices (Chart 9). The growth contribution of net exports can also be observed in the rising volume of trade, but the continuing growth in the trade surplus in 2016 was also significantly influenced by the change in external trade prices. In the first part of the year, due to the decline in oil prices – and to the delayed reduction of gas prices linked to this – the terms of trade still made a strong contribution to improving the trade balance. However, as a result of the gradual increase in 2016, energy prices at year-end already exceeded the previous year's level, and this mildly reduced the trade surplus, due to the terms of trade. The improvement in the terms of trade in 2016 contributed more than HUF 350 billion (more than 1 percent of GDP) to the trade surplus at the annual level, which was further increased by an additional HUF 200 billion stemming from volume effects

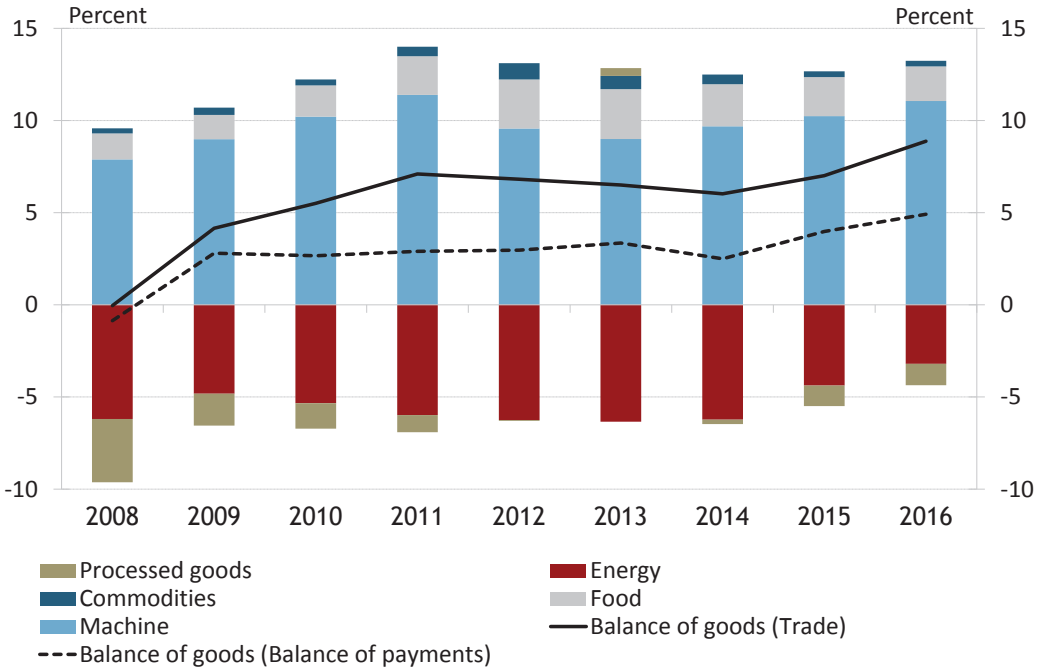
Chart 9: Developments in the balance of trade factors according to GDP (year-on-year)



Source: HCSO.

The decline in energy prices and stronger output by mechanical engineering also contributed strongly to the rising goods balance in 2016 (Chart 10). Net exports of machinery increased further in 2016, with more moderate growth in automotive production and an increasing production of electronics and electrical equipment. The growing shortage of processed products is probably attributable to an increasing households' consumption. Due to moderate energy prices, net imports decreased further in 2016.

Chart 10: Net external trade in goods by main groups (as a percentage of GDP)



Note: The difference between trade in goods based on external trade statistics and the balance of payments is subject to the different requirements of individual methodologies and the content of data provided by the available data sources. Accordingly, we arrive at the trade in goods figures of the balance of payments by means of adjustment factors derived from the external trade statistics.[1] At the same time, data derived from various sources have been similar in recent years, which makes them suitable for trend analysis.

Source: HCSO and MNB.

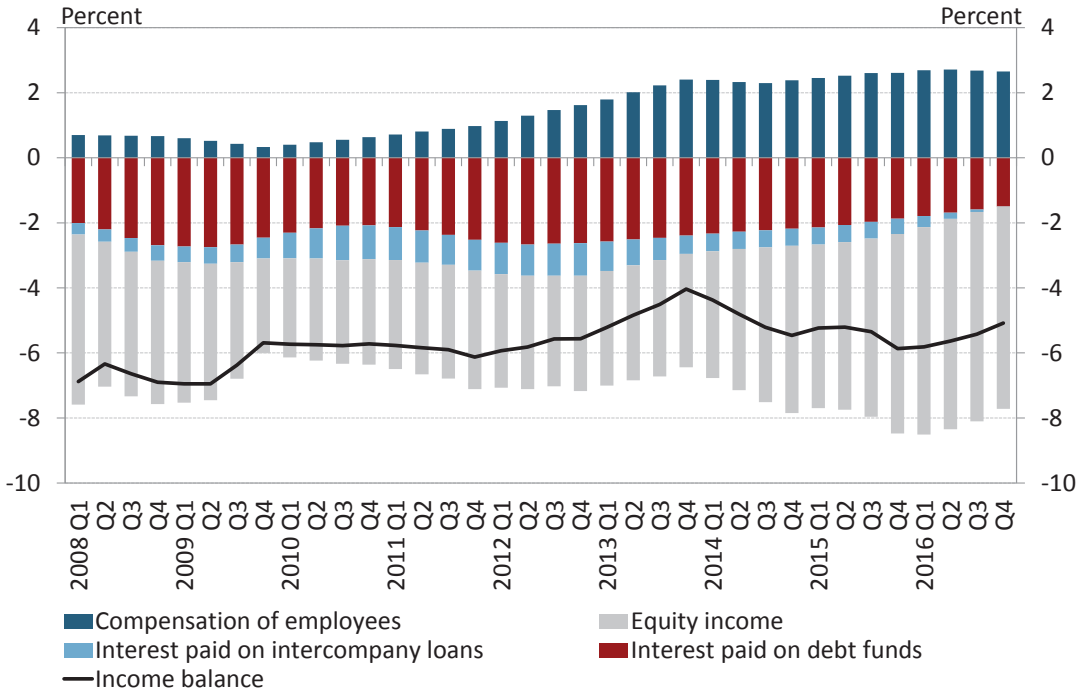
1.2. Income balance

The income balance deficit continued to fall in Q4, reaching 5.1 percent of GDP at end-2016 (Chart 11). In Q4, it was primarily the improvement in the foreign loan interest balance and the moderate changes to the profits realised on foreign direct investments which contributed to the decline in the income balance deficit.[2] With the low yield environment and a decline in external debt, net interest expenditure paid abroad on loans and bonds changed in favour of Hungary during the year. Similar to the situation seen in previous quarters, in Q4 the income of residents temporarily working abroad amounted to a stable 2.7 percent of GDP. Overall, considering the entire year, the income balance deficit improved by some 1 percent of GDP compared to the previous year.

1 For more details on this see the following publication (pp. 8): https://www.mnb.hu/letoltes/bop-meth-notes-bpm6-en.pdf

2 Profit of foreign owned companies, as well as the reinvested income shown in the income balance are based on an estimate for 2016, which will be replaced by actual figures based on corporate surveys together with the publication in September 2017.

Chart 11: Developments in the items of the income balance (four-quarter values as a percentage of GDP)

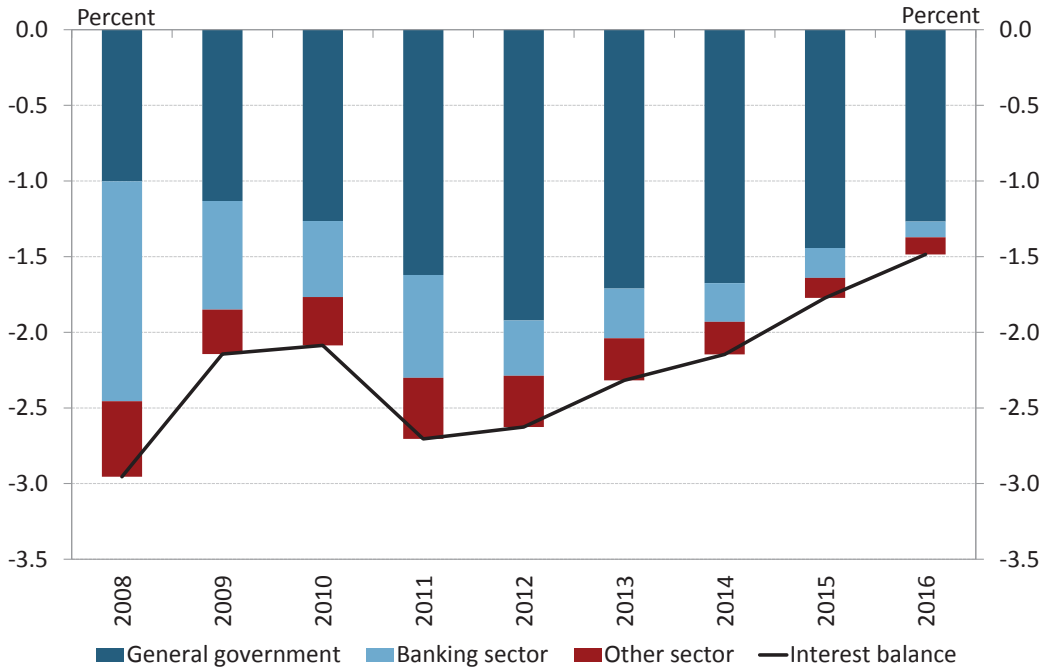


Income outflow figures related to participations are based on estimates. We only have limited quarterly data on the profitability of foreign-owned companies operating in Hungary, and thus information on profit outflows are essentially based on estimates.[3] Within expenses related to equity, data on dividends are available; based on such, in 2016 net annual dividend payments were slightly below the previous year's figure, amounting to nearly EUR 2.2 billion. In this regard, it is important to highlight that dividends are typically approved in respect of the performance of the previous year (for more details see Balance of Payments Report of October 2016).

Similar to the previous year, the net deficit on the interest balance fell by 0.3 percent of GDP in 2016, mainly supported by the lower interest expenses pertaining to the government (Chart 12). The decline in the government's net interest expenditures was supported by the fall in the foreign funding of public debt (for more details see chapter 4.1), in addition to the considerable drop in yields, with the central bank's easing also contributing by 45-55 basis points in case of short term yields.[4]

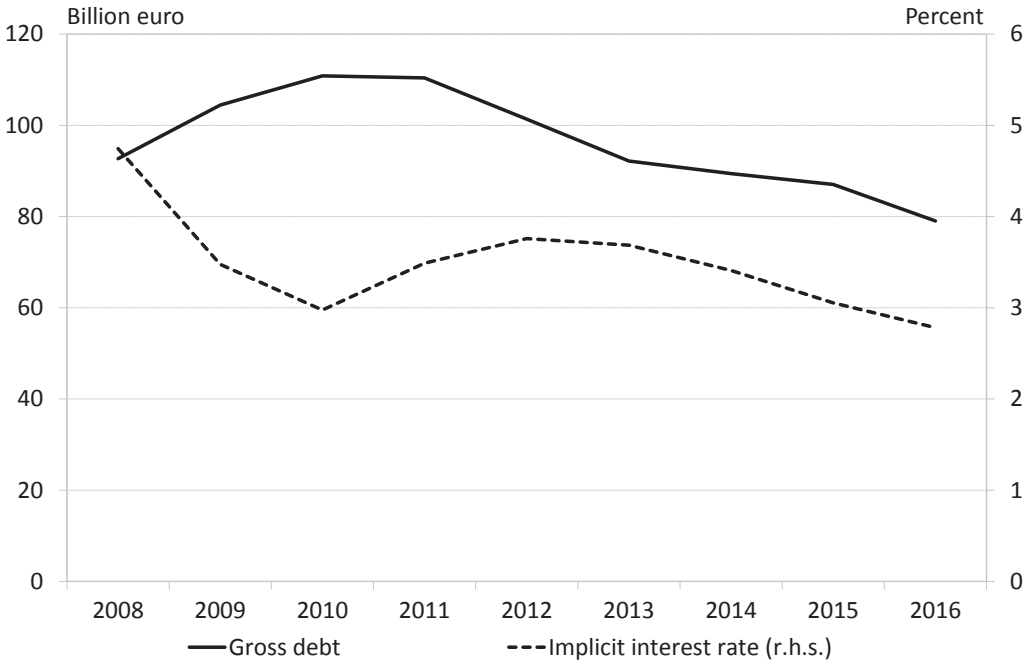
3 For more details, see the statistics publication "Methodological notes to the Balance of Payments and International Investment Position".
4 See in more details the article of Márton Nagy – Barnabás Virág: The central bank's unconventional easing is successful

Chart 12: Developments in the net interest balance and its breakdown (as a percentage of GDP)



In 2016, both the low yield environment and declining external debt contributed to the decrease in foreign interest expenditure (Chart 13). Hungary's gross external debt continued to decrease in 2016: on average it amounted to EUR 79 billion during the year. The reduction – in line with the self-financing programme – was primarily seen in the volume of the government's external debt, and in addition to this, the reduction of debt by the banking sector and companies also continued. The historical low national and international yield environment also strongly supported the decrease in the implicit interest rate of external debt, which thus fell overall to 2.8 percent during the year.[5] Overall, the interest paid on the debt of all three sectors declined in 2016.

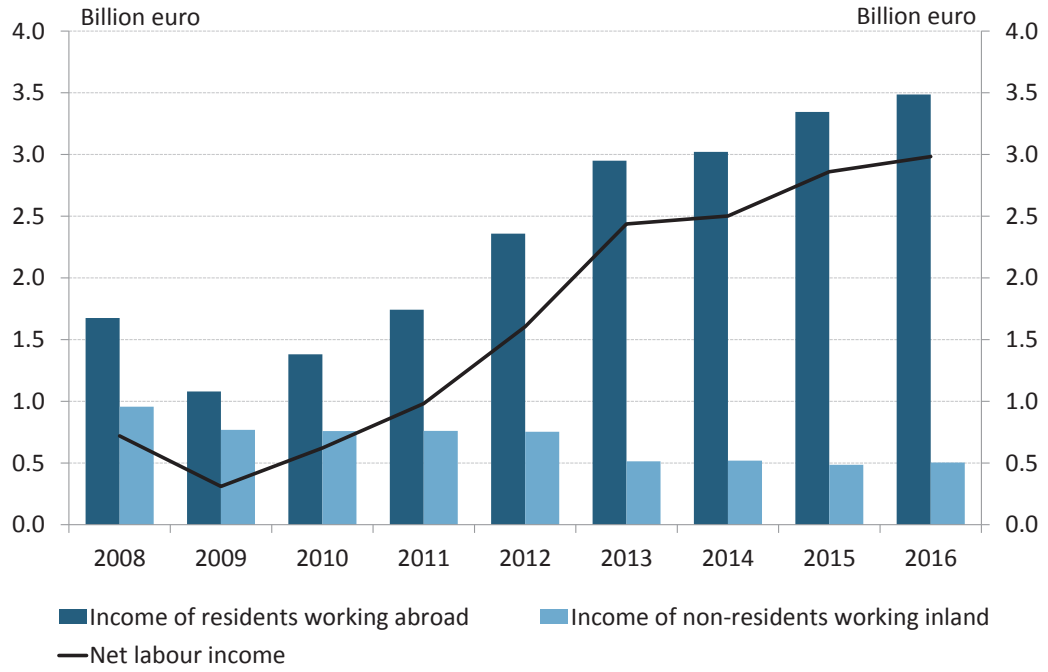
Chart 13: Developments in average gross external debt and the implied interest rate



5 Developments in the implied interest rates (i.e. average interest paid on debt) do not necessarily reflect the changes in the current interest levels, because at present interest must also be paid on debt originating from earlier periods at the applicable rates (for example, fixed-rate debt); in other words, the repricing of the total debt volume to the new interest rates may prove to be a lengthy process in view of the multiple-year average maturity period.

In 2016, the net income of residents working temporarily abroad[6] reached EUR 3 billion. Employees' income increased rapidly until 2013, supported by both dynamic growth in the gross income of residents working temporarily abroad and the reduction of non-residents working in Hungary for less than 1 year. Thus, due to net employees' income the income balance deficit fell by EUR 3 billion in 2016, which was the result of residents' income of EUR 3.5 billion and non-residents' income of EUR 0.5 billion (Chart 14). However, the tax payments of residents working temporarily abroad moderate this positive effect exerted on the external position of the economy through the transfer balance. At the same time, the remittances of workers with more permanent employment abroad improve the balance of current transfers. As a result, the incomes of workers employed abroad contribute to the increase in net lending to a lesser degree compared to their positive impact on the income balance.

Chart 14: Income of employees temporarily working abroad



Following strong growth last year, the increase in the average number of residents working for up to one year abroad slowed in 2016, and thus their income also grew more slowly (Chart 15). In the income balance, the income of residents temporarily working abroad is shown. This typically includes employees who work in the neighbouring countries, but are residents in Hungary. The increase in the number of commuters grew dynamically after the Western European countries have their labour markets up until 2013, and then temporarily halted in 2014 and began to rise again in 2015. In 2016, number of residents commuting abroad no longer increased compared to 2015, but the number of residents working abroad continued to increase on an annual average, which is reflected in the moderate increase in the average value of foreign wages, which thus supported the increase in foreign wages.

6 In this case, net income means the difference between the gross income revenue of residents working abroad and gross income expenses paid to non-residents working temporarily in Hungary.

Chart 15: Income and number of resident workers employed abroad for less than a year

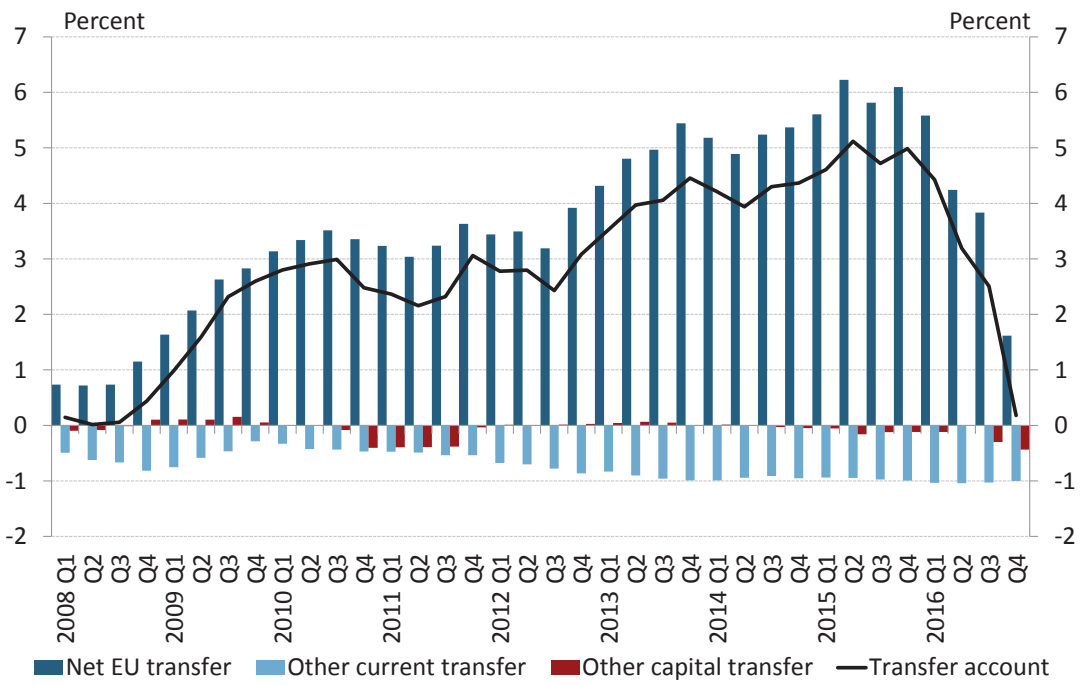
Source: HCSO and MNB.

1.3. Transfer balance

In 2016, the transfer balance fell considerably, slipping back to 0.2 percent of GDP, with the closing of the EU's previous budget cycle as one of the factors behind this. A major part of the drawdowns of EU funds in the 2007-2013 budget cycle occurred in 2015, as a consequence of which the transfer balance increased significantly during the year. However, in 2016, the funds under the previous cycle dried up, while the use of new funds under the 2014-2020 cycle got off to a slow start, as a result of which a considerable fall in EU funds was seen in the period under review. The four-quarter transfer balance fell by nearly 5 percent of GDP compared to the same period of the previous year, mainly due to the reduction in the net EU transfer balance, while the combined deficit of other current and capital transfer moderately increased in the period (Chart 16). The general government also played a role in this, by providing funds (generally to support investment) to several organisations outside of Hungary.[7] In addition to EU funds, there are current items – without consideration – in the transfer balance, which are typically provided by the private sector to abroad (such as social security contributions or tax payments of those working abroad).

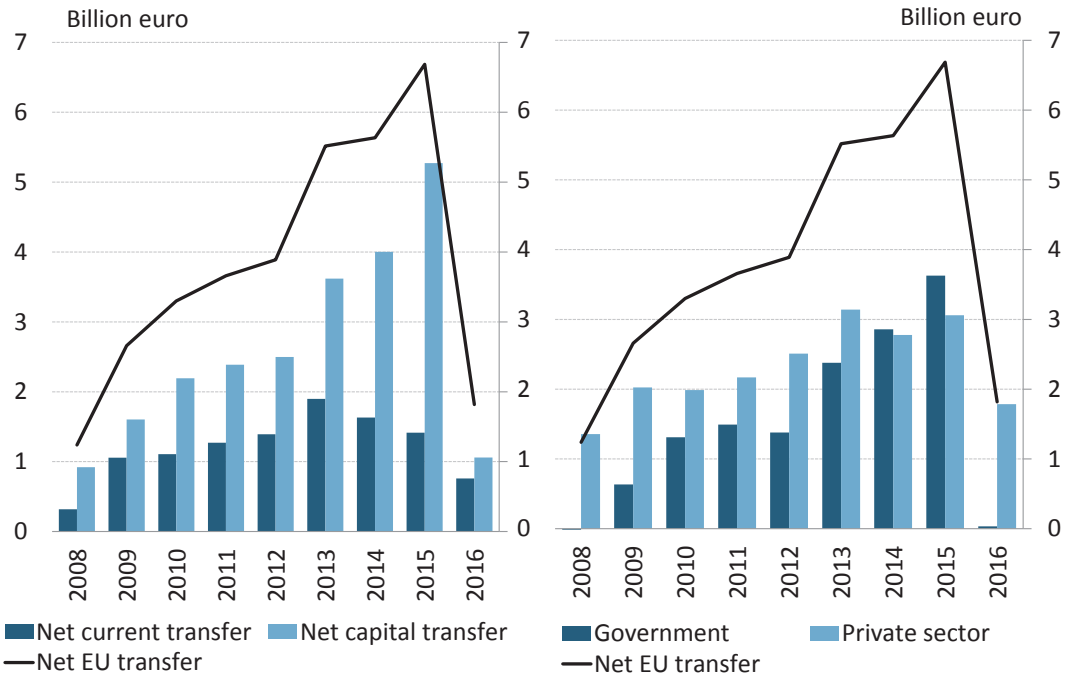
7 For more details see Government Decrees No. 1801/2016 and 1802/2016. http://www.kozlonyok.hu/nkonline/MKPDF/hiteles/MK16210.pdf

Chart 16: Developments in the transfer balance (four-quarter values as a percentage of GDP)



Net use of EU transfers fell to EUR 1.8 billion in 2016, with this primarily affecting capital transfers. Capital transfers fell from a historical high level of EUR 5 billion in 2015 to nearly EUR 1 billion (Chart 17). Developments in capital transfers that finance investments are basically subject to EU projects to be launched, and thus the low level of capital transfers, and within this, that of public transfers can be explained by the start of new cycle. The value of net transfers also fell in 2016 and is below the fairly stable value of EUR 1.5 billion observed in recent years. In addition to agricultural funds received on an ongoing basis (i.e. regardless of a cycle), the mainly non-investment supporting EU transfers are shown on the revenue side of current transfers, which are also paid through the tendering system, which may have caused the low use of current transfers due to the new cycle.

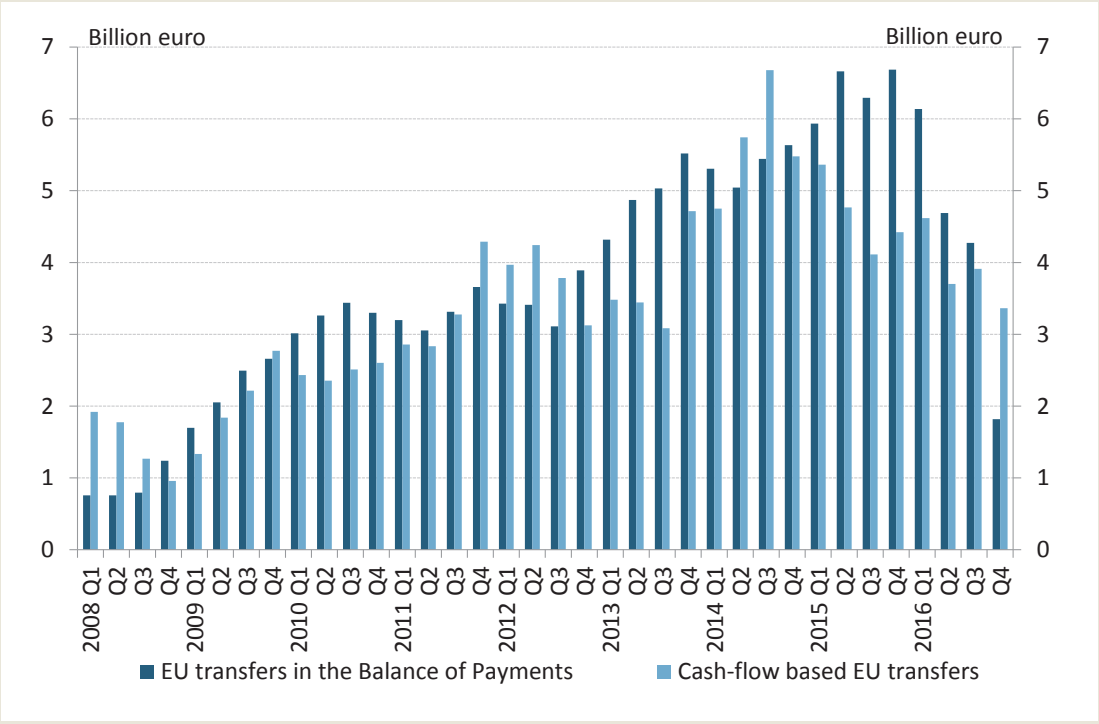
Chart 17: Developments in net EU current and capital transfers and their sectorisation



Box 1: Cash-based and accrual-based accounting of EU transfers

The value of the EU transfers transferred by the European Commission in 2016 was by more than EUR 1.5 billion higher than the accrual-based use (Chart 18). Considering 2016 as a whole, the transfers of the European Commission amounted to nearly EUR 3.4 billion, which consist on the one hand of the EU's accounting for the investments advanced by the government in the previous cycle, and on the other hand the advances received for the new cycle and the agricultural payments of the new cycle, as well as the transfers from the Cohesion Fund and the Structural Fund made against invoice. The accrual-based use of EU transfers shown in the balance of payments against cash-based transfers increasing foreign currency reserves amounted only to EUR 1.8 billion. It is however important to highlight that this figure (and thus the balance of payments) does not include advances paid by the government, but only transfers which had been already used. Over the longer term, there is no difference between accrual-based and cash-flow based indicators, but typically at the end of the cycle, accrual-based use is higher than the amount transferred by the EU. This can be explained by the fact that, apart from the prepayments received, the government typically advances EU funds in order to facilitate the quick and more complete use of the development framework, and the last 5 percent of funds are only transferred by the EU once it has confirmed that everything was in order with the project. Currently, cash transfers exceeded the accrual-based use of transfers, because part of cash transfers included also – temporarily withheld – funds of the previous cycle.

Chart 18: EU transfers according to the accrual-based and the cash-based approach (four-quarter values)

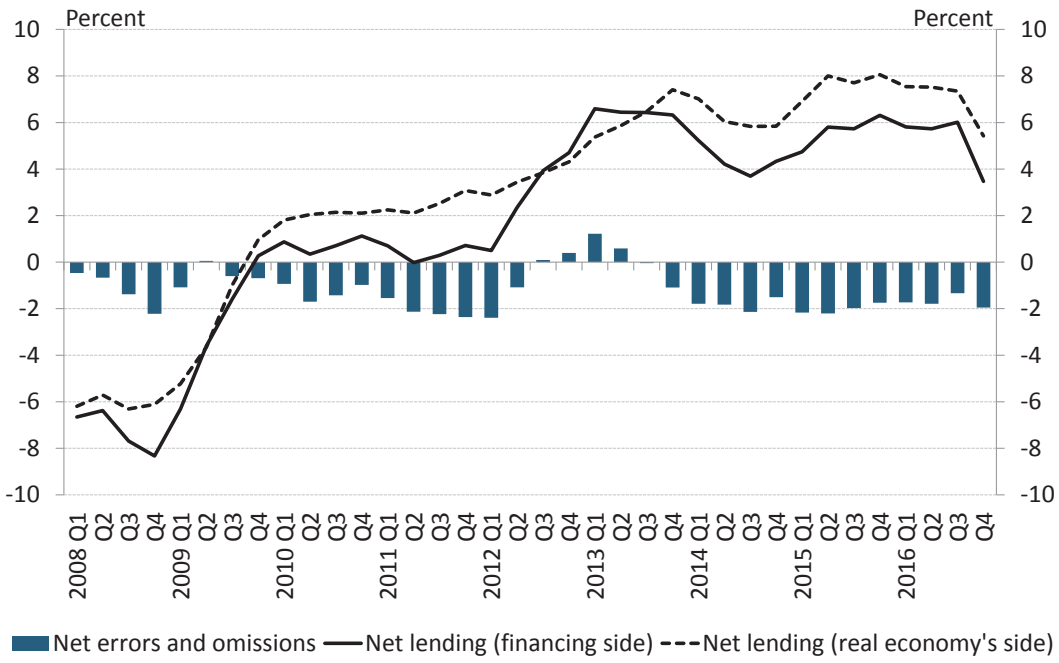


2. FINANCING APPROACH

Financing items also confirm the decrease in Hungary's net lending at the end of 2016, which again resulted from a significant downward shift in external debt and considerable net FDI inflows. Throughout 2016, the net outflow of funds was below that of the previous year, as a result of economic agents reducing their net external debt by nearly EUR 7 billion, while the growth in the volume of net FDI by non-residents amounted to over EUR 3 billion, which considerably exceeded the previous year's value. The net external debt of the banking system and companies also declined considerably in 2016, but unlike in the previous years, the net external debt of the government grew. The extremely large reduction in banks' debt was driven by the foreign currency liquidity received from the central bank related to the forint conversion of foreign currency loans, in addition to the funds from the considerable deposits of the private sector. Meanwhile, through the reduction of the MNB's foreign currency reserves, foreign currency transactions related to forint conversion also contributed to the increase in the government's net external debt, but it is important to emphasise that, due to maturing foreign currency bonds and government bonds sales by non-residents, the downward trend in the government's gross external debt observed since 2011 also continued in 2016. The fall in government bonds held by non-residents is accompanied by the still strong domestic demand of banks – supported also by the demand of households and the self-financing programme. Consequently, tensions were still not felt on the government bond market. Compared to the previous year, one significant change was that the decline in the private sector's net external debt entailed only a moderate drop in gross external debt and this was mostly reflected in the increase in foreign assets. The decline in banks' funds showed up primarily in the short-term segment, and thus the maturity structure continued to change favourably.

In Q4 2016, the net lending of the Hungarian economy decreased more according to the financing approach than according to the real economy approach. Net lending calculated based on real economy data fell to 5.4 percent of GDP, and in parallel with this, the indicator calculated from the financing side decreased to 3.5 percent of GDP (Chart 19). All of this continues to suggest that debt and liability indicators decreased less than signalled by the amounts of the balance of payments and capital account. The difference between the two indicators rose moderately, advancing to nearly 2 percent of GDP, which corresponds to the levels typical for the regional countries (for more details see chapter 5.4).

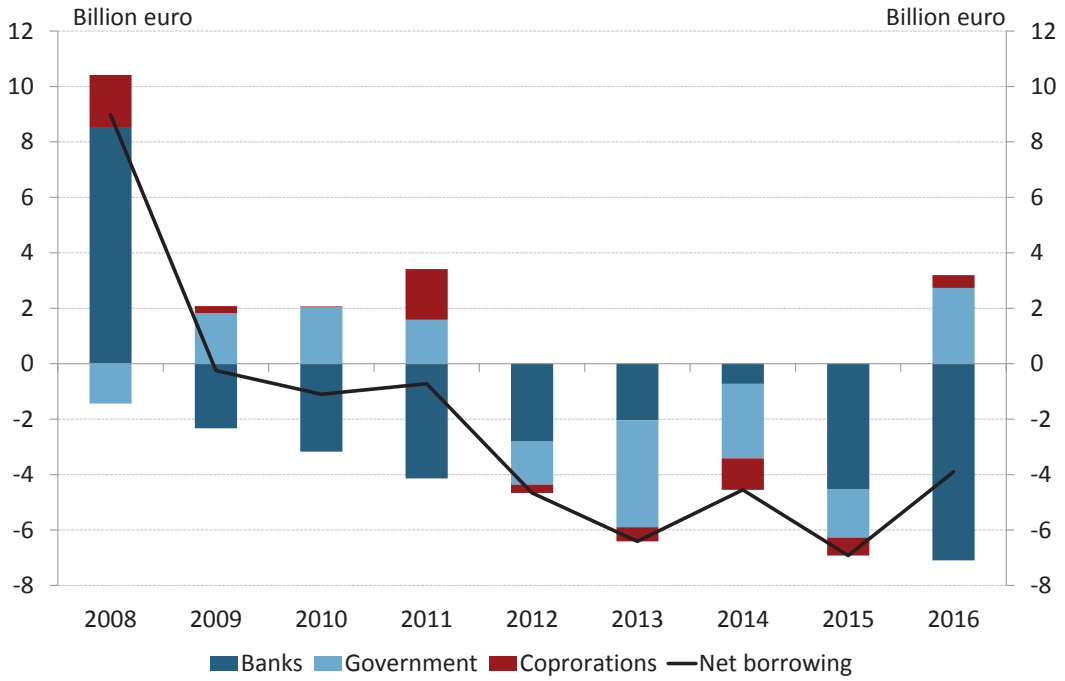
Chart 19: Developments in the two types of net lending (four-quarter data as a percentage of GDP)



The decline in the foreign liabilities of the Hungarian economy slowed down – but remained considerable – in 2016; this was mainly driven by the fall in the net external debt of the banking system, while the external funds of the

state and companies increased. During the years following the crisis, these outflows were mainly linked to the banking sector, before public finances and corporations gradually stepped up their role in downsizing external debt from 2012. The outflow of the economy's foreign funds decreased in 2016, and the sectoral structure of these funds changed significantly: while the liabilities of banks fell, the external funds of the state and companies grew (Chart 20). The decline in the external debt of banks was the result of foreign currency liquidity linked to the forint conversion of foreign currency loans in addition to funds from households' deposits – and the increase in the net external liabilities of the state[8] consolidated with the MNB can be partially attributed to the foreign currency reserve effect of the same process, and partially also to the lower use of EU transfers. Fund-raising by the corporate sector can be primarily attributed to the rise in direct investments, in addition to the continued decrease in its net debts.

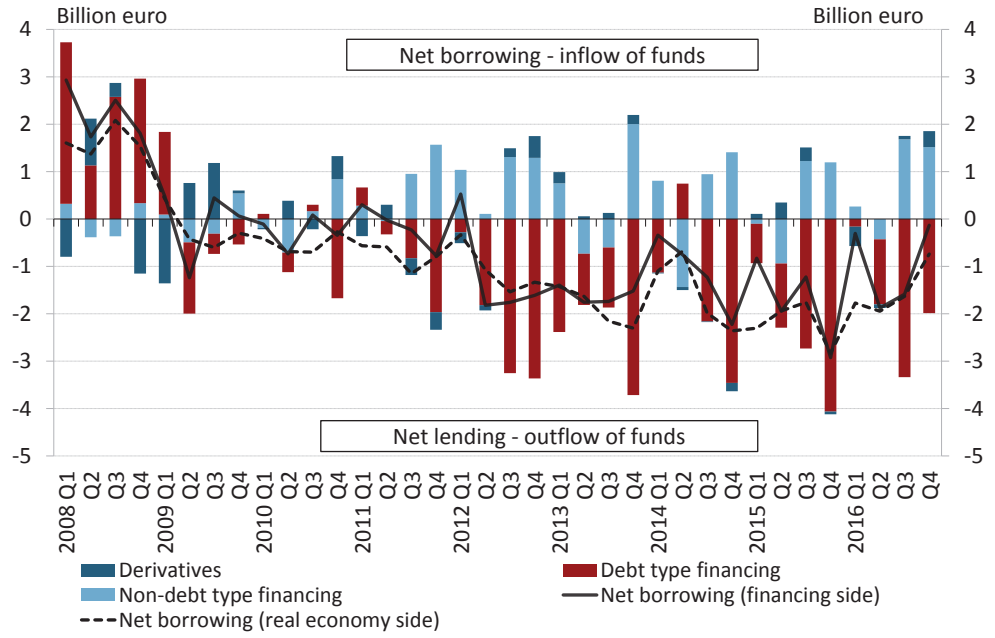
Chart 20: Net outflow of funds by sector



Net lending according to the financing side decreased with the ongoing strong outflow of debt liabilities and the sharply increasing inflow of non-debt liabilities. In Q4, the outflow of debt liabilities amounted around EUR 2 billion (which was less than in the previous quarter), linked to the continuing deleveraging of balance sheets by economic agents, debt reduction and the increase in foreign assets. The foreign non-debt liabilities of the economy rose considerably in Q4, advancing by more than EUR 1.5 million, in which net foreign direct investments played a larger role, while portfolio investments had a smaller role. According to financing items, as the result of all these the external position of the economy fell to nearly zero in Q4 (Chart 21).

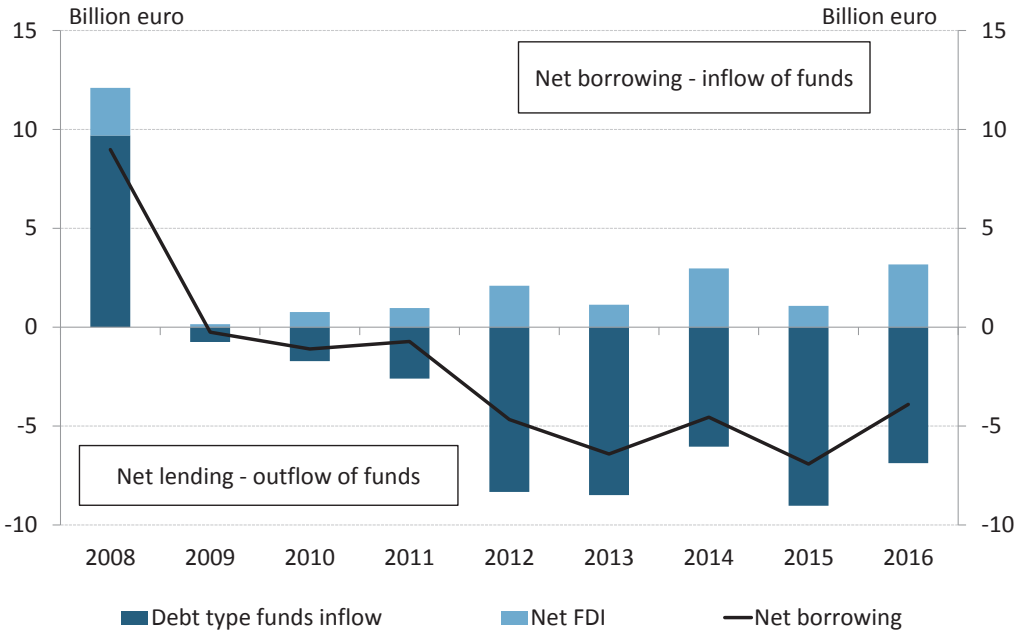
8 For the purposes of the analysis, the general government sector is consolidated with the MNB when examining the structure of external financing.

Chart 21: Structure of external financing (unadjusted transactions)



The volume of the funds outflow declined in 2016, which was realised with a smaller but still considerable reduction of debt liabilities and a greater increase in foreign direct investments (Chart 22). The debt liabilities of the economy shrank by nearly EUR 7 billion in 2016, which is still deemed to be considerable, although it is lower than the value in 2015. The outflow of debt liabilities affected the banking sector to a greater degree and the corporate sector to lesser degree, while the net external debt of the state increased. The external funds of the banking system fell significantly, while its foreign assets increased, with the foreign currency liquidity granted to banks by the MNB in connection with the forint conversion of foreign currency loans also playing a role in this regard. The government's net external debt increased, alongside a lesser reduction in gross external debt and greater reduction in foreign currency reserves. The increase in foreign direct investments of non-residents by over EUR 3 billion was linked to the reinvestments of foreign companies.

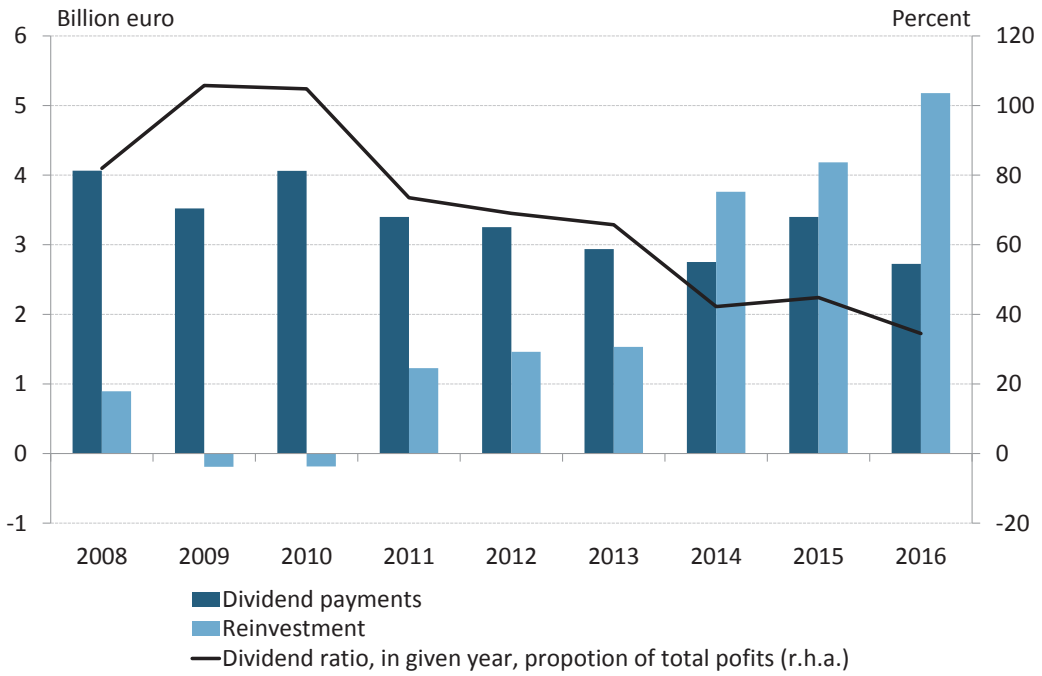
Chart 22: Developments in foreign direct investment and debt-type financing*



* In addition to the components presented on the chart, net external borrowing also includes the equity transactions of portfolio investments and transactions associated with derivatives.

The increase in net FDI can mainly be linked to the higher volume of inflows of foreign direct investment, while Hungarian FDI outflow was of a similar volume. The higher profitability of foreign-owned companies (for more details see Chapter 1.2) in recent years was accompanied by fairly unchanged dividend payments, and accordingly the higher profits led to higher FDI inflows through reinvested income (Chart 23). It is worth noting that in 2016 dividend payments by foreign-owned companies fell, which also supported FDI inflows realised through reinvestment (thus, dividend ratio in relation to the profit of the given year fell below 40 percent, which is much lower than the level characteristic in the region – for more details on this see Chapter 5 of the Balance of Payments Report of October 2016). However, in 2016 FDI inflow was slightly restrained by the fact that companies continued deleveraging their balance sheets – i.e. in parallel with reducing their external debt, they also repaid part of their intercompany loans.

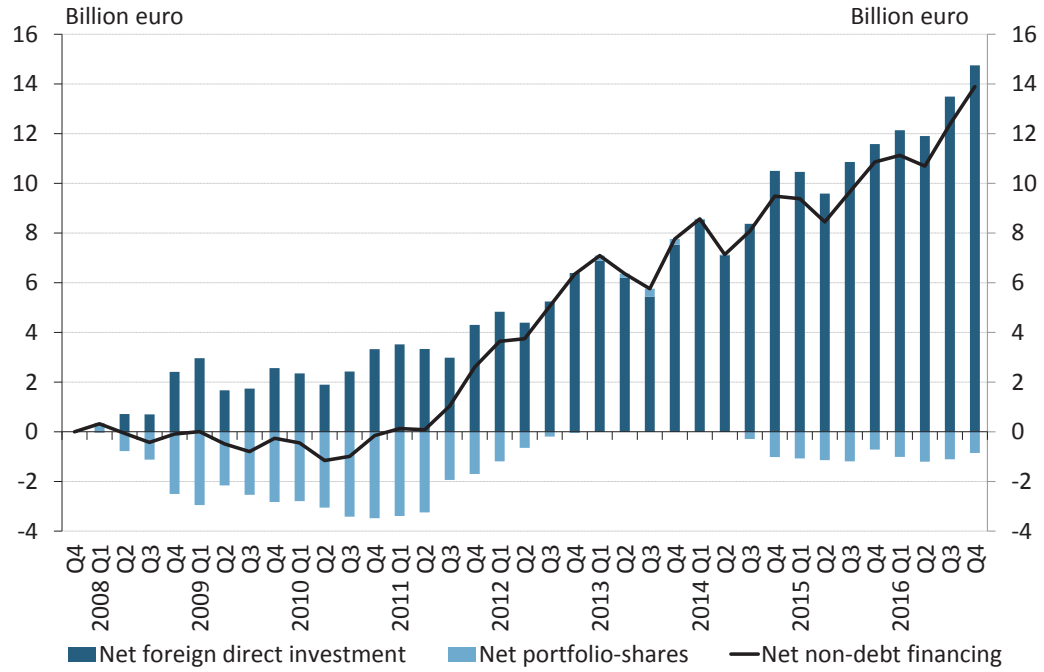
Chart 23:Distribution of profits generated by foreign-owned companies incorporated in Hungary



2.1. Non-debt liabilities

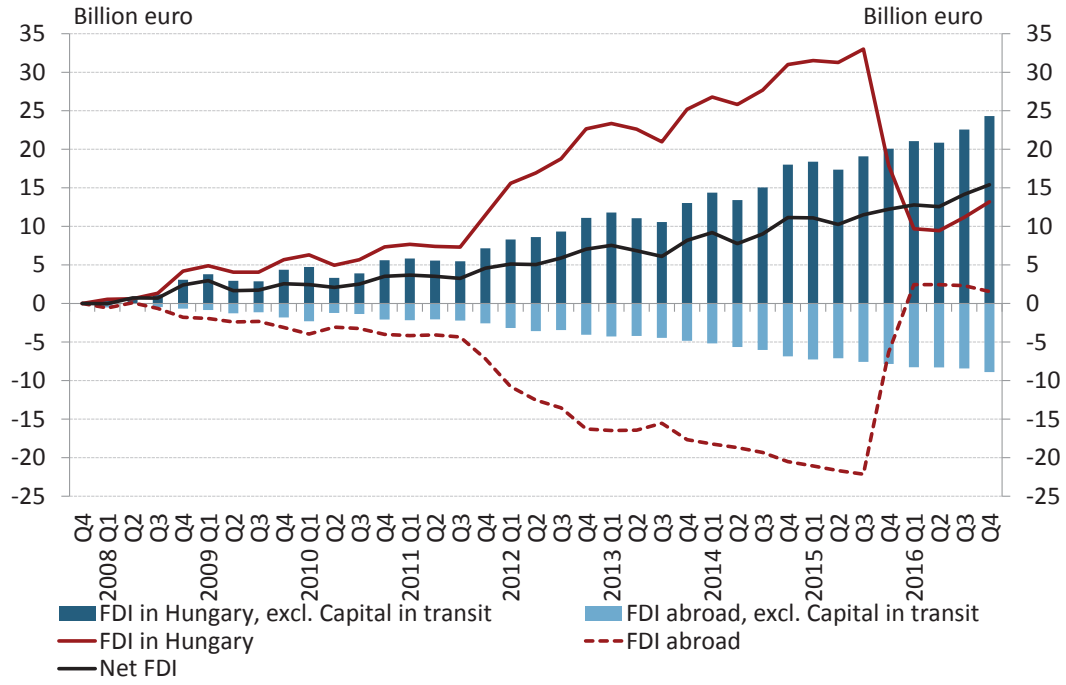
In Q4, the volume of net direct investments by non-residents grew considerably, with a smaller increase in portfolio investments. The growth in net direct investments of the economy amounted to EUR 1.3 billion in Q4, which can be entirely attributed to investments by non-residents in Hungary, and within that to the reinvestment of their income. The fact that the FDI outflow of resident corporations also grew acted towards a net reduction of FDI. Overall in 2016, non-debt liabilities increased by some EUR 3.2 billion, which was mainly due to non-residents' direct investment inflow in a volume not seen for more than ten years (Chart 24).

Chart 24: Developments in non-debt financing (cumulative transactions)



Transactions associated with capital in transit and the rearrangement of asset portfolio strongly influence the gross legs of direct investments, and thus it is worth analysing the net inflow of funds. Due to the features of Hungarian tax system, some non-resident corporations grant intercompany loans and capital, respectively to their Hungarian subsidiaries presumably for tax optimisation purposes, which are transferred by these subsidiaries to abroad. The balance of payments statistics refer to this kind of capital movement as capital in transit, and the MNB shows this separately (traced back until 2008). Capital in transit affects outflows and inflows, but due to its nature it does not distort net FDI data.[9] According to the transactions, cumulated value of capital in transit dropped significantly in 2015, but in 2016 there was not any considerably capital in transit transaction that affected direct investments (Chart 25). Net working capital investments increased significantly in the second half of the year, which is mainly attributable to the reinvestment of income by non-resident companies.

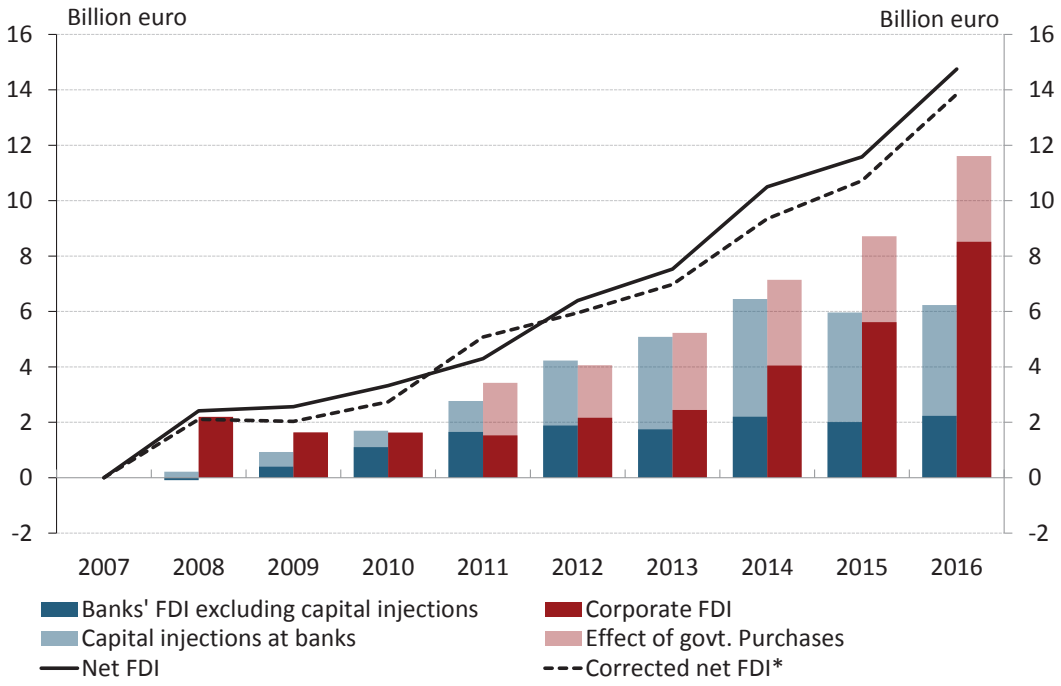
Chart 25: Developments in foreign direct investment (cumulative transactions)



9 Capital in transit, on the other hand, also has a major impact on the sectoral structure of Hungarian FDI. Indeed, an investment in Hungary may be classified in a different sector than the purpose of the direct investment, distorting the sector-based FDI data.

In 2016, the inflow of direct investment was not influenced by individual effects, and thus the inflow of working capital accelerated significantly – in this regard, it was especially favourable that FDI inflow in 2016 was entirely linked to companies. Since the outbreak of the financial crisis, the development of Hungarian direct investments was influenced by multiple individual effects (Chart 26). Capital increases required due to banking losses increased, while government purchases of companies owned by non-residents (MOL, E-On, Antenna Hungária Zrt., Főgáz, Budapest Bank) decreased the volume of direct capital. However, overall, the original and adjusted data (taking into account the capital increases by banks and government purchases) showed a similar increase in recent years. Considering the processes in 2016, it must be highlighted that the entire volume of high net FDI inflow was related to working capital flowing into the corporate sector.[10]

Chart 26: Developments in net FDI by sector (cumulated annual values)

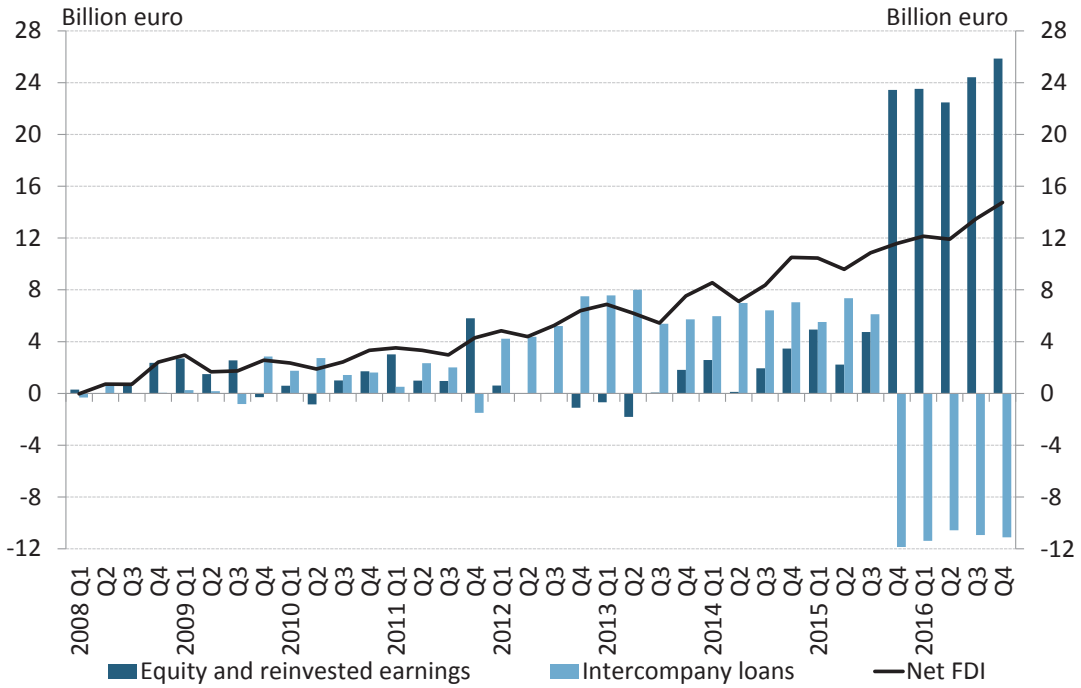


*Adjusted net FDI includes foreign direct investment inflows adjusted by public acquisitions and banking capital increases. The column presenting banks' capital injections also includes other one-off effects associated with the banking sector (such as the acquisition of Budapest Bank).

In the previous year, the increase in net foreign direct investment was primarily driven by the rise in reinvestments, while intercompany loans increased in parallel with the decrease in equity (Chart 27). In the second half of 2016, the previously steadily increasing net inflow of direct investment accelerated considerably, which is attributable to rising reinvestment by non-resident companies. Following the crisis, a reduction of equity and an increase in intercompany loans was observed, which was associated with the fact that following the changes in ownership parent companies partially replaced their equity-type liabilities with intercompany loans. Cumulated capital in transit transactions, as well as transactions associated with asset portfolio rearrangement strongly influenced both the 2015 Q4 and the 2016 Q1 figures, which at the end of 2015 impacted also equity and intercompany loans with an opposite sign.

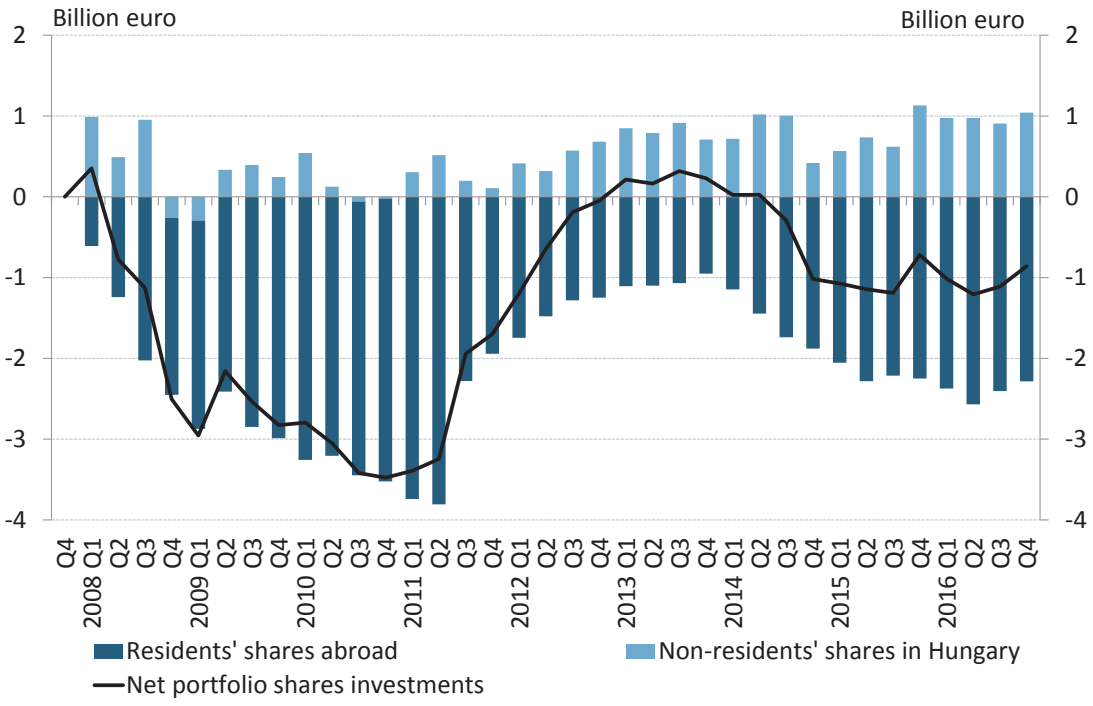
10 It is worth noting that the value of reinvested income is influenced by the estimate of corporate profits, which will be replaced by the actual 2016 data in the September data release.

Chart 27: Developments in net direct investment (cumulative transactions)



The volume of net portfolio investments continued to grow in Q4, attributable both to the increase in investments in Hungary by non-residents and the reduction of foreign investments by residents (Chart 28). While in 2014 mutual fund purchases by residents decreased the volume of net portfolio capital (due to their demand for foreign assets), stock investments by non-residents in 2015 acted in the opposite direction. On the contrary, the volume of net portfolio investments did not change significantly in 2016. The growing volume of foreign portfolio investments in the first half of the year moderated in the second half of the year, while portfolio investments by non-residents in Hungary remained practically unchanged during the year.

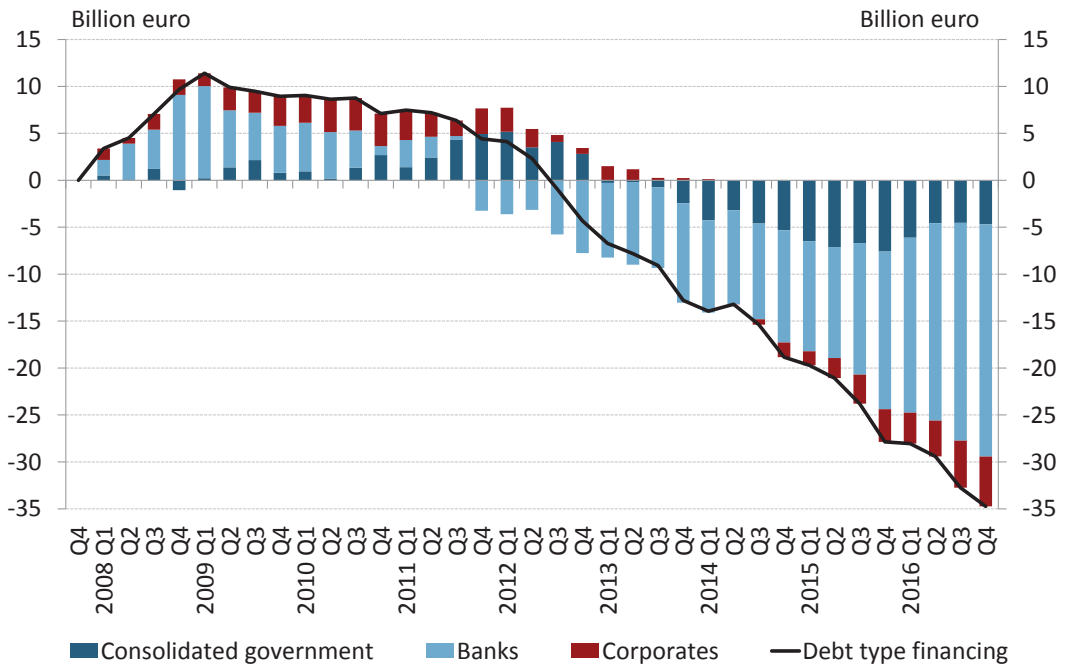
Chart 28: Drivers of changes in net portfolio investment (cumulative transactions)



2.2. Debt liabilities

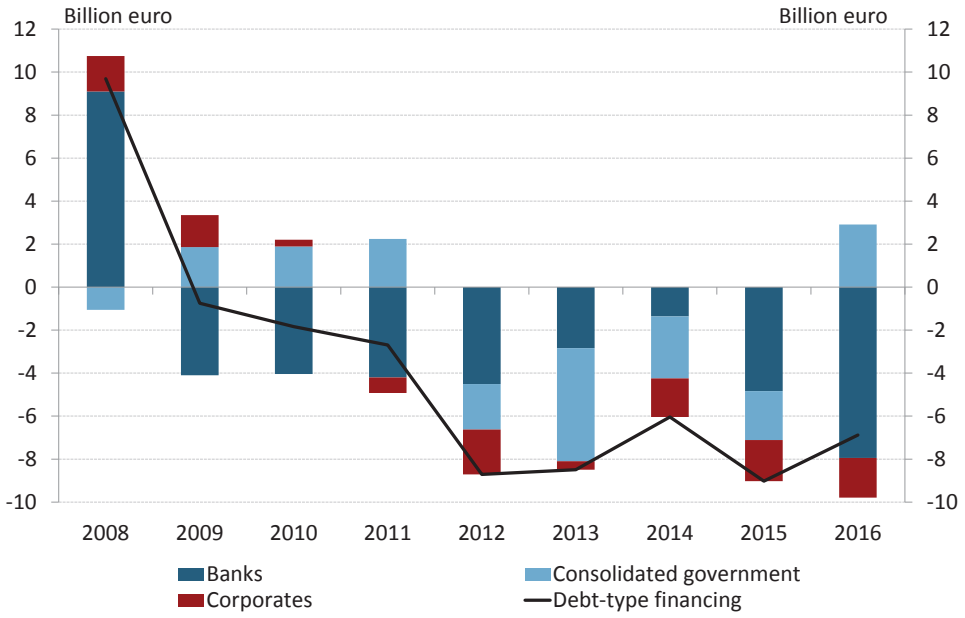
In 2016 Q4, the net external debt of the economy fell by some EUR 2 billion, primarily due to the banking system, while the external debt of the general government and the corporate only sector decreased to a lesser degree (Chart 29). The banking system's net external debt was reduced by transactions associated with balance-sheet optimisation by foreign banks at the year-end, as well as the foreign currency liquidity provided by the MNB to banks related to the forint conversion of foreign currency loans, which was only partially counterbalanced by the foreign currency liquidity reducing effect of the fine-tuning central bank's asset. The reduction of net external debt of the consolidated state was associated with the use of EU transfers and the falling government bond holdings of non-residents. During the quarter, the corporate sector continued to scale back its external debt.

Chart 29: Developments in net debt-type financing by sector (cumulative transactions)



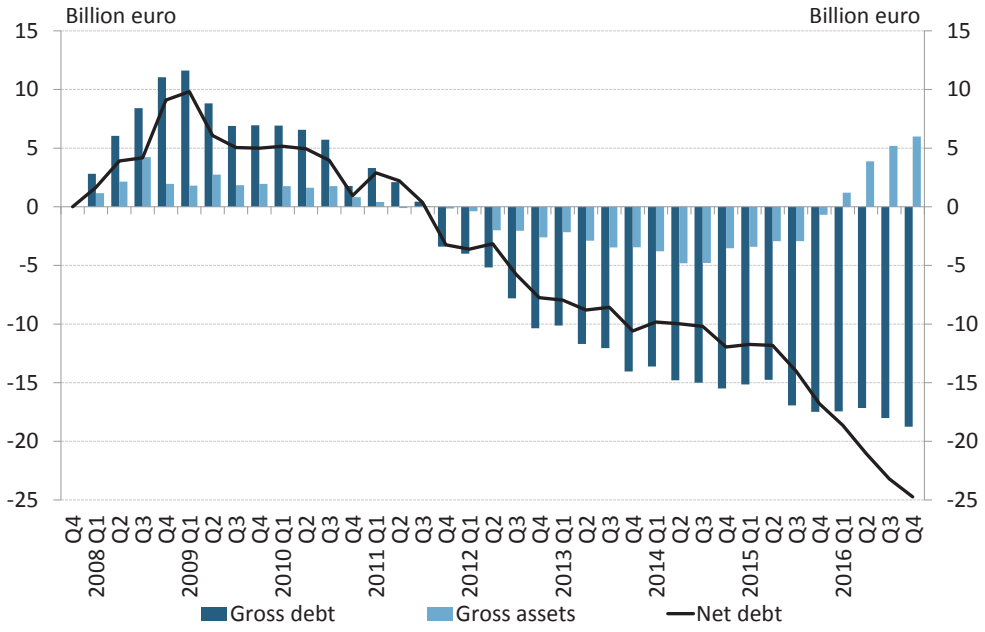
The pace of adjustment declined slightly in 2016: as a result of transactions, net debt fell by nearly EUR 7 billion, mainly due to the debt reduction of the banking system and to a lesser degree to that of companies, while the net external debt of the government increased (Chart 30). The foreign exchange liquidity provided by the MNB to the banking system in relation to the forint conversion of foreign currency loans played a major role in the changes in the structure of net debt processes. Partially due to this, the volume of the banking system's foreign assets rose by more than EUR 6.5 billion over the whole year, while external banking liabilities fell by EUR 1.3 billion. The latter helped the private sector's bank deposits to continue to considerably exceed borrowing. At the annual level, the corporate sector also reduced its net external liabilities by nearly EUR 2 billion, which was mainly due to the increase in foreign assets. The net external debt of the consolidated general government rose again after five years, resulting from the fact that the falling volume of foreign currency reserves due to the foreign currency liquidity provided to banks exceeded the reduction in foreign debt. The use of EU transfers increased the government's outflow of funds to a lesser degree as compared to the previous years, but still resulted in an increase.

Chart 30: Developments of debt-type funds in individual sectors (annual transactions)



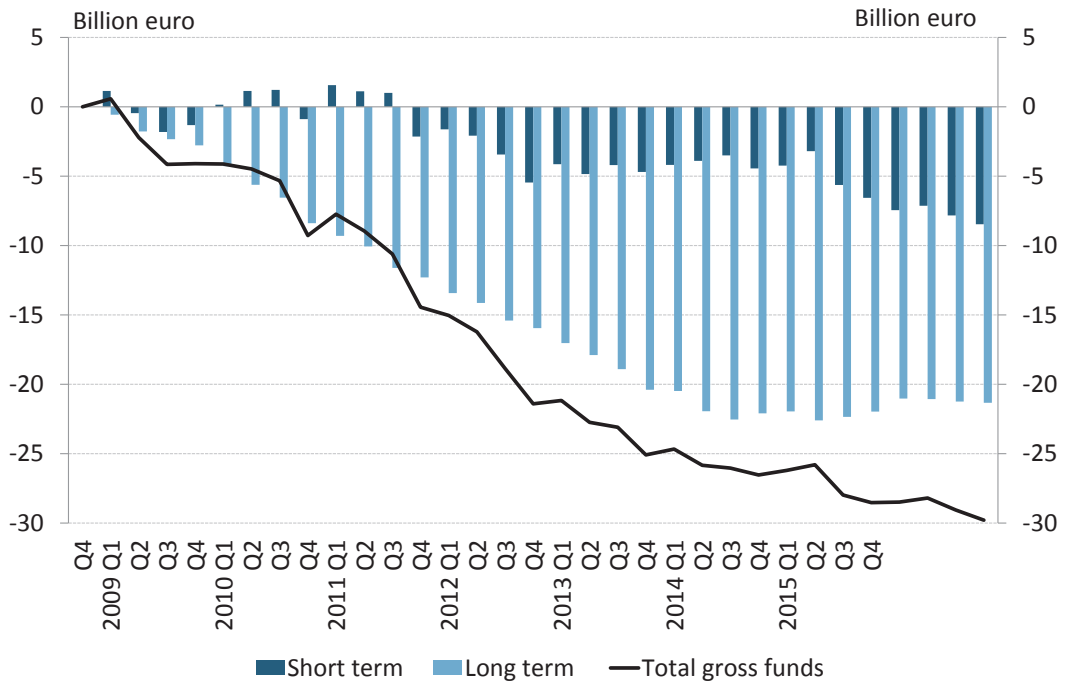
The net external debt of the banking system continued to decline in 2016, supported mainly by the increase in the volume of foreign assets and to a lesser degree by the reduction of gross external debt. In 2016 Q4, the banking system's net external debt continued to fall, which occurred with growth in volume of gross assets and the reduction of gross debt of the same volume (Chart 31). The maturities of foreign currency swaps with the MNB during the forint conversion of foreign currency loans may have also been a factor behind the rise in the gross assets of banks. Partially as a result of this, considering the whole year, the foreign assets of the banking system increased by over EUR 6.5 billion, while gross external debt fell by an additional EUR 1.3 billion. Thus, overall in 2016, the net external debt of the banks dropped by nearly EUR 8 billion, considerably lowering the external vulnerability of the banking system.

Chart 31: Developments in the banking sector's external debt and asset transactions (cumulative transactions)



Similar to the previous year, the decline in the banking system's gross external debt in 2016 was associated primarily with the decrease in short-term liabilities. In Q4, the total foreign debt of the banking system fell by some EUR 0.7 billion, which was due to a lesser degree to the reduction of long-term debt, and to a larger degree to the reduction of short-term debt (Chart 32). The maturity structure also changed favourably in 2016, as it was primarily an outflow of short term funds that was observable, which also supported reducing the economy's vulnerability though the mitigation of renewal risk.

Chart 32: Maturity breakdown of the banking system's external debt (cumulative transactions)



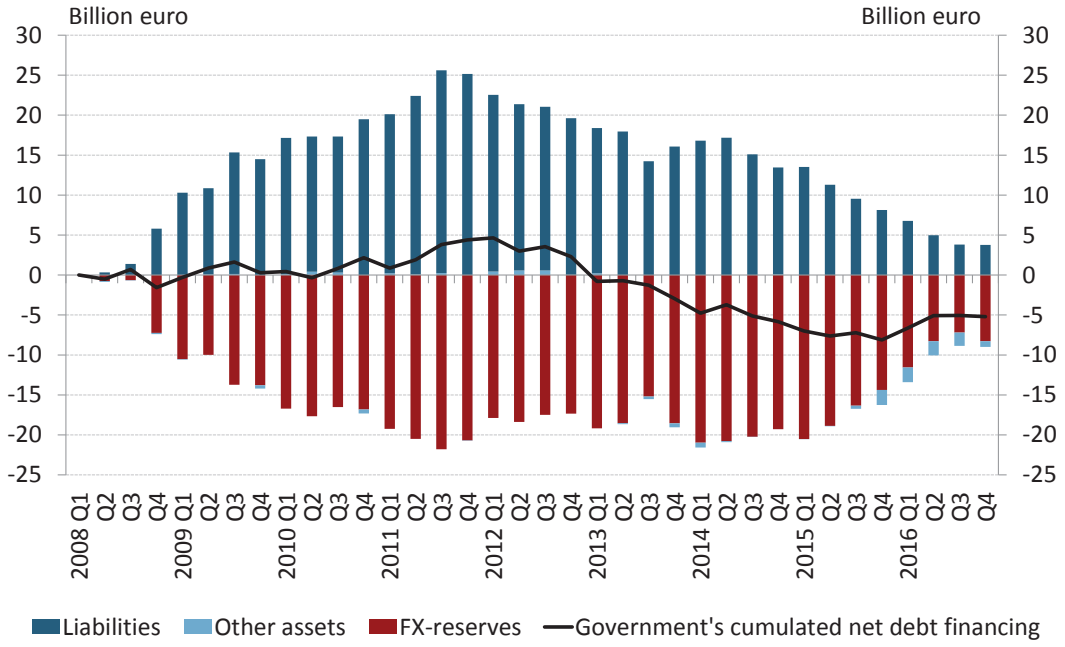
The net external debt of the general government consolidated with the MNB dropped slightly in 2016 Q4, owing to factors with opposite effects. After one year, the net external debt of the government fell again in the final quarter of 2016. The main factors behind this decline in net debt were nearly EUR 500 million in EU transfer use, as well as the reserve increasing effect of over EUR 1.3 billion of the fine-tuning foreign currency-swap tenders related to the quantitative restriction. In addition, the drop in the HUF government bond holdings of non-residents also fostered a reduction in net external debt. However, net external debt was increased by factors acting towards the reduction of reserves (for example the fact that foreign currency swap transactions related to the forint conversion of foreign currency loans continued to expire during the quarter, within the scope of which banks received foreign currency assets to the account of foreign currency reserves).

In 2016, on the whole, the net external debt of the consolidated state rose by nearly EUR 3 billion as a result of transactions, but the downward trend in the government's gross external debt that started in 2011 continued. The government's external debt was influenced by the following key factors:

- The government's net external debt was reduced by non-residents' cutting their government bond holdings by EUR 1.5 billion. The place of non-residents in financing the government was taken over by domestic sectors: partially related to the self-financing programme, banks significantly increased their government bond holdings. It is worth noting here that the maturity of foreign currency bonds – which also lowers the government's gross external debt – exceeded EUR 2.3 billion. This amount however impacts the gross legs only, and, due to the reserve decreasing effect of maturities, it did not influence the government's net external debt.
- EU-transfer use during the year reduced net external debt.
- The MNB's foreign currency swap transactions providing forint liquidity also resulted in lower net external debt.
- However, foreign currency liquidity provided by the MNB to the banks considerably reduced the foreign currency reserves throughout the entire year.
- Foreign currency bond (PEMÁK) maturing vis-á-vis domestic sectors also increased net external debt through the reduction of foreign currency reserves.

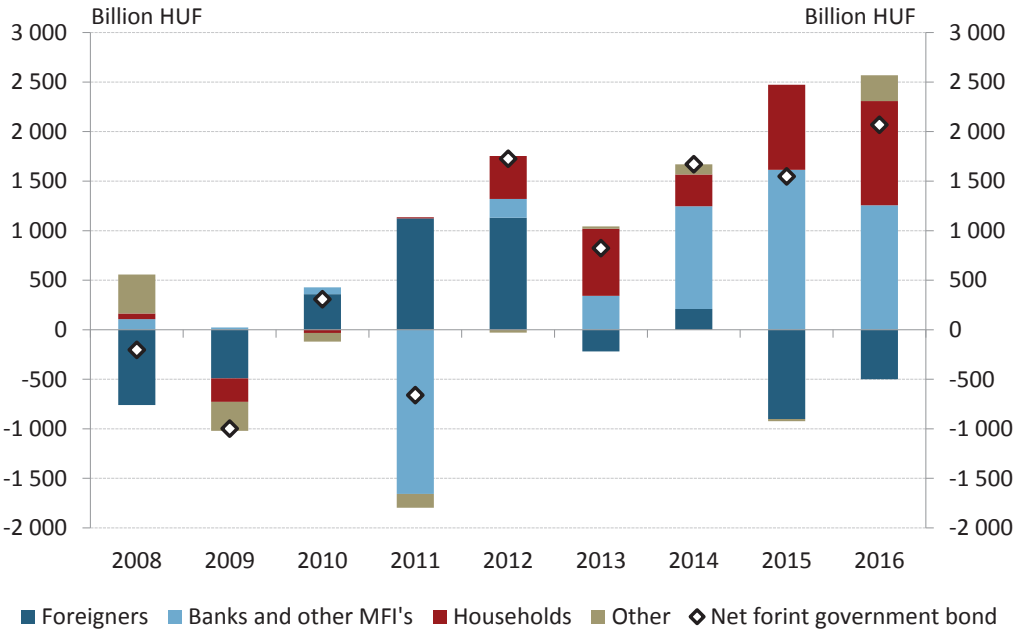
As the result of this, the decline in the government's foreign liabilities was less than the foreign currency reserve reduction, which led to an increase in net external debt (Chart 33).

Chart 33: Breakdown of net external debt of the general government consolidated with the MNB (cumulative transactions)



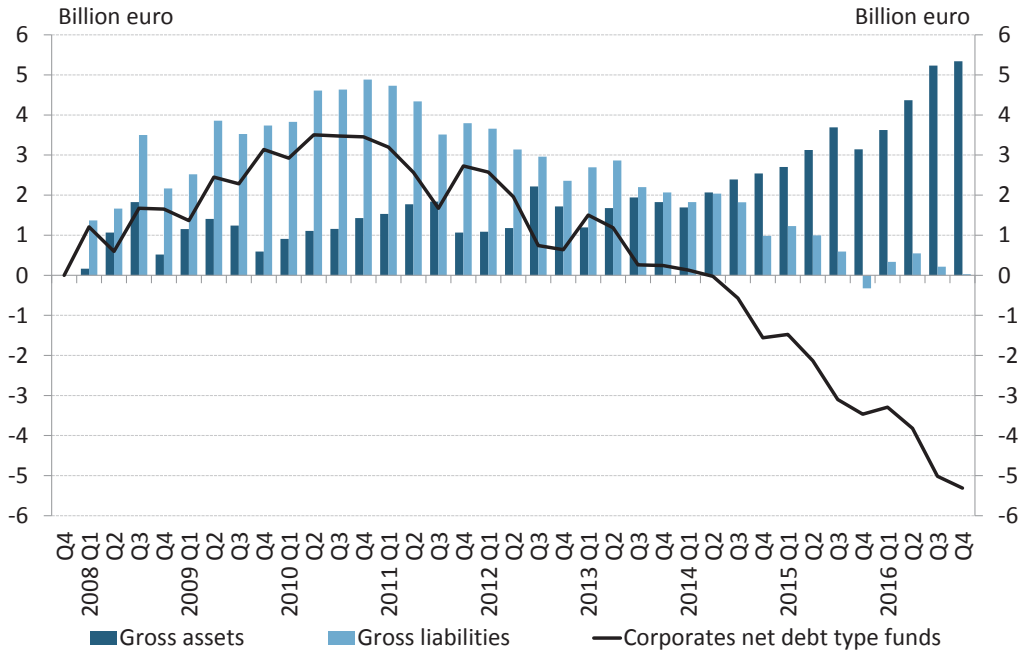
The continuing rearrangement of investor structure in the Hungarian government bond market also supported the reduction of Hungary's external vulnerability in 2016. During the period, the entire Hungarian government bond holdings of non-residents (denominated in foreign currency and in HUF) fell by more than EUR 3.4 billion (nearly HUF 1,100 billion), and thus the share of non-residents within the total Hungarian government bond holdings fell from 44 percent to 39 percent. The sale of government bonds by non-residents took place with a reduction of foreign currency government bonds by HUF 600 billion and a reduction of HUF government bonds by HUF 500 billion (Chart 34). In parallel with this, the HUF government holdings of the banking system grew by over HUF 1,200 billion, which was supported inter alia by the MNB's demand stimulating self-financing programme. In addition to this, extremely large net government bond purchases by households of over HUF 1,000 billion supported the government's financing from internal funds to an unseen extent. The considerable demand from both sectors for government bonds contributed to the decline in the foreign exchange proportion of public debt, and supported the reduction in Hungary's external vulnerability.

Chart 34: Changes in the volume of HUF-denominated government bonds by sectors



The net external debt of companies continued to fall in 2016 Q4, explained by the larger reduction of liabilities to abroad (Chart 35). The sector's net external debt dropped by roughly EUR 2 billion at the annual level, in line with the pace seen in previous years. Companies' net external liabilities increased mildly in an annual comparison, while receivables from non-residents grew dynamically in 2016 as well, strongly supporting the reduction in net external debt.

Chart 35: Developments in companies' net debt liabilities (cumulative data)



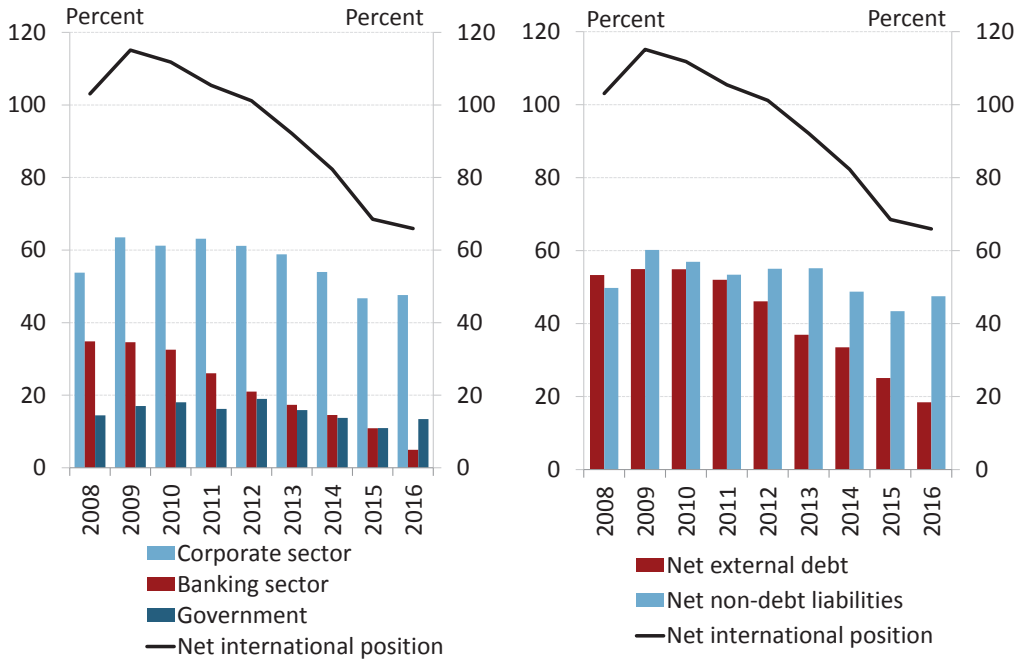
3. DEVELOPMENTS IN DEBT RATIOS

The adjustment of external debt ratios which are of key importance in terms of Hungary's vulnerability continued in 2016, in line with the country's net lending. Net external debt fell to nearly 18 percent of GDP, gross external debt fell below 69 percent of GDP, which is mainly attributable to the outflow of funds and the growth of nominal GDP. The decline in net external debt in 2016 is mainly associated with the banks: the sector's net external debt fell by more than 7 percent of GDP, which occurred with a larger increase in the volume of the bank's receivables from abroad and the reduction of their liabilities to a lesser degree. The net external debt of the consolidated general government rose however, with the main role in this regard played by the foreign currency liquidity provided to the banking system in relation to the forint conversion of foreign currency loans, via a fall in foreign exchange reserves, as well as the foreign currency maturities of the government. In addition to the net indicator, a significant adjustment could be observed also in the case of gross external debt, which can be attributed to the reduction of the general government's gross external debt also supported by the self-financing programme. The reduction in Hungary's external vulnerability was also supported by the further reduction of short-term external debt based on residual maturity: short-term external debt dropped to nearly EUR 18 billion by the end of 2016. This also means that the gross borrowing of the Hungarian economy may be less in 2017 than it was in 2016 (EUR 18 billion). Despite the downward trend due to the MNB's programmes, the level of foreign currency reserves continued to substantially exceed the level expected by investors.

3.1. Net external liabilities

Despite the rise in direct investments in 2016, Hungary's net external liabilities declined further, amounting to 66 percent of GDP at the end of 2016 (Chart 36). In addition to external debt indicators, it is also worth paying attention to the changes in the external liabilities, which also include non-debt liabilities (direct investments and portfolio investments). As in previous years, Hungary's net external liabilities declined again in 2016, reaching nearly 66 percent of GDP. The decline may be associated with the ongoing balance-sheet deleveraging in the wake of the crisis: the external liabilities of the banking system fell considerably, while the net external liabilities of the consolidated general government and companies increased slightly. While in 2014-2015 non-debt liabilities also fell, the decline in non-debt liabilities came to a halt in 2016, mainly due to the rise in direct investments. However, the outflow of debt liabilities also continued in 2016.

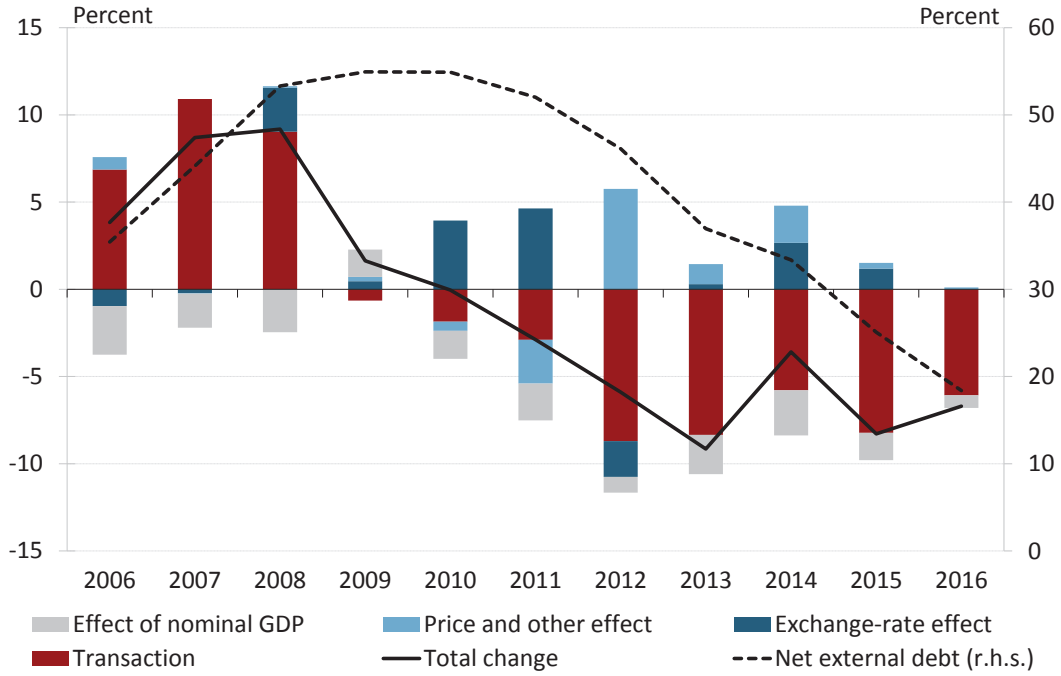
Chart 36: Developments in net external liabilities (end-of-period values relative to GDP)



3.2. Net external debt

In 2016, it was primarily transactions and the increase in GDP that contributed to the decline in net external debt (Chart 37). In the past years, in line with the adjustment of sectors, debt liabilities fell, mainly as an adjustment of the excess indebtedness seen in the pre-crisis years. While in the post-crisis years, the effect of the reduction of debt liabilities was partially counterbalanced by the decline in nominal GDP and then the depreciation of forint, starting from 2011 Hungary's net external debt fell by nearly 37 percentage points, mainly due to the outflow of debt liabilities. In 2016, net external debt declined by 7 percentage points, in which – in addition of the outflow of debt liabilities – the increase in GDP also played a role.

Chart 37: Decomposition of net external debt changes (as a percentage of GDP)



Net external debt amounted to 18.4 percent of GDP at the end of 2016, nearly 7 percentage points lower than the year-end value in 2015 (Chart 38). The decline in 2016 was mainly associated with banks: the net external debt of the banking sector fell by more than 7 percent of GDP, which occurred in conjunction with a larger increase in the volume of banks' receivables from abroad and, to a lesser degree, a reduction in their liabilities. The expiry of swaps related to the forint conversion of foreign currency loans may have contributed to the rise in banks' assets. As a result of the process, banks' net external debt became negative – i.e. the volume of foreign assets already exceeds the amount of external debt (Chart 39). However, the general government's net external debt increased slightly during 2016, which is primarily attributable to the foreign currency liquidity provided for the banking system in relation to forint conversion, via a reduction in foreign currency reserves. Companies' net external debt also continued to decrease in 2016, mostly due to the sector's rising foreign assets. In Q4, Hungary's net external debt fell by nearly 2 percent of GDP, which is attributable mainly to the external debt reduction of the banking system. The net external debt of the consolidated general government slightly increased in Q4 (similar to the first three quarters), which was mainly attributable to the revaluation.

Chart 38: Breakdown of net external debt by sectors (as a percentage of GDP, without intercompany loans)

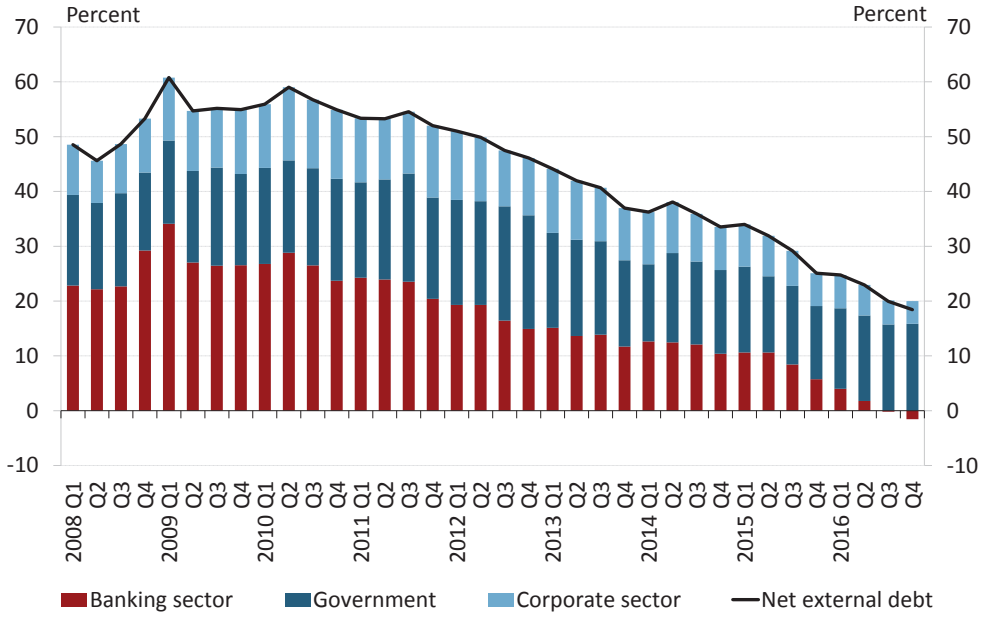
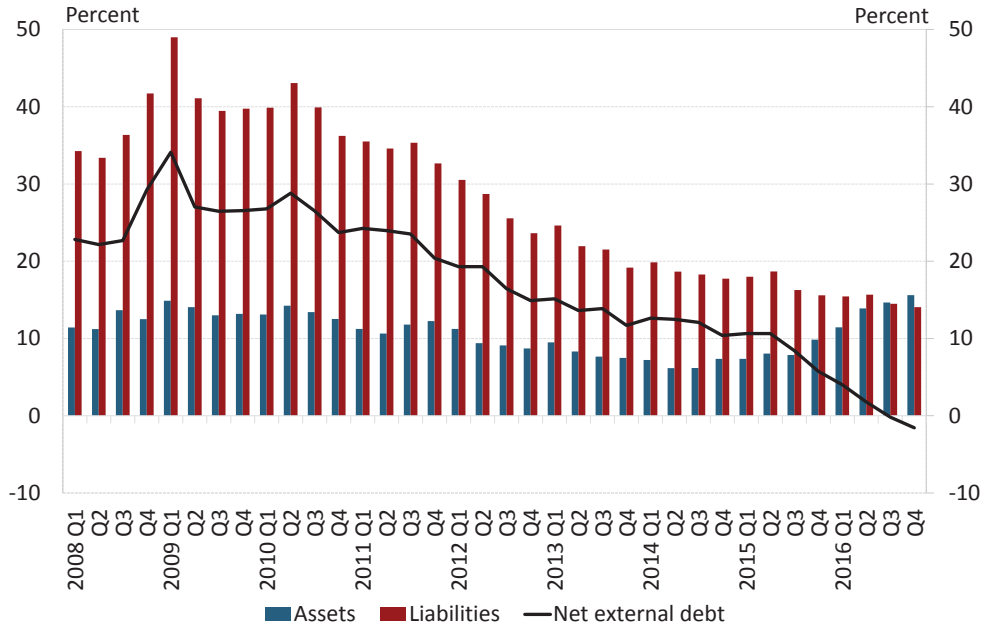


Chart 39: Developments in the banking system's external assets and debts (as a percentage of GDP)

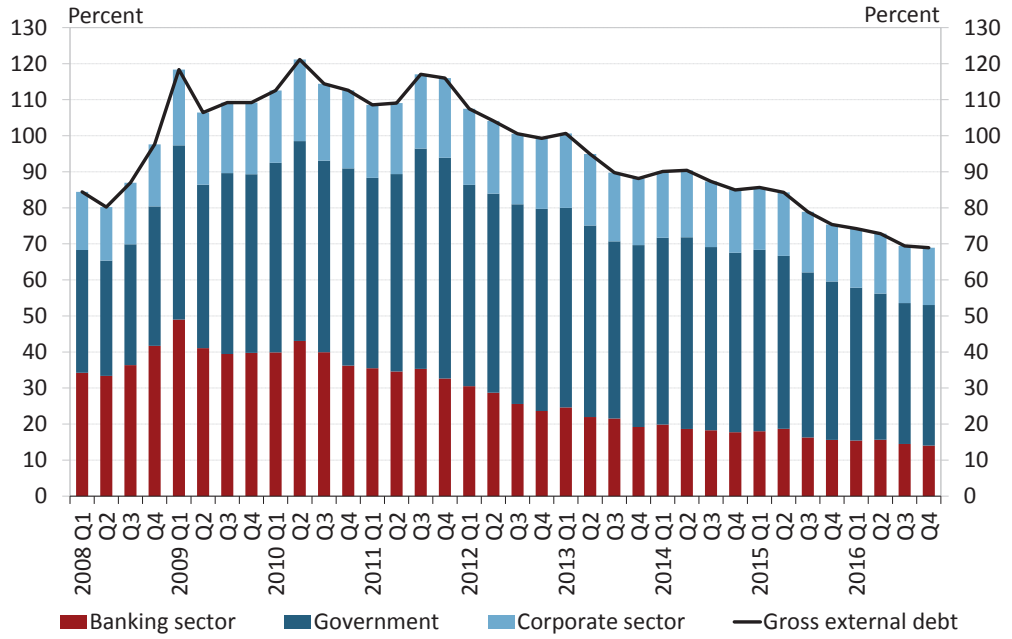


3.3. Gross external debt

At the end of 2016, mainly in the context of the government's declining foreign financing, Hungary's gross external debt fell to below 69 percent of GDP, which is nearly by 7 percentage points lower than the year-end value in 2015 (Chart 40). In addition to net external debt, gross external debt also dropped in 2016, and thus, since 2010, the indicator has decreased considerably overall, falling by more than 50 percent of GDP – mainly due to balance sheet adjustments. The decline in gross external debt in 2016 was mainly associated with the general government and to a lesser degree to the banking system. The general government's gross external debt was reduced by the fact that non-residents cut back their HUF government bond holdings, as well as that the general government did not issue new foreign currency bonds for the repayment of maturing foreign currency bonds. The decline of the sector's dependence on abroad was strongly supported by the MNB's self-financing programme, through the increase in the banking system's demand for government bonds, as well as by households' government bond purchases. The banking system also played a role in the reduction of Hungary's gross external debt: the external liabilities reduction may have been supported also by the expiry of swaps related to the forint conversion of foreign currency loans. A smaller reduction in gross external debt

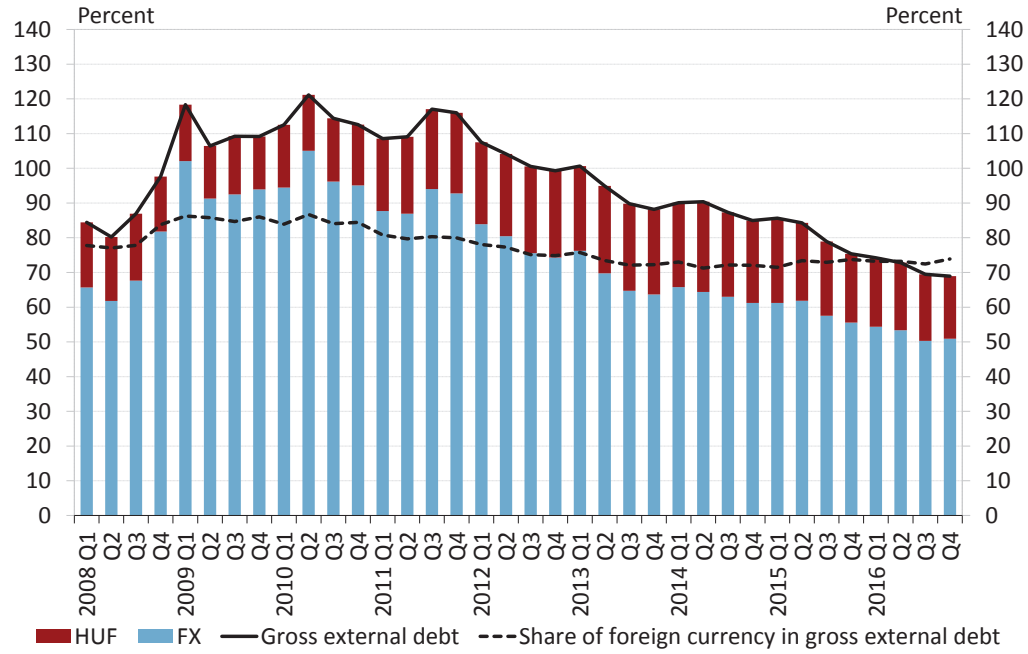
compared to the net indicator can be traced back to the fact that in the past eighteen months the private sector reduced its external debt only to a lesser degree and increased its foreign asset holdings instead.

Chart 40: Breakdown of gross external debt by sectors (relative to GDP, without intercompany loans)



The foreign currency ratio within gross external debt did not change significantly, remaining at slightly above 70 percent, similar to recent years. The foreign exchange ratio within gross external debt is also worth monitoring, as due to the foreign currency liquidity needs, as well as to the exchange rate sensitivity of repayments, this ratio can seriously impact a country's external vulnerability. As a result of the decline in non-residents' government bond holdings, HUF-denominated external debt also fell, and consequently the foreign currency debt ratio of gross external debt remained unchanged in 2016 despite the fact that the bulk of the decline in gross external debt was seen in relation to foreign currency debt (Chart 41). During the final quarter, the foreign exchange ratio in external debt increased, mainly associated with the rise in the foreign currency debt of the general government (and within this with the margin holding and new issues). However, the foreign exchange ratio of the government's external debt declined in 2016 due to foreign currency maturities and dropped to nearly 63 percent. The foreign exchange ratio of private sector external debt rose moderately in 2016 and amounts to around 88 percent.

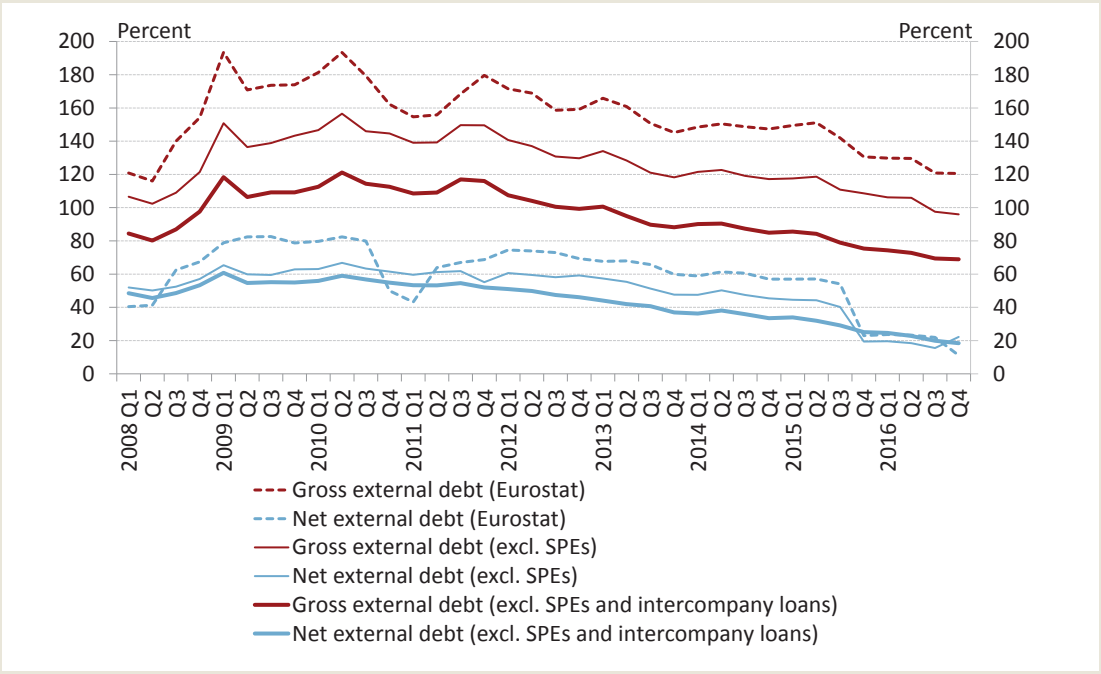
Chart 41: Breakdown of gross external debt by denomination (values as a percentage of GDP) %



Box 2: On various external debt indicators

Based on economic considerations, in its analyses and publications the MNB shows debt ratios excluding SPEs (special purpose entities) and intercompany loans. In addition to central bank websites, the net and gross external debt figures of the EU member states are also available on Eurostat. However, in the Eurostat database only a time series including SPEs and intercompany loans are available. However, these factors should be ignored when examining the underlying trends. SPEs do not perform real economy activities, they only have their funds "flow through" the given country for taxation considerations. Although their activity does not influence the country's net investor position they significantly influence the gross legs. In addition to this, they may also impact the level of net external debt, as the transactions are shown under both debt and non-debt items. One of the consequences of this is that the change in the time series including also the net liabilities of SPEs is typically more volatile. In addition to SPEs, intercompany loans may also significantly modify the debt ratios, but the renewal and interest risk of intercompany loans is much lower compared to loans from the financial intermediary system, and due to their other features, they can be considered more like non-debt liabilities than debt liabilities (for more details see Balance of Payment Report of April 2014). With due regard to this, it is also worth mentioning that an individual transaction of a company may also significantly influence the debt ratio including intercompany loans. For example, at the end of 2015 a foreign-owned multinational large company sold its foreign subsidiary, but the purchase price has not been paid, and this was reflected in the increase in loan receivables, which reduced Hungarian investments and ultimately also net external debt including intercompany loans (for more details see press release "Balance of payments trends based on 2016 Q1 data"). One of the consequences of the individual transaction is that currently – presumably temporarily – the debt ratio including intercompany loans is lower than the time series according to the underlying trends excluding intercompany loans. Overall, however, it should be highlighted, that in the case of Hungary all ratios have fallen continuously and considerably in the past years (Chart 42).

Chart 42: Developments of net and gross external debt (relative to GDP)



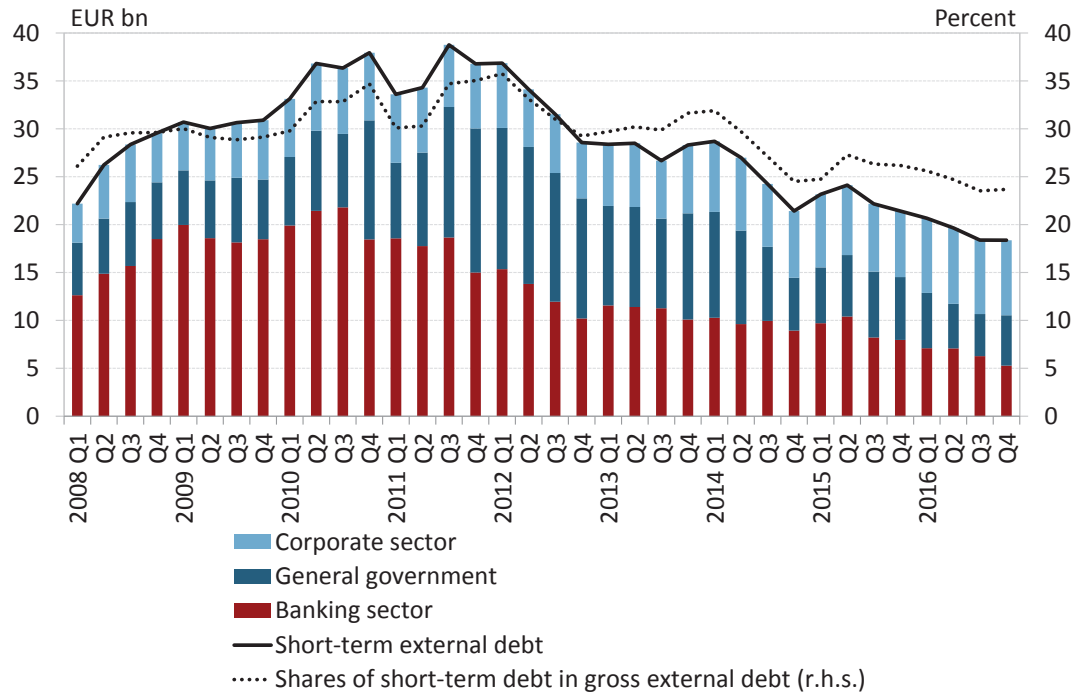
Source: Eurostat.

3.4. Short-term external debt and gross borrowing

Hungary's short-term external debt continued to fall in 2016, and thus at the end of Q4 it amounted to EUR 18.4 billion, which was similar to the Q3 figure. At the end of 2016, short-term external debt – which is of key importance for the purposes of assessing the economy – was nearly EUR 20 billion lower than the historical high registered in 2011. During 2016, short-term external debt fell by nearly EUR 3 billion, which can be explained by the decline in the short-term debt of the banking system and the consolidated general government, which was partially counterbalanced

by the rise in the short-term external debt of companies. The banking system's short-term external debt based on residual maturity fell by nearly EUR 2.7 billion, which is also associated with the reduction of the sector's originally short-term and amortising debt on account. The general government's short-term external debt also decreased significantly, dropping by nearly EUR 1.3 billion as compared to the end of 2015, which was mainly due to the amortising debt on account through the repayment of the last instalment of the EU loan. Overall, the short-term external debt of both the banking system and the government is historically low: at the end of 2016, the short-term external debt of the banking system amounted to EUR 5.3 billion, a level unseen since 2004, and the short-term external debt of the consolidated general government was similarly low, amounting to EUR 5.3 billion, which is also considerably below the EUR 15 billion peak value recorded at the end of 2011. The short-term external debt of companies was nearly by EUR 0.9 billion higher at the end of 2016, compared to December of the previous year. Short-term external debt based on original maturity of companies rose by nearly EUR 0.3 billion, while the sector's amortising debt on account grew by EUR 0.6 billion. The reduction in the ratio of short-term debt within total external debt continued in 2016, and thus it is lower than the pre-crisis level (Chart 43).

Chart 43: Developments in short-term external debt based on residual maturity



Compared to the previous quarter, at the end of 2016 Q4 short-term external debt was nearly unchanged, which was the result of mutually opposing processes. Short-term external debt amounted to EUR 18.4 billion: a larger increase in the short-term external debt of the general government and the slight increase in the short-term debt of companies was counterbalanced by the reduction of banks' short-term external debt.

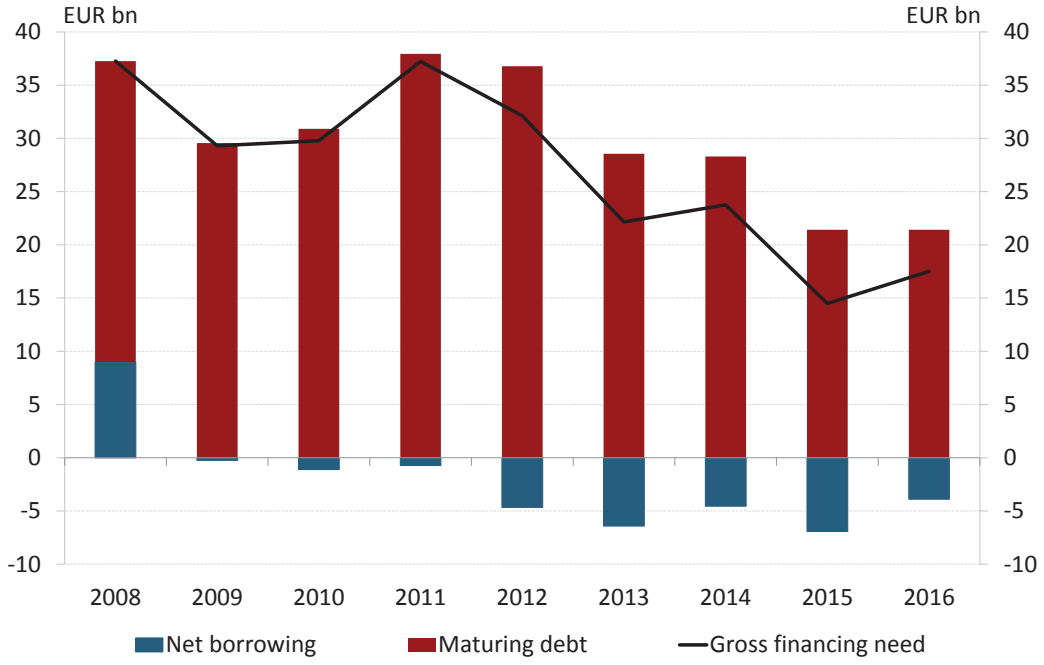
- In Q4, the short-term debt of the *consolidated general government* rose by more than EUR 800 million, with the increase in originally short-term and amortising debt on account contributing to this development. The sector's external debt based on original maturity increased by almost EUR 400 million, primarily attributable to the ÁKK's margin liabilities. In addition to this, the sectors' amortising debt on account also grew compared to the end-Q3 value, which is mainly explained by the government's debts maturing in Q1 2017 falling due within one year. Although the general government's short-term external debt increased in Q4, it is still below the 2015 year-end value.

- The *banking system's* short-term external debt based on residual maturity continued to fall in Q4, decreasing by nearly EUR 1 billion. It amounted to nearly EUR 5.3 billion at the end of 2016. The reduction was mainly due to the short-term external debt based on original maturity, but the decline in the sector's amortising debt on account also lowered the indicator.

- The short-term external debt of the *corporate sector* increased slightly during the quarter, which can be attributed to both the sector's amortising debt on account and short-term external debt based on original maturity.

Hungary's gross financing needs increased modestly in 2016, in which weaker net lending played a key role. The debt maturing in 2016 (short-term external debt based on residual maturity at the end of 2015) was similar to the previous year's value. The country's external vulnerability, its reliance on external funds was strongly reduced by the fact that maturing external debt fell from EUR 38 billion to nearly EUR 21 billion (Chart 44). However, the economy's net lending declined: compared to previous year's EUR 8 billion, it amounted in 2016 to EUR 3.9 billion. Thus, the gross financing need calculated using the two indicators rose to nearly EUR 18 billion in 2016, but this value is still considerably below the post-crisis levels (in the case of then gross financing need we can already consider actual data). In 2017, Hungary's gross financing need is expected to decline again, as short-term external debt at the end of 2016 (i.e. debt maturing in 2017) was lower than the previous years' value. The decline may also be supported by the forecasted maintenance of Hungary's considerable net lending in 2017.

Chart 44: Developments in the gross financing need



3.5. Reserve adequacy

In 2016 Q4, the volume of foreign exchange reserves grew, primarily as a result of funds received from the European Commission, as well as the foreign currency swap tenders providing HUF liquidity related to the quantitative restriction of policy instruments. At the end of 2016, international reserves amounted to EUR 24.4 billion, representing an increase of EUR 0.7 billion as compared to the Q3 figure. Changes in the foreign currency reserves were influenced by a number of factors, from which the key reserve increasing items were the following:

- EU funds increased the reserves by nearly EUR 1.2 billion.
- Related to the MNB's quantitative restriction on the three-month deposit instrument, the MNB has been holding foreign currency swap fine-tuning tenders providing HUF liquidity since October 2016, to manage uncertainties related to liquidity processes. The impact of swap instruments on foreign currency reserves amounted to EUR 1.3 billion in Q4.
- Changes to the volume of mark-to-market deposits related to the ÁKK hedging swap transactions showed a surplus of EUR 0.4 billion.

The increase in the level of reserves was mitigated by multiple reserve reducing items, most of which were associated with the MNB's programmes:

- The maturity of unconditional swaps related to the forint conversion of retail foreign currency loans in December 2016 lowered the level of reserves by over EUR 600 million.
- Net foreign currency financing of the ÁKK reduced foreign currency reserves by a total of EUR 750 million. This includes also P€MÁK maturity in October, quarterly P€MÁK and Hungarian residency bond issues, as well as early repayment of government foreign currency loans and foreign currency bond repurchases at the end of the year.
- The reserve-reducing effect of loans granted under the foreign currency pillar of the third phase of the Funding for Growth Scheme amounted to some EUR 170 million in the quarter.
- Other foreign currency transactions of the ÁKK and MÁK amounted to a total of nearly EUR 500 million, presumably the latter grew mainly temporarily related to year-end budgetary processes, while their revaluation due to the weakening of certain other currencies against the euro reduced the foreign currency reserves by more than another EUR 200 million.

In 2016, foreign currency reserves of the MNB fell by nearly EUR 6 billion, which is mainly associated with the forint conversion of retail foreign currency loans and with the internal HUF financing of government debt. In parallel with the reduction of short-term external debt, the international reserves of the central bank fell from EUR 30.3 billion in December 2015 to EUR 24.4 billion by the end of 2016. Planned reserve reducing programmes of the MNB continued in 2016; the aggregated effect of forint conversion and refinancing of government debt from internal funds was over EUR 9 billion:

- The maturity of unconditional swap instruments related to the forint conversion of retail foreign currency loans in March 2016[11] had an effect of EUR 0.9 billion, while the maturities of unconditional swap transactions due quarterly had a reserve reducing effect of EUR 3.9 billion.
- Due to the increased forint money market bond issues, the ÁKK repaid foreign currency debt with a value of EUR 4.6 billion during the year, without undertaking significant foreign currency bond issuance on the international markets. The reserve reduction related to the net foreign currency financing of the debt manager was primarily the result foreign currency bond maturities and repurchases, the expiry of the last instalment of foreign currency loans from the European Commission, the renminbi-denominated foreign currency bond issue, the net retail foreign currency bond (P€MÁK and Hungarian residency bond) issues, as well as the early repayments of foreign currency loans.

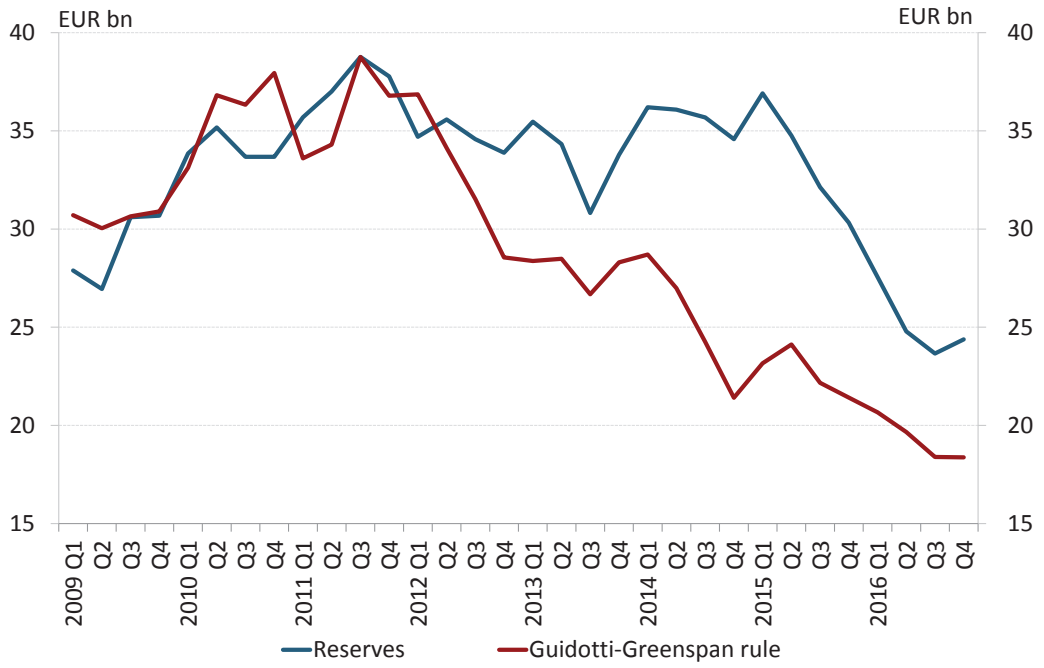
In addition to this, the other foreign currency transactions (e.g. foreign currency interest payments) of the ÁKK and MÁK and the cash flows associated with the foreign currency pillar of the third phase of the Funding for Growth Scheme also showed up as reserve reducing items (in a value of approximately EUR 1.9 and 0.3 billion). In contrast to the reserve reducing items, the total of EUR 3.4 billion in EU funds received in 2016 acted towards the increase of reserves. The maturity of one-week liquidity providing swap transaction at the end of 2015 had a reserve-increasing effect of approximately EUR 0.5 billion, while foreign currency swap tenders providing HUF liquidity called for as of October 2016 had a reserve increasing effect amounting to some EUR 1.3 billion between 2015 and end of 2016. Other factors (for example, banks' foreign currency deposit at MNB, as well as the revaluation of foreign currency reserves) increased the volume of reserves overall.

In addition to the increase in foreign exchange reserves, short-term external debt remained unchanged in the final quarter of 2016, and thus at the end of 2016 the volume of foreign exchange reserves still considerably exceeded the level expected by investors. Based on the Guidotti-Greenspan rule, which is particularly followed by both the central bank and investors, the foreign currency reserves of EUR 24.4 billion at the end of 2016 significantly exceeded the level of short-term external debt, which amounted to EUR 18.4 billion. Changes in the foreign currency reserves were

11 In the MNB's short-term external debt reducing conditional swap instrument credit institutes could roll over their foreign currency purchased on foreign currency tenders related to the forint conversion up until 30 March 2016 with weekly frequency.

strongly influenced by the payment of EU funds, as well as by the MNB's foreign currency swap transactions for monetary policy purposes, the effect of which was only partially reduced by the MNB's previously announced targeted programmes (foreign currency swaps related to the forint conversion of foreign currency loans, self-financing and other foreign currency FGS). The increase in short-term external debt seen in the general government and the corporate sector was entirely offset by the reduction in the banking system. In accordance with this, the reserve adequacy in the proportion of short-term external debt improved by nearly EUR 1 billion in 2016 Q4, and thus the room for manoeuvre above the Guidotti-Greenspan indicator reached EUR 6 billion, which continues to represent a safe level (Chart 45).

Chart 45: Developments in foreign currency reserves and the Guidotti-Greenspan indicator

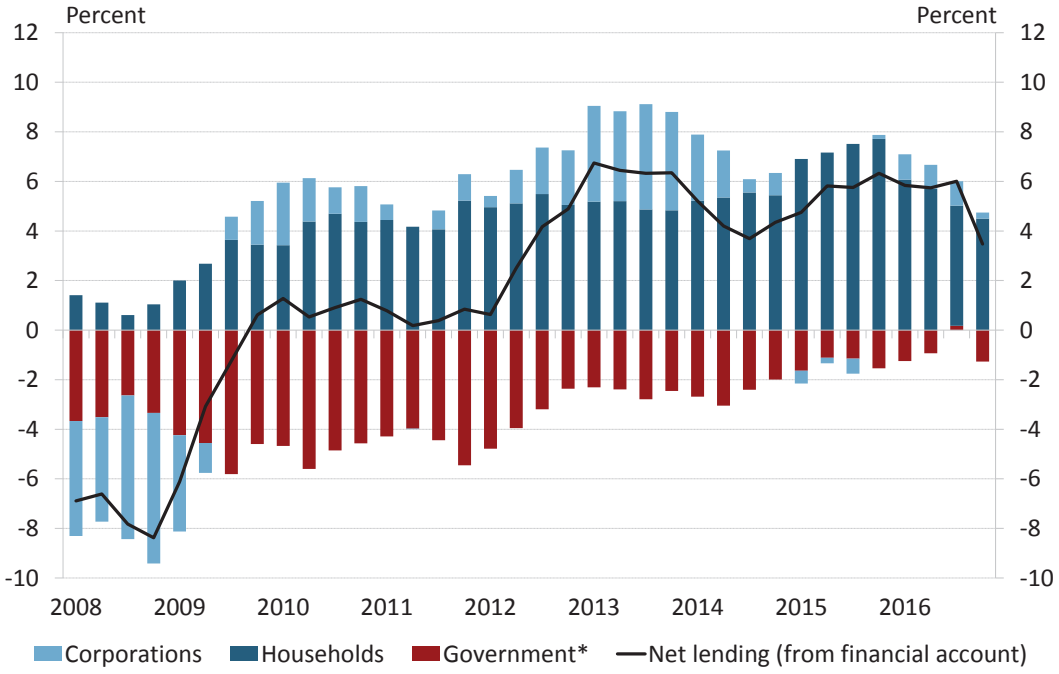


4. SECTORS' SAVINGS APPROACH

In 2016, the net lending of the Hungarian economy fell primarily due to the decline in the private sector's financial savings, while the net borrowing of the general government decreased at the annual level to a historical low. The net lending of the corporate sector fell to nearly zero in 2016 Q4, while the decline in households' net savings which started at the beginning of the year continued in line with the growth in consumption. The moderate increase in corporate investment activity and the recovery in retail lending played a key role in the decline in the private sector's net lending, which was supported by the easing of precautionary considerations, in the context of improving income and labour market perspectives. The net borrowing of the general government rose in Q4 related to the budgetary release, but at the annual level, its value of 1.3 percent of GDP marked a historical low. The increase in budgetary income in parallel with the increase in wages and consumption, as well as the reduction of expenses related to the declining interest expenses and moderate public investments also contributed to the general government's moderating net borrowing.

According to the sectors' savings, the net lending of the Hungarian economy fell significantly in 2016 Q4, with both the decline in the financial savings of the private sector and the increase in the general government's net borrowing contributing to this development (Chart 46). The change in the financial savings of the individual sectors is ultimately reflected in the financing of abroad, and thus changes in the external balance can also be captured as the sum total of the sectors' savings. Although the net borrowing of the consolidated general government increased in the last quarter of 2016 after the significant decline in the previous quarters related to the budgetary release at the end of the year, its value in 2016 was historically low, amounting to approximately 1.3 percent of GDP. The fairly low net borrowing was mainly supported by rising fiscal revenues linked to the expansion of consumption and higher employment, as well as decreasing interest expenses. Households' net lending fell to nearly 4.5 percent of GDP in Q4, with growth in consumption volume and increasing in the volume of borrowing. The net lending of the corporate sector fell to nearly zero, which can be attributed to the slight decline in income and a slight increase in investments and stock accumulation.

Chart 46: Net lending of the individual sectors (four-quarter values as a percentage of GDP)

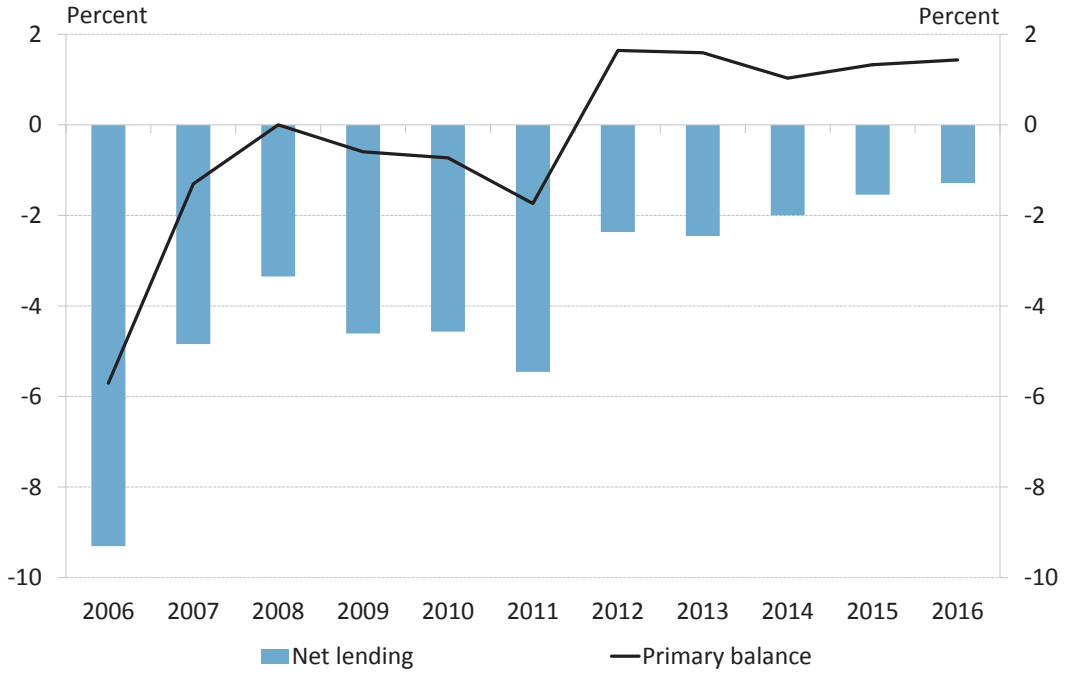


* "General government" represents the financing requirement according to the financial accounts. "Corporate" was determined on the basis of the residual principle.

4.1. General government

The net borrowing of the general government continued to decline in 2016, falling to a historic low (Chart 47). In 2016, based on the preliminary data of financial accounts, the net borrowing of the general government amounted to 1.3 percent of the gross domestic product, i.e. GDP-proportionate deficit of the budget continued to decrease in 2016.[12] Due to the increasing wage outflow and dynamic growth in households' consumption expenditure, the budget's major revenues grew in 2016 in spite of targeted price reductions and the one percentage point cut in personal income tax. On the expenditure side, the decreasing interest expenditures, the declining GDP-proportionate value of financial transfers as well as the lower use of EU funding acted towards a reduction of the deficit. In addition to underlying economic trends, the lower-than-planned volume of public investment projects also contributed to a low deficit.

Chart 47: Developments in the net lending of the general government (as a percentage of GDP)

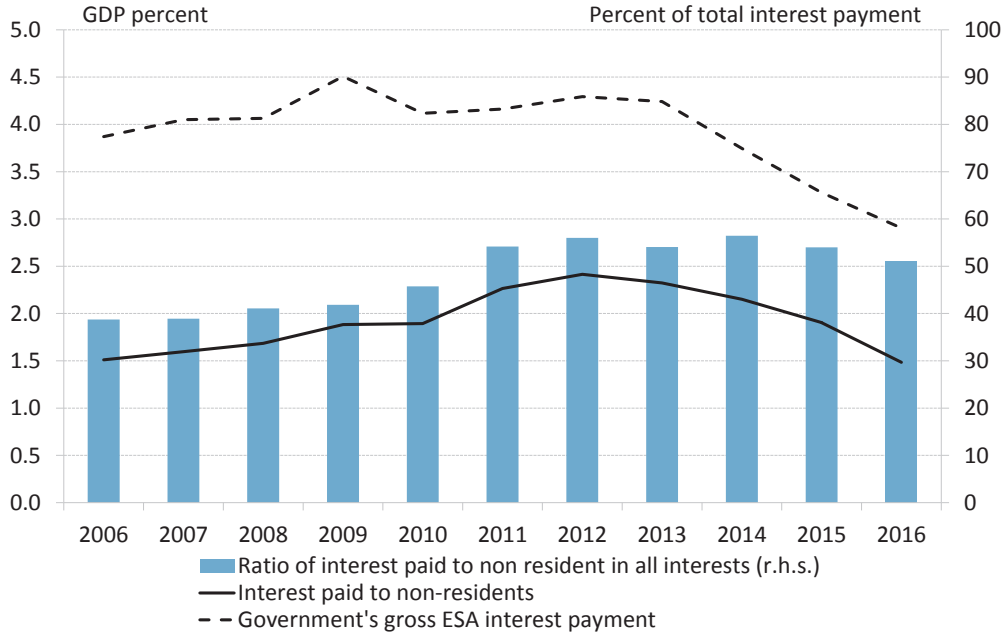


Source: MNB.

In parallel with the decrease in the government's interest expenses, interest paid to non-residents declined. As a result of a low yield environment and gradual rearrangement of debt, the general government's gross GDP-proportionate interest expenses continued to decline in 2016 (Chart 48). Gross interest expenses decreased to below 3 percent in 2016 from 4.3 percent in 2012, thus enhancing the budget's room for manoeuvre. Stable domestic macro-economic conditions, the central bank's programmes (interest cutting cycles, self-financing programme), upgrades and the supportive international environment all contributed to the decline in government bond yields and thus, a decline in gross interest expenses. From the perspective of the income balance in the balance of payments, it is worth noting that the share of interest paid to non-residents by the government within all public interest payments declined further in 2016, in line with the change in the ownership structure of government debt. In 2016, government interest paid to non-residents fell to 1.5 percent of GDP, which has never been that low since 2006.

12 For 2016, the data regarding the ESA balance of the budget is not yet available, but preliminary net lending data calculated according to the financial accounts differs usually only slightly from the ESA-balance.

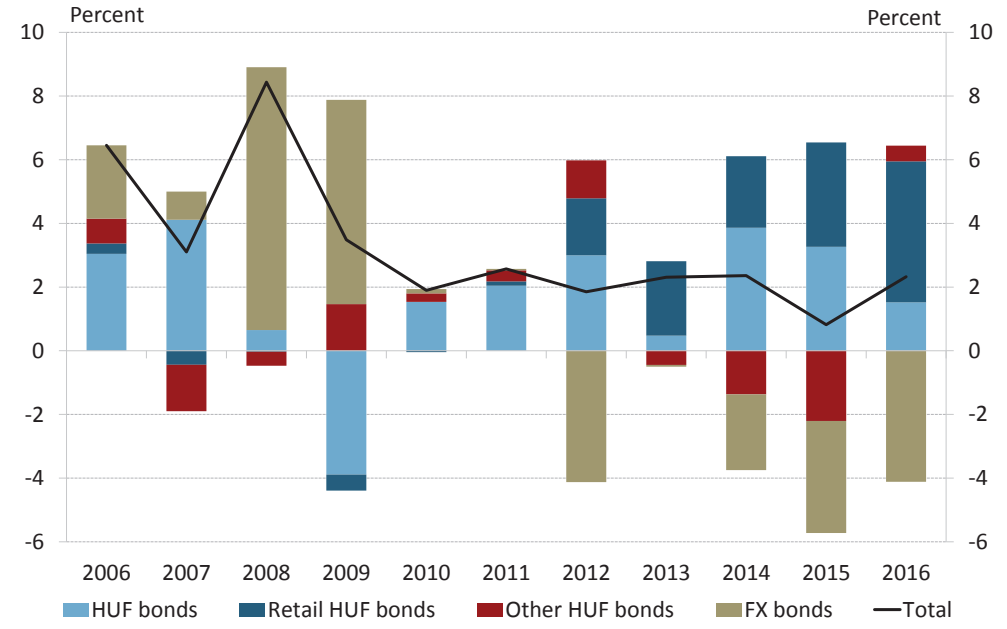
Chart 48: Developments in the interest expenses of the general government



Note: The data do not contain the imputed interest expenditures incurred since 2012 on account of the pension system reform.

Stable demand for retail government bonds and HUF bonds in 2016 provided sufficient funds for repaying a significant volume of maturing foreign currency debt, and thus there was no need to issue international foreign currency bonds for financing purposes. In addition to the last instalment of the HUF 450 billion EU-IMF loan, foreign exchange bonds were repaid in the equivalent value of an additional HUF 1,000 billion in 2016. The reduction of foreign currency debt was supported by a large net issue of retail bonds, as well as the strong demand for HUF bonds. The volume of retail HUF bonds rose by approximately HUF 1,500 billion in 2016, while the volume of HUF bonds increased by HUF 530 billion (Chart 49). Domestic savings enables not only the reduction of foreign exchange debt, but was also able to entirely finance the budgetary deficit, and thus there was no need to issue foreign exchange bonds for financing purposes.[13]

Chart 49: Structure of the Government Debt Management Agency's annual net debt issuance (as a percentage of to GDP)

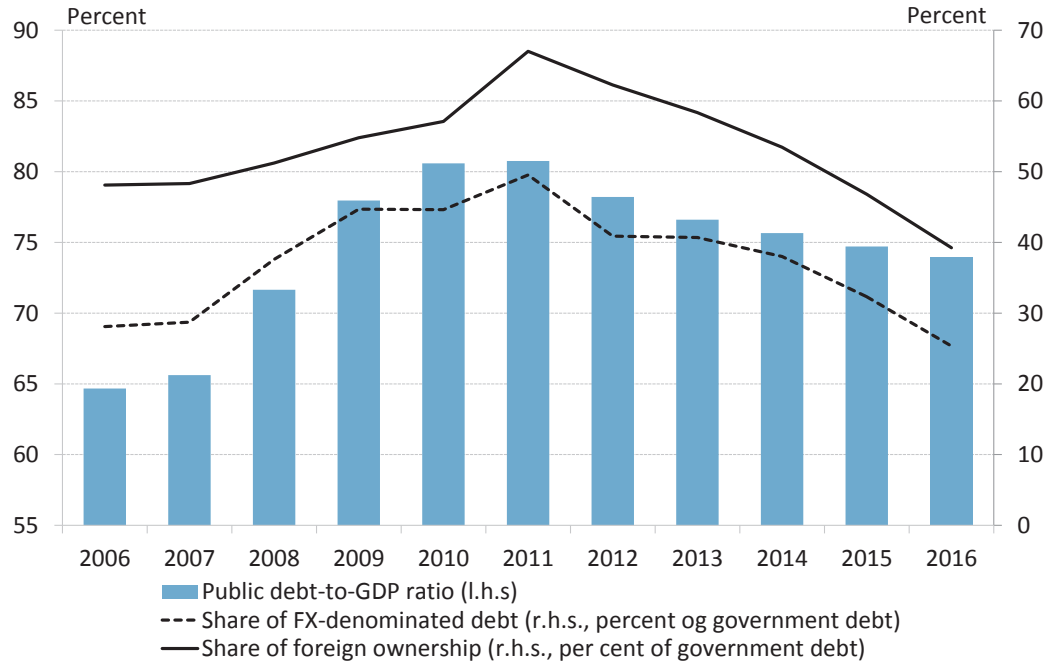


Source: ÁKK.

13 The CNY 1 billion international bond issue in April 2016 was of key importance more from an economy policy point of view.

In 2016, the downward trend in gross government debt relative to GDP and within that the foreign currency ratio, and the ratio of foreign ownership within government debt observed since 2011 continued (Chart 50). By the end of 2016, GDP-proportionate gross government debt fell to 74.1 percent, and thus the Hungarian debt ratio declined by 0.6 percentage points compared to the 2015 year-end value, and by nearly 7 percentage points compared to the historical high recorded in 2011. The key driver behind the structural change in government debt in recent years was the rising demand for government bonds by households and the domestic banking system, also supported by the central bank's self-financing programme. As a result, the proportion of foreign ownership within government debt decreased substantially, dropping from 67 percent at the end of 2011 to below 40 percent by the end of 2016, i.e. below the level before the 2008 global crisis. In the meantime, the foreign currency ratio within central debt dropped to 25 percentage points, reaching one half of the 50-percentage point peak recorded at the end of 2011. The foreign property and foreign currency ratio have been on a downward trend for five years in a row and in 2016 this played key role in the continuous reduction of external vulnerability, as well as in the improvement of Hungary's credit rating.

Chart 50: Developments in gross government debt and the proportion of foreign ownership and foreign currencies within that



Note: The proportion of foreign ownership in 2016 is an MNB estimate.
Source: ÁKK, MNB.

On 6 April 2016, Hungary repaid the European Union the last instalment of EUR 1.5 billion from the EUR 14.3 billion loan taken within the framework of the IMF-EU loan agreement in 2008. With the repayment of the last instalment of EU-IMF loan, the foreign exchange ratio within government debt and the ratio of foreign ownership declined significantly. Repayment of the last instalment of the loan lowered both the foreign exchange ratio within government debt and the ratio of foreign ownership by 2 percentage points. In parallel with the decline in short-term external debt, the required volume of foreign exchange reserves also fell. In addition to this, due to the decline in the foreign currency ratio, exchange rate risk of the debt also dropped, which also supported the upgrading of Hungary.[14]

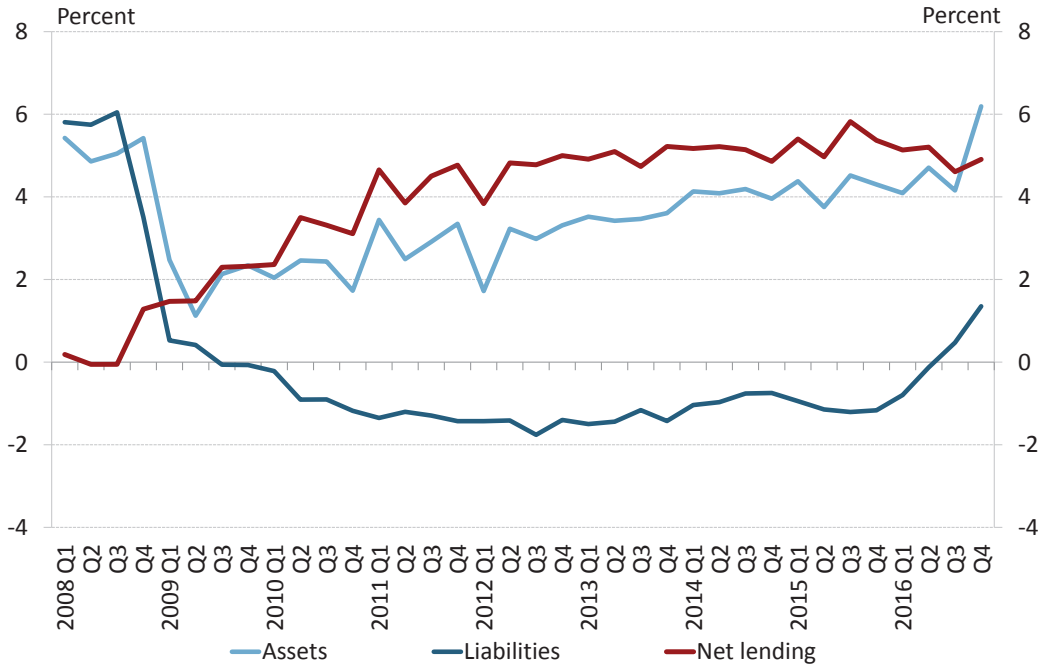
4.2. Households sector

In 2016 Q4, the net lending of households amounted to approximately 5 percent of GDP according to the underlying trends based on seasonally adjusted data (Chart 51). The downward trend in households' net financial savings halted at the end of 2016 based on the seasonally adjusted data, but its value was lower than in the same period of the previous year, which is associated primarily with the recovering demand for loan of households. The seasonally

14 Gergely Kicsák: (The repayment of the last instalment of EU loan reduced both Hungary's vulnerability and the costs of debt financing)

adjusted volume of borrowing exceeded 1 percent of GDP by the last quarter of the year, which primarily reflected the effect of strong demand for loans granted to the self-employed. The growth in the volume of financial assets of households soared in the last quarter of 2016, to which – in addition to the increase of employment and wages – a partial leverage potential of financial receivables of the households' borrowing might have also contributed.

Chart 51: Net lending of households (seasonally adjusted revised values, as a percentage of GDP)

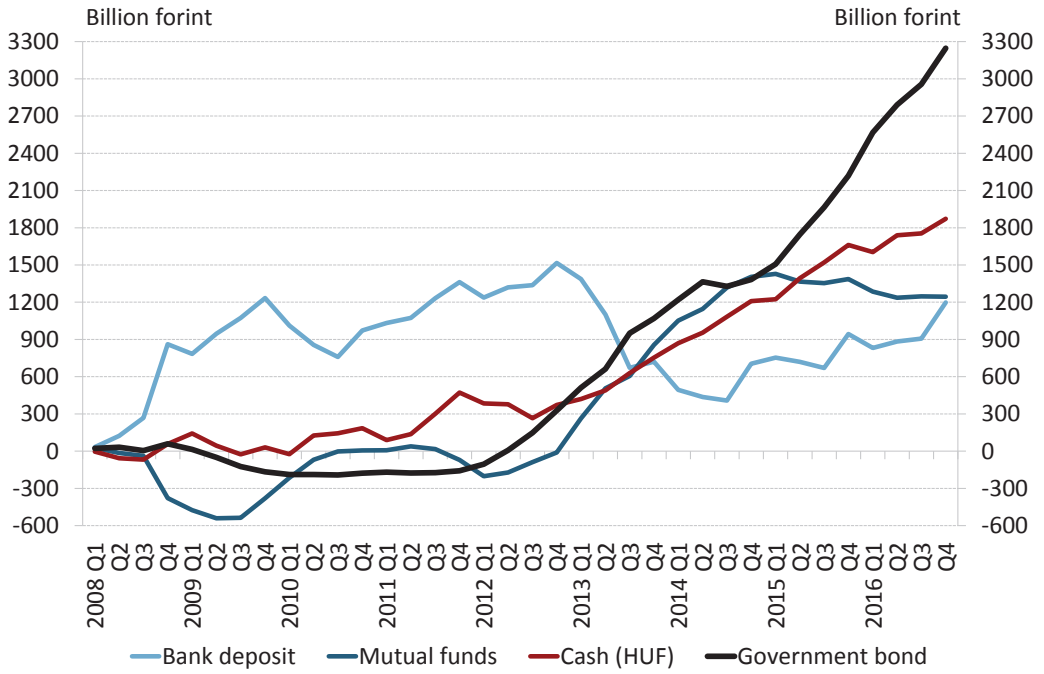


Note: Figures showing underlying trends, adjusted for the impact of pension savings, the early repayment scheme and real yield payment, the indemnification of the depositors at liquidated savings cooperatives as well as the forint conversion and settlement.

Throughout 2016, developments in the financial savings of households were driven by growth in the volume of borrowing and the high accumulation of financial instruments. According to the financial accounts, the net lending of the households amounted to 4.5 percent of GDP in 2016. The downward trend seen in the previous year was associated primarily with the recovering demand for loans by households, which is also supported by the recovery in the housing market, the improving income prospects and the growth in the volume of consumption. The net loan repaying position of households changed to net borrowing after 2016 Q2, and then lending gradually increased in the second half of the year, with the growing volume of loans granted to the self-employed also playing a role. The accumulation of financial assets reached a high level also in 2016, which is due to the fact that – even with increasing consumption – the increasing wages as a result of the tightening labour market still enable considerable growth in the volume of receivables. In addition, the moderately rising drawdown of housing loans may have also resulted in an increase in financial instruments, as the consideration for used homes purchased from loans typically appeared at the seller households in the form of financial instruments.

The strong growth in the volume of the households' government bond holdings continued in 2016 Q4. Via the financing of the general government from internal funds, this supports the decline in Hungary's vulnerability (Chart 52). The continuous growth in the volume of households' government bond holdings that started in 2012 continued without interruption in 2016, due primarily to the major yield benefits available in a low yield environment as compared to other types of investments, and as a result of which the government bond holdings of households amounted to nearly HUF 4,200 billion by the end of 2016. The composition of the financial asset portfolio of the households was primarily influenced by new savings, and the rearrangement between government bonds and bank deposits seen in the previous years came to an end in 2016. A major part of the new savings of households was spent on government bond purchase, but cash and bank deposit holdings also grew slightly. After stagnation in 2015, mutual fund holdings fell slightly in 2016 as a result of two opposing forces. Investments held in money market instruments – representing a less attractive investment alternative in a moderate yield environment – dropped significantly, which was not counterbalanced fully by the growth in the volume of savings held in REITs, in parallel with the housing market recovery.

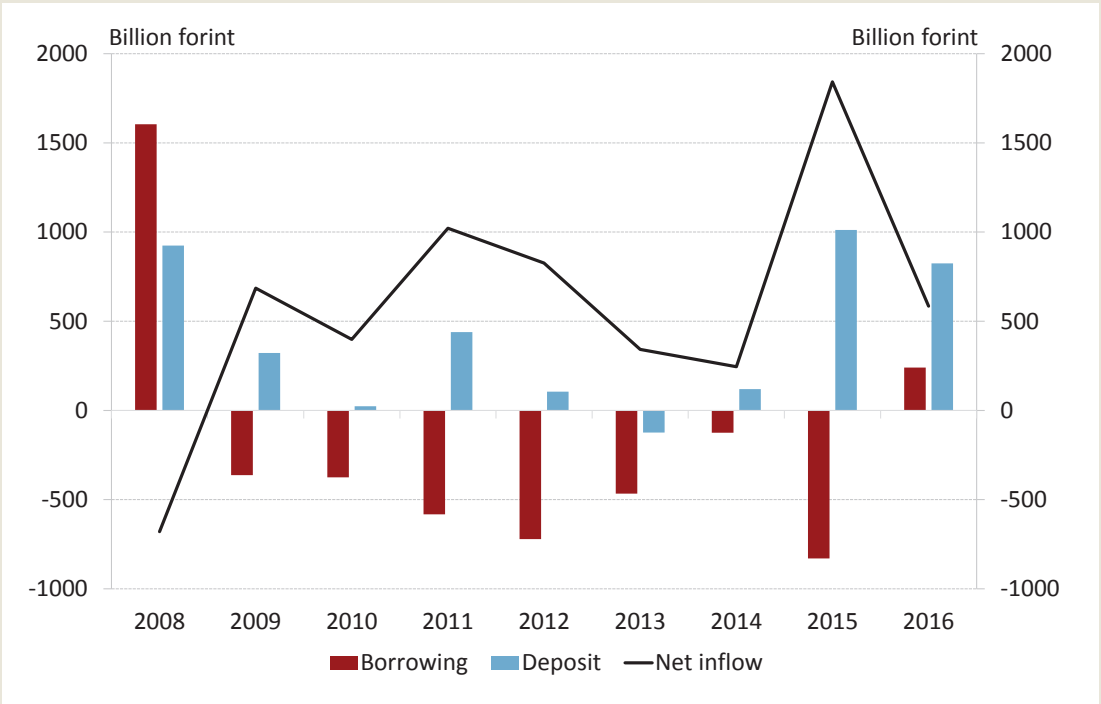
Chart 52:Developments of households' key financial assets (cumulative transactions)



Box 3: Developments of the private sector's bank loans and deposits

In addition to the lending-side changes in 2016, the private sector once again considerably increased the volume of its deposits, and thus households and non-financial companies provided considerable funds for the banks on the whole. Following the continuous reduction after the crisis, the volume of the households' and companies' bank loans grew for the first time in 2016 (Chart 53). This process, however, did not mean that banks received significantly less funds than previously, as households and non-financial companies increased the volume of their bank deposits by more than HUF 800 billion in 2016.

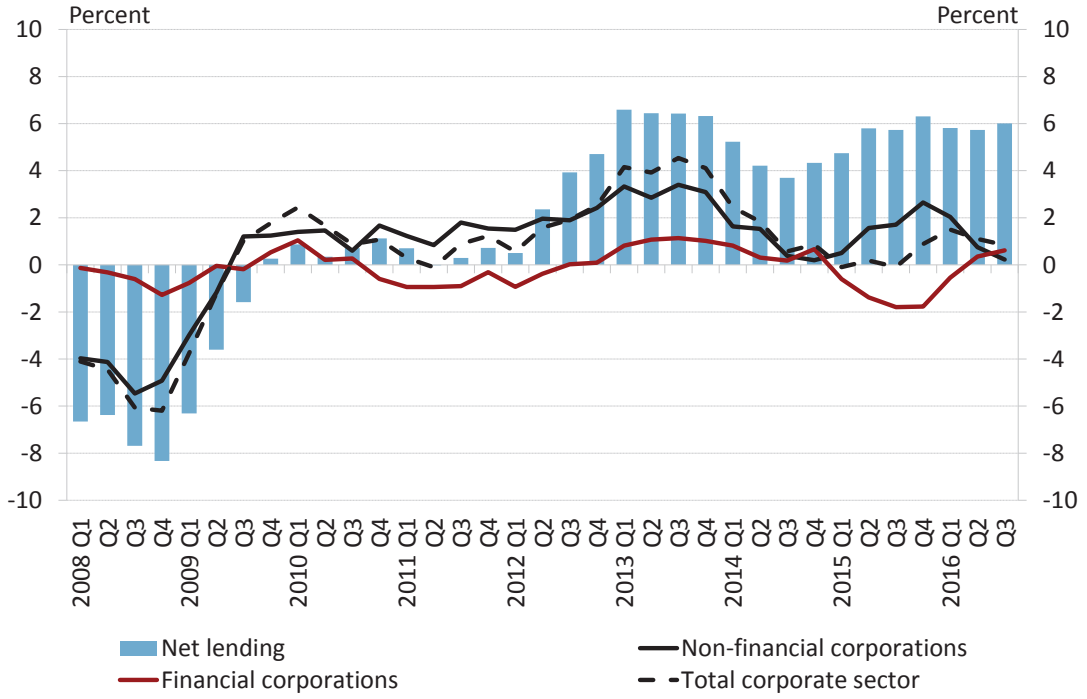
Chart 53: Developments in the private sector's bank loans and deposits



4.3. Corporate sector

The decline in the net savings of the corporate sector also contributed to the lowering of net lending calculated from the financing side. The net lending of the entire corporate sector gradually decreased as of the beginning of 2016, and amounted to approximately 0.8 percent of GDP in Q3.[15] This decrease can be attributed to the drop in the net lending of non-financial corporations to nearly 0, which was only partially counterbalanced by the increase in savings reflecting the improvement in corporate profitability (Chart 54). The net lending of financial companies returned to the previous – pre-foreign exchange loan settlement – level of close to zero through a gradual increase.[16]

Chart 54: Net lending of companies and external lending (four-quarter values relative to GDP)

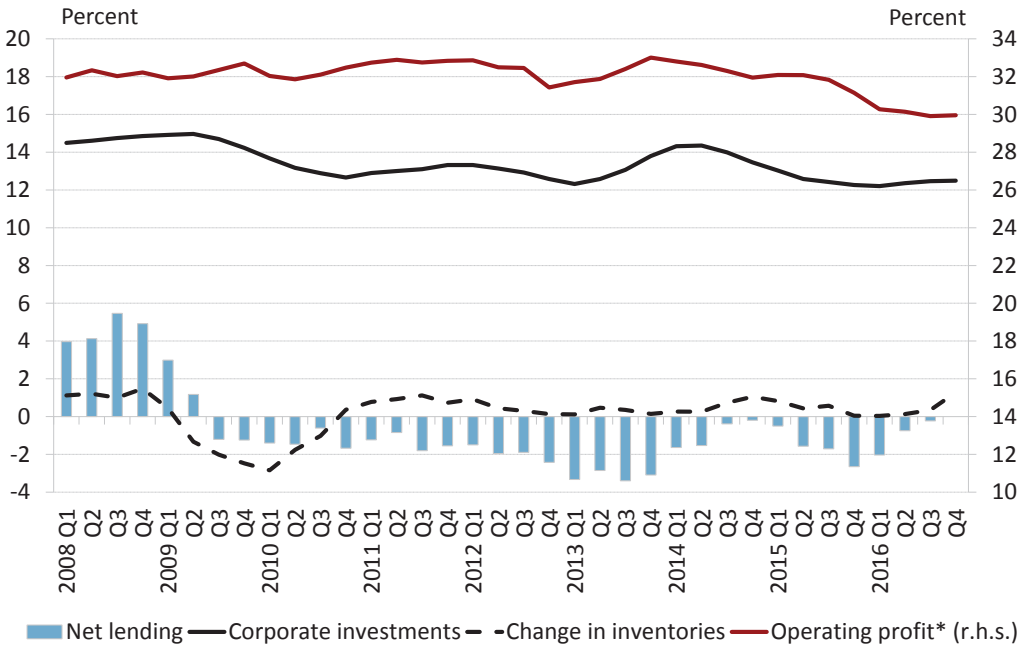


The net lending of non-financial companies fell to almost zero during the year: in the first half of the year this was driven by the decline in income, while the rise in stock accumulation and investments was the driving force in the second half of the year. The income of non-financial companies weakened in the first half of 2016 as a result of lower operating profits and declining EU transfers, but then stabilised in the second half of the year. Following the moderate investment activity seen at the beginning of the year, corporate investments rose slightly in the second half of 2016, while the significant growth in the volume of inventories at the end of the year also drove the decline in net lending (Chart 55).

15 Financial accounts for 2016 Q4 will only be published after the editorial deadline for this report.

16 The net lending of financial corporations is mainly influenced by the profits or losses of the sector, and the change in their non-financial assets (e.g. properties). However, in addition to these, the crisis and later the losses incurred during the early repayment scheme and the foreign currency settlements also substantially influenced the position of the sector: the difference between the market rate and the fixed exchange rate, and the foreign currency settlements as a capital transfer provided to the household sector reduced the net lending of banks, while at the same boosting households' net financial savings.

Chart 55: Non-financial corporations' net borrowing relative to GDP and the main underlying real economy factors (four-quarter values calculated from national accounts)

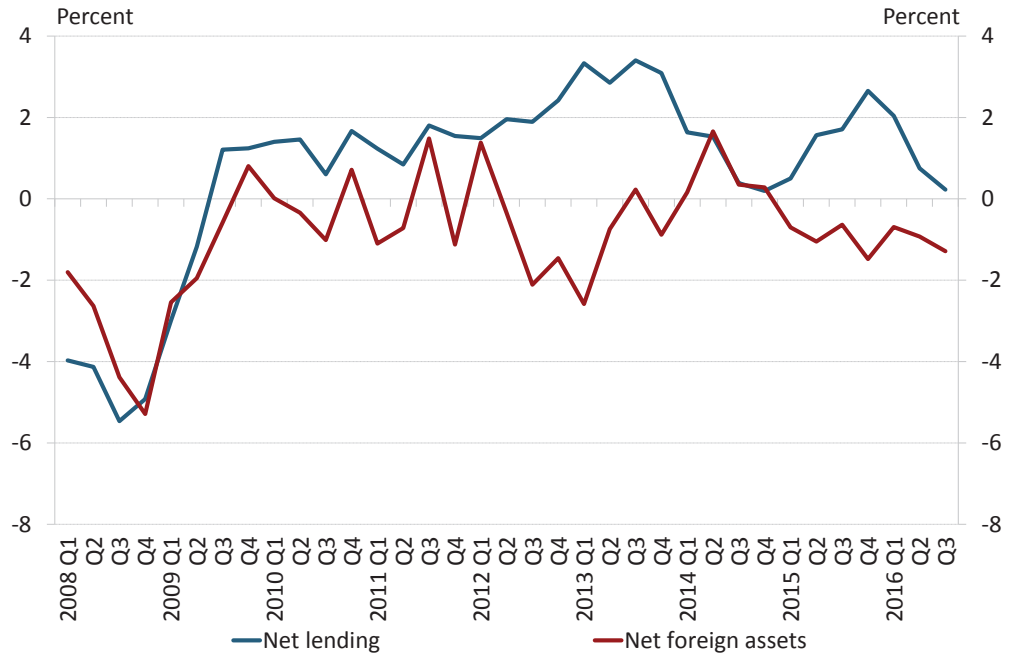


* Indicator adjusted for companies' interest and property income. Net borrowing data are only available until the third quarter.

Source: HCSO and MNB.

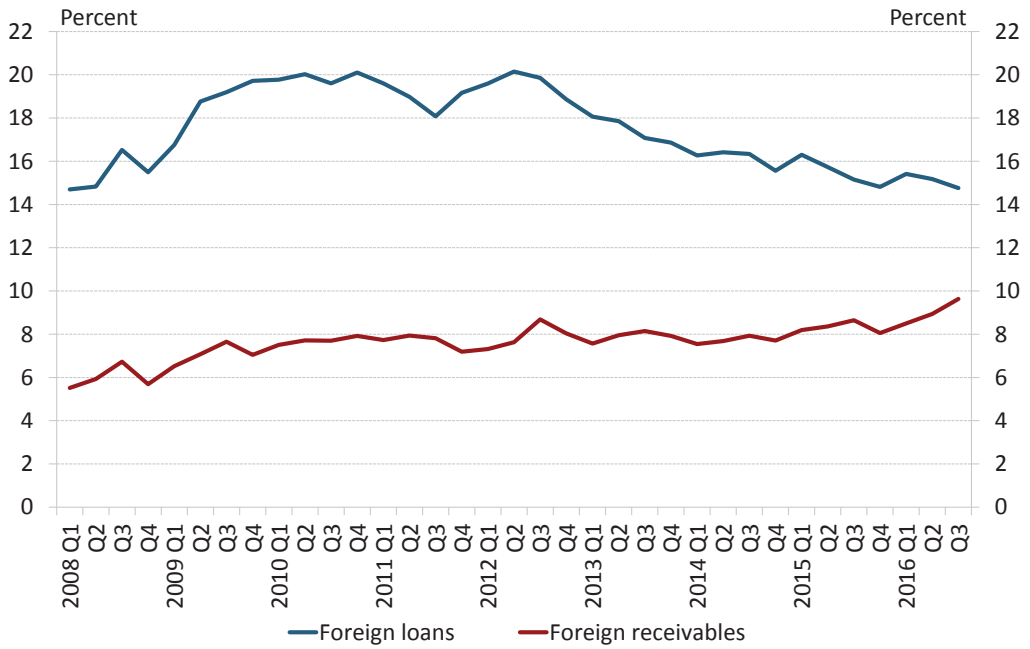
The net lending of non-financial corporations declined to nearly zero with increasing fund raising from abroad during the year (Chart 56). After the slight decline in 2015, the liabilities of companies increased significantly in the first three quarters of 2016. The rise in companies' foreign liabilities was mainly driven by the increase in the participation liabilities attributable to the high reinvested earnings, based partially on estimates. In addition to this, domestic loans increasingly lowered companies' net savings, i.e. the debt reduction seen in the previous year came to an end in 2016. Driven by the increase in bank deposits and foreign assets, the financial assets of companies grew considerably in 2016, although to a lesser degree compared to the increase in liabilities.

Chart 56: Net lending and net external transactions of non-financial corporations (four-quarter data, as a percentage of GDP)



The downward trend in external liabilities of companies that started in 2012 slowed down in 2016, while the foreign receivables of the sector grew considerably. The volume of companies' foreign loans amounted to approximately 15 percent of GDP in 2016. The slow reduction following an adjustment in 2016 Q1 was also supported by the effect of nominal GDP growth, in addition to moderate loan repayment. Similar to banks, the foreign receivables of companies began to rise in 2016 (Chart 57) which – in addition to bank deposits – also reflected growth in the volume of commercial loans.

Chart 57: Volume of foreign loan liabilities and receivables of non-financial corporations (relative to GDP)



5. INTERNATIONAL COMPARISON

The net lending of the Hungarian economy continued to rank among the highest in an EU-level comparison in 2016. The savings position was lower than in 2015, but was still outstanding. This can mainly be explained by the surplus of the balance of real economy, which can be attributed to the previously established new automotive industry capacities, a balance of services much higher than typical for the region, as well as to the improvement of the terms of trade. Hungarian net lending remained high, despite the fact that the surplus of the transfer balance fell significantly in 2016. Meanwhile, external debt continued to be cut back, as a result of which external debt indicators approximated the value observable in the countries of the region: net external debt and net external liabilities both dropped to the level of the Slovak and Polish figures. Although the level of gross external debt also fell, it is still higher than in the other countries of the region. At the same time, gross financing requirement based on original maturity – partially also due to high net lending – was again the lowest among the countries of the region in 2016.

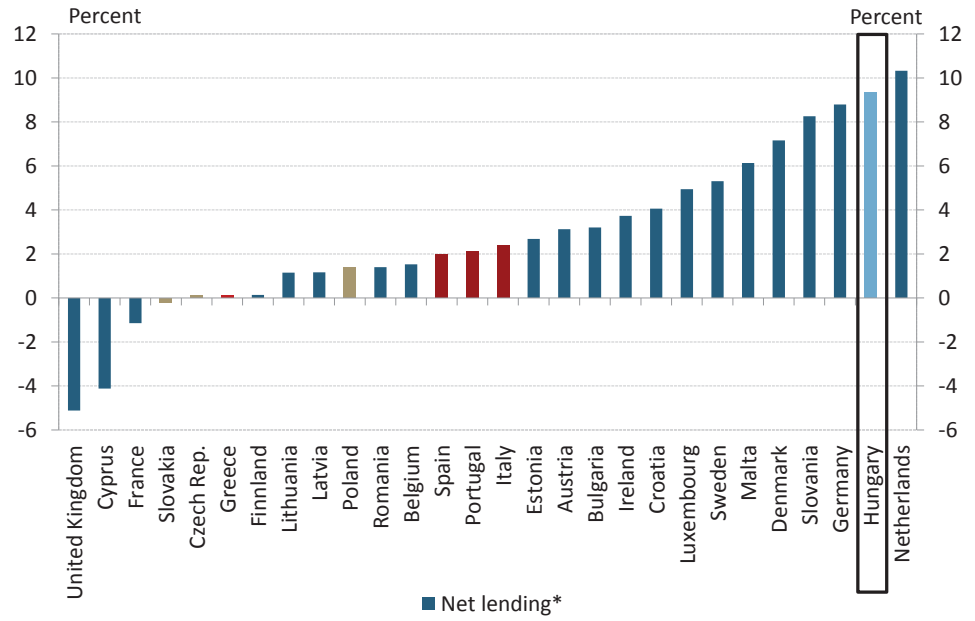
In the section 'International comparison', we discuss Hungary's external balance in comparison to other, primarily regional countries, while also covering the key drivers behind the Hungarian developments. In the next chapter, we draw comparison between net lending of the Hungarian economy and that of similarly developed groups of countries. In addition, we highlight the factors which most strongly influenced the development of net lending in the Visegrad countries. Furthermore, we explore the processes that contributed to the different development of the external debt indicators of similarly indebted Southern European member states following the crisis.

The external balance position of the Hungarian economy should basically be compared to two groups of countries. On the one hand, a comparison to regional countries may be useful, since in the past decades they faced similar challenges as Hungary did, and on the other hand, it is also worthwhile to perform a comparison to the Southern European countries, since Hungary was similarly vulnerable at the outbreak of the crisis, due to the high indebtedness. In this respect, Hungary achieved significant results in comparison to both groups of countries. As the adjustment process of the Southern European states was realised only later and to a lesser degree, in the comparative charts we show the Visegrad countries which more closely resemble the Hungarian economy.

5.1. Net lending

Based on the prognosis for 2016, Hungary's net lending is still one of the highest in the European Union (Chart 58). Hungary's net lending fell in 2016, but still ranks highly among the EU member states. Net lending in the average of EU 28 countries developed similarly to last year; based on the forecast of the European Commission it totalled 2.8 percent. The countries with the highest net lending were export-oriented countries, such as Germany and the Netherlands. In the countries with significant net lending, primarily the net export balance was outstanding, which was further supported by the improvement of terms of trade during the year. However, the net external balance position of the regional countries and the Southern European states typically lagged behind the average of the euro area. With the end of EU funding pertaining to the EU 2007-2013 budgetary cycle, transfers fell significantly in 2016, which was observable primarily in the regional countries and in Portugal and Greece from among the Mediterranean countries.

Chart 58: Development of net lending in 2016

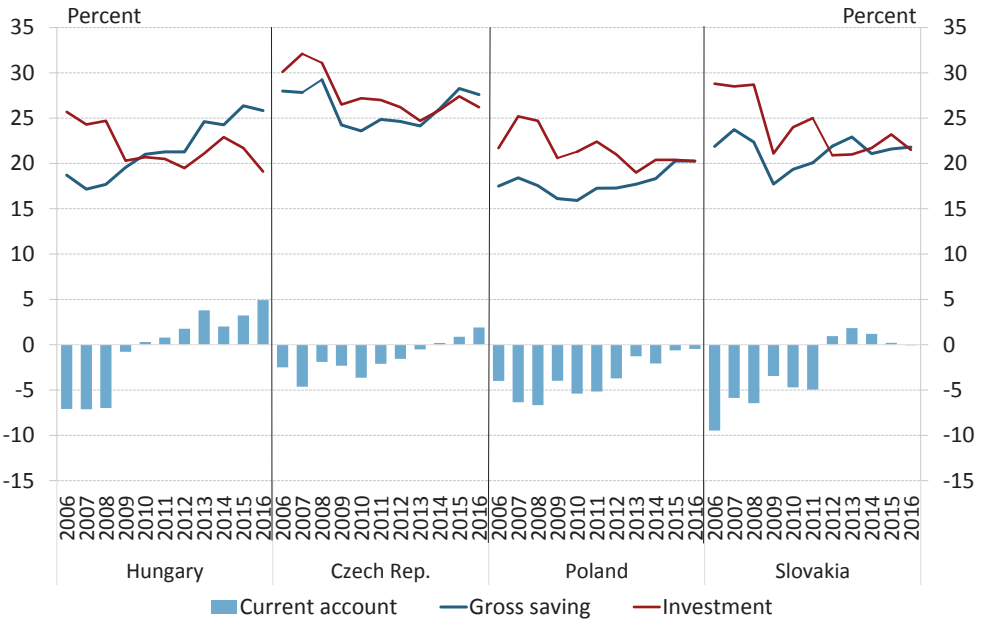


*Based on the European Commission's forecast.
Source: European Commission.

5.2. Development of savings and investment ratios

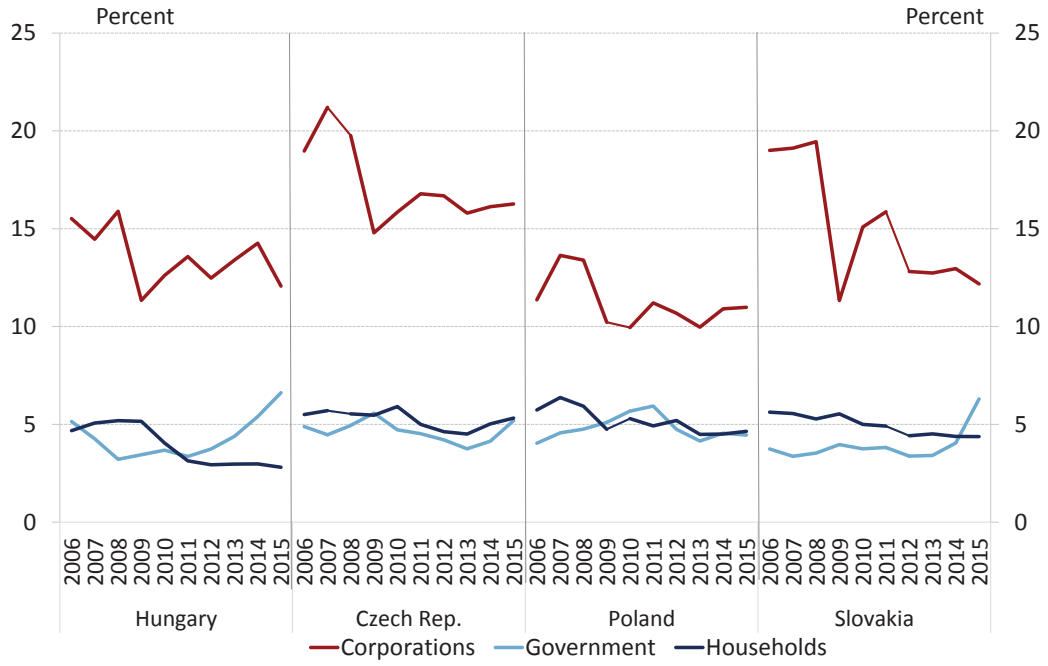
The current account increased in Hungary with lower investment and higher internal savings compared to that typical for the region. The development of the external balance was driven by the result of the internal gross savings ratio (i.e. income not spent on consumption) and investment. Following the outbreak of the crisis, all regional countries faced decreasing investment ratios, resulting in the improvement of external positions (Chart 59). It should be mentioned that the investment of Hungarian companies broadly corresponds to the regional level, while the investment of households is much lower than the level observable in other countries (Chart 60). However, the changes in the gross savings ratio were not so uniform: whereas in Hungary a significant increase in internal savings also contributed to the improvement of external balance, in Poland the savings ratio stabilised, in Slovakia there was a temporary decline and in the Czech Republic there was a permanent decline. However, the past two years were characterised by an increase in the savings ratio, while investment ratios fell in 2016 – which is presumably due to the decline in EU transfers.

Chart 59: Development of gross savings and investment ratios (as a percentage of GDP)



Source: WEO, Eurostat.

Chart 60: Sectoral distribution of investment ratio (as a percentage of GDP)



Source: Eurostat.

5.3. Net lending and its real economic factors

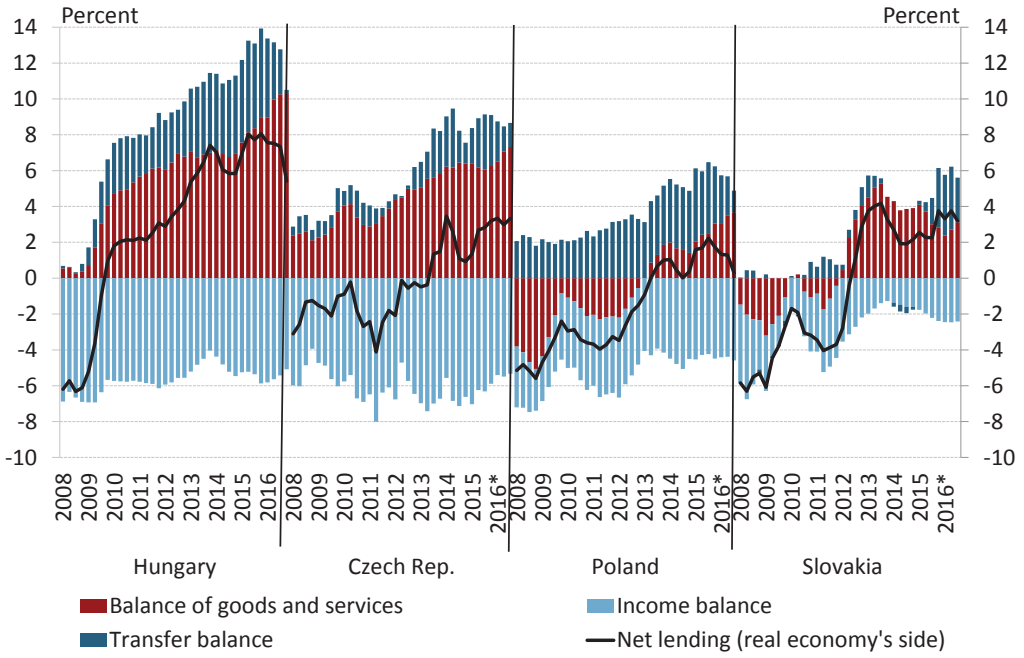
In the countries of the region, the increase in net lending halted or shifted to a decline, which is primarily due to the significant fall in the transfer balance. Based on the four quarterly data, the external Hungarian balance position calculated according to the real economy approach was around 5.5 per cent of GDP, which is still significantly above the level measured in the regional countries (Chart 61). The decrease in external lending observed in the region can primarily be linked to the closing of the EU 2007-2013 budgetary cycle, as the result of which transfer payments fell significantly last year compared to 2015. Related to certain factors of external position, attention should be paid to the following:

- The surplus of goods and services balance stabilised at above 10 percent of GDP in Hungary during the year, which is still outstanding in the region. In the Czech Republic, at the end of Q3, the indicator of the four quarters stabilised at around 7 percent, while in Poland and Slovakia at 4 and 3, respectively. While in the Czech Republic and Slovakia high goods export could explained by automotive production, in Poland, services export continued to contribute the most to the trade surplus. In Hungary, by contrast, the level of both the goods and services balance continue to show a high surplus, and the surplus of the services balance is outstanding in the region.

- Similarly, to the previous periods, the deficit of income balance continues to be the highest in Hungary and the Czech Republic. In the past quarters, income paid to abroad fell in both countries, declining in Hungary to 5.1 percent of GDP and in the Czech Republic to 5.5 percent of GDP at the end of the year. In Poland and Slovakia, however, the deficit of income balance was below the Hungarian figure during 2016, which may be associated with lower interest paid to abroad, due to the lower level of gross external debt.

- In parallel with the end of the EU 2007-2013 budgetary cycle, the transfer balance fell significantly in the countries of the region, which also drove the development of net lending in 2016. Hungary faced the largest change in the transfer balance: the indicator declined from 5 percent of GDP at end-2015 to 1.1 percent of GDP. The decline in the transfer balance in the other regional countries was less spectacular compared to the same period of the previous year, as it amounted to approximately 1-2 percent of GDP. The rise in the volume of the Slovak transfer balance can be explained by the carry-over effect of the outstanding Q4 value in 2015 (see Chart 69).

Chart 61: Current accounts and capital accounts of Visegrad countries
(four-quarter data as a percentage of GDP)



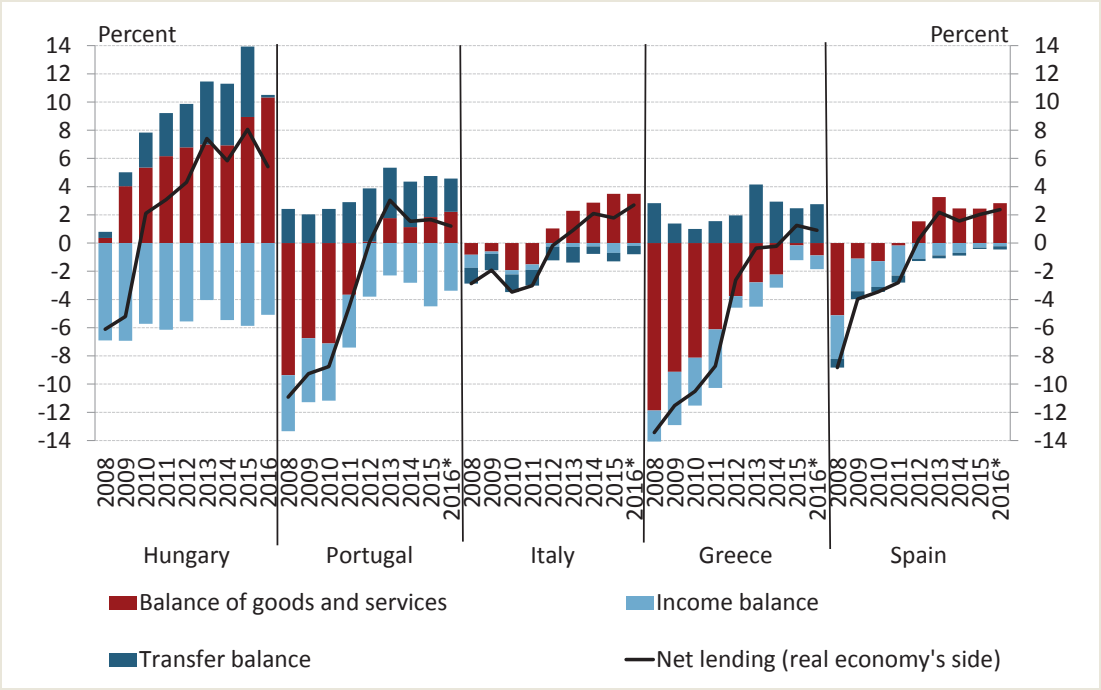
Source: Eurostat, national central banks

* Values for 2016 reflect four-quarter values calculated up to the third quarter.

Box 4: External balance developments in Mediterranean countries

Despite the fall observed during the year, Hungary's net lending continues to be well above the level observed in the Mediterranean countries. At the outbreak of the crisis Hungary struggled with the same indebtedness as the Mediterranean countries, and therefore, it may be relevant to compare the Hungarian figures also with this group of countries. In Hungary, due to the more dynamic balance sheet adjustment process, net lending showed a surplus as early as immediately after the crisis, while in the case of the Mediterranean countries net lending generally moved into the positive range in 2012, which may be due to the prolonged sovereign debt crisis. In the case of the Mediterranean countries, it was primarily the improvement of goods and services balance which played a key role in the increase of net lending, but in Portugal and Greece the stable EU transfer payments also contributed significantly to the external balance surplus. In Hungary, on the other hand, after the crisis the increase in both the balance of trade and transfer balance contributed to reaching an external balance position deemed high even at the international level. As a result of the decline in the transfer balance in Portugal in the previous year – similarly to Hungary – net lending fell, while in Italy and Spain it increased slightly based on the Q3 figures. The deficit on the income balance in Hungary is higher, despite the fact that the level of net external debt was significantly below that of the Mediterranean countries. The reason for this is that the Mediterranean countries were characterised only by lower yields due to the ECB'S strong commitment to lower sovereign yield spreads and its government securities purchase programme, and the previously realised FDI payments also improve the income balance.

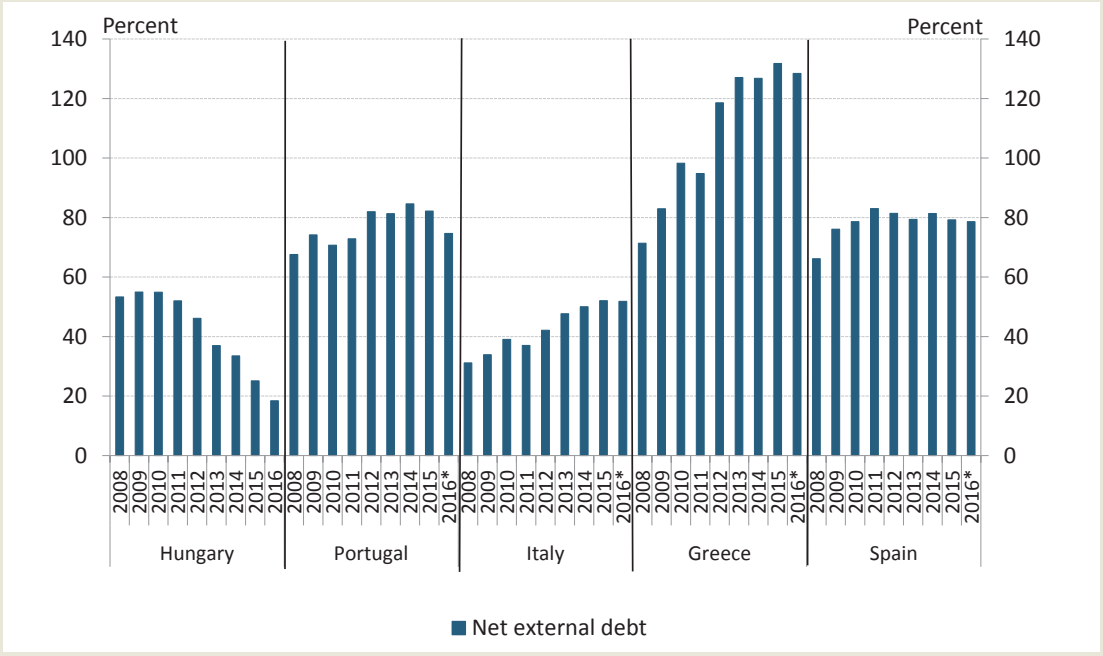
Chart 62: Current accounts and capital accounts of Hungary and the Mediterranean countries (as a percentage of GDP)



* Values for 2016 reflect four-quarter values calculated up to the third quarter.
Source: national central banks, Eurostat.

Compared to the Mediterranean countries, as the result of adjustment, net lending became the highest in Hungary, and thus the largest decline in net external debt indicators was observed there after the crisis. In the years of the crisis, the Mediterranean countries had similar external debt levels as Hungary, but following the crisis, very different processes evolved compared to Hungary. While in Hungary we observed a dynamic reduction in net external debt indicators since 2010, in the Mediterranean countries – primarily as the result of the previously mentioned sovereign debt crisis – external debt continued to increase even after the crisis and finally only stabilised in the past years (Chart 63). By the end of 2016, net external debt fell below 20 percent of GDP in Hungary. In the Mediterranean countries, net external debt measured in 2016 Q3 was still high: in Portugal and Spain the indicator was at approximately 80 percent of GDP, in the case of Italy close to 50 percent of GDP, and the indicator was still extremely high in Greece (around 130 percent of GDP). Due to their membership of the euro area, these countries were unable to adjust via exchange rate depreciation, but it is also true that external debt was also not impacted by the risk arising from revaluation. Overall, it can be stated that the decline in external debt would require a larger degree of adjustment in the Mediterranean countries.

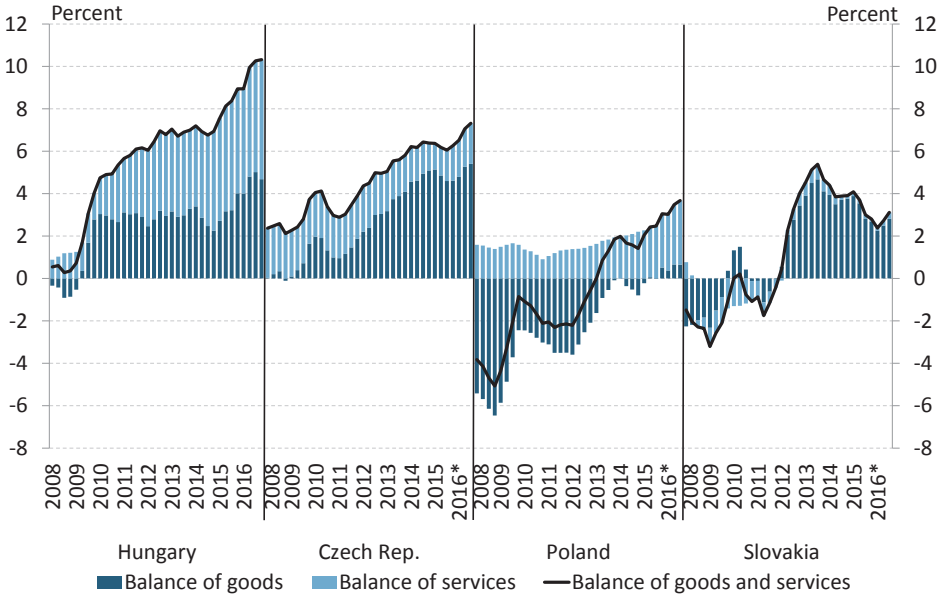
Chart 63: Net external debt of Hungary and the Mediterranean countries (as a percentage of GDP, without intercompany loans)



* Values for 2016 reflect four-quarter values calculated at the end of the third quarter.
Source: national central banks, Eurostat.

Overall, the balance of trade increased in the regional countries, possibly due to improving terms of trade and the reduction of investments with higher import content. The automotive export performance is of key importance in Slovakia and in the Czech Republic, as a result of which it is primarily the surplus of goods balance that dominates the balance of trade. On the other hand, in Poland the surplus on the services balance contributed the most to the improvement of net lending, but in addition to this the goods balance also showed a surplus in the previous period, albeit a small one. In Hungary, the goods and services balances both increased compared to 2015, resulting in a balance of trade exceeding 10 percent of GDP. The high level of the services balance was supported by service centres operated in Hungary ("shared service centre" SSC), tourism and the expanding transport services, while the improvement in the goods balance was basically linked to lower imports and improving terms of trade. Overall, Hungary's four-quarter balance of trade as a percentage of GDP is still significantly higher than the regional average (Chart 64).

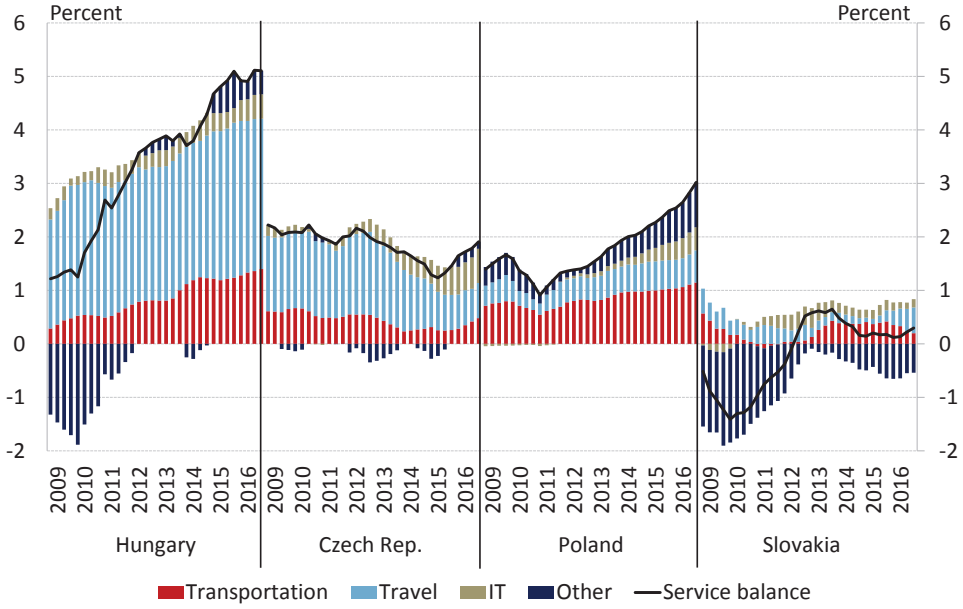
Chart 64: Distribution of the balance of goods and services (four-quarter values as a percentage of GDP)



* Values for 2016 reflect four-quarter values calculated up to the third quarter.
Source: Eurostat

Hungary's services balance significantly exceeds the level typical for the region, which is primarily supported by the surplus of tourism (Chart 65). In the regional countries – excluding Slovakia – the surplus of the services balance is considerable, with the travel, transport and IT sectors essentially contributing the most. However, Hungary stands out from among the regional countries due to the surplus of the travel sector which ranges as high as 2-3 percent of GDP and is thus several time higher than the value observed in regional countries. In Slovakia, the services balance surplus was around 0 in previous years, as the surplus of travel and transport was offset by the deficit of other sectors.

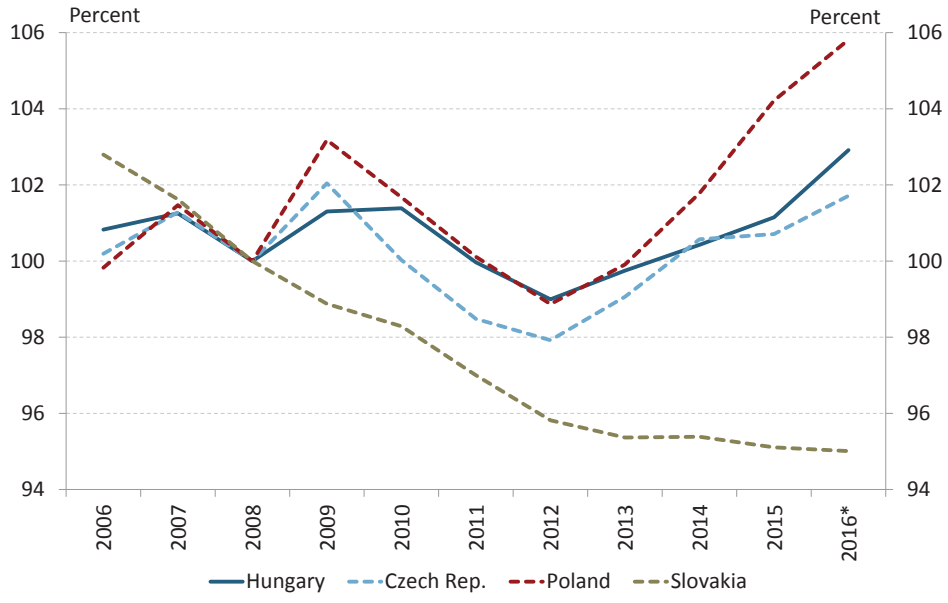
Chart 65: Distribution of the balance of services in Visegrad countries*
(four-quarter values as a percentage of GDP)



* Values for 2016 reflect four-quarter values calculated up to the third quarter.
Source: Eurostat.

In the regional countries with their own currencies, the improvement in the terms of trade that started in 2012 continued in the previous year. Following the crisis, the terms of trade initially improved a bit and then gradually deteriorated in the regional countries up until 2012. Thereafter, the low inflation environment and lower oil prices contributed strongly to the improvement in the terms of trade in the region. As a result of the large volume of energy imports, low raw material prices contributed significantly to improving net lending through the rising volume of net exports in previous years.

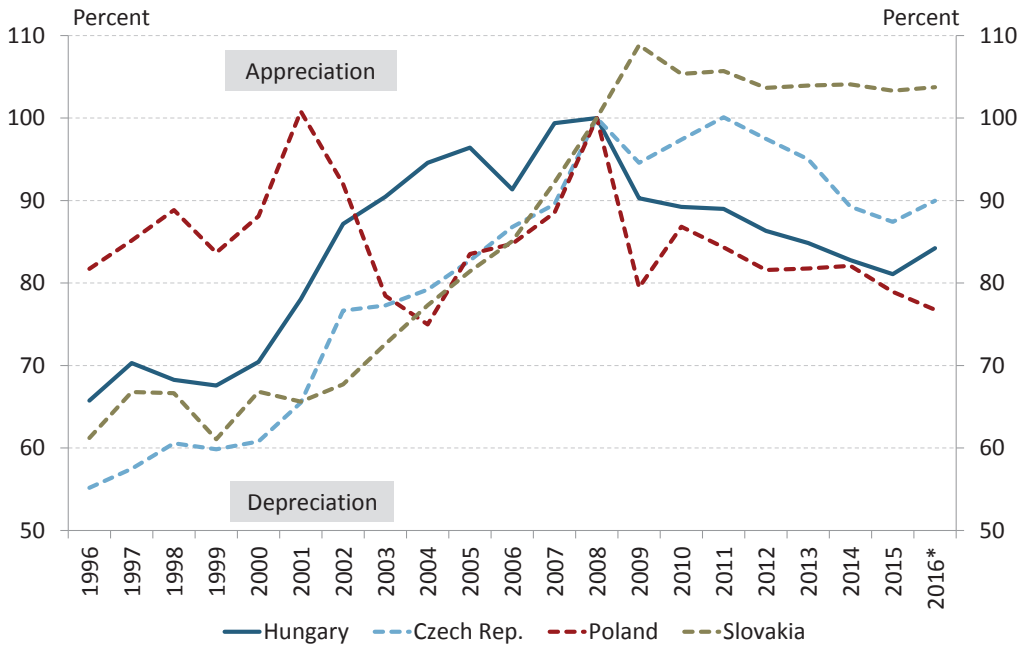
Chart 66: Changes in the terms of trade in the region (2008 = 100)



* 2016 value is based on the European Commission's forecast.
Source: European Commission.

The depreciation of real exchange rate in Hungary and in the Czech Republic that started in 2008 stopped in the previous year, but the level of the real exchange rate remains significantly below the value observed at the outbreak of the crisis. Starting in the 1990s, a gradual appreciation of the labour costs based the real exchange rate could be observed in the countries of the region, which is explained inter alia by the increasing productivity and labour costs as a result of direct capital inflow. This trend, however, changed in the year of the crisis, and the exchange rates of the region gradually depreciated – certainly with the exception of Slovakia – where in 2009 the EUR was introduced as official currency (Chart 67). The falling labour costs based real exchange rate contributed significantly to the improvement of export sector competitiveness in the region. Following the crisis, the real exchange rate depreciated the most in Hungary and in Poland, but in the previous years the exchange rate threshold introduced in the Czech Republic impeded the appreciation of CZK. Based on the estimate of the European Commission, the real exchange rate of PLN fell further in 2016, while a slight appreciation of CZK and HUF was observed (the latter may be attributable to the strong domestic wage dynamics).

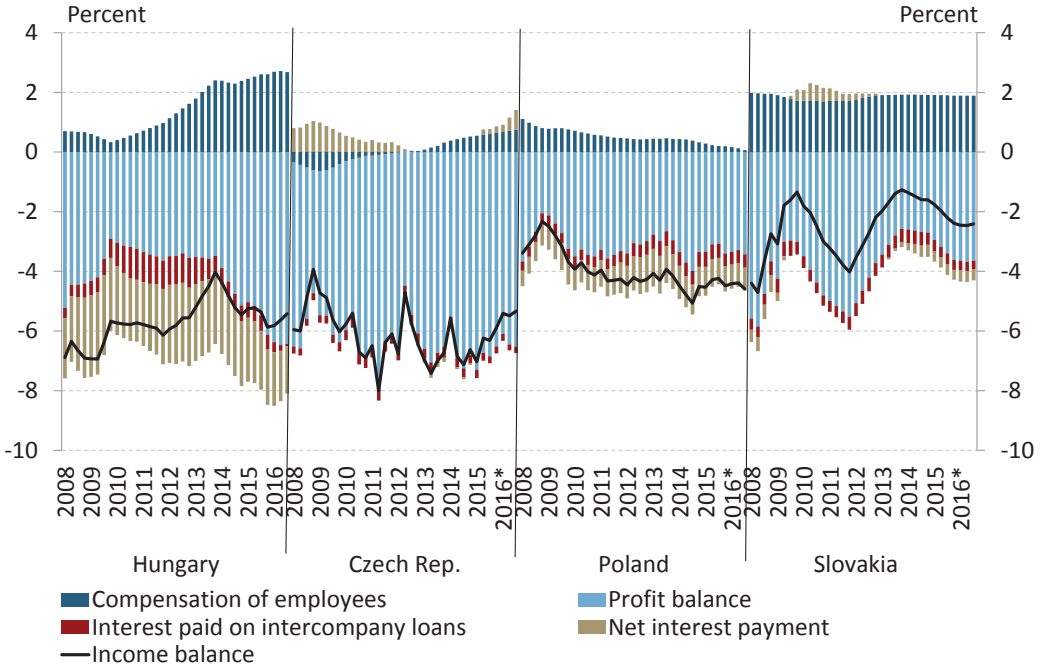
Chart 67: Changes in labour cost-based real exchange rate (2008 = 100; 37, vis-a-vis 37 countries)



Note: *2016 value is based on the European Commission's forecast.
Source: European Commission.

Within the region, the deficit on the income balance continues to be the highest in Hungary and in the Czech Republic, but income paid to abroad fell somewhat during the previous year in both countries (Chart 68). In the previous years, the profits realised on direct capital investments generally tended to lower the income balance in the countries of the region, but to different degrees, despite the similar GDP-proportionate FDI volume. In Hungary, significant growth in the volume of the profit balance of foreign companies has been observed since 2013 owing to the re-start of economic growth and as a result of this the indicator rose to 6.5 percent of GDP in 2016 Q3. This value corresponds to the Czech figures, from which we may arrive at the conclusion that the profitability of foreign companies operating in these countries was similar in the previous year (as the FDI volume is similar). Besides this, net interest expenditures on loans and bonds also contributed to the income balance deficit – to a higher degree in Hungary and to a lesser degree in Poland. Despite the decline in net external debt, Hungarian net interest expenditures remain significantly higher than the regional average. However, the deficit caused by the profit balance and interest expenditures is partially counter-balanced by the income of residents working temporarily abroad, which was the largest in Hungary.

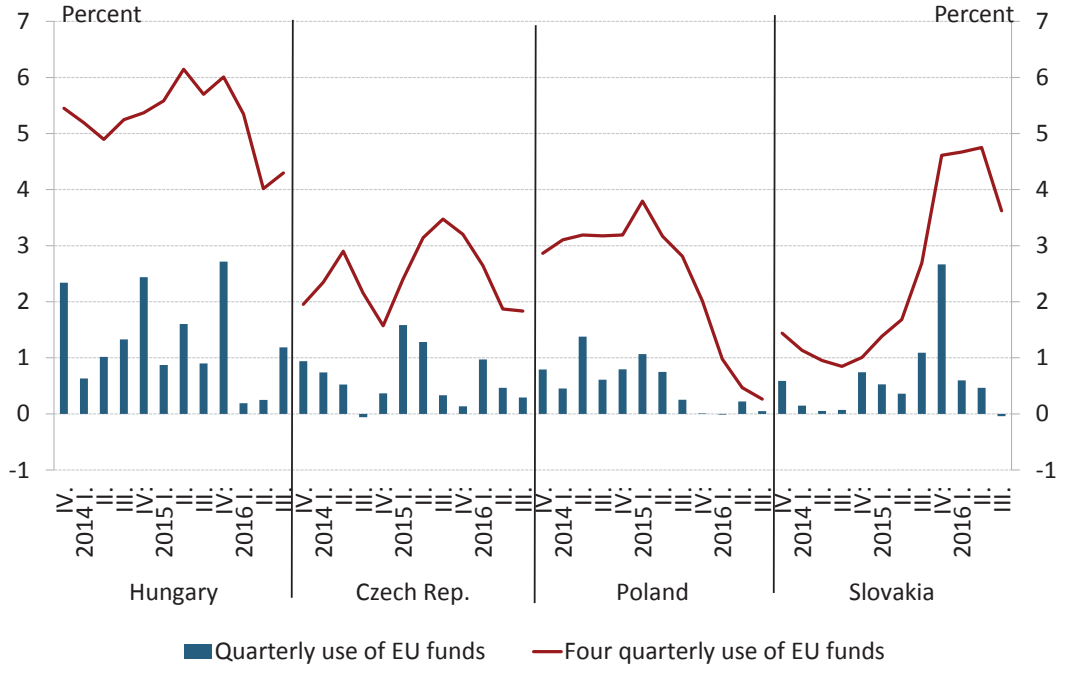
Chart 68: Developments in components of the income balance* (four-quarter values as a percentage of GDP)



Note: *2016 value is based on four-quarter data up to 2016 Q3.
Source: National central banks.

The use of EU transfers in the Visegrad countries followed a similar pattern in recent years: following a gradual increase prior to 2015 it fell significantly at the beginning of 2016 (Chart 69). The four-quarter use of EU transfers in Hungary was at around 5-6 percent of GDP before 2016, but in the previous year – associated with the new budgetary cycle – it dropped to 4 percent of GDP. Compared to regional competitors, the stabilisation in the Hungarian use of EU transfers at a higher level was basically due to current transfers (for instance agricultural supports). In Slovakia, in the second half of 2015, the so far low EU transfer increased significantly, which temporarily maintains the four-quarter value at a high level.

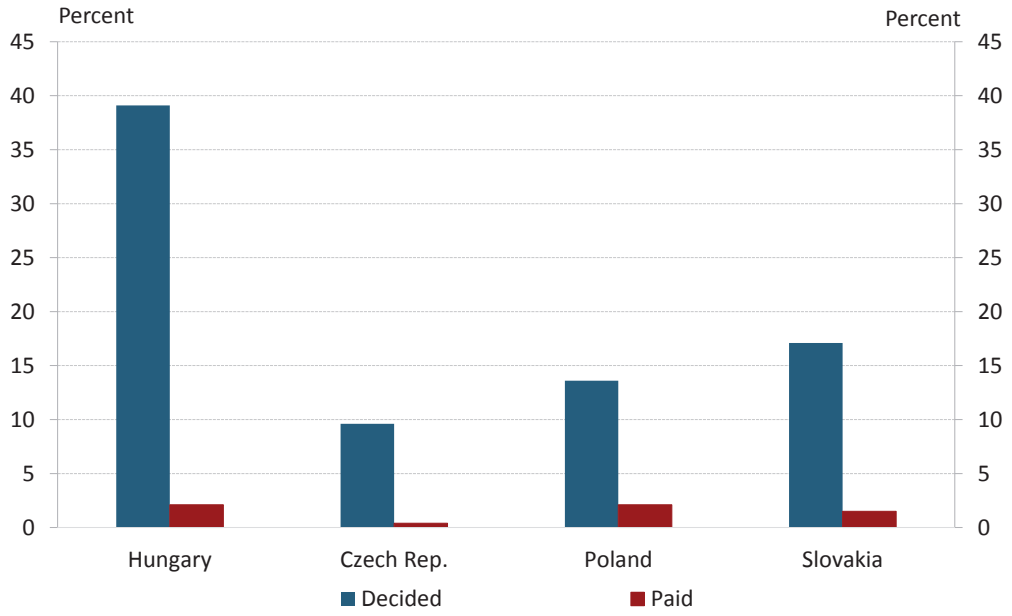
Chart 69: Use of EU transfers in the regional countries (as a percentage of GDP)



Source: Eurostat.

In a regional comparison, the ratio of EU funds awarded to the beneficiaries in the proportion of the total available limit is outstanding, which corresponds to preliminary expectations. Funds received from the European Union significantly impact the development of the external balance position of the countries through capital transfers supporting domestic investments and unrequited payments increasing available income. By closing the EU 2007-2013 budgetary cycle, paid supports dropped significantly in the regional countries during the previous year, as a consequence of which the net lending of these countries usually fell via the decline in the current and capital balance. EU funding in the new, 2014-2020 budgetary cycle of the European union will mostly start to increase in the next two years, which may also support the dynamics of domestic investments by significantly increasing capital transfers. Thus, compared to the previous cycle, in the new cycle drawdowns of larger amounts of funds is expected rather in the first half of the cycle, which may help to minimise the risk of loss of funds. The chart clearly illustrates that in the third year of the cycle the awarded EU funding amounted to 40 percent of funding scheduled for the entire cycle, which significantly exceeds the level observed in other countries of the region (and is a relative large amount even regarding the payments). This amount corresponds to the strategy of the government for the new budgetary cycle, which may have a beneficial impact on Hungary's external balance position in the next periods.

Chart 70: Awarded and paid* funding in the new EU budgetary cycle (as a proportion of the total limit)



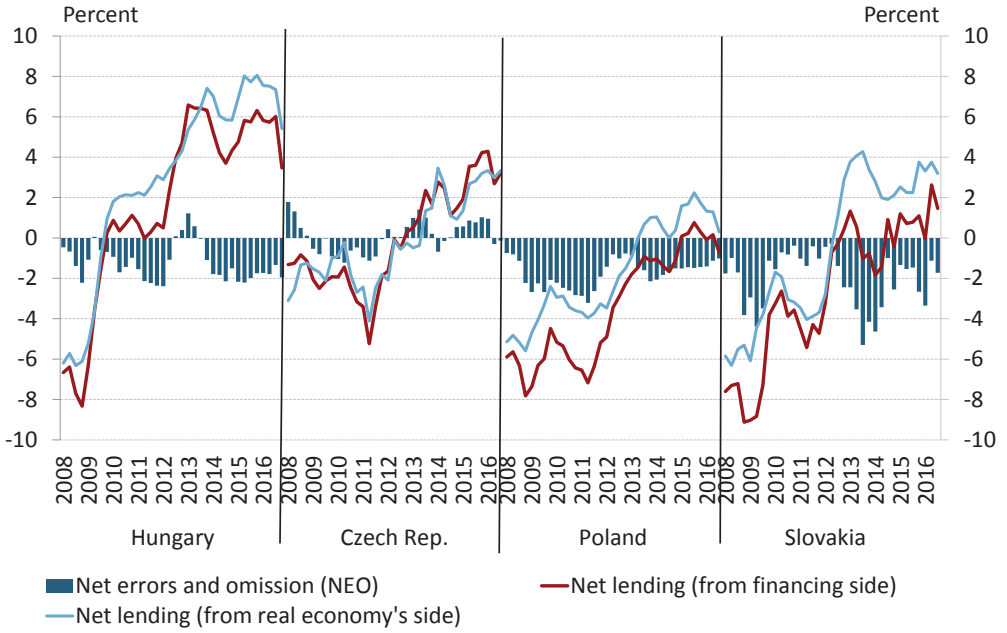
* In the case of Hungary, the data excludes the amounts paid as governmental advances, the use of which may in the near future significantly raise the value of amounts paid by the European Commission.

Source: European Commission, European Structural and Investment Funds, as of end-January 2017.

5.4. Financing side developments

Net lending calculated from the real economy side generally exceeds the value calculated based on the financial account. "Net errors and omissions" captures the differences between the net lending figures calculated based on financing and real economy side. Net lending calculated from the financial account is in general lower in all Visegrad countries than net lending calculated from the real economy side (Chart 71). The largest difference can be observed in the Slovak and Polish figures, where the financing side developments showed net borrowing around 2014, whereas from real economy side they showed net lending, and thus debts increased despite the fact that the balance of current account and capital account was positive. In recent years, the difference declined and accordingly the Slovak and Polish net errors and omissions decreased from the previous 3-5 percent to 2 percent, which is also typical in Hungary.

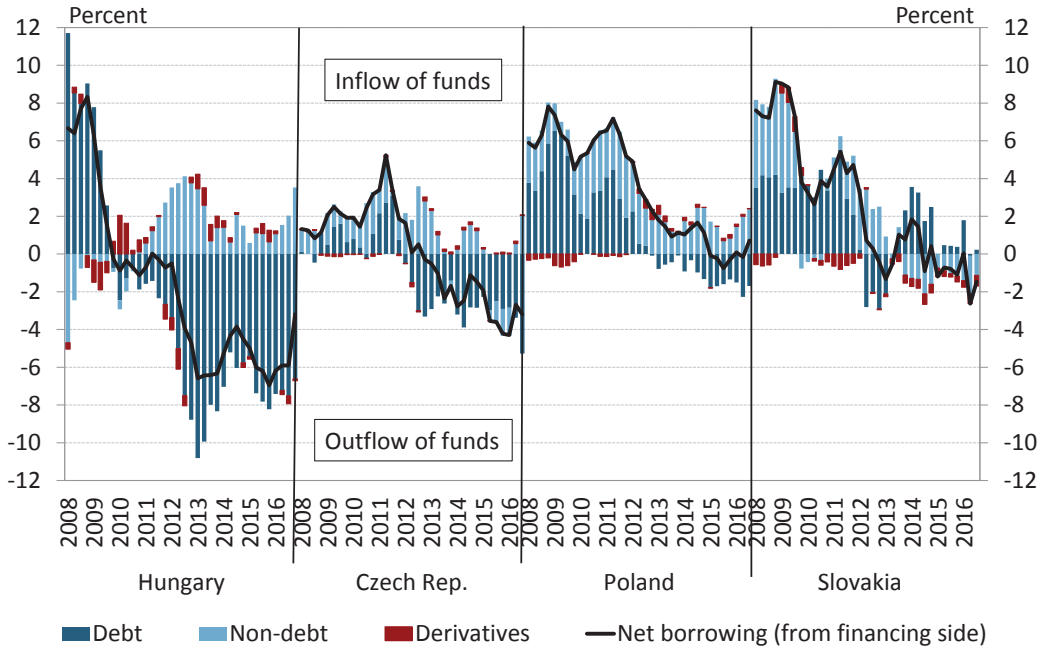
Chart 71: Development of net errors and omissions* (four-quarterly data, as a percentage of GDP)



Note: *2016 value is based on four-quarter data up to 2016 Q3 in regional countries.
Source: Eurostat, national central banks.

Most countries in the region reduced their net external debts with the inflow of smaller non-debt type liabilities. In Slovakia, debt-type liabilities remained basically unchanged, while non-debt type liabilities decreased slightly further (Chart 72). In the countries of the region the post-crisis adjustment continued, which – due to the high initial level of debt – was the highest in Hungary: the reduction of debt-type liabilities amounted to approximately 8 percent of GDP in the previous year, while Czech and Polish figures totalled to 2-3 percent of GDP. The GDP-proportionate inflow of non-debt type liabilities increased mildly in most Visegrad countries, except for Slovakia, from among which the Hungarian figure was the highest.

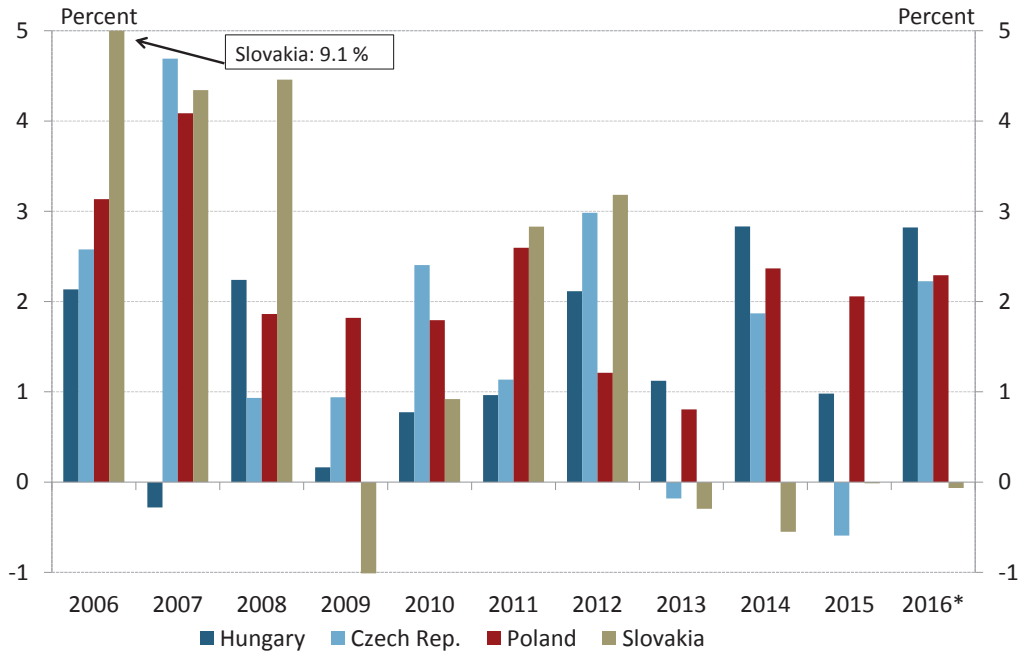
Chart 72: Net borrowing and the form of financing* (four-quarterly data, as a percentage of GDP)



Note: *2016 value is based on four-quarter data up to 2016 Q3.
Source: national central banks, Eurostat.

Although following the crisis, FDI directed towards the countries of the region fell considerably, in the previous year, with the exception of Slovakia, the volume of direct capital increased significantly. Based on the last ten years, regarding FDI inflow, the figures of the regional countries basically correlated, suggesting that foreign investors took a similar view of all of the regional countries (Chart 73). In Hungary and in the region, the FDI inflow fell after 2014, but last year the direct capital inflow once again amounted to over 2 percent of GDP. It is important to highlight that in 2016 – unlike in the previous years – it was not the banks' capital increases, but the re-invested capital of non-financial undertakings that increased more the direct capital investments.

Chart 73: Net FDI inflow in the Visegrad region (as a percentage of GDP)



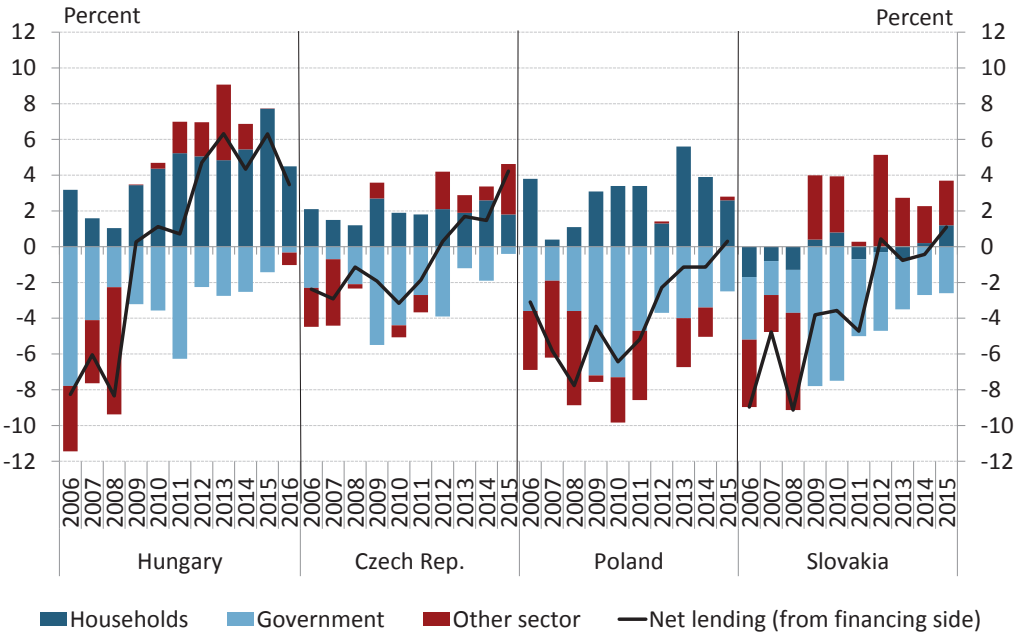
*Four-quarter data up to 2016 Q3.
Source: Eurostat.

5.5. Savings side developments

Compared to the countries of the region, the high Hungarian external position is related to the higher savings of the private sector and the low deficit of the general government.[17] In Hungary, in the previous year, the net financial savings of the private sector fell slightly, but can still be deemed high (Chart 74). The high savings of households were slightly reduced by the slow increase in loans, and in addition companies are still net savers, although in the SME sector lending growth was observed. The temporary effect of FX loan settlement, which decreased the net savings of companies and increased that of households, in 2015 was no longer felt in 2016. In the Czech Republic and Slovakia, the net savings of companies was also high, but the net saving of households fell to a much lower level, reaching 1-2 percent of GDP. In Poland on the other hand – in line with the increased volume of consumption – the weakening financial position of households just offset the higher net borrowing of the general government. In 2015, in Poland and in Slovakia the net borrowing of the government was higher, at around 2 percent of GDP, while the Hungarian figure declined to a historical low level. Overall, in 2015 the external balance position calculated from the savings side increased above zero in all Visegrad countries.

17 As data are not available for countries in the region for 2016, they are only provided with respect to Hungary.

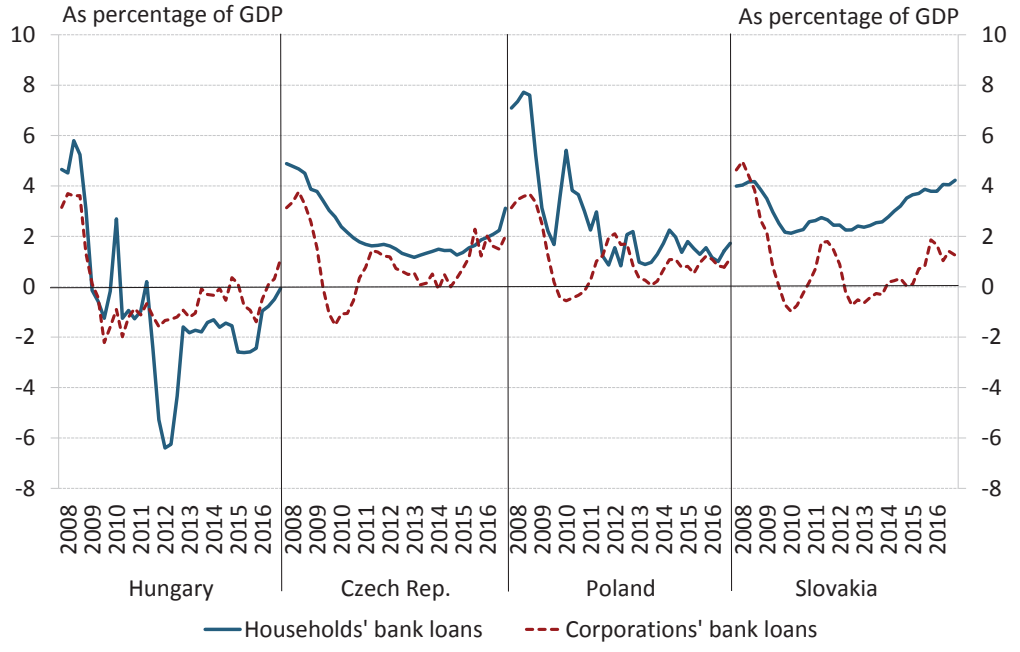
Chart 74: Net lending of the economy in a sectoral breakdown (as a percentage of GDP)



Source: MNB, HCSO, Eurostat.

In Hungary, the balance sheet adjustment seems to be over, and borrowing by the private sector significantly increased in the previous quarters. The net borrowing of Hungarian households increased to close to zero in the third quarter, i.e. repayment and gross financing need offset one another. In the regional countries, the households' borrowing also improved, with the highest figure found in Slovakia, where the annual figure exceeded 4 percent of GDP (Chart 75). This means that, although domestic borrowing strengthened in the case of households, it is still below not only the pre-crisis level, but also that of the regional countries. The situation is more favourable for companies: in Q3 the Hungarian indicator moved close to the Polish and Slovak figures, while it was slightly below the net borrowing of loans by Czech companies. As a result of the continuously increase in the demand for loans, the private sector's net lending, which is currently high even at a regional level, may be reduced.

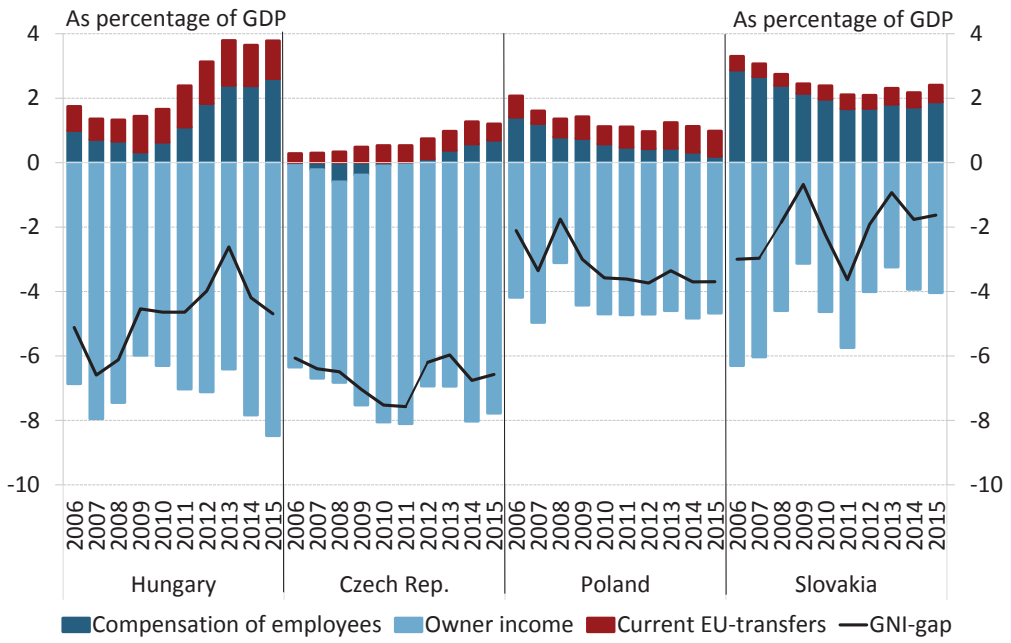
Chart 75: Four-quarter net borrowing of loans of companies and households as a percentage of GDP*



* Four-quarter data up to 2016 Q3.
Source: MNB, HCSO, Eurostat.

In the countries of the region, GDP is typically higher than GNI, which is attributable to the profit of foreign companies. Gross national income is the income generated by the actors resident in a given country, which differs from GDP basically by the income of residents active abroad and the income of non-residents. Foreign companies play a considerable role in the economies of the regional countries, and therefore, the profits they generate are also considerable in each country, amounting to 4-8 percent of GDP. The net profit of foreign companies is the highest in Hungary and the Czech Republic, which is only partially counterbalanced by the net income of foreign workers or by current EU transfers (Chart 76). In the past two years, the difference between GDP and GNI increased in all Visegrad countries, but rose the most in Hungary, which is typically the result of growing income of foreign-owned companies. However, it is important to note that the Hungarian GDP-GNI gap is still much lower than the Czech value.

Chart 76: Factors of the difference between GDP and GNI

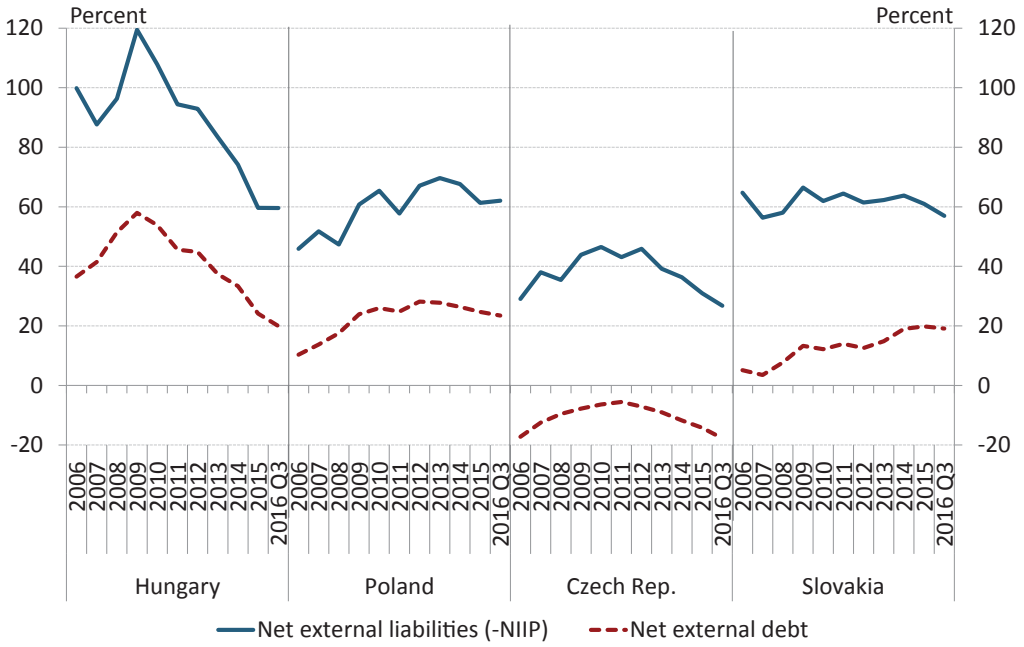


Source: Eurostat.

5.6. External debt indicators

Hungary's external debt indicators fell dynamically after the crisis and are now at a level similar to that of the Visegrad countries (Chart 77). Hungary's net debt and net external debt peaked high above the level of regional countries in 2009, and then fell significantly due to the adjustment that started. In the past years, in Hungary and the Czech Republic – due to the net savings position – the decline in external debt indicators continued, and in parallel with this in Slovakia and Poland, in line with a net lending close to zero, the debt indicators did not change significantly in the previous years. In 2016, the net external debt indicator (NIIP) in Hungary stabilised at around 60 percent of GDP, which corresponds to the Slovak and Polish level. In Hungary, net external debt fell from the extremely high post-crisis level of close to 60 percent of GDP to 20 percent of GDP by 2016, representing a level similar to the Slovak and Polish figures. In the case of the Czech Republic, due to the use of the exchange rate threshold, the country's assets further increased, resulting in an increase in the gross figures, but leaving net external debt unchanged. Overall, it can be established that, due to the stable net lending and sustainable debt indicators, external vulnerability decreased further in the Visegrad countries.

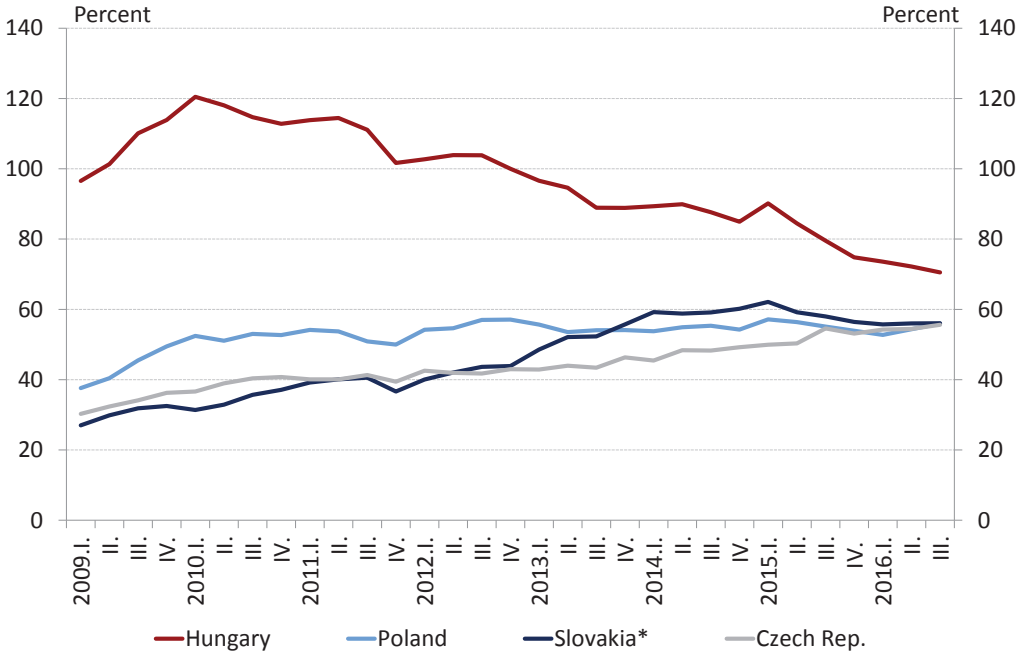
Chart 77: Net external debt and liabilities (as a percentage of GDP, net external debt excluding intercompany loans)



Source: national central banks, Eurostat (dated polled by SCV).

In Hungary, the level of GDP-proportionate gross external debt decreased further, while the indicators of regional countries stabilised at a level much lower than the Hungarian figure (Chart 78). In the past decade, gross external debt fell significantly in Hungary, dropping from 120 percent of GDP to 70 percent. However, no similar adjustment was required in the other countries of the region, and thus their gross external debt indicators even increased. In the year of the crisis, the gross external debt of competitors was at around 40 percent of GDP, which rose significantly in 2016 Q3 to close to 60 percent of GDP, but was still lower than the Hungarian figures.

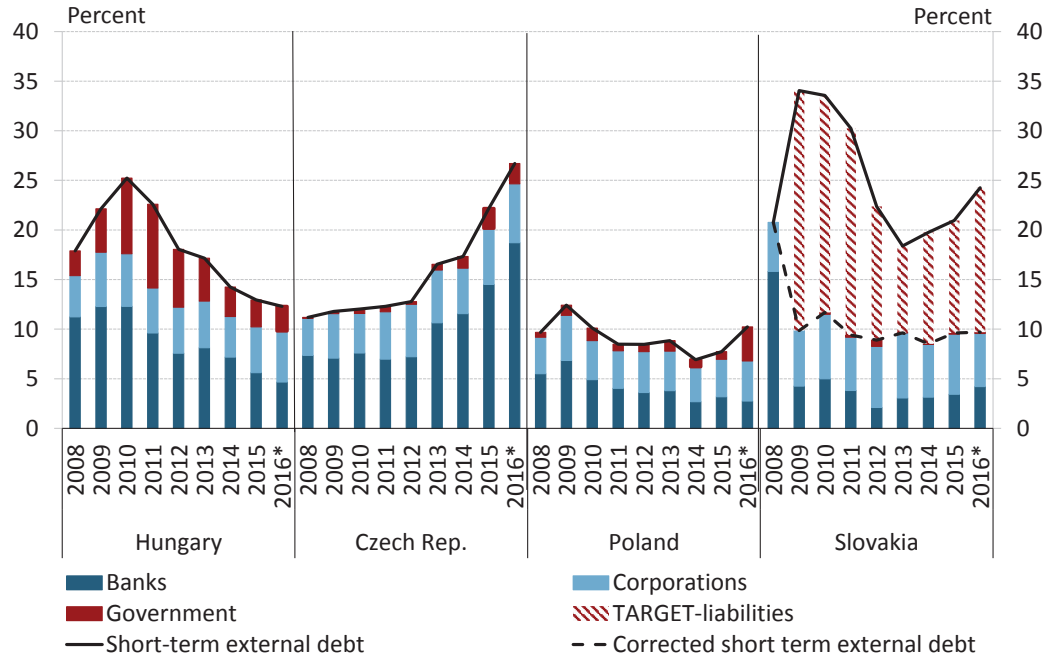
Chart 78: Gross external debt in the region (as a percentage of GDP, without intercompany loans)



Note: * In the case of Slovakia, the technical debt incurred due to the TARGET system was excluded.
Source: Eurostat.

Debt based on original maturity fell further in Hungary, while it increased in the other countries of the region (Chart 79). Hungary's short-term external debt based on original maturity[18] increased to 25 percent of GDP in the two years following the crisis, which at that time was significantly higher than the level observed in other countries of the region. After 2010, Hungary's short-term external debt gradually fell to 12 percent of GDP and is thus slightly higher than the Slovak and Polish level of approximately 10 percent, but is already significantly lower than the 27 percent value observed in the Czech Republic. The dynamic increase seen in the case of the Czech Republic can be primarily attributed to the significant growth in the volume of the sources of foreign banks – even compared to their balance-sheet total. This may be explained by the exchange rate threshold applied by the Czech central bank, within the scope of which during the FX purchases of the central bank a certain part of the CZK provided in the transactions goes to foreign actors, who place a major part of this as short-term liabilities in the banking sector. Meanwhile, adjustment of the banking sector continued in Poland and in Hungary, which was reflected by the further decline in short-term external debt based on original maturity of banks. The short-term external debt of the Hungarian general government was considered as extremely high in the region, but its volume of 2.5 percent at the end of 2016 is only slightly higher than the short-term external debt of the Czech general government, although it is much lower than the 3.4 percent value measured in Poland. Related to the Slovak figure, it must be noted that the unadjusted high gross financing need is caused by the technical-type items arising as a result of the accession to the euro area. Eliminating these, we arrive at a figure similar to the Hungarian one.

Chart 79: Short-term external debt based on original maturity (as a percentage of GDP)

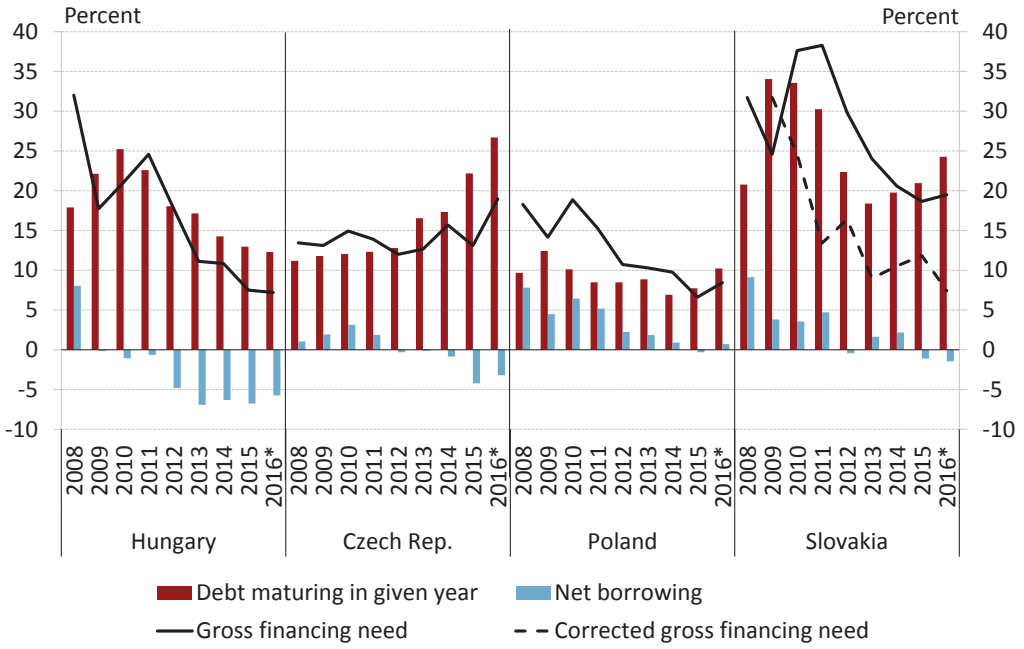


Note: * Based on data from 2016 Q3.
Source: World Bank.

Hungary's gross financing need fell to 7 percent of GDP in 2016, which can be considered as favourable in a regional comparison (Chart 80). The gross financing need shows the volume of total maturing external debt and net borrowing in the given year. In Hungary, the gross financing need calculated on the basis of short-term external debt based on original maturity fell further in the first three quarters of 2016.[19] In the past years, the gross financing need declined in Hungary with stable net lending and – due inter alia to the self-financing programme of MNB – the dynamic fall in short-term external debt. The Polish and Slovak gross financing need was at a level similar to that of Hungary in 2016 Q3. On the other hand, we see a trend increase in the level of gross financing need in the Czech Republic, caused mostly by the (previously explained) significant growth in the volume of short-term external debt.

18 There are no data available for the regional countries on shortening debt.
19 For the sake of comparability, the gross financing need was calculated by using short-term external debt based on original maturity.

Chart 80: Gross financing need (short-term external debt based on original maturity, as a percentage of GDP)



Note: * Based on data from 2016 Q3.
Source: Eurostat, World Bank.

LIST OF CHARTS

Gábor Bethlen

(15 November 1580 – 15 November 1629)

Prince of Transylvania (1613–1629), elected King of Hungary as Gábor I (1620–1621), one of the most prominent personalities of 17th century Hungary. At the beginning of his career he loyally served the Princes of Transylvania Zsigmond Báthory, Mózes Székely, István Bocskai and Gábor Báthory. When Gábor Báthory contemplated alliance with the Hapsburgs, he turned against him and got himself elected to the throne of the principality. During his reign, he consolidated the position of Transylvania setting both the economy and the cultural life of this part of Hungary on a path of development later generally referred to as the 'golden age of Transylvania'.

The twenty-five years preceding the rule of Bethlen were heavy with external and internal wars leaving the population considerably thinned out. Bethlen set out to stabilise the domestic situation, to consolidate his power and to rebuild Transylvania with great patience. He established a centralised state apparatus and concurrently sought to strengthen the financial status of the principality. He ordered an accurate statement of treasury revenues, had the lands and properties granted since 1588 reviewed and ratified only those which had been awarded in recognition for service to the country.

To promote industry and trade, Bethlen encouraged an economic policy of mercantilism and settled foreign craftsmen in the country. Instead of taxation, he relied on the more rational utilisation of other means deriving from his status as prince in building his rule. He developed precious metals mining, invited renowned specialists from abroad and strove to boost trade. Gábor Bethlen minted coins of a stable value and regulated the multidirectional trade in goods by prohibiting exports of key merchandise.

Gábor Bethlen attempted to form an international anti-Hapsburg coalition among western and eastern European countries. In order to strengthen his ties with the Protestant Powers, on 1 March 1626 he wed the sister of George William Elector of Brandenburg, Catherine of Brandenburg, and in 1626 he joined the Westminster alliance of the Protestant Powers.

REPORT ON THE BALANCE OF PAYMENTS

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